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# Business Trend: Global Trade – A House of Mirrors or Horrors

Doylestown, PA | Pittsburgh, PA | Buffalo, NY

# Are Trade Wars Reshaping the Global Economy or Vice Versa

The rise of economic nationalism (putting your nation's economic goals first), the erection of trade barriers and shortening of global supply chains appear to be concurrent trends, but they are more likely causal than concurrent in nature.

Economic nationalist sentiments first arose in Britain when the British rejected the European Union initiating Brexit and quickly manifested themselves in the U.S. as Donald Trump became President.  Italy and France followed suit and other major economies like Mexico and Brazil have also focused on Economic nationalism.  China, of course, has always pursued this strategy.

In the UK, the British believed that their economic interests were being subordinated to those of the EU.  In the U.S. the administration believed that current economic pacts, even when obeyed, benefited others at the expense of the U.S. and that most of the U.S.'s trading partners had long been abusing these pacts.  Similar sentiments arose in Italy, France Mexico and Brazil.

As a result, leaders in many of these countries and China sought to erect barriers to protect native industries against foreign competition and initiate other directives including espionage to support their economies.

Multinational Business leaders who, benefited enormously from the rise of globalism in the post-war economy, have recently been forced to prune their global supply chains as they have become too expensive to administer and too prone failures caused by political disruptions like trade wars.

# Anatomy of Economic Warfare

Trade wars are generally fought by creating import tariffs (taxes) on specific goods and services from specific countries.

Sometimes the goods and services are targeted based upon allegations that the goods and services are: 1) being dumped (products sold in foreign countries for less than they are available in the originating country) or 2) produced using direct or tax subsidies by the originating state;  other times the goods and services that are targeted are for 3) strategic reasons(designed for the highest impact up on the targeted country) or 4) an entire targeted country's trade and funds flows are embargoed to support political or military agendas.

Frequently the targeted country retaliates by creating strategic tariffs of their own.

Escalation frequently occurs when the originating tariff erector is faced with a retaliatory tariff and decides to up-the-ante.

Like any governmental action, trade wars always have known downsides and frequently create unintended consequences.  Consumers from both countries are generally required to pay more for goods and services, capital markets suffer and established trade practices like supply chains become contorted or truncated to adjust for tariffs and restrictions.

# Current Areas of Trade Friction

Presently the largest area of dispute is between China and the US where tariffs have emerged on over $250B of Chinese Goods (an additional $250B is contemplated). In addition there are other concerns regarding intellectual property protections and China's requirement that US companies partner with their Chinese counterparts before the gain access to Chinese economy.

The second largest area of trade disputes is between the US and the EU. Although the focus appears to be on steal and autos, the main areas of discord in U.S.-EU trade are: Agriculture (Bio Tech principally the use of GMOs and hormones), Information Technology (particularly individuals' privacy) and the US's use of economic sanctions to enforce foreign policy which impacts EU financial and commercial institutions.

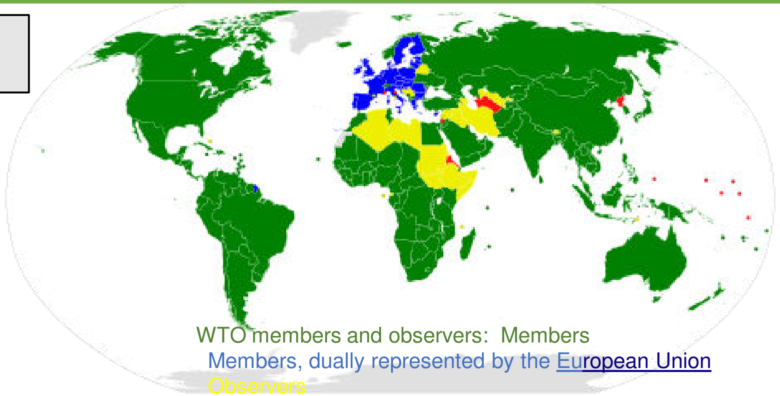
The third largest area of trade dispute is between China and the EU. To date their focus has been on the dumping of textiles and manufactured goods, and intellectual property protections. Despite the trade friction between the U.S. and E.U a consensus is emerging that the EU and US will set aside their disputes in favor of banding together to provide a concerted focus on China trade.

The fourth largest area of trade dispute was within North America, but the USMCA, although not yet ratified, appears to have resolved these disputes. With a Democratic majority in Congress there may be further requests for modification.

Global trade pacts for the last few decades have tended to be multi-lateral (e.g. NAFTA, Trans-Pacific Trade Agreement), however the current US Administration and certain other Governments are now favoring bi-lateral agreements because the negotiations are simpler and the ability adjust them is generally easier.

# Largest Trade Organizations and Agreements

World Trade Organization




Creates the agreements, enforcement mechanisms and courts to adjudicate disputes. Japan, US and EU are likely to band together to change WTO rules on subsidies and State Owned Enterprises that China has exploited to better compete.

The European Union and Japan free trade Agreement (2018)

#1 Creates the world's largest open economic area - 30% of world's trade

The EU and Japan hope to involve the US in order to address China

USMCA (Awaiting Ratification)

#2 Successor to NAFTA ( Canada, Mexico, US)

Governs $12T of GDP

Trans Pacific Partnership (defunct)

Comprehensive and Progressive Agreement or Trans-Pacific Partnership


The US withdrew its support from TPP causing the agreement to fail

#3 The Remaining 11 countries ( ex-USA) (13% Global Trade-$13.5T) created the third largest free trade area

# Supply chains in the Era of Trade Conflict

Over the last three decades supply chains have grown in length and complexity as trade restrictions ebbed and international corporations searched for the lowest cost and most efficient sources of production. A good barometer of the growth in supply chains is the expansion of container ships. In 1970 virtually no goods were shipped via containers, today $12 Trillion of goods annually are shipped by containers.

Not only are supply chains long, they can be complex. For instance various parts of a car travel across the Mexican, US and Canadian borders an average of eight times during assembly and each of the countries are adding components that may be imported by non-USMCA/NAFTA countries.

Four trade related factors are presently impacting the scale of supply chains, nationalism, tariffs, intellectual property protection concerns and the declining opportunities available for companies to arbitrage labor costs in less-developed-countries.

Today the trend is toward onshoring (returning to domestic production) and producing goods closer to their consumption. In addition to the above four factors, shipping costs, weather, automation and timing are shortening supply chains.

Tariffs are also having unintended consequences on supply chains. BMW of Germany has centered the production of SUVs in the U.S. and the Chinese import thousands of these SUVs, but when China retaliated against US sanctions by establishing punitive tariffs on U.S. made vehicles it was a German company that bore the brunt of the action

# What is Next

One School of thought is that once the U.S. gets USMCA ratified, it will quickly pivot and focus on the U.S. – EU trade disputes.

This school also believes the EU needs the leverage of a U.S. partnership in order to effectively negotiate with China, so the EU might be more inclined to capitulate to certain U.S. demands.  The EU is also very nervous about tariffs on cars, the production of which is the lifeblood of its most prosperous state, Germany.

The US, unlike the EU, is also concerned with other issues including: Chinese theft of intellectual property, Chinese demands that US companies partner with Chinese State Owned Entities when they do business in China, and countering the growing Chinese  economic and military influence in the South China sea and beyond.  Undoubtedly China will seek to capitalize on these divisions as it seeks to obtain results that favor its own best interests.

Having the above scenario playout is like winning the trifecta at the race track.  The Democratically controlled Congress could derail USMCA,  The EU and the U.S. might not be able to come together or stay together when negotiating with China and China has a wide array of options available to it from additional sanctions to inciting regional skirmishes with it or its South Korean proxy as it pursues its economic development.

# What’s Next (2)?

On the other hand, China with it many ethnicities and languages is not a homogenous culture and the Communist state has to walk a fine line to assure the Communist party’s control.  A deep recession caused by a major trade war could jeopardize the role of the Communist Party.

The most likely outcome in all of these disputes will be some form of compromise with those who have leverage getting a slightly better deal, but the other side cannot completely capitulate or they will face domestic consequences.

Another likely outcome will be a reduced reliance on global supply chains  As these chains become more expensive to administer, more difficult to govern and more prone to political disruption, business leaders will seek safer, more reliable sources of supply which will require shorter chains with increased redundancies.