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RESEARCH SUMMARY

How Policy Uncertainty Hurts International Trade

Higher tariffs and other controls on international trade and investment hurt the US economy. They raise costs, create inefficiencies, and slow economic growth. But according to Robert Krol in "Uncertainty about Future Policy Changes Could Be Harming the US Economy," it is not only bad policy that hurts the economy. Anticipation of bad policy can do it too.

POLICY UNCERTAINTY ALONE IS ENOUGH TO RATTLE THE ECONOMY

Since the end of WWII, the United States has vastly expanded its international commerce through trade agreements. However, recent withdrawals from trade agreements, a trade war with China, and a global pandemic have created international economic policy uncertainty. Indicators of uncertainty have increased nearly fivefold since President Trump took office in 2017.

Higher levels of economic policy uncertainty, both in the United States and abroad, make businesses less likely to invest. Higher tax rates, regulations, increased tariffs, and threats to private property rights all jeopardize profits. Businesses facing uncertainty in these areas are likely to put planned investments on hold. This results in

- reduced foreign direct investment inflows for the United States and
- a fall in US imports and exports that particularly harms lower-income Americans, who are disproportionately likely to buy inexpensive imported goods.

INCREASED POLICY UNCERTAINTY COSTS THE US ECONOMY BILLIONS OF DOLLARS

- Policy uncertainty negatively affects imports for up to six quarters after the initial shock. Data from the first quarter of 2019 show that increased policy uncertainty would result in a $10.6 billion decline in imports in a single quarter.
- Economic policy uncertainty in the United States reduces exports for up to seven quarters after the shock. Data from the first quarter of 2019 show that increased economic policy uncertainty would result in a $7.5 billion decline in exports in a single quarter.
- Increases in trade policy uncertainty also decrease exports, with drops ranging from 0.23 percent to 0.96 percent in a quarter.
- Together, economic and trade policy uncertainty can depress foreign direct investment for up to seven quarters after the shock. Data from the fourth quarter of 2018 show that together, increased economic and trade policy uncertainty would represent a $53.4 billion decline in foreign direct investment inflows.

KEY TAKEAWAY

When investors are uncertain about economic policy, they are more reluctant to invest, causing worldwide losses in imports, exports, and foreign direct investment. This lack of investment hurts not only the economy at large, but also hardworking Americans who rely on inexpensive imported goods. Businesses and consumers would benefit from clear policy signals regarding future US and global economic policy.