Economic & Investment Perspectives

Trade Protectionism: Moving Past Campaign Rhetoric

While the financial markets in the U.S. have remained focused on healthcare, tax reform, potential deregulation, and interest rate moves by the Fed, we continue to be concerned that the risks of offsetting actions remain underestimated. We believe trade is one area the markets are not properly discounting. There are potential negative implications of upcoming protectionist measures be they exiting trade deals, renegotiating others, and taxation of imports that can be significant in our view. The regulatory nature of such actions will elicit counter measures by our trading partners in the form of retaliatory tariffs on U.S. exports, creating lengthy and costly disputes at the World Trade Organization (WTO) and U.S. courts, increasing volatility within the currency and bond markets, and raising uncertainty for businesses which will impact investment and jobs over time.

At the core of this risk lies the protectionist belief that a negative trade balance (particularly in goods) is an issue in need of resolution, and trade deals that either cause or expand a negative balance are inherently flawed. Viewing trade from this perspective and as a zero-sum game naturally leads to the conclusion that actions are necessary to increase exports and/or reduce imports. The attractiveness of a border adjusted tax (BAT) to the protectionist camp is that it not only advantages exports over imports, but also the false notion that it contributes towards rebalancing the budget deficit by raising tax/tariff revenues.

The skeptic in us argues that campaign promises and rhetoric at least on this front were just that, and are likely to fade with time. Unlike healthcare and taxes, we have not seen any definitive moves on the protectionist front to date. The pragmatist in us, however, believes it is only a matter of priority and they are forthcoming as the teams in charge of such actions are hired and put in place. In fact, we are beginning to see firsthand the foundations for such actions publicly. While the focus of investors, markets, media, and policymakers was on Washington during the past several weeks, the G-20 Finance Ministers managed to come together for two days in Munich for their first meeting of 2017 – and the first with representatives of the new administration in Washington. Though these meetings occur quite frequently (Finance Ministers and Central Bankers meet several times a year) and tend to be dominated by matters of immediate concern, their communiques do include statements that tend to reflect many long-term perspectives and thinkings. And while no one tends to review the communiques the way statements coming from central bankers are reviewed, a change in the statement which reportedly originated as a demand from the U.S. team did manage to grab our attention. In recent history, the communiques have included a brief, albeit firm, statement on protectionism:

"We are firmly committed to open trade and investment, expanding markets and resisting protectionism in all its forms." 2012

"We will resist all forms of protectionism and keep our markets open." 2013

"We will resist all forms of protectionism." 2016

But at the insistence of the U.S., the reference to protectionism was replaced by a far more feeble statement:

"We are working to strengthen the contribution of trade to our economies."

This is not exactly progress from where we sit. The U.S. currently has 14 free trade agreements with 20 countries dating back to the Reagan Administration,

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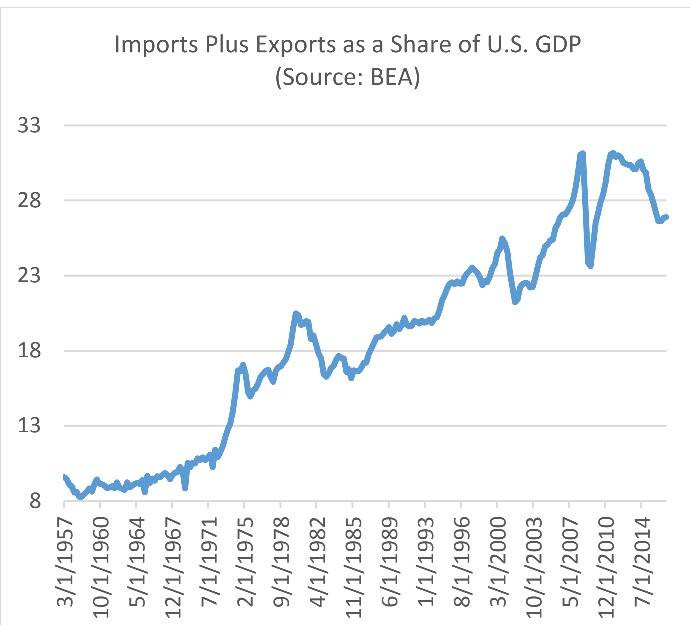
with 17 more in the works. Total trade represents over a quarter of economic activity and growing (see Chart of the Month). The failure of the passage of TPP was very disappointing and a major loss of opportunity for the U.S. in shaping trade with Asia over the coming decades, and a major loss for our private sector. Major alterations to existing trade agreements, any withdrawals, delays in completing negotiations of potential deals, and moves against individual countries and regions with the mindset of protectionism will only increase uncertainty and reduce investment.

Chart of the Month



Whatever the outcome of tax reform discussions, trade relations will begin to grab the attention of policy makers in the coming months, and subsequently the attention of the media. We believe that eventually the financial markets will have to discount the risks more appropriately.

As always, stay tuned…

Ardavan Mobasheri
Chief Investment Officer
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