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Trump's US, Japan's Economy and Korea¹

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I. Trump's America: What It Means for East Asia?

by Gerald Curtis

Let me start by saying just a few words about the relationship between Mr. Abe and Mr. Trump which may actually be of some relevance to what is going to be happening at the end of this month when President Moon meets with Mr. Trump in Washington because Abe has done a brilliant job, in my view, of handling Trump and building a personal relationship.

As I understand it, about a week before the election, the US Ambassador of Japan got a message to the Trump camp that the Prime Minister would like to call him to congratulate him if he were elected. And Trump was tickled that the Prime Minister of Japan thought he might actually be elected, which I think Trump himself didn't expect. Within 24 hours after the election, Abe called. Again, from what I've been told, they didn't talk policy. They talked about golf and Abe talked about how Trump sort of personified the American Dream, the expression that Trump is very fond of. In the conversation about golf, Abe said "You know, I like golf, too. It would be wonderful to play golf some time together." And Trump said, "Well, when you come to Washington, let's go down to Florida and play some golf." Apparently, that was when the decision was made to go to Mar-a-Lago after Washington.

In any case, the point here is that Abe set his initial goal to build a personal relationship and avoid talking about substance because Trump was not yet President and 10 days later Abe was in Trump Tower to meet with Trump. Again they had a very informal conversation with his daughter Ivanka, Jared Kushner and Michael Flynn. He laid the

¹ This is the transcript of the speech by Drs. Gerald Curtis and Hugh Patrick at the IGE Distinguished Lecture Forum on June 8, 2017. The views expressed here are the speakers'.

groundwork for this relationship by taking this very personal approach and focusing on how to build a personal rapport with the US President. It has paid very large dividends. As you know, when he met in February with Trump in Washington, Abe said absolutely nothing critical of US policy. For Trump, Theresa May had been in Washington before Trump. She took a very different position publicly at their joint press conference on sanctions on Russia. Merkel came later and had a very testy meeting in which he refused her offer to shake hands. Trump was so pleased with Abe that they shook hands and Trump would not let go. Japanese newspapers timed it 19 seconds of this handshake during which Abe smiled kind of frozen to a kind of painful grimace till he got his hand loose. In Mar-a-Lago they had 27 rounds of golf, lunches and dinners. From what I understand and I am sure it's true, Abe did the most of the talking and Trump was in a listening mode. He talked about North Korea, about China, about how Japanese investment in manufacturing companies in the United States has created employment.

One thing about this peculiar man we have as President of our country is that for an extreme Narcissist, which he is, we would have thought that he would surround himself with the yes men who would tell him how wonderful he is. I think it's interesting about Trump that he likes to surround himself with people with strong opinions. And he listens to them and then he makes up his mind. I think Abe did something very clever in not talking down to Trump but kind of talking up to Trump but educating him; it was very successful. As you know, Abe came back to Japan with Trump having said not even one word, not the slightest echo of any of the criticisms he had made of Japan during the campaign. Nothing about Japan's free ride on defense money, nothing about currency manipulation and the Bank of Japan (BoJ) policy that has led to depreciation of the yen and increasing Japanese exports, nothing about the trade barriers. So it was a very successful visit.

But I would just add just this about Abe and about Japan. We learned something very important about that trip. For Japan, there is no option but to try to develop the closest relationship with the American President whoever she or he might be. There is nothing to be gained, at least Japanese think, from criticizing the US President. So Japan is very different from America's European allies. It reflects difference. Despite all the problems of the EU, Germany is in a region of democratic, economically advanced states with common values. Britain after Brexit is not part of the EU but it is part of that world. But look at Japan and the same goes for Korea. Look at Japan and who its neighbors are – China, North Korea,

and Russia; all autocracies and all with nuclear weapons. The only democracy in the neighborhood is right here in South Korea with which Japan has a difficult relationship because of the problems that are left over from its poor handling of the colonial-era issues, comfort women and so on.

I think there are two lessons that came for the Japanese. One is there is nothing to be gained from criticizing the United States. There is no option but to have a strong relationship with the United States. There is no way to maintain a balance in East Asia without a strong US presence in Asia. But Abe is not putting all his eggs in the US basket. I think we see in Japan now a comprehensive foreign policy strategy. With the US alliances at the center, Japan is working hard to develop a security relationship with Australia and with Southeast Asian countries, Vietnam, the Philippines, and India; trying to see if they come to some accord with Putin on the northern islands issues; and now changing its tune about One Belt, One Road, indicating Japanese interest in participating in this Chinese project. I think we see a strategy not to be dependent highly on the alliance but to develop other relationship, both economic and security, and to be prepared in case they get blind sighted by Trump's erratic behavior. We saw Trump being very critical of Germany as very bad because of its trade policy and its trade deficit with Germany. You know, the US-Japan trade relationship is not very different from the US-German one. So there is always a chance of being blind-sighted. But so far, I think Abe has handled Trump well and Trump calls Shinzo Abe fairly regularly.

Let me turn to the two issues that I really want to talk about. One is what to expect from the Trump administration and secondly and the most important question on why he has won. I think we need to think about what has driven American politics into a situation in which the American public decided to elect this unqualified demagogue as president of our country. He has been in office now for 5 months. You would think and I had thought and I had hoped that by 5 months we would see the situations start calming down and more systematic and predictable behavior take place. But it is as chaotic as on Day 1. I think you should expect it to remain that way. He will continue to use his Twitter feed to create all kinds of problems. He is serious about changing many aspects of American foreign policy. He meant it when he said the US was going to get out of Trans-Pacific Partnership. He meant it when he said we were going to withdraw from the Paris climate agreement. You should not have false hopes that somehow the mainstream voices of common sense will

capture this President and point him in a more conventional direction. He won't be able to. It is not a revolution; he will not be able to fundamentally change the country. Thank Goodness, in our country I think the system of checks and balances still operates. You see what the courts have done to Trump's efforts to prevent immigration from Muslim majority countries. We see the problems he is having and will continue to have to get repealed and replacement of the healthcare, so-called Obamacare, because of opposition from within his own Republican Party in the Senate. So, the checks and balances system will keep him from doing something that he wants to do.

But this is a time of quite dramatic change in American policy. One issue of concern is that 5 months after becoming President, it is not unusual for a lot of political appointee positions not to have been filled. But never in our history have there been fewer top level political appointees not yet appointed as in this government. Of the 550 leadership positions in the US government, only 29 have been confirmed by the Senate as of this morning. 29 out of 550! Only another 70 or 80 names have actually been put forth. In the State Department only 1 or 2 top people have been appointed and defense, environmental protection agency and all the others have not been staffed up to run the government. You cannot run the government by a few people, by the President and his family in the White House. They think they are doing it but it is not a family business. It is not Trump's real estate operation. But that is the way so far he is running it. So there is a matter of great concern and it creates great concern around the world about reliability, credibility, and sustainability of American policy. We hope things will calm down but later today former FBI Director Comey is going to be testifying in the Senate. It is going to keep the Russian interference and the US election at impasse. The question of conspiracy between the Trump camp and Russia is very much on the front pages of newspapers. Trump's reaction will be to react, not to just let it alone, but to overreact. It is a very worrisome thing.

So, I think what is most important to reflect on is why this man got elected. I don't believe for a minute that it was because the majority of the people that voted for him racists are homophobic or Islamophobic. He won because so many Americans, especially working class people in the Midwest, so-called Rust Belt, but around the country are frustrated and they are angry. And they blame the establishments in Washington for having not been paying attention to their economic concerns and for not doing what needs to be done to deal with negative consequences of globalization. Globalization is good for the world and for the

economy. But there are sectors of the economy that paid the price of the adjustment. They paid the price of a company moving from Wisconsin to Mexico, or to China, or to Bangladesh. And the US does less in the way of trade adjustment assistance than any other advanced country in terms of job retraining programs, helping people move to other parts of the country where the growth rate is high. So I think the problem is not globalization; the problem is the failure to deal with the negative consequences of a globalizing economy. And I suspect that is true for all our advanced countries including the one we are sitting in today.

Hillary Clinton blames her defeat on FBI Director Comey and his email issue, on Russian hacking and on the fact that she is a woman and there is still prejudice against electing a woman as President in the United States. But that is not why she lost. She lost because she was an inept candidate. I remember last year when I spoke at this Forum, I said I didn't think Hillary Clinton could win this election if she ran a campaign about how dangerous it would be to elect Trump as President. She had to have a positive message but she never had a positive message. And she never ran after the traditional Democratic Party base which has always been the working class and middle class people. Towards the end of the election campaign, when I thought there was a real chance that she might lose was her final rally. That was a clinching point for me. There were lots of people in the auditorium. On stage she was joined by Beyonce, Katy Perry, Jay Z and all these celebrities. And they were having a grand time and so were the people in the audience. And I was thinking if you were a man in Ohio who had lost his job and watching TV with his family looking at the rally, what will you think? You will think, "This lady lives in a world so different from mine and she is not concerned with my issues."

And Donald Trump, with his "Make America Great Again" baseball cap on, was talking at these huge rallies about the problems of immigrants and liberals to people who are angry and frustrated. They may not be really against immigrants and liberals; but they are surely against so-called limousine liberals. These people who run the Democratic Party of the United States drive around in chauffeur-driven limousines and hang out with their hedge fund friends. One of the interesting developments in the American politics is how many younger, very rich Americans support the Democratic Party. They support the Democratic Party because they are social liberals. They believe in climate control, in gay rights, in better treatment for minorities and so on. These are people who have in a way captured this Party, especially because you need so much money to be in politics these days.

And who has the money? My anger at the Democratic Party which I have been a supporter all my life overwhelms me. In the month of August, while Donald Trump was running around having these big rallies and making these outrageous proposals about not letting Muslims into this country and so on and so forth, Hillary Clinton spent the whole month in the Hamptons, Long Island, having fundraising money with her friends and mostly spending that money on TV advertising which was the strategy for winning this election. So at the end of the campaign, her husband, Bill Clinton, told her campaign manager that he had got to have Hillary go out to Midwest, Wisconsin. She had never been to Wisconsin once after nomination. Bill said, "Go to this blue collar area. She needs to go." And the reaction was "That's old style Democratic politics. We are in a new world, a world of identity politics." That's the problem. At the end of the day, people vote their pocket book. They vote their economic interest. It was Bill Clinton who said "It's the economy, stupid." But his wife didn't listen.

I think you will be making a big mistake to think that Trump is simply an aberration and when he is gone, we will revert to the norm. We are not going back to America that we used to know in many important ways. If it's not Donald Trump, perhaps the next President will be a populist on the left rather than a populist on the right. We have to come to grips with our domestic problems – the fact that the US has the highest level of inequality among all industrialized world and the fact that support for people who lose out in the globalization race is not being paid attention to. We have to come to grips with the reality that American attitude about our country's role in the world is changing. I think the era in which America saw its national interest to be magnanimous in maintaining a liberal international order is at an end. We are not feeling so generous anymore. We feel that other countries should be doing more. We are not used to in our history to this kind of situation. Before the World War II, we were isolationist. After the War, we became globalist with unparalleled power. We are still the most powerful country in the world and we will continue to be but it's not the kind of power, especially in economic terms that we once had.

So in this part of the world, what country is the major trading partner for every country in East Asia? It's China, it's not the United States. I think we're seeing Trump representing something very fundamental in the way of changing attitudes in the United States. Unfortunately, in my view, he is not competent to be President but we're stuck with him. I suspect that he will be President for four years. There is a lot of wishful thinking

about impeachment and so on, but it's not very likely that something comes out of the Russian investigation that would lead to that.

Now here in East Asia, one thing that can be said as positive about Donald Trump is that I don't believe he has any strategy. But his tactics and his threats about dealing with this North Korean problem if the Chinese don't do something about it come across as pretty credible. I think we see some real concern in Beijing that they have to do more to work with the US, with South Korea, with Japan to try to get the North Koreans to decrease the continued development of nuclear weapons.

I think President Moon's visit to Washington is absolutely critical and I hope that he can sort of do an Abe in the sense of building a personal relationship with Trump, expressing his support and appreciation for what the US is doing to put pressure on North Korea and then having a very clear message about what he wants Trump to understand South Korea would like to see us do together. We need a strategic agreement between the US and South Korea on North Korea.

Q&As

Q: Mr. Trump pulled out of TPP and Mr. Abe is trying to move forward TPP without the US membership. Japan is working with Australia, New Zealand, etc. Do you think TPP minus the US would be essentially coming back? And if that becomes mature, do you think Trump might revisit TPP?

A: I place my bet on the US not coming back to TPP as long as Donald Trump is President of the United States. He will not change his view on this issue. Abe interestingly has changed his own view on TPP-11. After the US pulled out, he said there was no point in going forward with TPP without the United States. Now he's taking a very different position and is trying to find a way for Japan to exercise leadership in East Asia, as contrasted with China, for Japan to be a leader in East Asia and to be sustaining the free trade regime. The big problem is TPP-11 includes Vietnam and Malaysia, both of which want to be in TPP because of the access that would have provided to the US market. Whether TPP-11 is going to go forward, I am not sure. But clearly, the Japanese view is "Let's keep the momentum behind TPP and wait for Trump to change his mind and come back." It amazes me how

much Japanese have convinced themselves that this is a real possibility. But I don't think it's a possibility at all. We don't really know very much what Trump will do. (*Robert*) Lighthizer has just been appointed and we don't know how much influence he has vis-à-vis the people like Peter Navarro and Steve Bannon in the White House. It's all very uncertain. But I think the Japanese have made it clear to the Americans. Agricultural liberalization is a big issue for the US with Japan. If Japan is prepared to make the concessions on agriculture that has already made in the TPP and if that's what the US wants, that negotiation can happen pretty quickly. But if the US wants more than what Japan gave in the TPP negotiations, then the negotiations will drag on for a long time. In the meantime, Australia will capture the market for imported beef and in many other ways, the US will lose out. I think the Japanese have taken a strong position and they are willing to liberalize agriculture but only up to the TPP level.

The politics of the economic relationship which I find very interesting is that the US-Japan agreed to set up this bilateral economic dialogue headed by Pence and Aso. From what I know, this was Abe's proposal which Trump at first was reluctant to accept. He couldn't figure out what his Vice President would be doing, heading up a bilateral economic dialogue. But it was clear what Abe was after. They wanted two things. They wanted a dialogue that focuses on strengthening economic cooperation rather than a dialogue that focuses on the things under disputes, on trade conflict. And they wanted Pence to be the key person because as governor of Indiana he had been very successful in attracting a lot of Japanese investment from Toyota and other companies. So they see Pence as friendly to Japan. And most importantly, this fits in well with the Japanese strategy that we are all familiar with. Economic dialogue would kick the can down the road in terms of dealing with trade disputes. And that's exactly what happened. Pence showed up in Tokyo with no staff, no preparation and not able to do very much more than offer some very energizing comments on how this is a vital trade relationship and the one the US cherishes. That was music to Japanese ears. So I don't think we should expect the turning back to the multilateral agreement by this government.

Q: With the America First policy, US withdrawal from TPP, Paris climate deal, and so on, and it retreat from Asia, China appears to take great advantage of US absence. Chinese leadership may be more visible and they might be ready to re-write the global trade orders. Do you think China will be able to fill that vacuum?

A: This is clearly an opportunity for China to take a major leadership role in the world. Will they succeed in doing so? I am very dubious. First on Paris, I think it's important to realize that Trump's decision is widely opposed in the United States by many state governors and by many corporations who are banding together to try to maintain the US commitment at the state level and at the corporate level to the agreement made in Paris. The fact that Trump has pulled out of the agreement does not mean that America has really pulled out of its commitment to do what it should be doing to try to contribute to control climate change. So I think it's a terrible, terrible decision that hurts the American image, American credibility and American leadership, to be certain. But I would be a little careful about its implications because on the immediate reaction from several state governors such as California, Washington state and elsewhere, saying that "We will keep the commitments." But as to China, I would be very interested in your views but I think it is very difficult for China to exercise this kind of leadership role.

Leadership means that people have respect what you're doing, that they respect your political system and that they respect the way you treat foreign companies. Does China enjoy that kind of respect? I don't think so. I don't think a country with an authoritarian regime that rejects the values of freedom, a true market economy and human rights can become a world leader. I don't see it being a leader of our countries. I think that the Chinese government decision to stop a lot of tourism and group tours to South Korea and punish Lotte in China because of the Terminal High Altitude Area Defense (THAAD) show that they mix the security issue with their treatment of foreign investors in their country and their own tourists. Is this the behavior that is acceptable from a leader of the world? I don't believe that for a minute.

I think we are facing in a way even a more challenging situation. We are in a world in which there is no one leader. So the question is how we create a more cooperative, collegiate form of leadership. This is very difficult to do. We are now into a multipolar world rather than the old bipolar Cold War system. In a multipolar world the dangers of miscalculation and the different combinations that become possible are so complex that the opportunities for conflict grow greater. The US is the strongest country, so we have to learn how to listen and how to work with other countries, with Japan and with Korea, in this part of the world in particular, to come up with a joint strategic view of how to serve our mutual

national interests. We have not had much experience with this. Our view of alliance cooperation is ‘We’ll decide in Washington what needs to be done and then we will consult with our allies about how to share the burden of doing it.’ That’s not the way things can work as much in the future as they in the past. So I don’t see China as the leader replacing the US. I don’t see the US reverting to the leader it was before the Lehman shock and before the collapse of Russia. So that’s the challenge how we figure out together how to provide leadership.

Q: To sum up, President Trump will stay for at least next four years although there are some possibilities of getting impeached. But as Gerry, said, the probability is not that high. Also, China is not capable of exerting global leadership. That leaves us with the danger of the “Kindleberger trap”, that is, the existing hegemonic power is declining and cannot continue to play global leadership. On the other hand, the emerging leadership country is not ready to play global leadership role. So the world is in short supply of global leadership, which leaves us a gloomy picture. It’s a big challenge. What are solutions? So, I for one have been advocating for doing things collectively. One of the forums is G20. The world needs collective leadership. But the problem is there is no ownership. On that ground, I have been recommending the Korean government indirectly, as I’m not in the government now, that Korean play a role. Korea is not a superpower and not a threatening power, so Korea can play a role. So in the upcoming G20 Summit in Hamburg, I hope our President can play some role.

A: I agree with what you said. I also think potentially there is a role for South Korea in the G20. And there should have been a greater role for G20. But I am rather skeptical about how much the G20 can do for steering the world issues. I think we need to what we can do to strengthen the G20. And I think Korea is in an almost uniquely advantageous position to play a role. But I think we need to think about how we build issue-specific coalitions among countries with common concerns about some set of issues and try to come up with a common strategic approach to deal with it. But the G20 is so diverse that on most issues you are not going to get that kind of consensus. You take the issue of North Korea; it is quite clear that we need a common strategy of the US, South Korea, Japan and hopefully China to deal with this North Korean issue. I think depending on the issues we are talking about there are different coalitions. It’s very complex and therefore it’s easy to fail. It seems to be that’s really where we need to use our imagination more to figure out how we structure

these kinds of issue-specific coalitions.

Q: As a casual observer from the United States who knows this area so well, Japan and Korea in particular, let me ask you how you see the issue of THAAD. I am very curious to know the ordinary Americans' views and reactions.

A: First, ordinary Americans have no idea what THAAD is. I think the bigger question is what Americans think about North Korea developing its missile capability to deliver atomic weapons not only to South Korea and Japan but potentially to the United States with an inter-continental ballistic missile (ICBM) capability. And the response is "We have to stop." So in that context, building ballistic missile defenses in South Korea and Japan, I think, is seen as common sense by people who think about these issues, whether it be THAAD or some other system. It's kind of a technically question that most people don't care about.

But I think there are two things. We have to try to develop a defense system and we need to put pressure on North Korea to decrease. As Trump has said, if China is the only country that has the ability to really squeeze the North Koreans' heart hard enough because of oil, I think it's kind of foolish to say "You help us on North Korea and we're going to be nice to you on trade issues." Anyway, the short answer to your question is there is a lot of support for the ballistic missile defense system. And if the Chinese are so upset about the THAAD deployment in South Korea, it's quite obvious what they need to do to prevent THAAD, that is, to get the North Koreans to give up the nuclear weapons. If we didn't have the nuclear weapon problem in North Korea, you wouldn't have the THAAD missile defense system in South Korea. So instead of blaming Lotte for giving the land to the Korean government to build the system, look in the mirrors, it's a Chinese problem to deal with the North Korean issue.

Q: I would like to ask about the fate of the US-Korea free trade agreement (KORUS FTA). During the election campaign, Trump said the KORUS FTA is a bad deal and even talked about scrapping the deal. At least, he said the KORUS FTA should be renegotiated. What steps do you think Korea should take to prevent a collapse of the KORUS FTA or a possible renegotiation?

A: Why don't you establish a Korea-US economic dialogue and include discussion of KORUS in the dialogue? And play for time and wait and see. I think it is the best strategy for

dealing with this administration. We have no idea what the Trump administration's view is going to be six months from now or even next week. What I think is probably the most useful is to engage in a dialogue, keep the dialogue at a fairly general and comprehensive level, talk about what American dissatisfactions or Trump's dissatisfactions with KORUS are, and talk about how they might be resolved. Talking can take an awfully long time but the longer it takes, the better it is.

Q: President Moon is going to Washington this month to meet with Mr. Trump. If you were asked for advice for President Moon, what advice would you give him?

A: First, focus on developing a good personal rapport. Assume that Trump really doesn't know a lot about issues that are important to Korea and try to find a way first to appreciate what the US is doing for this country and take the opportunity to educate him without being condescending. That's the trick. As I said, that was what Abe pulled off very well. I think your President can, too. He can also set up some kind of system for continuing dialogue, not simply pushing the issue off forever. We need some structure to create a strategic agreement and we have to be prepared to think outside the box about how to deal with the North Korean issue. I do think that it's very important to have strong sanctions to make it clearer to the Chinese that we need them and insist on their participating. But at the same time, there has to be an exit ramp; there has to be incentives for the North Koreans to engage in a process leading towards de-nuclearization. Sanctions alone will simply drive the North Koreans to tougher positions.

II. Japan' Economic Challenges and Prospects

by Hugh Patrick

I am going to talk about Japan's economic challenges and prospects. One of my dilemmas is that I think you all already know a lot about the Japanese economy. In a sense the Korean economy's structure and problems are quite similar to those of Japan, with maybe a 10-20 year time lag. Therefore, it is particularly important for Korea to learn from the mistakes Japan has made as well as the things it has done well in its last 20 years and even longer.

I have just come from three and a half weeks in Japan, including three nights in the Miyazaki city in Kyushu. There I was able to meet with several strong local companies. During my stay in both Tokyo and Miyazaki, I came away with a sense that the Japanese economy not only is fundamentally strong but it is doing pretty well. The growth rate is sustained and industrial production has finally surpassed its peak in 2008. The unemployment rate is amazingly low at 2.8%.

One problem is that the price stability, which I define and I think the government of Japan defines as a 2% annual rise in the consumer price index (CPI), has not been achieved and it will take a long time for it to be achieved. However, the good news is that I think the "deflationary mindset" of Japanese is finally being broken. I found it really interesting that when the Yamato express delivery company recently announced that it was going to raise prices for the first time in 26 years. This was big news in Japan. You would not think that price increase would be big news. But essentially this was a signal for other companies that they, too, could start raising prices, creating an atmosphere in which price increase is a normal part of the adjustment process. It is a major change. I think Japan is finally reaching the stage of being able to move in a more normal path. When you have full employment but with some labor tightness, some wage increases and some productivity adjustment will be expected.

Like all other countries, Japan faces both major international and domestic challenges. Most of the international challenges are due to the increasingly complex global and regional geopolitical environment. In my view, the international economic system is strong, effectively market-based and has been able to absorb the rise of the Chinese economy and indeed of other challenges in the international political system – Brexit in Europe, the Middle East, and now the dramatic increase in North Korean nuclear weapons and missiles. This is the international environment Japan faces.

Nevertheless, Japan's major challenges are domestic. Certainly, the most obvious long-run one is demography as indicated by Japan's aging and decreasing population. The second major challenge is how to increase labor productivity and how to achieve good growth, which is the most difficult and comprehensive of the three objectives of Abenomics, especially since it relies so much on private sector response and involvement, not just the

government.

A third challenge is to prepare for inevitable natural disasters ranging from typhoons and other weather-related disasters to a major earthquake. There is a significant probability that the Tokyo area will be subjected to a major earthquake sometime in the next 30 years. Most Japanese I know in Tokyo respond by having a few extra days of food and water supply at home but then basically shrug their shoulders and hope that it will not happen in their lifetime. That is probably how the people in California are behaving, too, because of the same fault line.

As I just said, Japan's most important challenge of the longer run is its declining and aging population and continuing low fertility rates. This is not a new issue. This is an issue more of future than it is of now. Japan's population is declining today because of two fundamental Japanese values. One is the value at the family level of aiming for two children, which seems to be very widespread now as a target. As a result, fertility is below two. The other holding down the domestic population is, of course, the very low acceptance of immigrants as permanent residents. Fertility has been below the replacement target of a little over two ever since 1974. My expectation is that current young generation will maintain a low fertility rate and that their children, many of them unborn, will also maintain a low fertility rate. And the question is whether their grandchildren will aim for three children instead of two and that is so far ahead of us. So I do not think that there is any way to do anything other than acknowledging that is the way it is going to be. It is clear that the Japanese population will gradually decline for at least the next 30 years.

When we talk about immigration, we have to distinguish between guest workers and those who move to Japan permanently. Japan has an increasing number of foreign guest workers who stay 3-5 years or some quite longer and eventually they have to return to their homes. I think it would take the Japanese a very long time to change their mindset about accepting foreigners to be permanent residents. I think there are about 15,000 immigrants a year now and my suspicion is that most of them are foreign women marrying Japanese farmers. I understand that is not only a Japanese condition but it is happening in Korea as well. Japan is one of the lowest recipients of refugees, something like 15-20 refugees accepted a year out of the thousands that apply.

Let me turn to aging. Aging is a happy result of Japan's economic development and advances in the standard of living. Certainly, the proportion of older Japanese, 65 or older, is rising because of the low fertility rate and the absolute numbers of older people. Japan has achieved a 20-year increase in life expectancy over the last 75 years or so. It is a wonderful thing but it is also challenging. The challenge is how the society copes with having a higher proportion of older people. Part of the adjustment is that older people are working. A higher percentage of those aged 65-75 works in Japan than in the United States. Nonetheless, the costs and future costs are real concerns. Japan has a universal healthcare and it is a very good program. I do not see them cutting back on elderly healthcare. They may try to pay for it by having higher fees for higher income Japanese. That would seem to me as quite a reasonable response. It is of course politically difficult to carry out that sort of thing. Retirement benefits that the government pays for the people of elderly and welfare-related programs, I think, are sustainable in the short to medium run, but not in the longer run. So the question is how the smaller number of younger people paying to support the greater number of older people is going to be handled. And it is not clear. I think eventually they will have to reduce the support for elderly people, but that will be another terribly difficult political solution.

Of course, as in Korea and everywhere else, a key to Japan's good economic performance in the future is to increase its productivity through R&D innovation, better allocation of capital and labor resources. Two of the major issues relating to productivity are the operations of the Japanese labor markets and the increasing inequality of income and wealth. Japanese labor markets are segmented and quite rigid with significant differences in wages plus the fringe benefits for full-time regular workers as compared to contract and part-time and other non-regular workers that are about 40% of the labor force.

Let me make just two final points. First, small and medium enterprises (SMEs) in Japan are important as producers and suppliers to large firms as subcontractors, but they also provide goods and services to local and regional markets and some are even exporters. I am always impressed by the local companies whenever I go to different parts of Japan. Local companies that I meet are strong and good. When I was in Miyazaki, I met Japan's largest *shochu* producer, a small domestic airline company with 12 modern low-cost operating airplanes headquartered in Miyazaki airport, and a company that is doing a special pancake mix business which is being marketed as a dessert item together with fruits, jams, ice cream and so forth. It is growing tremendously. Seeing this helps me get a flavor of

what is going on in Japan. When someone says that Japanese SMEs have problems, my impression is that Korean SMEs have greater problems.

My other final point is that our attempts to measure GDP and GDP per person in Japan or in Korea really do not adequately estimate the high value of services because of the nature of the Japanese and Korean societies. I think everybody is brought up to just learn how to provide good service. It is not something that happens universally in America, I have to say. When I talk about services, it ranges from doctors or lawyers, business services including accounting and auditing, to consumer services such as retail and restaurants. As wages go up in Japan and the costs of labor rise, retail stores and restaurants will reduce their hours of service. We are already seeing that. They will have fewer staff to serve in stores and restaurants. The quality of service will be just as high but it will be slower. It is just going to take us more time to have a nice meal in Japan than we used to. We as consumers will be paying that cost but measured GDP productivity will be going up because there are fewer workers.

Let me just conclude by simply repeating that Japan is a normal, advanced country and a demographic leader because of its declining population. We all can learn from how Japan deals with these problems and other problems. Fundamentally, I continue to be quite optimistic about the Japanese economy. It will maintain its high standard of living and over time will gradually increase it.

Q&As

Q: You mentioned about the Japanese SMEs. I know that the Japanese SMEs are very strong and many are global hidden champions. What is the relationship between SMEs and large conglomerates in Japan? In Korea, we have a zero-sum type of relationship between SMEs and big companies. Many of the large business groups are trying to penetrate the lines which used to be dominated by traditional SMEs and micro family businesses. Do you observe this happening in Japan, too?

A: I think 20-30 years ago there was big tension between small companies as suppliers and large companies. Large companies were generally perceived as exploiting of their strong power. My sense is that over time that issue has sort of gradually declined. Small firms

supplying Toyota or other large firms have worked out good working relationships, so it's less of an economic, social issue. But it took time. The other issue whether SMEs can find markets is that they are too small for large companies to bother with. That's true for specific local markets and services. It takes time to sort this out. My impression is Korea is still at a much earlier stage and it's more of a problem. When I said there are good, strong SMEs, it's certainly true. But there are also lots of zombie SMEs. They stay alive basically because interest rates are very low and banks don't want to make them go bankrupt because it will cause problems for banks. But when interest rate goes up, there are going to be a lot of problems of adjustment on the SME side.

Q: Mr. Trump pulled out of TPP and Mr. Abe is trying to move forward TPP without the US membership. Japan is working with Australia, New Zealand, etc. Do you think TPP minus the US would be essentially coming back? And if that becomes mature, do you think Trump might revisit TPP?

A: I think it's a major mistake for the United States to decide not to participate. My impression is that in Washington the trade people who are still there are trying to figure out how to take the substance of many TPP issues and incorporate in new discussions. If that works out, then maybe there will be a new Trump public policy on trade. That's possible but I am not going to bet on it. I think we simply have to see how the trade negotiations go. One of the issues is what to do about the fact that important countries are not part of the TPP-11.

Q: Japan has a very low unemployment rate at 2.8% as of now. But they also have a problem of stagnant wage. Do you think Japan will be able to see a wage growth in near future?

A: It has been a surprise to me because I was trained in a rather standard economics. Labor became really tight and the way you competed was you had to raise wages to get workers. What has happened apparently is that regular workers and unions are really concerned about continuing the system of more or less guaranteed employment. So they are quite conservative about asking for wage increases. On the other hand, as for the non-regular workers who are 40% of the labor force, you do see much more labor market wage increases that are beginning to show themselves in the economy. I think this is a process in which wages will gradually continue to rise. I think it's just in the beginning but I think it will persist. And in that sense I am fairly optimistic.

Q: To sum up, President Trump will stay for at least next four years although there are some possibilities of getting impeached. But as Gerry, said, the probability is not that high. Also, China is not capable of exerting global leadership. That leaves us with the danger of the “Kindleberger trap”, that is, the existing hegemonic power is declining and cannot continue to play global leadership. On the other hand, the emerging leadership country is not ready to play global leadership role. So the world is in short supply of global leadership, which leaves us a gloomy picture. It’s a big challenge. What are solutions? So, I for one have been advocating for doing things collectively. One of the forums is G20. The world needs collective leadership. But the problem is there is no ownership. On that ground, I have been recommending the Korean government indirectly, as I’m not in the government now, that Korea play a role. Korea is not a superpower and not a threatening power, so Korea can play a role. So in the upcoming G20 Summit in Hamburg, I hope our President can play some role.

A: Let me say I agree with you completely about trying to utilize the G20 as an effective operation. As you say, so long it’s not done as much as it should have. Countries like Korea or Australia or others have the intellectual capacity and leadership capacity. I hope that you will do that. I wanted to make one different point. Generally, when we’re talking about difficulties, we’re talking about geopolitical difficulties and security difficulties. But at the same time, we have great strengths in our international economic system and in our trading system. This has always provided sort of a reality that is cooperative, productive and important and we have to be very careful not to let creeping protectionism come in in the United States, Korea, Japan or anywhere. Just don’t take a good operating economy for granted, you political scientists and political makers. Take it as something that you have to also protect as one of the strengths as we try to figure out how to cooperate with each other.

Q: As a casual observer from the United States who knows this area so well, Japan and Korea in particular, let me ask you how you see the issue of THAAD. I am very curious to know the ordinary Americans’ views and reactions.

A: I was really surprised that the Chinese responded by attacking a single company that has investments in China. I think the Chinese have been trying very hard to demonstrate the world the separation of politics and economics and that they would treat foreign investments reasonably. So they have sent a major signal that they are not a reliable country to invest in. I was quite surprised about that.

The broader issue of what to do about North Korea and defense, THAAD becomes a symbol among those of us who have heard about what THAAD is. But as Gerry said, many Americans don't know what THAAD is. It's just one component of a comprehensive military strategy of how you try to contain North Korea. I am skeptical that the Chinese will push North Korea far enough. I don't expect North Korea to denuclearize. The American government policy at dilemma is it will not accept the idea that North Korea is a nuclear power officially. It may accept that reality in practice but it cannot officially. So it is a very difficult adjustment process we have to do in American official policy because I think the reality is that it is going to be a nuclear military capable nation within a few years. And I don't see any way that's going to be stopped.

Q: President Moon is going to Washington this month to meet with Mr. Trump. If you were asked for advice for President Moon, what advice would you give him?

A: Clearly, I think it's very important to identify what your priorities are. And if you are talking about the economic side, you really want to talk about policies to promote efficient and effective allocations and full use of resources. I think that the government has always an important role but hiring a few thousand people in the public sector is an opportunistic way to go. One should be thinking of more fundamental longer-run problems to increase the growth rate, to increase the demand for labor, and to work to those sorts of things. Those are reference to the very specific proposal about trying to increase the number of government officials and change from temporary workers to permanent workers which are very complex issues. I like Gerry's solution. Have a dialogue. You talk and talk and that's when you find a solution for difficult issues. But this is a new government with new leadership. It takes time to find out what this (*Korean*) government would really like. As an economist, I just would give him rather standard economic advice.