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Comment

US TARIFFS

A NEED FOR AN IN-DEPTH LOOK BEFORE WE LEAP

It is important that before we start reacting to the decision by the United States Government to introduce a range of taxes on imports, we listen to what the US has to say about why they have taken this action.

A professor at Stanford University is reported to have put it this way - that the United States is only rebalancing the costs and benefits of economic globalization.

Relatively free access to the great United States' consumer market has had major benefits for the progress of many countries. But it has been at the expense of a major loss in some sectors of the United States' economy and there have been concerns about the fairness of the current system. The United States has had three major issues.

The first is the impact of the Value Added Tax (VAT) system adopted by many countries.

In the 1993 federal election, as a Liberal Party candidate, I was one of those who argued for the introduction of the GST (Australia's VAT), as an alternative to increasing already high-income taxes. We put the case that it was better to have a number of taxes resting lightly than one tax resting heavily with strong distortionary effects in the economy. One of the strong arguments for the GST, was exports be GST tax free, whereas if the extra tax was in the form of income tax, the tax would have been collected on the labour content of the export goods in the production process. Compared with income taxes, the GST system effectively subsidies exports. Now if the receiving country also has a VAT system, a VAT would be imposed in that country on arrival and the effect would be neutral compared with locally produced goods.

But while the UK, European countries and many others have a VAT tax system, the USA does not. The US taxation system heavily relies on income and corporate taxes at federal level and sales taxes at state level. While there is dispute about it, US officials have expressed concern that the VAT system tips the playing field in favour of the VAT system countries.

And this leads us to the second issue – the tariff and other constraints on imports imposed by many countries that impact on US exports.

Australia, in an attempt to broaden its economy, especially by building up manufacturing was, for many years, a highly protectionist country with a wide range of tariffs (custom duties), levied on imports.

In my first professional employment in the 1960s, I worked in the Tariff Policy Section of the Department of Trade in Canberra and then as the Research Officer in the Australian Chamber of Commerce small secretariat in Canberra, often on tariff policy issues, and on a number of occasions prepared and presented 'Cases' to the Tariff Board.

Now while Australia gave up protectionist policy programs from the 1970s to the 1990s and adopted a 'free trade' stance and today has virtually no tariffs on imports, it is still not completely innocent. This was raised by the US President in relation to 'fresh' beef imports. There are also issues over pharmaceuticals.

In a 'lucky country' where things turn up, Australia's massive increase in mineral exports (mainly from Northern Australia that now accounts for about 60% of Australia's export income), enabled it to adopt a free trade policy without great balance of payment woes.

However, some countries are notorious for imposing restrictive constraints. For instance, Australia along with the United States has had a constant battle with the European Union (EU), especially over EU agricultural protection policies.

Australia knows all about the People's Republic of China's use of trade restraints as an instrument of policy when Australia recently suggested an international enquiry into the origins of Covid.

And this brings us to a third issue - exchange rates.

Most countries these days allow their currencies to be freely traded. They have a 'floating' exchange rate. However, an export advantage can be gained by 'fixing' your exchange rate at an artificially low level.

Before Australia 'floated' its currency about 1986, I can remember constant internal turmoil within the Coalition between the Country Party (when rural membership had a vested interest in keeping the exchange rate as low as possible) and the Liberal Party city interests (with an interest in cheap imports and higher living standards).

Of course, communist China has been notorious at artificially pegging its exchange rate in the interest of gaining exports at the expense especially of the United States. Of course, it has been at the expense of the standard of living of ordinary Chinese citizens.

We were in the United States in 2016 while the Trump/ Hilary Clinton election campaign was underway. On the train from New York through to Washington, between New Jersey and Philadelphia, I was surprised and appalled to pass abandoned derelict factory building after factory building, mile after mile, along the railway line. I came away, after having watched the election debates, believing that Hilary Clinton would win. In my innocence at the time, I had been watching the debates and commentary on CNN.

But we had talked to quite a few Americans on both sides and when back in Australia, I was asked by a local shop owner why I thought Donald Trump had won. I said that Americans were sick of three things – disproportionally carrying the world's defence, open borders with masses of people flocking in, and allowing the world into their markets.

Well Trump is back with a mandate. NATO has been put on notice; Australia has been told it should raise its defence spending to 3% of GDP; the US southern border has been slammed shut; and the trading relationship with the rest of the world is now being dealt with.

Looking forward, there has been indications of a willingness to negotiate. But I suspect from some remarks that the global 10% tariff is being regarded as more of a revenue raising source like a revenue raising VAT.

If negotiations triggered results in some of the 'bad boys' of international trade such as China and the EU negotiating away some of their current tariffs and other constraints, the net effect on world trade will be positive and definitely in Australia's interests.

The fact that Australian goods will only face a 10% tariff while competitors will often face higher tariffs will be positive for Australia.

Main impacts for Australia are likely to be secondary effects as tariffs affect other countries (notably China), that are large export markets for us.

Under the US constitutional set up, the tariff program has been able to be introduced without clearance through Congress because of an old Act that delegated this power to the President. That situation could change. Given the short-term panic effect on share markets, there will be pressure to negotiate and modify the program over time.

But at a fundamental level, it needs to be recognized that the United States has been running massive trade deficits and massive debt has been building up that has the potential to eventually threaten the US dollar world reserve currency status. Australia has a vital interest in this reserve currency status remaining with an ally, the United States.

On this issue, the circumstances require that we take a long look, before we leap.

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