# Trade Policies

**January 10, 2019**

The Trump Administration's America First Policy has led to the reconsideration of the US commercial relationship with different regions of the world. As part of this policy the Trump Administration renegotiated the North America Free Trade Agreement (NAFTA) and relabeled it the United States-Mexico-Canada Agreement, USMCA. Additionally, the US demanded that China open its economy and protect US intellectual property while at the same time, withdrew itself from the 12-country Trans-Pacific Partnership or TPP. Critics have characterized these actions as evidence that the US is stepping back from the world. That is one possibility, but there are other considerations. We believe these actions may precipitate a potentially bullish outcome that could result in lower trade barriers.

As the US withdrew from the TPP, the remaining countries — Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam — were undeterred by the US withdrawal and forged ahead. In addition, a new agreement between Japan and the European Union is about to kick in. These trade agreements call for a reduction of trade barriers among the member countries with the long-term goal of having a truly free trade zone among the members. Lower tariffs and fewer trade restrictions increase the after-tax return to the producers in the exporting countries. Generalizing the results, we look for these economies and their stock markets to improve on an absolute and relative basis to other economies in the world.

Much is being said about the trade policies under the Trump Administration, but keep in mind that the US has much lower tariffs than most countries in the world. This means that any trade deal that involves a bilateral tariff reduction will force the tariff rates of the trading partners to decline much more than the US. In fact, by virtue of having very low tariff rates, the US tariffs will not decline much. Hence, the bulk of any benefits of US negotiated trade agreements will come from tariff reductions taking place with the US trading partners. That is already occurring with TPP. There is also the fact that Canada and Mexico are both part of TPP and USMCA raising the possibility of broadly defined transshipping, where goods from the TPP countries could enter the US as inputs to goods produced in Canada and Mexico. Although this effect may be tempered by local content laws in the USMCA agreement, the important point here is that there are plenty of ways for the TPP member countries to access and benefit from the US market. The US consumers would also benefit as they will have access to high quality, lower price imported products. All of this suggests that our cost projections associated with withdrawing from TPP are overstated.

Whether the US will be able to get a trade deal with China remains to be seen. We are not too keen on a deal that simply leads to China buying more grain from us. In a global market for commodities, such a deal would only result in a musical chairs game: If the Chinese buy more from us, some of our previous buyers will be displaced. In the US the price of grain will tend to rise. In contrast, the previous Chinese suppliers, i.e., Argentina and Brazil, will experience a decline in the price of their exports. The lower prices will then attract the displaced former buyers of US grains. In the end, the global demand and prices remain unchanged. The buyers and sellers have traded spots. Hence the musical chairs analogy. The big windfall from a deal with China would be in the protection of intellectual property as well as increased access to the Chinese market. The

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intellectual protection of property is analogous to a tax cut that increases the income stream generated by the intellectual property, while the increased access is analogous to a tariff reduction that increases the profitability of US companies doing business in China.

As the UK leaves the EU, there is also a trade deal that can be made. The UK, Canada and the US have similar legal systems, speak the same language, and have well-developed financial markets. The UK would be a natural and perfect candidate to join the USMCA trade agreement. Although a long shot, such a trade deal would be an extremely bullish development for the UK and the USMCA but not for the EU. Finally, if these trade deals progress, the "supply chain" countries will also benefit greatly. Trade is a rising tide that lifts all boats.

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