U.S. Policy Directions: Effects on East Asian Economies

Steven J. Davis

Prepared for the Roundtable Organized by the Korea Economic Research Institute

Chicago, 7 January 2017
The 2016 American election outcome brings unusually large shifts in the direction of U.S. economic policies. Favorable shifts include better prospects for corporate tax reform and a rollback of anti-business and anti-growth regulations. The most unfavorable and worrisome shift is a lurch toward mercantilist rhetoric and trade policies that will inhibit global supply chains, raise production costs, and increase consumer prices in a largely futile effort to protect American jobs and wages.

A President Trump can access many policy instruments to implement his trade vision – ranging from a largely symbolic move to name China as a currency manipulator to punishing tariff hikes. Anti-China rhetoric and trade policy could spill over to U.S. relations with Japan, South Korea and Taiwan. Descent into a major trade war is a possibility, but the rise of trade in intermediates in recent decades may restrain protectionist impulses. Regardless, the anti-trade tenor of the U.S. presidential election campaign and Trump’s surprise victory greatly elevate trade policy uncertainty. In turn, that uncertainty curtails investments in trade creation and slows future trade and output growth.

Hopefully, the Trump team will recognize that the U.S. has legitimate grievances vis-à-vis China that have little to do with Trump’s campaign themes about currency manipulation and stealing jobs. Instead, well-founded American concerns include China’s pressures on U.S. firms to relinquish technological know-how, China’s weak efforts to deter intellectual property theft, and its many policy actions that hamstring U.S. firms operating in China or selling to Chinese consumers.

The sharp increase in U.S. trade policy uncertainty contributes to, and takes place during a period of, highly elevated political and policy uncertainty around the globe and in South Korea, in particular.
Revised U.S. Policy Outlook after November 2016 Elections

Favorable Shifts

1. Better prospects for corporate tax reform and rate cuts → improving the near-term and long-term macro outlook
2. New restraints on, and some rollback of, anti-business and anti-growth regulations → improving the near-term and long-term macro outlook.
   • See Davis (2017) for more on this topic.
3. New fiscal stimulus (tax cuts + more infrastructure spending) → improving the near-term macro outlook but intensifying concerns about the longer term U.S. fiscal stance.
Revised U.S. Policy Outlook after November 2016 Elections

Unfavorable and Worrisome Shifts

1. A wrong-headed shift toward mercantilist rhetoric and trade policies that will inhibit international supply chains, raise production costs and increase prices for consumers in a largely futile effort to protect U.S. jobs and wages.
   b. Much worse outcome: major new trade barriers, disruption of trade treaties and WTO, trade war → large negative effects on U.S. and global growth.

2. Immigration: Trump has softened rhetoric and plans, but his campaign leaves a legacy of fear and ill will that may deter many desirable immigrants.

3. Interference in business decision making (e.g., the Carrier episode):
   a. Trump has and will interfere in business decisions in an ad hoc manner to advance his political agenda and burnish his populist & nationalist credentials.
   b. Whether his interferences and ad hockeries will be worse than under Obama is unclear. Recall Dakota Pipeline decision, waivers of ACA medical care loss-ratio requirements, Boeing’s attempt to move production to South Carolina, etc.
Trade Policy Instruments Available to President Trump

• Vigorous pursuit of anti-dumping complaints and alleged violations of trade agreements.
• Labelling China a currency manipulator – largely symbolic, but sets a hostile tone.
• Denying ”Market-Economy Status” to China 15 years after WTO accession.
• The President can withdraw from NAFTA (and other FTAs) on six month’s notice, raising tariffs on Mexican imports to MFN levels under the WTO.
• Under the Trade Act of 1974, the President can impose quotas or tariffs up to 15% for up to 150 days on imports across-the-board or against particular goods/countries.
• Under the Trade Expansion Act of 1962, the President can implement high targeted tariffs in certain industries, as Ronald Reagan did on steel imports.
• Trump threatens 45% tariffs on Chinese imports. He can levy such tariffs through executive action by declaring a “state of economic emergency” or that U.S. is in “a time of war”
• Trump wants a 35% tax on firms that fire American workers, build a factory in another country, and then seek to sell foreign-produced goods in the U.S. By my understanding, implementing this policy would require legislation.
• Even rhetoric along these lines and threats to raise tariffs chill the development of global supply chains and investments that promote trade.

See Hufbauer (2016) for a fuller discussion.
A Trade Policy Irony

• Trump’s trumpeting about trade deficits, currency manipulation and stealing jobs has created concerns over the fallout for U.S. trading partners, pushing down their currency values relative to the U.S. dollar. (To be fair, the pro-growth aspects of Trump’s policy rhetoric and plans work in the same direction.)

• Thus, Trump has single-handedly – without so much as an executive action! – managed to increase (decrease) the competitiveness of U.S. imports (exports).
On the Possibilities for Spillover and Retaliation

Anti-China rhetoric and trade policy could spill over to U.S. relations with Japan, South Korea and Taiwan, all of which run current account surpluses with the United States.

U.S. policy actions against Chinese imports and Chinese firms could trigger many forms of retaliation, including (a) Chinese actions to raise burdens on U.S. firms that operate in or sell to China, (b) cancelling plane purchases from Boeing, and (c) cutting agricultural imports from the United States.

On both American and Chinese sides, the rise of global supply chains may restrain protectionist impulses. (Let us hope.) Trade in intermediates gives rise to concentrated commercial interests that benefit from pro-trade policies. These interests will agitate against protectionist policies that penalize import-using producers. See Gawande et al. (2014).
Trade Policy Uncertainty

• The anti-trade tenor of the U.S. presidential election campaign and Trump’s surprise victory have raised fears about the direction of U.S. trade policy, continued U.S. participation in NAFTA, and U.S. support for the WTO and other international institutions (e.g., NATO, and alliances with Japan and South Korea) that undergird the global economic and security order.

• In my judgement, these sources of uncertainty are already inhibiting investments in trade-creating activities, slowing the further development of global supply chains, and working against future trade and output growth. This judgment finds support in a growing body of empirical evidence that policy uncertainty discourages and delays investment and that trade policy uncertainty, in particular, inhibits investments in trade-creating activities. See, for example, Handley and Limao (2015), Baker, Bloom and Davis (2016), Crowley, Song and Meng (2016), Feng, Li and Swenson (2016), Gulen and Ion (2016), Liu and Ma (2016),
A Hopeful Direction for U.S. Trade Policy

• It’s hard to foresee how U.S. trade policy will evolve under Trump.
• A hopeful possibility: Senior folks on the Trump team will recognize that the U.S. has legitimate grievances vis-à-vis China that have little to do with Trump’s campaign themes about currency manipulation and stealing jobs by selling goods at low prices. Instead, well-founded concerns relate to:
  1. Pressures on U.S. firms to relinquish technological know-how in exchange for operating or selling in China and, more generally, China’s practice of exploiting its large market to extract concessions from foreign firms.
  2. Hamstringing foreign firms in China in various ways. Examples: (a) Making it hard for Google to operate in China, benefiting Baidu; (b) blocking Twitter in China, benefiting Weibo; (c) banning Flickr, benefiting Bababian; (d) recent rule against internet publishing by foreign firms, forcing Apple to end sales of iBooks and iTunes movies in China; and (e) “Buy China” procurement practices of China’s SOEs.
  3. Weak efforts to deter theft of IP developed and owned by U.S. firms.
Some Advice for South Korea’s Political Leader

• Meet Trump, hold joint press conference. Remark at length on his brilliance, business acumen, political savvy, and good looks.

• Offer concessions that open South Korean markets to U.S. firms and U.S. goods and services.
  • Pick concessions that benefit South Korea’s economy by strengthening the supply chains of Korean firms and by providing lower prices and greater product selection for Korean consumers.
  • Attribute the concessions to Trump’s business savvy and negotiating skills.

• Highlight large Korean procurement contracts won by American firms.
  • Attribute the contract awards to Trump’s business savvy and negotiating skills (whether true or not).
Global Economic Policy Uncertainty Index, January 1997 to November 2016

Using data for 17 countries that account for 2/3 of global GDP

- Economic Financial Crises
- Asian & Russian Financial Crises
- 9/11
- Gulf War II
- Global Financial Crisis
- Eurozone Crises, U.S. Fiscal Fights, China Leadership Transition
- European Immigration Crisis
- Brexit
- U.S. Elections And Political Developments in Brazil, China, France, South Korea and the UK

Notes: Global EPU calculated as the GDP-weighted average of monthly EPU index values for US, Canada, Brazil, Chile, UK, Germany, Italy, Spain, France, Netherlands, Russia, India, China, South Korea, Japan, Ireland, and Australia, using GDP data from the IMF's World Economic Outlook Database. National EPU index values are from www.PolicyUncertainty.com and Baker, Bloom and Davis (2016). Each national EPU Index is renormalized to a mean of 100 from 1997 to 2015 before calculating the Global EPU Index.
Economic Policy Index for South Korea, January 1990 to November 2016

Notes: Index reflects scaled monthly counts of articles in six South Korean newspapers containing ‘uncertain’ or ‘uncertainty’, ‘economic’ or ‘economy’ or ‘commerce’, and one or more of the policy terms specified for South Korea in Appendix A of “Measuring Economic Policy Uncertainty” by Baker, Bloom and Davis. The series is normalized to mean 100 from 1995 to 2014.
References


References


Liu, Qing and Hong Ma, 2016. “Trade Policy Uncertainty and Innovation: Firm-Level Evidence from China’s Accession to the WTO,” working paper, University of California, Davis.