TRUMP'S NEW ADMINISTRATION: WHAT ECONOMIC POLICIES CAN IT ADOPT?

Hiroshi Akune
North America & Latin America Dept.
Mitsui Global Strategic Studies Institute

Mr. Donald Trump has been elected the 45th president of the United States. During the election campaign, he tactically voiced the anger of the white working class, touted his "America-first" policy by rejecting globalism, and maintained that he would bring back jobs lost as a result of US factories' relocation abroad, which substantially contributed to his winning the election. This paper will discuss the economic policies that Trump's new administration is able to employ in order to revive the US manufacturing industry, which has been on the decline, and to expand the US middle class.

TRUMP'S 100-DAY ACTION PLAN POST-INAUGURATION

The following are economic policies described in Mr. Trump's *100-day Action Plan to Make America Great Again*, released on October 22, among others: (i) withdrawal from the Trans-Pacific Partnership (TPP) pact, and renegotiation of, or withdrawal from NAFTA; (ii) labeling China as a currency manipulator; (iii) lifting of restrictions on the production of energy reserves, as well as an investment increase in infrastructure projects; (iv) cancellation of payments to U.N. climate change programs; (v) ending of the Offshoring Act (i.e., imposition of punitive importation tariffs on goods produced by companies that have moved their manufacturing bases abroad); and (vi) inducing of return of internal reserves back to the US of companies that have relocated to foreign countries through corporate tax reduction (from 35% to 15% or 10%). While this action plan did work in pandering to the voters, if implemented without sufficient preparations, the US is likely to suffer costly retaliation from its trading partners. Accordingly, Mr. Trump himself has toned down the rhetoric regarding some of his policies after winning the presidential election.

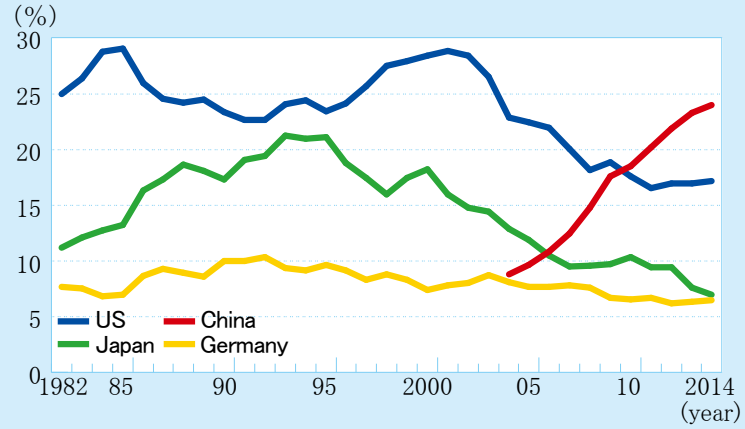
HISTORY OF THE DECLINE OF US MANUFACTURING INDUSTRY

The revival of its manufacturing industry (i.e., the restoration of its international competitive edge) is a crucial agenda for the US. Although direct employment in the manufacturing industry has been on the decline in recent years due to the trend for labor saving at manufacturing sites, it is still expected that, if revived, the industry will create a significant number of jobs and improve the trade surplus thanks to its exports. Hence, manufacturing's revival has a huge potential to raise the standard of the US economy. That said, however, just sparking attention to the issues without formulating concrete scenarios for their solution, as Mr. Trump did, is quite dangerous. Sufficient clarification of the causes of the decline, as well as searching for the conditions that will allow a revival of the manufacturing industry, are now called for.

In 2011, US manufacturing fell to second place globally behind China after that country overtook the US. The GDP share (value added) of US manufacturing in the global market, which once accounted for almost 30% in

the 1980's, fell to as low as 17.2% in 2014 (Fig. 1). Also, manufacturing's share of the total US GDP decreased from 26.8% in 1950 to 12.1% in 2015. Moreover, the number of people employed in manufacturing has decreased by 7.11 million (36%) to 12.31 million in 2015, after peaking at 19.42 million in 1979[1]). Given below are the factors considered to have contributed to this decline of the US manufacturing industry.

Fig. 1. Shift of major countries' manufacturing industry's share in the global GDP (denominated in USD)



Source: Compiled by MGSSI based on the UN statistics

1)Companies have remained satisfied with being comfortably settled in the huge US market. As a result, they lacked motivation to export their products, and have been negligent in developing new products targeted for overseas markets.

2)Personnel costs are higher than those in other countries: When NAFTA came into force in January 1994, many companies relocated their manufacturing bases to Mexico and Canada, where wages were lower. Mexico especially became a hub for export of automobiles to the US (the ratio of vehicles shipped to the US was 90% in 2015). As a result, the number of factories in the US decreased just as the vehicle production in Mexico increased. (The number of automobiles manufactured in Mexico increased from 1.05 million units in 1993 to 3.56 million units in 2015, while in the US, 55 automobile-related factories were shut down during the period from 2005 to 2011[2]).

3)Financialization of the economy: After a policy for a stronger dollar was proposed by then-Secretary of the Treasury Robert Rubin in 1995, the foreign exchange rate rose from JPY 79.92/USD in 1995 to JPY 147.62/USD in 1998. Although the policy for a stronger dollar dampened the manufacturing industry's motivation for export, for the financial industry, there was an advantage to the policy in that it induced capital return from abroad. Furthermore, the abolishment of the Glass-Steagall Act in 1999 opened a way for banks to be engaged in the business of both commercial banks and investment banks, thereby shifting the center of the US economy from the manufacturing industry to the financial industry. Concurrently with this move, talented human resources with scientific backgrounds are also said to have flown from the manufacturing industry to the financial industry.

4)Offshoring: Companies have established international manufacturing value chains premised on the global economy. Taking Apple's iPhones as an example, Apple has very few manufacturing sites in the US. This is because only the core parts of iPhones are being manufactured on US soil, while the manufacture of almost all of the iPhone parts and the assembly process are done at plants overseas entrusted with such work.

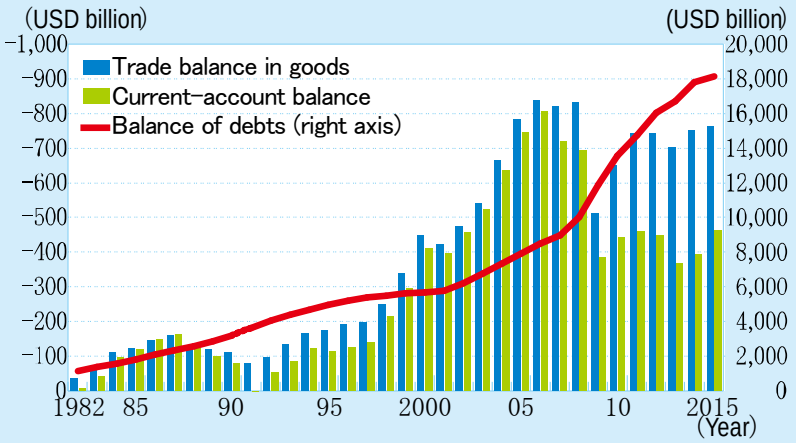
5)China's accession to the WTO (2001): Although the US-China trade has soared rapidly since China's accession to the WTO, the US's light industry (such as toy and furniture industries) has been in decline since then. In the US, the number of manufacturing businesses decreased by 78,000 (22.2%) in the period from 2000 to 2014, and 4.86 million jobs were lost (a 28.3% decrease) in the period from 2000 to 2015.

6)Spillover effect of the shale gas revolution: The gas-derived chemicals industry has surely gained a competitive edge thanks to the shale gas revolution. However, the industry has not developed as much as expected, with some new plant construction plans having been put on hold due to the recently lowering prices.

COUNTERMEASURES ADOPTED IN THE PAST

In the US, since the 1980's, both the President's Commission on Industrial Competitiveness and its succeeding body, the U.S. Council on Competitiveness, have taken the lead in formulating solutions to the issues of how to rebuild the US economy and to eliminate the twin deficits (i.e., the current-account deficit and budget deficit). The so-called Young Report, issued in 1985, proposed the following, based on the premise that the US should not try to compete by leveraging low wages: (i) creation of new technologies and protection of intellectual property rights (i.e., the so-called pro-patent policy), (ii) raising of the low saving rate, and a more stable monetary policy, (iii) re-employment support for displaced workers, and enhanced elementary education, and (iv) strengthening of measures against the unfair trade practices of foreign countries. Then, in 2004, the so-called Palmisano Report was published. This report acknowledged the more-than-ever heightened importance of innovation, with a focus on the globalized economy and the manufacturing industry, which had been increasingly growing in a service-oriented direction (one typical example is the evolution of telephones: from phones with a single function to smartphones with a variety of applications installed). The report suggested (i) a national strategy on innovative education, (ii) revitalization of research in frontier fields, and (iii) creation of diverse industrial clusters, among others. These propositions were based on the idea that as free trade progresses, both industrialized and developing nations will be able to amicably coexist by focusing on their respective strong industrial areas, and that in the case of the US, new industries will be created one after another through innovation, which will ultimately expand the size of the global economy on the whole. Although the number of people directly employed at manufacturing sites has decreased, some companies such as Intel, which gave up on semiconductor memories and specializes in the manufacture of logic semiconductors, maintain production bases in the US and contribute to whole regions in the country by creating a large amount of indirect employment[3]). The same can be said about the pharmaceutical and aircraft industries, which boast a competitive edge on the technological front. That said, however, if we take a panoramic view of the whole US economy, we can see that (i) the twin deficits described above are still on the rise (Fig. 2), (ii) the automobile industry has lost the competition against German and Japanese companies in the global market, (iii) reemployment of former factory workers in the Rust Belt has not much progressed, and (iv) the service industry has not been able to increase, by a sufficient number, jobs for which salaries are higher than those paid in the manufacturing industry. Moreover, the number of new businesses started, which can be said to be a barometer of innovation, has been on the decline since the Lehman crisis (The number of newly founded businesses in the manufacturing industry decreased by 45% (16,000 cases) in the 15 years from 2000[4]).

Fig. 2. US twin deficits (i.e., current account deficit and budget deficit, which represent the balance of the government's debts)



Note: "Trade balance in goods"is data for non-service exchanges.
Source: Compiled by MGSSI based on data from the IMF, the U.S. Census Bureau, and the U.S. Department of the Treasury.

Unfortunately, in the US, amid the ongoing hollowing-out of the domestic manufacturing industry, overall upgrading of the industrial structure is still only half done.

WILL THE TRUMP ADMINISTRATION BE ABLE TO PRESENT A CONVINCING ECONOMIC VISION?

What will the new administration be able to do to "Make America Great Again" in any kind of real sense? One answer lies in the report published in 2011 by the US Council on Competitiveness, titled "*Make: An American Manufacturing Movement.*" While this report continues to uphold the suggestions made in the past, it goes one step further to propose that the US should have more mass production facilities in the country. This proposal was based on the following reasons: Mass production facilities (i) not only have a ripple effect to create indirect employment at related companies and local municipalities in addition to the direct employment there (e.g.; In 2011, the US manufacturing industry created 7 million jobs of indirect employment, in addition to 11 million jobs of direct employment.), but also (ii) serve as an engine to eliminate the trade deficit (the manufacturing industry accounts for 60% of the total exports in 2011.). That said, US financial institutions tend to avoid investment in mass production facilities, in comparison to startup companies developing new technologies, since the amount of investment in mass production facilities is generally higher, and accordingly, so is the risk entailed. The report points out the necessity to get rid of various regulations, lower the investment risk, and create a long-term financial system to support mass production facilities.

The US has led the world economy since the end of World War II, touting the expansion of free trade. Therefore, if it chooses an easy path of protectionism merely because its domestic manufacturing industry has been on the decline, it might well end up relinquishing its economic hegemony through its own actions as a result of losing the trust of other countries. (That said, the US still continues with some agricultural export support policies despite the suggestions of violations of WTO agreements, as seen in the case of cotton exports[5]). Also, a lot of the companies that have established international manufacture value chains based on the global economy would not want to see their manufacturing bases abroad relocated back to the US. Wall Street, which has expanded its investment business on the leverage of a strong dollar, would not want a drastic policy for a weaker dollar either, which is favorable for exportation of products.

If Trump's new administration truly intends to revive the US domestic manufacturing industry in order to carry out the mandate from the voters, it needs to (i) present a vision that is more persuasive than the case for free trade and is fully based on historical realities, and (ii) comprehensively examine various policies that may support the industrial process, ranging from technological innovation to mass production (e.g., education, advanced research, finance, protection of intellectual property, infrastructure development, trade policies, and prevention of extreme tax avoidance). This issue will not be solved by merely criticizing imagined external enemies, or leaving the problem to the discretion of private companies and individuals after implementing a large-scale tax cut. Accordingly, the key point for tackling this issue will be whether Mr. Trump will be able to find someone who can serve as a theoretical pillar for all the economic policies of his administration in the course of selecting his team members, which will be gradually unveiled in due course.

1) Statistics of the Economics and Statistics Administration, the US Department of Commerce, and the US Department of Labor
2) A 2012 survey report by the University of Michigan
3) Economic Impacts of Intel's Oregon Operations, 2009 (ECONorthwest)
4) A census by the Economics and Statistics Administration, the US Department of Commerce

[5] A WTO dispute settlement panel ruled in 2005 that US subsidies on cotton violate a WTO agreement. However, the US still continues with the system of agricultural subsidies including those on cotton.