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The good, the bad, and the ugly: A decisive election for trade, or is the writing already on the wall?

"Practical men [and women] who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist."

John Maynard Keynes

The trade policy world is not a pretty sight

Keynes lived in much more interesting times than we do now. The real fear is that we, too, might create a world that compares with the upheavals that Keynes lived through: war, retribution, depression, and more war.

This is why the election in the United States, with its likely wafer-thin majorities, can be looked at with horror and fascination.

We should hasten to add that we have not done any in-depth analysis on the likely relative impacts of what each President and party will do. What we have done is look at some of the pronouncements, use some economic logic (albeit at a high level), and apply what we know has happened in the past.

Currently, we have a trade policy world that Republicans/Trump created. When Trump ripped up the Trans Pacific Partnership (TPP) deal on his first day in office, it was clear we were in for a rough ride.

Imposing US\$300 billion of tariffs on China was the next step. The Biden administration has kept the Trump tariffs and added a further US\$18 billion, plus, of course, 100% tariffs on Chinese electric cars. The Chinese have

responded by targeting United States farm products, oil, plastics, chemicals, medical equipment, and liquified propane.¹

Alongside this, the United States has sabotaged the World Trade Organization (WTO) by refusing to appoint judges to the appellate board, so the dispute settlement process has been slowly strangled.

The impact of these tariffs and wider trade policy mayhem has been to push up the United States dollar (making United States products even less competitive), increasing prices for consumers in the United States market, and costing United States jobs, possibly in the vicinity of 200,000.

Despite this, trade between New Zealand and the United States has been growing strongly (see chart below). Services, particularly tourism, have driven post-COVID trade (helped by the Soccer World Cup). Goods trade has also picked up, particularly commodities like meat.

A clear driver is the low New Zealand dollar relative to the United States dollar, which is driven by the tariff policy in the United States.

There is a question about how long this trade will continue to boom, given the incoherence of the United States' position on trade. For example, a direct impact on New Zealand is that we have tariffs on steel and aluminium going into the United States (Australians don't). We are supposedly an unfriendly nation. This is forgotten (somewhat) since New Zealand has been invited to make a

¹ <https://www.piie.com/blogs/trade-and-investment-policy-watch/chinas-retaliation-trumps-tariffs>

NZIER INSIGHT

proposal to join AUKUS II. This is the non-nuclear part of AUKUS, which nobody really knows what it is for, but we know what it is against China. China, of course, as for 140 other nations, is New Zealand's biggest trading partner.

Figure 1 New Zealand exports to the US trending upwards



Source: Ministry of Foreign Affairs and Trade²

The other impact of the Trump and Biden tariffs is much more important: the chilling impact on world trade. We are selling fewer products in a world economy where trade is more restricted. Possibly part of the reason why commodity trade is strong with the United States is that it is weaker with other markets. Looking at the United States-New Zealand trade masks a bigger picture, which only shows world trade growing at just over half the rate it was between 2001 and 2008.³

The following graph looks at capacity utilisation by comparing domestic and export industries in New Zealand. It shows that capacity utilisation for exporters in the recent quarters has been lower compared to historical averages. We also know from the NZIER's Quarterly Survey of Business Opinion that export sales are down at levels not seen since 2008.

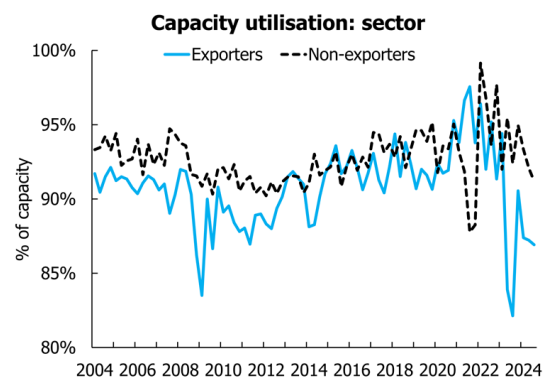
² <https://www.mfat.govt.nz/en/trade/mfat-market-reports/nz-exports-to-the-us-strong-growth-continues-june-2024>

³ <https://www.weforum.org/agenda/2024/05/global-trade-to-double-2024-imf-wto/>

⁴ <https://www.sciencedirect.com/topics/economics-econometrics-and-finance/mercantilism>

The dampening of world trade by the United States has been predictable. We have known since the 17th and 18th centuries that encouraging exports and discouraging imports is a bad idea. The idea that countries should maximise exports and minimise imports was the brainchild of the Mercantilists.⁴ Their views tend to come in vogue when countries have forgotten about the damage it did when it was last applied (most famously prior to the Great Depression with the Smoot–Hawley tariffs (1930)⁵ and the start of the Second World War).

Figure 2 Capacity utilisation



Source: NZIER

Protectionism tends to entrench vested interests and makes industries uncompetitive. The continued decline of the United States steel industry symbolises the lack of competitiveness despite it being behind tariff walls.⁶ Yet the people who support these policies have always seen themselves as practical people who have vested interests in supporting industries in which they have a stake. Mercantilism was not the right policy prescription in the 17th century, and it is not the right policy prescription in the 21st century.

⁵ <https://www.investopedia.com/terms/s/smoot-hawley-tariff-act.asp>

⁶ <https://www.nbcnews.com/business/economy/trump-steel-tariffs-raised-prices-shrived-demand-led-job-losses-n1242695>

NZIER INSIGHT

In the United States, freer trade and systems set up under the GATT and WTO have gotten the blame for policies that are much closer to home. To be very clear, trade is seen as a zero-sum game when it is not, and trade creates net new jobs in most cases, while protectionism in most cases does not. All this has fallen on deaf ears in the United States and has been magnified by the electoral system.

Uncertainty is the only certainty

As we approach the United States election what the policy settings might be is still very unclear.⁷

Both Democrats and Republicans are wedded to tariffs as some cure-all panacea. Republicans like them a lot, and Democrats like them a bit – it seems.⁸

In the table below, we look at the possible impact of the United States election through an uncertainty matrix. We use this to focus attention on the options being considered.

It does not make good reading. The matrix sets out the good, the bad, and the ugly (with apologies to Clint Eastwood et al.). One axis tests the likely confidence in the trading system, while the other axis examines the likely impact on trade.

Table 1 United States trade policy: The good, the bad, and the ugly scenarios

		Freer trade rather than less		
		Good (mercantilism fading)	Bad (mercantilism light)	Ugly (mercantilism entrenched)
Confidence in New Zealand's trading future	Good	A structured approach to reducing tariffs, which includes a reduction in state subsidies. Talks to focus on WTO/rules. Negotiations on how to resolve the impasse at the WTO	Re-engagement with China and the WTO but no agreement. Trade remains stalled. It depends on what comes next	Continued tit-for-tat tariffs and other restrictions but no escalation. A reduction in trade in specific areas (Targeted tariffs seem to be advocated by the Democrats)
	Bad	Winding back recent tariffs and developing a structured engagement on a pathway that replaces the rules. Trade increases	The status quo is where both Democrats and Republicans are advocating tariffs despite their adverse impacts on their own economy and the world economy. No interest in wider rules-based approaches	Increases in tariffs across the board. This will depress trade, supporting onshoring and inefficient investment (increasing tariffs and targeting China further is the Republican strategy)
	Ugly	Some improvement in trading conditions. More by one-off efforts and luck than structured systematic good management	A winding up of threats and counter threats but with limited widespread trade action and economic impact	Doubling down on tariffs as the United States faces increased prices and a rising dollar. Like beggar thy neighbour policies of the 1930s. Mercantilism is the dominant paradigm

Source: NZIER

The United States, under Republican and Democrat leadership, have ripped up the playbook of the last 50 years and looked inwards. The status quo is not a good place to

start, but that is where we are (bad, bad). It is bad because jobs have been lost in the United States and around the world since tariffs were

⁷ <https://www.lowyinstitute.org/the-interpreter/kamala-harris-trade-better-alternative-not-much>

⁸ <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/trump-harris-clash-on-tariffs-broader-trade-policies-83338097>

put in place on China. It hurts not just China but all those countries that trade with China.

There seems to be no appetite whatsoever to return to a situation where we have a structured discussion on kick-starting the WTO or removing Chinese tariffs with some concessions from the Chinese around the use of state subsidies – a major bugbear for the European Union and United States (good, good).⁹

It is unclear what a Democrat/Harris win in November could mean. The most optimistic view is that the situation does not deteriorate further, and it moves towards the left-hand column (good, bad).

This is optimistic because tariffs will not solve the underlying problems associated with the United States economy (a balance of trade deficit, lack of productivity, and lack of savings), so the chances of a Democrat/Harris Administration doubling down and increasing tariffs are high (ugly, good).

A failing tariff policy is likely to produce more tariffs. This may not be the policy now, but the chances of it proceeding down the ugly column for the Democrat/Harris Administration are quite high.

A Republican/Trump Administration see tariffs as an answer to all their problems. If it looks foreign, put a tariff on it. A Republican/Trump Administration, if they get into office, have already said they will put a 10 to 20 percent across-the-board tariff and a 60 percent tariff increase on Chinese goods. This is likely to have the impact of pushing the United States dollar higher and increasing prices of imported goods. It could also push up the price of locally made United States goods not just because they are not competitive but also because they can get away with price gouging (ugly, bad).

Again, this will not solve the underlying economic problems of the United States, so

tariffs will likely increase further. We can see this from the current situation where the tariff policy is clearly not working, so the answer is to increase the tariffs, according to the Republicans/Trump (ugly, ugly).

You could also argue that there is little difference between the Democrats and the Republicans on tariffs. Once you head down the tariff road, it is unlikely you will turn back. It just might take the Democrats/Harris a little longer to arrive at that destination.

A further issue which has not been factored in is retaliation by other countries, particularly the European Union and China.

What might this mean for New Zealand and the rest of the world?

Mixed impacts for New Zealand

New Zealand is not going to change the minds of United States lawmakers on this; tariffs are here to stay for the foreseeable future.

For New Zealand goods going to the United States market, the impact will depend on whether consumers are responsive to the price impacts of a tariff increase.

Many commodities are less responsive to price increases (in the jargon inelastic); therefore, consumers suffer more than those who import them since they buy the product in much the same quantities, irrespective of the tariff imposed. United States authorities have imposed restrictions on New Zealand lamb and kiwifruit before but have given up since they damaged consumers in the United States, not producers in New Zealand.

It could be that commodities such as New Zealand beef, which is mixed with United States beef for the hamburger market, may be less impacted.

While these direct impacts garner all the news, the most damage may be the impact on the rest of the world. The United States is still the engine of the world economy. If the

⁹ Although that does not stop the United States or the European Union subsidising agricultural exports.

United States reduces its imports, it means that those countries will be poorer, impacting on the third country's demand for imports from New Zealand.

Making every post a trade policy winner

There may be a crack of light for New Zealand when it comes to restoring rules-based trade policy, despite the current situation. New Zealand has had success in more difficult times in the past and against greater odds (see Nixon and Yeabsley, 2002)¹⁰ so why not now?

What could aid this process is that other countries are well aware of the incoherence of the United States' position so they will be more amenable to New Zealand making a trade policy play.

Aside from this grand play to fix the system, areas that New Zealand can pragmatically explore include:

- The current push for further free trade agreements in the Middle East and India

- Projecting parts of the CER¹¹ mutual recognition agreement into ASEAN and beyond
- Encouraging further advances in paperless trade with supply chain partners and governments taking concrete steps to implement the necessary laws and investment in IT, lowering costs, and improving the efficiency of New Zealand's trade
- Encouraging ASEAN, East Asia and China to use New Zealand as a staging place for exports/imports to the growing South American market.

The aim would be to foster 'coalitions of the willing' that are prepared to trial innovative trade policy ideas, then once up and running, attempt to attract the major trading nations to join.

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¹⁰ Nixon, C. and J. Yeabsley (2002) New Zealand's Trade Policy Odyssey. NZIER Research Monograph No. 68.

¹¹ Technically another agreement with Australia: the Trans Tasman Mutual Recognition Agreement (TTMRA).