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The unanticipated and irreversible consequences of trade wars

Trade wars are the talk of the town these days as companies across the globe grapple with the challenges of what is fundamentally a battle for economic advantage. The most notable example today is what's happening between the two largest economies of the world – the United States and China. While numerous factors can trigger trade battles, one wonders who the likely winners and losers are and how should affected companies react in an environment loaded with speculation and uncertainty.

Trade wars are as old as commerce and in essence are a conflict between two states that often rapidly escalates with measures and counter measures such as taxes, tariffs, quotas, bans or even currency manipulation imposed to inflict economic pain on the other side. The main purpose of these actions is to attempt to change the behavior of the other party. Trade wars tend to last over extended periods of time and often result in progressive protectionism and attempts at economic self-sufficiency.

When two states start to ratchet up the heat, the rhetoric is often politically opportunistic and very public in an attempt to demonstrate strength by linking the imposed measures to expected positive gains at home. However, what's less obvious, and the subject of significant debate as to whether trade wars have winners and losers, are the indirect measures taken and their ramifications, both of which are much harder to quantify.

One simple example occurred in the 1920s between the Weimar Republic and Poland, in what is referred to as the German-Polish customs war. The Weimar Republic wanted to force Poland to give up territory by creating an economic crisis that increased the tolls for Polish coal and steel products. As a counter-measure, Poland increased toll rates for many German products in a classic 'tit for tat' escalation. However, the unintended effect of this confrontation was that

Poland initiated the rapid development of its port of Gdynia, which was the only way Poland could export its goods to Western Europe without transporting them through Germany.

We see the same dynamics playing themselves out right now in the US-China trade war. Aside from the public tariffs, both states are pursuing many smaller, indirect, much less visible activities all while interested third parties, whether that be countries or companies, take matters into their own hands to reposition themselves for success. Collectively, these indirect measures can dwarf the effects of the direct tariffs and can have very meaningful consequences by altering entire market structures and re-setting the playing field for years, possibly decades to come.

An example is Vietnam which is economically benefiting from the trade war as US companies shift their purchases from China to Vietnam, while some Chinese companies swiftly relocate their factories to the ASEAN region in order to continue to serve America's appetite for high labor products such as furniture. Also, while Vietnam's steel industry is not as price competitive as China's, the trade war may very well present a real opportunity for Vietnam to build out this sector towards creating an attractive alternative to Chinese steel.

From low tech to high tech, indirect measures are increasingly common. European advanced technology players are seeing favorable market share gains as the Chinese public sector has imposed certain guidelines to favor purchasing non-US products. Meanwhile the Brazilian soybean industry is experiencing a rapid boom as the most valuable US farm export has been dramatically affected by Chinese tariffs all within a matter of a few months.

In the past, creating alternatives of supply as well as demand was more limited due to geographic distance, lack of information and capital. That is not the case in today's highly inter-connected world. Hence, alternatives can often be conceived and executed for countries and companies looking to adjust in order to improve their economic position. In addition, as new ways are put in place and adopted, those changes will likely be long-lasting without return to the prior situation. Therefore, the implication for private companies is to evolve with the environment, stay nimble, act and operate with a dual lens: much like executives must manage short term results in parallel of pursuing a long term direction. Trade war uncertainty is an opportunity to reset and reevaluate one's business by planning out new scenarios and strategic options to further one's interests and advantages. Those adopting a 'wait and see' mentality might lose out to others who take the initiative, place bets and move their companies forward even in uncharted territories.

Alex Schroder is a Principal at Prisma Group, a business development and investment firm that works with private company business leaders to accelerate Value Creation. Prisma's core focus is commercial growth and revenue expansion within domestic and international markets. <https://www.linkedin.com/in/alexschroder/>