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# Perspectives on the US economy after 8 months of Trump

## Key points

- **The US economy is growing steadily at 2%, and unemployment is low at 4.3%. The outlook for New Zealand exporters to the US remains solid, albeit not spectacular.**
- **The anticipated stimulus from a tax reform and infrastructure package is unlikely to occur, as the new administration struggles to keep Congress happy.**
- **US trade policy is focussing on penalising China for dumping steel and intellectual property theft, updating the North American Free Trade Agreement and potentially withdrawing from the Korea-US Free Trade Agreement.**
- **None of these processes will run smoothly, and the outcomes could contribute to a challenging global trade environment for Kiwi firms.**
- **Pro-trade US businesses are keeping their heads down to avoid the wrath of Trump instead of pushing for greater economic integration.**
- **New Zealand should take the next few years to reaffirm its bipartisan approach to trade policy and economic integration – starting with TPP – so that it is ready to move swiftly when political conditions improve.**

## I don't get out much…

Working primarily on New Zealand economic issues for New Zealand government agencies and businesses, it's easy to get swept up in local issues in New Zealand, particularly in an eventful election year.

Sometimes it's helpful to get some space – geographically and mentally – to think about the bigger picture, and what it all means for New Zealand.

## … but my recent three-week tour of the US opened my eyes

I was fortunate enough to be nominated by the kind folk at the US Embassy in Wellington to participate in the State Department's International Visitor Leadership Programme along with 24 other economists, officials, journalists and businesspeople from around the globe.

The theme of the programme was 'The global economy' and involved visiting Washington DC, New York, Chicago, San Antonio (Texas) and San Francisco and engaging with a wide range of speakers on all manner of things economic. It was absolutely outstanding.

We heard from Federal, State and City officials, academic and think-tank economists, financial analysts and traders, and leaders of business incubators and not-for-profit economic development organisations. All spoke very openly, and provided very helpful – and at times brutally honest – views on US politics and the global, US and local economies.

I supplemented these views with many informal chats with bartenders, fellow craft beer drinkers and Uber drivers, some of which are admittedly a little hazy.

Below I have tried to distil the key themes that struck me from the visit, starting with the one that I was most intrigued to explore during my visit.

## Trump confuses and embarrasses many, but they keep on keeping on

I stopped asking questions about Trump after a couple of days. The message I heard time and time again from all types of people was that while they cringe at, and are perplexed by, POTUS's tweeted missives, they don't feel particularly worried about his domestic policy prescriptions.

This is for two main reasons:

1. There is little prospect of any significant domestic economic reforms getting through Congress because the new administration

shows little desire or ability to manage the politics.[1]

2. States and cities can raise taxes and provide economic development incentives at the local level, and have their own local economic priorities and plans. They are not heavily reliant on Federal tax and spending policies. Or as one local official put it, admittedly somewhat tongue in cheek: "We don't care what Washington does".

Officials, businesses and the wider economic development ecosystem that drives economic activity at the local level are just getting on with things. While the volatile political environment was not helpful for US businesses, they weren't paralysed by Trump's pronouncements.

There was no sense of dread about the next three and a half years, and the organisations we spoke to aren't looking to the administration to make things happen. We heard from several stakeholders that economic development is a 'bottom-up' process, with policy innovations being primarily driven by individuals in firms and the highly influential not-for-profit sector.[2]

As one commentator noted:

***When government has to solve a problem, it's time to re-think the government.***

## And the economy keeps on chugging away

The US economy is growing steadily, at around 2%, and unemployment is down to 4.3%. One presenter asked: is this the "most robust 2% real GDP economy – ever?"

While there are some risks around how quickly the Fed starts to lift interest rates and unwind its quantitative easing, for now markets remain very positive, if not positively frothy, about the economic outlook. I suspect this optimism will ease once it becomes clearer that any significant tax reform and infrastructure spend-up are not going to happen any time soon[3], but the overall picture is for solid albeit not spectacular growth.

It was striking how rarely the discussion in our meetings strayed beyond the immediate short term. Aside from one notable and very welcome exception[4], longer term and intergenerational issues around productivity improvements, the benefits and risks of automation and reducing US debt levels were largely ignored, despite the wealth of analysis on these issues that is taking place.

## Concerns about POTUS were mainly reputational…

We were frequently asked what *we* thought of the new administration. Our contacts wanted to know how the Programme participants' countries were reacting to the new President and his unique approach to leading the free world.

Most participants used adjectives like "volatile", "confusing", "worrying".

My responses to these enquiries largely focused on his baffling stance on trade policy (TPP, NAFTA, KORUS, China – more below) and his bizarre obsession with bilateral trade deficits as a measure of economic health.

On the latter, it was encouraging to hear from officials and analysts in Washington that they were struggling with it too. One explained that the administration's position is "shaped by basic thinking, not economic evidence".

My sense is that officials *are* providing the sort of free and frank policy advice that you would hope for, but

1 The botched healthcare reforms are a case in point, whereby different factions of the Republicans were pulling in very different directions, with little centrally agreed philosophy for change beyond "We don't like the status quo" and almost no agreement on what a 'better' system might look like.

2 I was struck by the sheer volume of NFP organisations operating in State economies, and the impact they have at the local level. They provide a huge range of services, largely free of any Federal or State government interference. Services offered included start-up loans to entrepreneurs with no credit due to being incarcerated, support for businesses wanting to take advantage of FTAs, export and investment promotion, support for women in business, business incubators and much more. I was surprised that none were concerned about the duplication of resources, though they seemed to work effectively together and stick to their very specific knitting.

3 One analyst told us that "markets think Trump is losing any economic credibility he may have had, so are looking past his statements and becoming less reactive to them".

4 Professor Danny Leipziger of the Growth Dialogue (http://www.growthdialogue.org/) whose presentation was a sobering assessment of the US's medium- and longer-term economic prospects and the risks of 'de-globalisation' due to, *inter alia*, technological change and automation reducing the need for intermediate inputs to cross multiple borders. His view was that this is already happening due to advances in 3D printing, which may explain why world trade growth remains sluggish after the GFC, and why measures of GVC prevalence are not increasing a great deal.

He also outlined why domestic trade-related employment adjustment programmes are not as effective as they may have been in the past, primarily because workers and households are much more 'sticky' as a result of most households being two-income families with their wealth concentrated in one asset (housing). His overall theme was that governments and firms need to "fix globalisation, or suffer the consequences".

that it isn't gaining traction with the boss.[5] Or as one presenter put it:

> ***When it comes to the Trump administration, you have to suspend any sense of reason about cause and effect.***

And plenty of respected commentators are trying hard to bring some basic economics back into the debate. Barely a day went past without an op-ed in one of the major papers pointing out the idiocy of treating a bilateral trade deficit like a business loss, the folly of forgetting consumer welfare gains from cheaper imports, or the illogical expectation that a trade agreement might somehow solve an imbalance between domestic savings and investment.[6]

So there's no lack of smart people providing contestable advice on economic and trade policy issues. But it all seems to just bounce off The White House, sadly.

## …or about US foreign policy

The escalation of tensions between the US and North Korea has dominated headlines recently. And the new administration has made numerous statements about trade with China not being 'fair'. This, combined with Trump's lack of domestic policy 'wins', is making some of those we spoke to nervous. I tend to concur.

There is a risk that Trump will turn to areas where he has less need to rely on Congressional approval – due to the President's executive powers – to generate publicity and distract people from his dismal domestic reform efforts. This could be some form of pre-emptive military action in North Korea, further action in Syria or imposing stringent trade measures against China, for example.

The optimist in me thinks that even Trump wouldn't be so cynical, and that his advisers (those that stay the distance) will provide wise counsel. The pessimist in me is much less sanguine.

5 State Department officials have drafted a report on the relationship between trade agreements and bilateral trade deficits, which is due to be released shortly.

6 See, for example, https://www.wsj.com/amp/articles/lighthizers-economics-deficit-1503354754

## Trade policy prognosis: cloudy with a chance of carnage

> ***I know there are some people in the room right now that are upset. I know there are some globalists in the room right now. And they don't want them, John, they don't want the tariffs. But I'm telling you, I want tariffs.***[7]

**TPP not on the agenda any longer; most businesses are lying low instead of lobbying**

First up, there was little discussion about the US withdrawal from TPP. Aside from trade-promoting organisations[8] and some Washington policy-makers, TPP wasn't a big concern to many of the people we spoke with.

That said, there is starting to be some concern expressed by agricultural producers about being at a competitive disadvantage to the eleven countries who are forging ahead in the US's absence.[9]

But one presenter lamented the lack of wider business support for further trade liberalisation. In his view, even firms that have traditionally been strong proponents of regional economic integration initiatives don't want to put their heads above the parapet and risk attracting the ire of the President.

Instead they are lying low and waiting for his term to be over, which is freeing up the lobbying airspace for very well organised and vocal trade unions to express their concerns about the job losses (allegedly) caused by greater import penetration.

**NAFTA was a more pressing concern**

The renegotiation of NAFTA was certainly on the agenda of business associations, especially those we met in Texas and California, both of which have deep supply chain links with Mexico in particular. One trade promotion organisation explained that enquiries to its office about cross-border business opportunities had dropped significantly since Trump prioritised the 'wall' and linked it to the NAFTA renegotiation.

7 This is reportedly what Trump said to new Chief of Staff John Kelly in late August. See https://www.axios.com/exclusive-trump-vents-in-oval-office-i-want-tariffs-bring-me-some-tariffs-2478121273.html

8 The general sentiment of these trade associations about the US decision to withdraw was "We were gutted".

9 A good example of these sentiments can be found at http://www.politico.com/magazine/story/2017/08/07/trump-tpp-deal-withdrawal-trade-effects-215459

Most accepted the need to update NAFTA to cover digital trade, labour and the environment.[10] One 'glass half-full' presenter made the valid point that if NAFTA were to be successfully renegotiated, the administration would find it much more difficult to keep using the "trade agreements are bad" line.

But there was real concern that the negotiations will stall fairly quickly, given the US's negotiating stance and objectives, particularly that NAFTA must "Improve the U.S. trade balance and reduce the trade deficit with the NAFTA countries".[11]

This essentially means that the revised NAFTA must lead to higher US exports and lower US imports. Or conversely, lower Mexican or Canadian exports, combined with higher Mexican and Canadian imports. That won't be easy for Mexican and Canadian negotiators and politicians to sell to domestic constituents.

Trump has commented in the past few weeks that "Personally, I don't think we can make a deal... I think we'll end up probably terminating NAFTA at some point". This isn't the first time he's played the 'walk away' card, and likely won't be the last, but I suspect he's right.

Unless the pressure of an impending election in Mexico in mid-2018 forces Mexican negotiators' hands to accept an outcome that looks like a win for Trump, I struggle to see how each NAFTA country can simultaneously meet their respective economic and political objectives.[12]

> ***Politics will also slow things down. Mr Trump seems to have little understanding that other countries have voters; as a slogan, "America First" tends to resonate less with non-Americans.***[13]

10 The irony of using TPP as a template for modernising NAFTA was not lost on most informed commentators.

11 See https://ustr.gov/sites/default/files/files/Press/Releases/NAFTAObjectives.pdf. This document also contains the gem: "the new NAFTA will promote a market system that functions more efficiently, leading to reciprocal and balanced trade among the parties". Quite how NAFTA will lead to "balanced trade" is beyond me, and just further highlights the madness of focusing on bilateral trade balances as a measure of economic health.

12 Perversely, the reallocation of US NAFTA negotiating resources may mitigate some commentators' concerns that the US simply doesn't have enough experienced negotiators to handle the multiple bilateral FTAs that the administration is proposing.

13 https://www.economist.com/news/leaders/21725562-special-relationship-reality-britain-and-america-suffer-similar-delusions-trade?frsc=dg%7Ce

**KORUS seems to be off-note**

In recent weeks, President Trump seems to be moving towards announcing US withdrawal from the Korea-US (KORUS) Free Trade Agreement, once again based on the erroneous belief that the agreement has been 'unfair' on the US. Despite evidence to the contrary[14], the administration believes that the FTA has made the US worse off.

While this did not come up frequently during my visit, from New Zealand's perspective it is another unwelcome move away from regional economic integration.

**Mixed views on trade sanctions on China, but mercantilist sentiment dominates the discourse**

Concerns over China's economic and trade policies are getting a lot of political attention. The administration has launched an investigation into alleged Chinese theft of US intellectual property under section 301 of the Trade Act 1974, as well as investigations into the dumping of Chinese steel and aluminium.

> ***We're going to run the tables on these guys… We've come to the conclusion that they're in an economic war and they're crushing us.***[15]

Those we spoke to had a range of opinions on China. They recognised the risks associated with inflaming a trade war, but also found it hard to ignore widely-cited evidence that greater import penetration from China has had negative employment impacts in some sectors in some regional economies (see below for why this matters from a political perspective).

The fact that cheap Chinese imports have delivered huge welfare gains for consumers, and especially low-income households, rarely warranted a mention. Mercantilism still runs rife.

Even if punitive tariffs were imposed on Chinese imports following these investigations, they simply won't deliver the employment gains they are intended to generate. Any domestic expansion of steel milling will be heavily capital-intensive due to automation.

14 See https://www.cato.org/blog/trump-advisers-are-all-wrong-about-korea-trade-deal-korus for example.

15 Trump's Chief Strategist Steve Bannon, before he was ousted, in https://www.ft.com/content/13e47868-8455-11e7-a4ce-15b2513cb3ff

And for every worker in US steel mills, there are 46 in downstream manufacturing sectors that use steel.[16] [17]

Imposing tariffs on imported steel will push up the cost of production in these downstream sectors, which will likely lead to job losses. The US construction sector (6.8 million workers), which purchases over 40% of US steel production, will also feel the pinch of higher input prices by delaying new projects and reducing their demand for labour.

As with many of the new administration's policies, the intent is generally admirable but the economic logic is naïve. The likely outcome will be a weaker, rather than "greater" US economy.

## It's all about jobs…

This refrain was heard repeatedly during the trip, from a range of commentators. Senators and Congressmen have to answer to their local constituents, and so look at all policy and business initiatives primarily through an employment lens.

The general theme was that if something creates jobs, it's a good idea. There was precious little consideration of opportunity costs, comparative advantage or efficiency. Employment multipliers are used with gay abandon to pump up job creation estimates.

This focus on employment has a big influence on City and State officials, and businesses are able to extract substantial incentive packages from local taxpayers as a result. There is huge competition between States to attract and retain big business through tax breaks in particular. Presenters suggested that this competition leads to a degree of fiscal discipline for these States – they can't afford to have local taxes at uncompetitive levels.

And there will be innovation benefits too from this decentralised model. As one commentator put it, there are essentially "50 labs" that are all trying different approaches to their State-wide economic, social, cultural and environmental priorities. States have information-sharing arrangements in place to learn from each other and coordinate where it makes sense.

## …at almost any cost

However, while this competition and innovation is no doubt great if you're a business, one contact suggested it has led to "a race to the bottom", with States competing to offer the lowest taxes and most favourable incentives, largely at the expense of local taxpayers.

A recent – albeit extreme – example is the US$3 billion in tax breaks that Foxconn is to be granted in exchange for building an LCD manufacturing plant in Wisconsin. This equates to US$230,000 for each of the 13,000 jobs that the plant would supposedly support.[18] The break-even date for this investment to start having a positive fiscal impact is 2042-43.

Given the pace of technological change, and hence risk of stranded assets, one has to ask whether this is a great investment for local taxpayers.

## "The currency of Washington is the vote"

One outcome of this focus on local economic impacts and jobs is that when officials have negotiated a trade agreement, having managed to satisfy a range of domestic agency and foreign government interests, the *real* negotiations then start with Congressmen.

Officials have to provide Senators and Congressmen with enough 'ammunition' for them to be able to sell it at the State level to their voters. Given the huge diversity in State economies' comparative advantages, this is hard work.

One presenter described these sales pitch discussions and compromises as "dehumanising… Congress makes you sell your soul". Ouch.

## First world problems

One final reflection is that we really are very lucky in New Zealand.

I had fascinating and deeply humbling discussions with Programme participants from around the globe about their economic and political situations. When I learnt more about the situation in countries such as Venezuela, the Democratic Republic of Congo, Palestine, Egypt and even the Philippines, and heard the personal experiences of Programme attendees from those countries, it made me realise that New

16 https://www.cato.org/publications/commentary/trump-wins-steel-us-manufacturers-lose

17 Along similar lines, Trump is promising to revitalise the US coal industry. Even if he manages this, which is unlikely, the employment impacts will be trivial at the macroeconomic level. Coal mining employs 76,000 workers. In comparison, theme parks employ 144,000 and car washes more than 150,000. Maybe there should be a ban on foreign clowns and subsidies to domestic sponge manufacturers.

18 Other estimates suggest a figure closer to 3,000 permanent jobs is more likely - see https://docs.legis.wisconsin.gov/misc/lfb/bill_summaries/2017_19/0001_ss_ab_1_foxconn_fiserv_legislation_as_passed_by_assembly_8_21_17.pdf

Zealand's economic and social challenges are much less concerning in comparison.

That sounds somewhat twee, and I'm not suggesting at all that we should use these economies as natural comparators for New Zealand, but the societal upheaval these people have experienced, or were returning to, is enormous. We have economic and societal problems too, as does the US[19], but at least we have robust democratic systems, checks and balances in place to try to address them.

## Kiwi firms should see stable demand from the US

In the short-term, unless something drastic happens on the foreign policy front, which I personally don't think can be discounted, then it looks like business as usual for Kiwi firms who have economic links with the US.

The US economy is in good shape, at least for now. I was encouraged by the degree of support for US businesses that local policy-makers and the NFP sector provide. It seems unlikely that New Zealand will be directly affected by the new administration's trade policy idiosyncrasies, although any threats to the global trading system from measures taken against China (and the inevitable retaliation that will follow) and a collapse of NAFTA and/or KORUS could have unwelcome indirect impacts.

## New Zealand needs to return to bipartisan trade policy support, starting with TPP

From a more high-level perspective, it seems that global leadership on issues important to New Zealand such as trade and climate change is unlikely to come from the US for the next few years. Given the ongoing challenges of Brexit, the EU may also struggle to make headway. More impetus will come from Asia, as China and Japan seek to fill the global leadership vacuum.

New Zealand is well-placed to tap into this change, given our ever-deepening economic and cultural links with Asia. But we need to get our own house in order too.

A common feature of recent developments in the US and UK has been public disquiet – and hence political shenanigans – about trade, immigration, economic integration and sovereignty. New Zealand can't afford to do the same. The loss of our long-cherished bipartisan support on trade policy in the wake of TPP should therefore be a concern for New Zealand businesses.

The debate on TPP was at times unseemly, and ultimately focused on the Labour Party's worries about land regulation – nothing to do with exports or imports. It is unhelpful to characterise Labour as anti-trade. They're not. Indeed, they have recently stated that new FTAs with the Pacific Alliance, the EU, UK and India "must be pursued vigorously".[20]

But they are caught up primarily on one issue that is preventing them from supporting the broader trade-enhancing aspects of TPP. That issue is whether New Zealand's trade agreements should permit the banning of house sales to foreigners other than Australians.[21] Their argument largely rests on the fact that Australia is allowed to do this, and so should we.

In practical terms, that is a redundant argument. Australia has maintained this policy space in all of its FTAs as an existing measure that is excluded from its services and investment commitments. New Zealand hasn't had any such existing measures in place, so cannot claim there are existing measures that should be carved out.[22]

We can't go back and change history, and there is little value in lamenting a decision by New Zealand negotiators or politicians that was made presumably as part of an overall negotiating package.

There is a very real risk of throwing out the trade baby out with the sovereignty bathwater here.

19 The top three problems in San Francisco, for example, are housing affordability and homelessness, inequality and infrastructure not catching up with population growth. Sounds familiar.

20 See http://www.tradeworks.org.nz/?p=2765 for an overview of Labour's position.

21 In technical terms, the debate is about whether foreign investors that are in 'like circumstances' can be treated differently to domestic investors. The legal aspects of these definitions are complicated and beyond the scope of this note (and this author's expertise).

22 However, there are alternatives to outright bans – such as imposing very high stamp duties – that are potentially permitted in TPP11 and future agreements and would make it much less attractive, or even almost impossible, for these foreigners to buy houses in New Zealand. With careful design, the same effective outcome as a ban (reducing housing demand from foreign investors) could likely be achieved without holding up the implementation of new FTAs.

Note that **we would strongly recommend against such an approach**, as there is little evidence that it would make any significant difference to house prices, and it risks retaliation from FTA partners. And because of the provisions in the New Zealand-Korea FTA, which now also apply to agreements with countries such as Singapore and China, these measures would not necessarily target the investors that are supposedly causing our housing market to overheat.

Labour is not anti-trade, but it has effectively prioritised limiting foreign demand for housing (which is likely to have little impact on house prices) over the interests of New Zealand's exporters, and the workers and incomes that depend on their success (which we know supports ongoing improvements in living standards).

Hopefully the next few years gives us a chance to sort out this irritant between the two main parties in New Zealand, allowing a return to bipartisan support of trade agreements. As Labour themselves note, "This is the largest area of disagreement on trade issues between National and Labour, and needs to be resolved".[23]

This in turn will help New Zealand be a responsive 'global player' as economic integration opportunities present themselves.

This *Insight* was written by John Ballingall, Deputy Chief Executive, at NZIER, 8 September 2017. The views are John's personal ones, and do not purport to represent an NZIER-wide position.

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[23] http://www.tradeworks.org.nz/?p=2765