



A conference convened by the University of Michigan's Center for Japanese Studies and the International Policy Center at the Gerald R. Ford School of Public Policy. Generously supported by the Japan Foundation Center for Global Partnership.

CONFERENCE REPORT

The recent evolution of Japan's domestic and international economic and security environment, punctuated by the arrival of the Trump administration, has raised a host of important policy questions. The Abe administration confronts challenges relating to maritime disputes in East Asia, unresolved tension on the Korean Peninsula, U.S. withdrawal from the Trans-Pacific Partnership (TPP), and uncertainty about the direction U.S. foreign policy. In this context, Japanese policymakers are weighing strategies to mitigate risks and seize opportunities to promote economic growth, stability, and national security.

To address these critical issues, the University of Michigan's Center for Japanese Studies and the International Policy Center at the Gerald R. Ford School of Public Policy convened a group of experts for a conference on February 3. They discussed Japan's macroeconomic, trade and security policy, explored the implications of the U.S. election and other recent developments, and considered Japan's prospects and policy options going forward. This report summarizes the proceedings, offers key takeaways, and notes priorities for further research.

OPENING REMARKS

Kiyoteru Tsutsui of the University of Michigan (Director of the Center for Japanese Studies) opened the conference by highlighting the past, present and future importance of the Japan-U.S. relationship. He noted some emerging foreign policy principles of the Trump administration – prioritizing American security over collective security, American jobs over free trade, and bilateral negotiations over multilateral institutions with set rules – and laid out concerns in Japan about President Trump's pronouncements that Japan and other U.S. allies should bear greater security costs and his pledges to be tougher on America's major trading partners. Tsutsui noted fears in Japan of U.S. abandonment or a grand bargain by which China and the United States divide the Pacific into respective spheres of influence. Tsutsui also noted the Abe administration's profound disappointment at U.S. withdrawal from the TPP and concerns about U.S. pressure for further trade concessions. Despite these uncertainties, he noted that Abe's upcoming visit to Washington offers an opportunity for the two leaders to build on a good start to a relationship that will have critical effects on Japan's economic and security policies.

“ABENOMICS” AND MACROECONOMIC POLICY

The first session, chaired by Josh Hausman of the Ford School and University of Michigan, focused on recent macroeconomic developments in Japan. [Takeo Hoshi](#) of Stanford University’s Freeman Spogli Institute and Graduate School of Business began with an overview of Abenomics. He noted that its “three arrows” try to address both the supply and demand sides through bold monetary policy, flexible fiscal policy, and structural reform to promote private investment. He said that the reforms were appropriate ways to try to deal with challenges such as a rapidly aging population, the limits of an export-led growth strategy, and past protection of incumbent firms. He then reviewed some performance metrics, noting that there has been no clear jump in the real growth rate yet, but the labor market has tightened, and the output gap has narrowed. Inflation increased after Abenomics was introduced and has since returned to a near-zero level. The plan thus failed to achieve its aim of 2% inflation after two years but has moved Japan from negative to low-positive inflation rates. Low inflation, Hoshi argued, is mainly a result of flat average wages. Although wages within many industries have increased, jobs have reallocated to lower-wage sectors and from full-time to part-time employment.



Takeo Hoshi

[David Cashin](#) of the U.S. Federal Reserve, presenting in his personal capacity, focused on how consumption has responded to VAT increases in Japan. He noted that Japan’s consumption tax has been subject to much debate, and conventional wisdom holds that the 1997 rate hike from 3 to 5% tipped Japan into recession. Cashin’s research with Takashi Unayama shows, however, that the 1997 VAT hike had only a modest income effect on consumption and that Japan’s banking crisis better explains the 1997 downturn. Cashin explained that consumption of durables and storable goods increased briefly after the 1996 announcement of the hike, as consumers anticipated higher prices, before dipping modestly after the hike’s 1997 implementation. By contrast, Cashin showed consumption did drop nearly 4% after Japan’s 2014 VAT increase from 5 to 8%. This led to the delay of a further planned increase to 10% until at least 2019, though data suggest consumers may already have priced in that further increase. A key difference is that unlike the 1997 hike, the 2014 VAT increase was largely uncompensated and thus came as a long-term income shock. Moreover, Cashin noted that many Japanese households did not comprehend fully how the 2014 hike could benefit them. Overall, Cashin’s findings suggest that the effects of VAT increases on consumption depend on the manner and extent to which consumers are compensated.

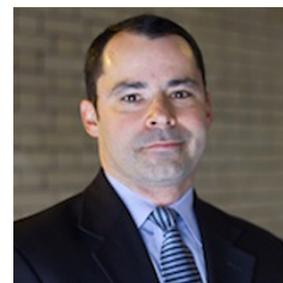


David Cashin

In discussion, panelists noted some areas of policy success, such as stronger per capita growth than other major economies and increased female labor force participation. They touched on the potential of Prime Minister Abe’s plan to engage more foreign workers while noting the challenges of immigration reform in Japan. For revenue generation, panelists considered the possibility of incremental VAT increases and variable VAT rates, agreeing that neither was likely to reverse the effects of higher taxes on consumption and that both would be costly and complex to implement. They agreed that even a sizable VAT increase would not bring fiscal sustainability, which will require social security reform, spending discipline, and higher inflation. To encourage the latter and manage ongoing risks of deflation, Hoshi argued that Japan should continue to pursue an expansive monetary policy.

JAPAN'S FOREIGN TRADE

The second session, chaired by Alan Deardorff of the Ford School and University of Michigan, focused on Japan's external trade. [Lee Branstetter](#) of Carnegie Mellon University emphasized that Japan and the United States had a lot riding on the TPP, a crucial pillar of the U.S. rebalance to Asia and a key means by which the Abe administration sought economic growth, greater regional influence, and reinforcement of the Japan-U.S. alliance. He noted that the projected economic benefits to Japan of the TPP were sizable – perhaps more than \$120 billion per year – and that projected U.S. gains were even larger. In addition to tariff reduction, the TPP addresses non-tariff barriers and promotes regulatory reforms conducive to investment. Japan and the United States were able to shape rules in key areas such as intellectual property, investor-state dispute settlement, and rules on state-owned enterprises. The TPP was thus a promising nucleus for a broader regional trade accord, and Branstetter argued that China would have had strong incentives to try to join by enacting desirable reforms. Without the United States, he contended that the TPP has little appeal. The United States and Japan lose from the deal's demise, and China benefits as the leader of the main alternative – the Regional Comprehensive Economic Partnership.



Lee Branstetter

More broadly, Branstetter expressed concern about U.S. disengagement from international trade given the composition of President Trump's economic policy team, which he faulted as protectionist and poorly versed in international economics. In that context, he argued that the outlook for Japan-U.S. relations is not encouraging. He contended that the Trump administration is apt to demand much more than it is willing to cede in trade talks and that its policies will likely lead to a stronger dollar and further pressure on the U.S. current account. He ended by noting that even in the 1980s, thoughtful and pragmatic officials in the Reagan administration had engaged in Japan-bashing when the U.S. trade deficit soared – suggesting the risk of similar friction between Japan and the United States in the Trump era.

[Kazuhito Yamashita](#) of the Canon Institute for Global Studies emphasized the TPP's merits, such as improved market access and rules to prevent a "race to the bottom" in labor and environmental standards. He noted the advantage of enabling new participants to join, which could have positive domino effects. Yamashita questioned President Trump's argument that protective trade barriers and immigration controls will promote U.S. job growth and retention, noting that in an era of global supply chains, American companies and consumers would suffer and migration could increase. He added that withdrawal from the TPP and threats of tariffs on China and Mexico undercut U.S. leadership in world trade.



Kazuhito Yamashita

Yamashita recommended that the remaining 11 TPP members conclude a deal. The United States would lose from this arrangement, as Japan would withdraw agricultural concessions, Canada, Australia and some other exporters of farm products would take advantage of Japan's tariff reductions or eliminations so that U.S. farms would lose substantial market share in Japan, and the U.S. government would have diminished negotiating leverage should it try to accede in the future. He did hold out hope, however, that a bilateral trade deal between the United States and Japan could help drive down Japanese agricultural tariffs, such as rice leading to the abolition of the long standing rice paddy set-aside program.

In discussion, panelists touched upon the possible effects of unilateral U.S. trade sanctions on China or Mexico. Branstetter argued that while the direct effects would not necessarily be large, such a tariff would show U.S. willingness to adopt ill-considered trade policies and add “fundamental uncertainty” with large adverse effects on global markets. Yamashita raised the added possibility of WTO complaints and “tit-for-tat retaliation” that could spark a counterproductive trade war. The panelists also discussed whether a smaller TPP deal would be possible without U.S. participation or whether the TPP could be revived. Yamashita noted the reluctance in some groups in the Japanese government to risk antagonizing the Trump administration by moving forward, and Branstetter argued that Trump’s clear stance on the TPP would make it difficult for him to reverse course. Panelists also reviewed the prospects for a bilateral Japan-U.S. trade deal, with Branstetter citing the risk that the Trump administration could use security support as a lever for pressing Japan on trade.

JAPAN’S PURSUIT OF EXTERNAL SECURITY

The final session, chaired by John Ciorciari of the Ford School (Director of the International Policy Center), focused on Japan’s efforts to meet its external security challenges in an era of intense maritime competition and uncertainty about future U.S. Asia policy. [Amy Catalinac](#) of New York University began by discussing the domestic politics of security policy reform in Japan. She argued that changes in Japan’s electoral system help explain why security policy has evolved considerably in the post-Cold War era after decades of relative stasis. Throughout the Cold War, members of the Liberal Democratic Party (LDP) competed with co-partisans in district-level elections, which encouraged them to prioritize pork and pay little attention to external security policy, which could not easily be used to reward local constituents. The 1994 electoral reforms enabled the LDP to run a single candidate in each district, freeing LDP politicians to pay more attention to the party’s provision of nationwide benefits such as national security.



Amy Catalinac

Catalinac argued that going forward, Japan will likely seek to satisfy the Trump administration first in the economic realm, as opposition parties relying on proportional representation still constrain the government’s ability to pass security legislation. She also noted that Japan’s behavior in the coming years will provide a good test of its intentions. Abe could use U.S. requests for an enlarged security role to increase Japan’s military activity, though Catalinac anticipated that Abe would be reluctant to move quickly in that direction.

[Jeffrey Hornung](#) of Sasakawa Peace Foundation USA then reviewed challenges and opportunities that the Trump administration presents to the Japan-U.S. alliance. Key challenges include fears of U.S. retrenchment and a security vacuum; questions about the unpredictable manner of U.S. engagement and likely “Trump shocks” such as his call with Taiwan’s president; and questions about the extent of the U.S. security commitment to Japan. Hornung also noted opportunities, however. These include a possible recalibration of burden-sharing that may be welcome to both sides, potentially closer alignment of the allies’ policies toward China, a greater regional leadership role for Prime Minister Abe, and chances for Japan to gain through renegotiation.



Jeffrey Hornung

Hornung reviewed regional security dynamics as well. He argued that President Trump’s possible rapprochement with Russia could benefit Japan. He noted the range of possible U.S. approaches to China and the Korean Peninsula and argued that while tough U.S. approaches toward Beijing and Pyongyang might reassure Japan, dramatic turns on issues such as Taiwan or the Korean Peninsula could unsettle Japanese foreign policy and regional relations more broadly. Lastly, he contended that while President Trump would unwind many aspects of the U.S. “rebalance” to Asia, the strategic importance of the region will continue to encourage U.S. involvement, and thus to some degree the rebalance may well remain intact—particularly in the military domain.

[Saadia Pekkanen](#) of the University of Washington followed, concentrating on Japan’s national security space policy and relations with the United States. She emphasized that Japan’s space capabilities have grown immensely. Dual-use technology for rockets, satellites, and related assets, coupled with a supportive legal framework, now enable Japan to build strong space-based military systems—progress often overlooked due to Japan’s strong peace norms, doubts about its conventional military prowess, and the commercially-focused development of most of its relevant technologies.



Saadia Pekkanen

Pekkanen then outlined the reasons for recent change in Japan’s security policy with respect to space. Corporations keen to find markets for dual-use technology, China’s military rise, North Korean threats and concerns about the extent of the U.S. security umbrella contributed to legal changes—particularly the 2008 Basic Space Law—that permit previously barred military activity in space. The concept of “proactive pacifism” and evolving interpretation of “collective self-defense” have created added normative room for investment in military space capabilities. Prime Minister Abe has also set explicit goals of boosting the space industry. The Japanese public generally has supported advancements in space technology (by contrast to public aversion to nuclear weapons), and the specialized and technical nature of space policy has given policymakers more room for maneuver than in other areas of defense policy. Pekkanen anticipated that President Trump’s call on Japan to carry more of its own security burden and uncertainty about U.S. staying power—which preceded the Trump administration but has deepened in recent months—will encourage Japan to invest more actively in an independent space-based deterrent capability.

In discussion, panelists spoke about the factors that will determine the vitality and effectiveness of the Japan-U.S. alliance going forward. Panelists emphasized that Prime Minister Abe and President Trump’s advisors would play key roles in explaining the importance of the alliance, and Hornung drew attention to several U.S. appointees who have strong area expertise and commitment to the alliance. Panelists also stressed that Japanese officials could usefully inform newly-appointed U.S. officials about institutional and policy changes within Japan that affect how security policy is made. There was general agreement with Pekkanen’s argument that Japan will seek to diversify in the face of uncertainties. Nevertheless, there was also general agreement with Catalinac that U.S. withdrawal from the TPP and tough rhetoric on trade does not preclude a productive start to the security relationship.

KEY TAKEAWAYS & RESEARCH PRIORITIES

In sum, the conference illustrated the clear linkages between Japan's economic and security policy. Although Abenomics has met with some successes in the short-term, the panel session on macroeconomics showed that Japan still faces longer-term challenges related to fiscal sustainability and the creation of more high-wage employment opportunities. Trade is a key engine for growth and revenue going forward, and hence the U.S. withdrawal from the TPP is a setback for the Abe administration, the Japanese economy, and the Japan-U.S. alliance. The conference panel on trade conveyed that even a bilateral trade pact between the two countries would not provide many of the economic benefits of the TPP, such as measures addressing state-owned enterprises and labor and environmental regulations that could help reshape other Asia-Pacific economies, including China. Moreover, U.S. withdrawal from the TPP removes a crucial pillar from the American rebalance to Asia and may call its long-term security commitment to the region into question. Uncertainty surrounding U.S. foreign policy only adds to Japan's need to review – and perhaps recalibrate – its external security policy.

Despite this challenging environment, the conference dialogue suggested that the Abe administration has important opportunities to promote economic welfare and security and to maintain a strong Japan-U.S. relationship. The fact that Prime Minister Abe visited Washington for a summit meeting with President Trump just days after the conference was a concrete indication of Japan's effort to reinvest in the alliance. Further research can help identify risks and opportunities facing Japanese policymakers and their U.S. counterparts moving forward. The connections across policy domains point to the need for robust interdisciplinary research and dialogue. The conference served to demonstrate that sound policy choices must be premised on in-depth understanding of monetary, financial, and trade economics; relevant principles of law and public policy; and the dynamics that drive international political and security relations.