GLOBAL LOGISTICS &
THE US TRADE DEFICIT

HAULAGE | AIR | OCEAN | WAREHOUSING | PROJECTS

CONTENTS

EXECUTIVE SUMMARY

The United States has for decades now been running a trade deficit, with the value of imports exceeding the value of exports by over $700 billion in each of the past four years. While many economists argue that a trade deficit alone is not a sign of a weak economy or of a country doing badly, US President Donald Trump has, as a core element of his policies, pledged to get "better deals" for the United States and reduce the trade deficit. Proposals to achieve this have included the introduction of protectionist policies to curb imports – such as duties or tariffs on foreign goods – and negotiating trade deals that will allow US exporters more opportunities to access foreign markets.

UK and US trade relations, in particular, will inevitably shift over the coming years as Britain exits the European Union and has to renegotiate its trade deals both with the remaining 27 countries of the EU, and with other nations. This presents potential difficulties as foreign trading partners may place incompatible conditions on future trade deals; for example, a UK deal with the EU might be dependent on continuing alignment with EU regulations, while a trade deal with the US may be contingent upon Britain moving away from EU regulations and aligning more closely with the US on matters such as health and safety or manufacturing standards.

SURPLUS VS DEFICIT

The US trade deficit varies in relation to different types of goods. The largest deficit is in automobiles, automotive engines and parts, and President Trump is keen to implement measures – including renegotiating the North American Free Trade Agreement (NAFTA) – to curb imports and boost domestic production and sales. One area in which the US has a trade surplus is in civilian aircraft and aircraft engines.

Shifts in US trade policy and other factors such as Brexit are likely to be disruptive to logistics companies over the next one to three years, but will also present opportunities. Businesses that are able to adapt to changes in global trade have the potential for success and growth, and we predict that in four to five years' time the industry will see a changed but more stable international trade landscape.

WHAT IS THE TRADE DEFICIT?

Every nation monitors, on an ongoing basis, its balance of trade with other countries. This is, in short, the positive or negative difference between the value of a nation's exports and its imports over a given period. Countries that export a higher value of goods (and in some measures, services) than they import are said to have a trade surplus. On the other hand, nations that import a higher value of goods than they export are said to have a trade deficit, or a trade gap.

A number of factors can affect a nation's balance of trade, such as:

- Variations in demand for certain types of goods.
- Production costs in an exporting economy versus an importing economy.
- The cost of goods manufactured at home.
- Cost and availability of raw materials.
- Variations in currency exchange rates.
- Taxes and tariffs affecting international trade.
- Non-tariff trade barriers, such as environmental, health and safety, or other regulatory restrictions.

While a nation may have an overall trade surplus or trade deficit, to understand a country's balance of trade in detail it is necessary to break this down for closer study. The United States, for example, has since the 1980s had an overall trade deficit, particularly with China and the European Union. On the other hand, the US has mostly had a trade surplus with Australia. It can also be useful to examine individual sectors and types of goods; for example, in 2015 the US had a trade deficit on most goods, but a trade surplus on medical equipment, plastics and aircraft.

A nation's balance of trade can vary quite significantly from month to month, and while it would be easy to assume that a trade surplus is good and a trade deficit is bad, most economists see this as an oversimplification. In some cases, a trade deficit can be a sign of a strong economy in which domestic consumers are spending more on imported goods. However, there is a counterargument that a rapidly growing trade deficit can be a sign of an economy in trouble, while the large inflows of foreign investment that accompany trade deficits can lead to dangerous financial bubbles.

UK AND US TRADE RELATIONS

While the United States has maintained a trade deficit with the European Union as a whole in the past two decades, the balance of trade between the US and the United Kingdom specifically has been more variable.

According to official figures from the United States Census Bureau, the year to November 2017 recorded a $3.095 million trade surplus with the UK, compared to a $1.017 million surplus in 2016. The previous four years, by contrast, recorded a trade deficit with the UK.

The matter is a little more complicated, however; in September 2017 the Financial Times reported that there are various periods over the past decade in which the US and the UK have each simultaneously claimed to have a trade surplus with the other.

Statisticians have so far failed to get to the bottom of the discrepancy, but one suggested explanation is that US figures include the Channel Islands as part of the United Kingdom, while the UK's own trade figures exclude the islands as they are self-governing Crown dependencies. The large sums of money flowing through the Channel Islands as an offshore banking centre could be enough to skew the figures.

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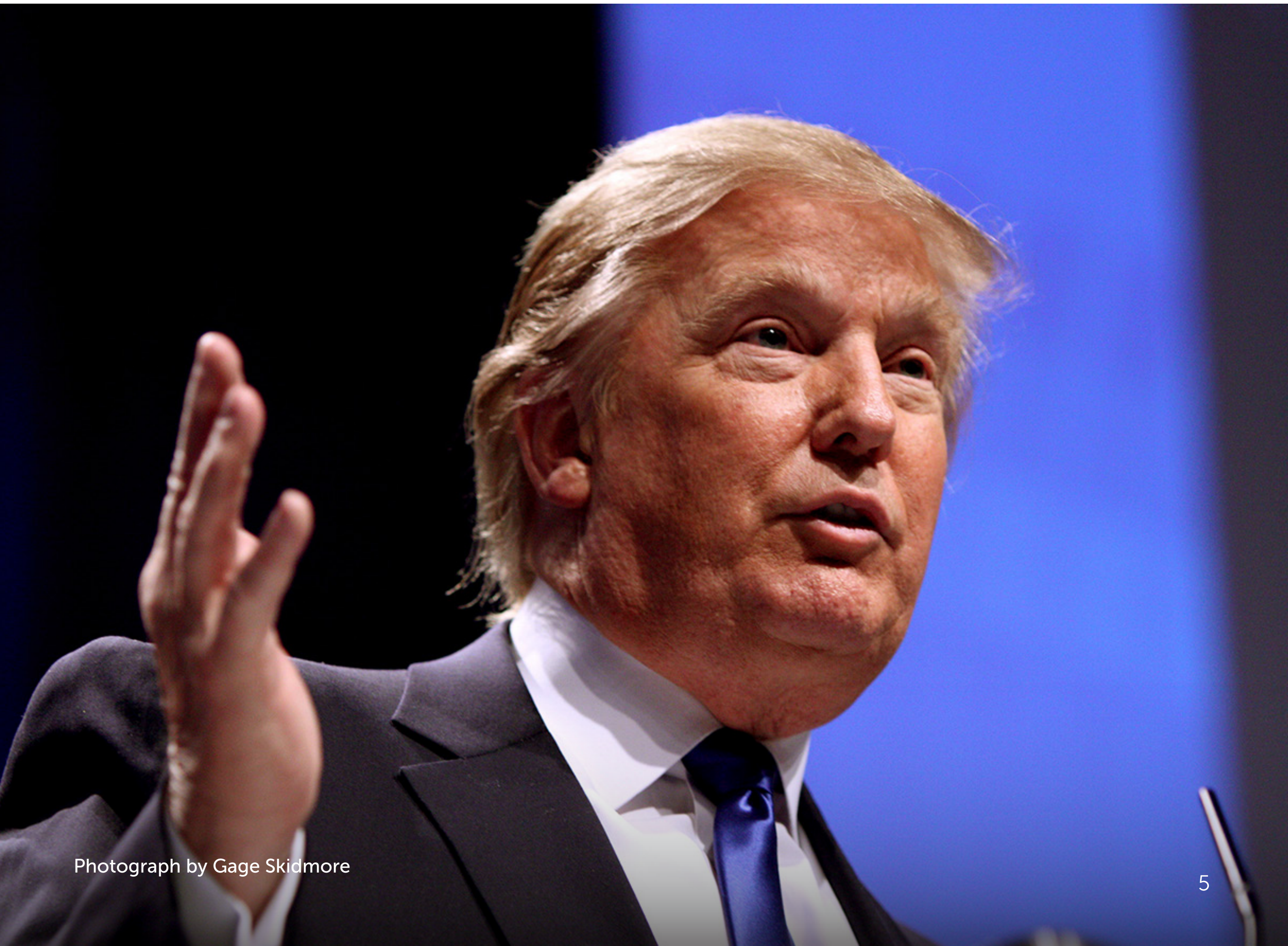
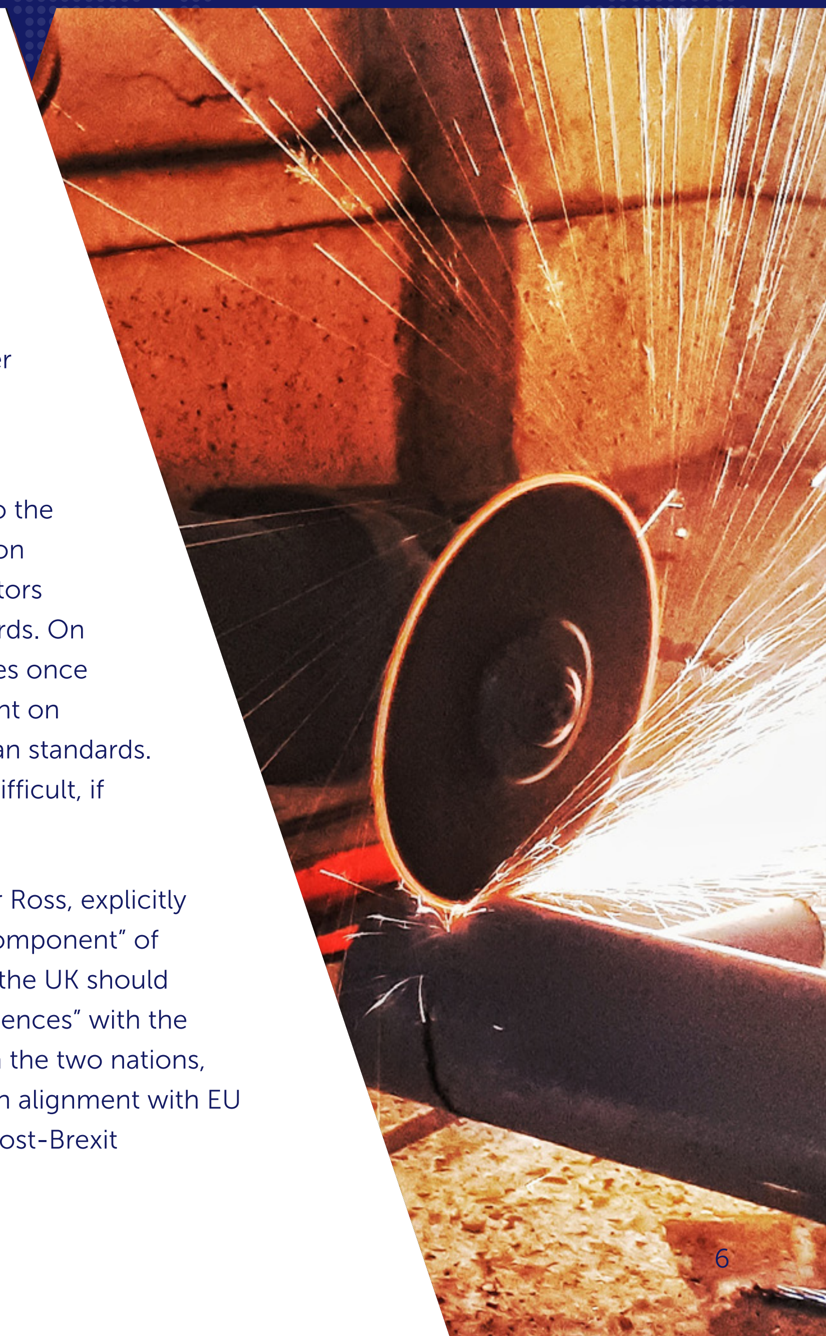


Photograph by Gage Skidmore

WHAT NEXT FOR UK AND US INTERNATIONAL TRADE?

Throughout the 2016 US election campaign and since taking office, President Donald Trump has spoken out against the United States' large trade deficit, in the belief that it harms the American economy and affects domestic employment. The Trump administration has indicated that it intends to narrow the trade gap through measures including renegotiating the 23-year-old North American Free Trade Agreement (NAFTA) with the intention of reducing the trade gap with Canada and Mexico, as well as potentially withdrawing from the KORUS free trade agreement with South Korea. Matters have been further complicated by the president's more recent stance that "trade wars are good, and easy to win" amid threats to impose punitive tariffs against various nations on steel, aluminium and other imports.

> US Secretary of Commerce, Wilbur Ross, explicitly said that regulatory alignment would be a "critical component" of any future UK–US trade discussions, and urged that the UK should take steps to remove "unnecessary regulatory divergences" with the US.



In terms of trade between Britain and the United States, the shape of the next two or three years is difficult to predict. The UK is scheduled to leave the EU on Friday 29 March 2019, and at the time of writing there is no consensus in government or parliament on whether this means leaving the single market and customs union entirely, or retaining access to it through either membership of the European Free Trade Association (EFTA) or some other mechanism.

The problem this presents is that future UK access to the single market will almost certainly be dependent upon continuing regulatory alignment with Europe on factors such as health and safety and manufacturing standards. On the other hand, a UK trade deal with the United States once Britain is no longer an EU member may be contingent on abandoning EU regulation and aligning with American standards. Reconciling these two positions may be extremely difficult, if not impossible.

Late last year the US Secretary of Commerce, Wilbur Ross, explicitly said that regulatory alignment would be a "critical component" of any future UK–US trade discussions, and urged that the UK should take steps to remove "unnecessary regulatory divergences" with the US. While Ross spoke of deepening the ties between the two nations, he warned that any UK deal with Brussels to maintain alignment with EU regulations might "hinder development of a closer post-Brexit US–UK relationship"

AUTOS, ENGINES AND PARTS

US PLANS TO NARROW THE DEFICIT

Automobiles, automotive engines and car parts form by far the largest component of the United States' trade deficit with the rest of the world; in 2016, the total deficit on these goods was $192 billion. President Trump has spoken at length about the trade deficit in general, as well as more specifically about the import of Mexican-made cars into the United States.

Although much of the talk from Trump during the election campaign and in his first year as president revolved around protectionist policies such as import tariffs on automobiles, many believe that a more sensible way of reducing the trade deficit – both overall and specifically in relation to the American automotive industry – would be to focus on facilitating opening up markets where US auto exports currently face barriers to entry.

In fact, the American Automotive Policy Council — which represents General Motors, Ford, and Fiat Chrysler's US division – has specifically called on the administration to pursue this path. The council has stated that increasing vehicle exports by 50% (or one million units) could see US exports "increase by over $25 billion, supporting an additional 155,000 US jobs ... If this goal was achieved, the U.S. could employ about the same number of auto production workers as it did in the early 1990s."

At the time of writing, NAFTA negotiations are ongoing, with Canada and Mexico reportedly resistant to US administration proposals that would require vehicles sold in North America to have 85% NAFTA-sourced parts – with half coming from the US – to avoid duties. Such proposals risk the danger of prices of both auto parts and manufactured automobiles being driven up, potentially threatening the industry's competitiveness internationally.

CIVILIAN AIRCRAFT AND ENGINES

MANAGING THE US SURPLUS

One of the few goods categories in which the US has a trade surplus with the rest of the world – alongside soybeans, chemicals and newsprint – is in civilian aircraft and aircraft engines, recording a $65 billion surplus in 2016. US aircraft exports are strong, but another reason for the trade surplus is that imported civilian aircraft are subject to strict regulatory approval by the US Federal Aviation Authority. There are also political and social pressures on US airlines to buy American despite China, in particular, trying to get a piece of the action. Many observers believe the public outcry that would accompany US airlines shifting to cheaper, Chinese-made planes means that it will be a long time – if ever – before China breaks into the US aircraft market.

International trade in civilian aircraft hasn't been without controversy in recent months, with the United States International Trade Commission (USITC) – in response to a petition filed by Boeing – imposing an almost 300% duty on sales in the US of civilian aircraft made by Bombardier Aerospace – a Canadian-based company with production facilities in Canada, the United States, Northern Ireland, Mexico and Morocco. The politically contentious move brought strong responses and threats of retaliatory action from the Canadian and UK governments in particular, with Canada eventually filing a complaint against the US with the World Trade Organization. The matter was finally resolved in January 2018 when the USITC ruled that the proposed imports would not "harm US industry", and overturned the tariff decision.

PREDICTIONS FOR GLOBAL LOGISTICS IN 2018

With Brexit on the horizon and the disruptive potential of some of the Trump administration's policies and attitudes to trade, the next year has the potential to be a tumultuous one for international trade and the world of logistics.

However, we predict that some of the more extreme positions of the US administration on trade will be reined in by the realities of the global trading landscape and the need to maintain good diplomatic relations with trade partners. Overall, 2018–2019 is likely to be a transformative period for global trade in which some challenges will arise; however, we believe those challenges are unlikely to reverse seventy years of increased global cooperation and trade.

For logistics businesses, 2018–2019 will likewise see some challenges, but shifts in attitudes and policies between international trading partners will also have the potential to present new opportunities – particularly for businesses that choose to be flexible and can adapt to changing circumstances. We expect to see more disruption over the following two to three years as the Trump administration's trade policies take effect and reshape some aspects of international trade relations, and the UK's trading deals are renegotiated and eventually take effect post-Brexit. In the longer term – by 2022 – these shifts are likely to have settled down and successful logistics companies will have fully adapted to this wave of changes in global trade.

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