Box A

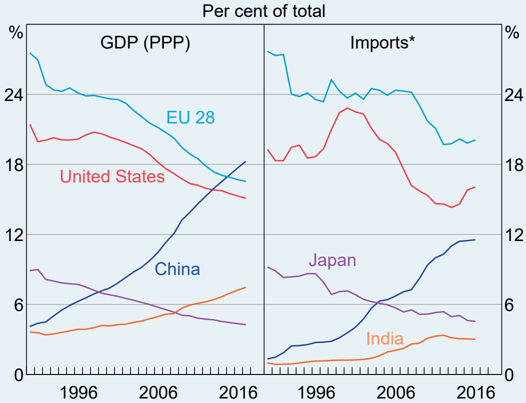
Recent Trade Protectionism Measures

Trade relations have been a key policy focus for the current US administration. It has begun renegotiating a number of trade agreements and more recently has increased import tariffs on certain items (including steel and aluminium). The effect of the recent increase in US tariffs on steel and aluminium imports on other economies is expected to be small, partly because temporary exemptions have been given to many countries (including Australia). China will also be little affected, as steel and aluminium exports to the United States are only a small share of Chinese production. In response to the US tariffs on steel and aluminium, the Chinese authorities imposed tariffs on US$3 billion of US goods (mainly food).

After concluding an investigation into China's policies and practices around technology transfer by US firms in China, the US administration has also announced plans to increase tariffs on 'high tech' manufactured imports from China. These tariffs could affect up to 12 per cent of annual US imports from China. The US administration is also considering restrictions on Chinese investment in 'industries or technologies deemed important to the United States' and bringing a case in the World Trade Organisation on certain Chinese trade practices. In response, the Chinese authorities have released a list of other US goods that could face tariffs if the United States introduces these measures. Both countries have subsequently foreshadowed further tariffs.

While the direct effects on economic activity of the recent tariff increases are manageable, a further escalation in protectionist measures could harm global growth significantly, given the importance of China and the United States in the global economy, both in terms of GDP and trade (Graph A1).

Graph A1
GDP and Trade Shares
Per cent of total



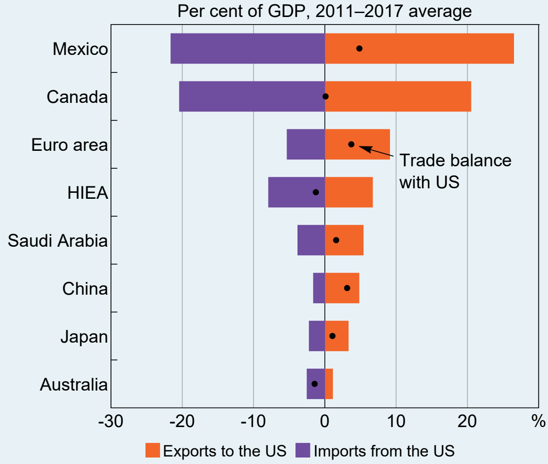
* Excludes European Union intra-regional trade
Sources: Eurostat; RBA; UNCTAD

If protectionist measures did escalate significantly, economies would substitute domestic production for imports as import prices rose. Global trade would therefore decline over time. An adverse reaction in financial markets could also be expected. Business confidence and investment could also decline in response to the increased uncertainty. Both the substitution towards more expensive domestically produced goods and higher import prices would be expected to contribute to higher inflation, especially for economies that are near full employment, such as the United States; this could lead to tighter monetary policy and more downward pressure on growth. In contrast, countries that lose key export markets could see deflationary pressure as lost production leaves them with some spare capacity for a time.

The relative size of these effects would depend on the tariffs' final rates and scope, how exposed economies are to trade, and how prices adjust; for example, exporters may absorb some of the tariff increase by lowering profit margins. The direct effects of any further US measures would be likely to be felt most by economies with larger trade exposures to the United States. These include China, the euro area, Japan, Canada and Mexico (Graph A2). The indirect effects on the global economy could, however, be larger and more broad reaching, particularly for the east Asian region (excluding China and Japan) which is highly reliant on trade and has closely integrated production chains.

Over the longer term, it is likely that productivity growth would be lower than otherwise, as global economic activity shifts to less productive domestically focussed sectors and reduced competition across borders weakens incentives to innovate and invest. Financial market prices, such as long-term interest rates and exchange rates, are also likely to be affected. A scenario published by the International Monetary Fund (IMF) (2016) found that if all countries raise tariff and non-tariff barriers such that world import prices increase by 10 per cent, over the long run, global imports and exports would be 16 per cent lower, output would be 2 per cent lower and investment would be 3½ per cent lower.[1]

Graph A2
Trade with the United States
Per cent of GDP, 2011–2017 average



Sources: ABS; BEA; RBA; Thomson Reuters

1 See International Monetary Fund (2016), 'Scenario Box 1. Tariff Scenarios', *World Economic Outlook*, October, pp. 37–39.