



Tariff Skirmish Could Liberalize Global Trade

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"It is difficult to defend protectionism without defective economics or flawed ethics."

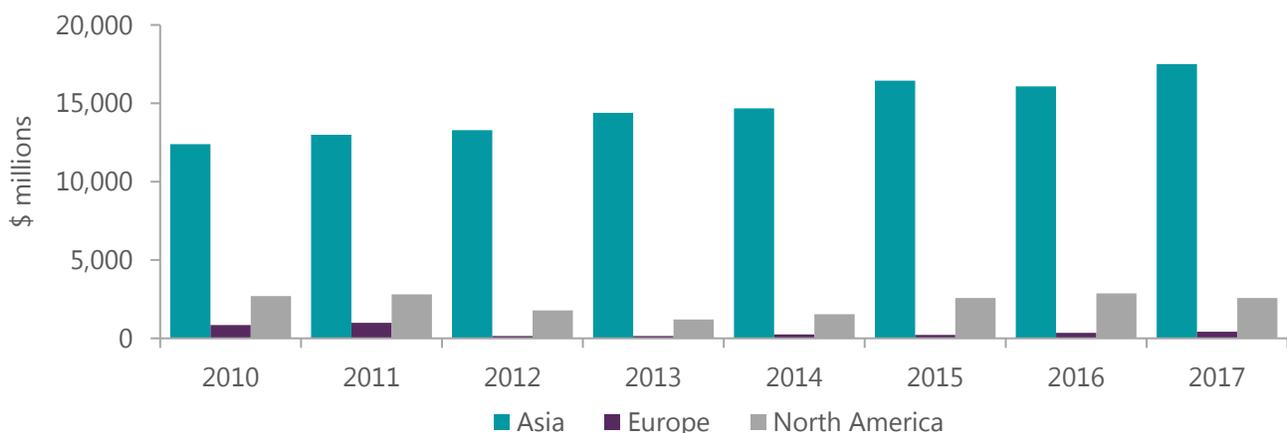
-Economist Pierre Lemieux, University of Quebec

Key Takeaways

- ▶ Tariffs end up impacting the wrong parties, in this case consumers of the supposedly harmed countries.
- ▶ Free trade promotes the most efficient production closest to the consumer.
- ▶ Trump's antagonistic approach could eventually broaden global trade and promote a "trade peace."

We live in a world of "managed trade" that has generally become more liberalized since the end of World War II, but unfortunately some of those entrusted to manage cross-border activities tend to possess both of Professor Lemieux's cited faults. This is primarily because tariffs, which can be a proper tool to enforce violations of trade agreements, end up being paid by the citizens of the supposedly harmed country. For example, the 50% tariff on imported washing machines imposed in January raised the price of the average appliance by an estimated \$150. These funds were extracted from the portion of the 97 million American families that own a washing machine which needed to be replaced. None of the proceeds from the penalty for buying an LG or Samsung appliance went to the 2,400 workers in the U.S. that make washing machines, but instead goes either to the U.S. Treasury or as a quota credit back to the foreign producers. It is simply a regressive tax. Also, this \$1.4 billion additional cost to American consumers needs to be held against the \$57 million in workers' wages and \$224 million in profits at Whirlpool and GE Appliances. Typically, both domestic and foreign producers raise prices equal to about half of the tariff and the overseas company works to cut costs and improve efficiency, so the protected company is left less competitive when the penalties expire in three years.

Exhibit 1: Tariffs Can Take Toll on U.S. Consumer: U.S. Household Appliance Trade Gap



As of Dec. 31, 2017. Source: U.S. Census Bureau.

The most troubling impact, lost in the political messaging agenda, relates to the reflexive paradox of globally free trade. Staying with household appliances, due to the cost of shipping and ongoing service demands, if uncoerced by penalties and trade barriers, the natural tendency is that production moves closer to the consumer. Samsung just began producing washing machines at a new plant in South Carolina and LG is building a factory in Tennessee, which should lower the \$19.4 billion U.S. trade gap on household appliances (Exhibit 1). These American job-producing investments would not have occurred in a 50% tariff environment that prevented the South Korean firms from building a U.S. business. The jobs at GE Appliances in Kentucky were "protected" by a Chinese firm in early 2016. BMW has built its largest final assembly plant in South Carolina and is hiring an additional 1,000 workers this year. This stems from the demand for BMW SUVs that originally had been imported into the U.S. In short, tariffs harm U.S. consumers and risk stalling the current renaissance in American manufacturing.

Being contrarian investors, when stock prices fall due to a specific concern, we work to find a silver lining. Looking beyond the obvious harm of a trade war, the impact of President Trump's confrontational approach may be to broaden and further liberalize global trade. Firstly, as with the metals tariffs, the President quickly shifts from stick to carrot and begins a negotiation process that delays and dilutes the negative impact. Secondly, in reaction to a more antagonistic U.S., other nations are incentivized to strike trade deals with each other to increase their bargaining power. President Xi of China recently called on fellow WTO members "to lock arms with China in fighting against the U.S. blatant protectionist acts." In the meantime, he is signing bilateral trade pacts with Africa, Latin America, Europe and the ASEAN countries. We are hopeful that this trade "skirmish" produces not a full-fledged trade war, but a more durable trade "peace."

About the Author



Paul Ehrlichman

Managing Director, Head of Global Value

- 35 years of investment industry experience
- Joined a predecessor firm in 2008
- BS in Finance and Quantitative Analysis from LaSalle University

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