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Tariffs tear across world trade

The Star, Malaysia

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WHAT are the benefits of free trade, and how has the US unilateral tariff policy disrupted trade due to the rise of nationalistic movements and twin deficits in America?

Free trade is based on the idea of comparative advantage which benefits all nations globally.

Comparative advantage dictates that a nation should focus on producing goods where its relative opportunity cost is lower (for example where they yield less in terms of other goods they could have produced).

As a result, each country will be able to produce and consume more through specialisation and trade. However, the United States recently unilaterally imposed tariff on all trading partners because it wants to narrow its decades-old trade deficit which almost reached US$1 trillion last year.

The US deficit was significantly impacted by the South-East Asia financial crisis after the mid-1990s, where hedge fund operators took advantage of poorly managed regional economies.

This crisis destabilised regional currencies, spreading to Latin America and Europe. The US dollar became a safe haven with capital flowing into the United States as the Federal Reserve reduced interest rates during financial distress.

This led to accelerated US gross domestic product (GDP) growth and increased imports. However a strong US dollar has reduced US export growth tremendously (Catherine L. Mann, 2000).

The US trade deficit, averaging 3.1% of GDP in recent years, is not a major concern for economists. However, its widening, along with a growing government budget (US$36.56 trillion), could lead to debt, dollar and economic crises.

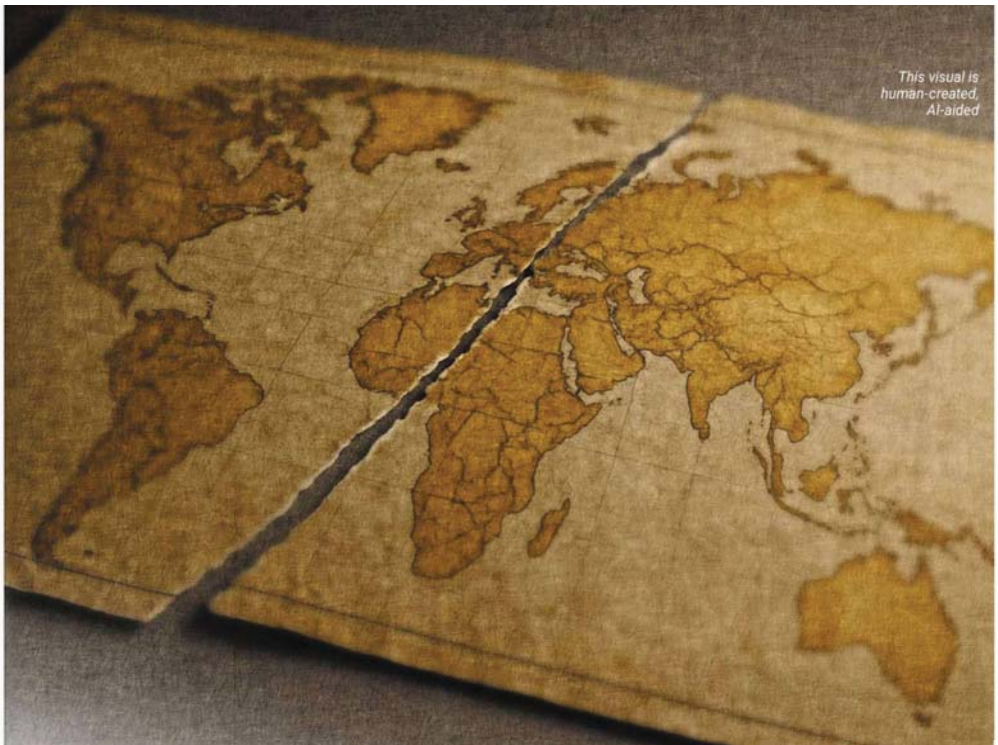
Next, we look at how geopolitical issues, twin deficits and nationalistic movements negatively impact international trade under the US unilateral tariff policy.

First, capitalists (especially in developed countries) invest in countries with comparatively lower production costs (cheap resources and manpower), high productivity, political stability, for instance, China, India and Malaysia.

The primary aim is to benefit from the economic opportunities these countries provide.

It's common for developed nations to delegate lower-end technology tasks and manufacturing to developing nations, often to achieve higher profit margins.

- US deficit was significantly impacted by South-East Asian financial crisis after the mid-1990s
- Geopolitical issues, twin deficits and nationalistic movements negatively impact international trade
- Developing countries could face exploitation by America, as American companies reap most of the profits



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TARIFF WARS

This "out-sourcing" strategy brings economic benefits to both the advanced nations and the developing economies.

Developed economies enjoy lower production costs, higher profits and better competitiveness in the global market, and they can focus more on higher-value innovation and research.

Developing countries benefit by acquiring new technologies that help to stimulate domestic growth, job creation and wealth.

They can also leverage on the imported technology to stimulate technological innovation and capabilities.

Unfortunately, the latest US tariff policy with the goal of bringing back all manufacturing jobs to its country has disrupted the win-win situation.

Second, the policy will hurt developing countries, especially those with low domestic value-added activities.

There are three possible scenarios:

> Country A doesn't import anything from the United States but exports 50% of its goods there, creating a trade surplus.

Both countries benefit from this trade. The United States enjoys affordable and diverse goods, while Country A gains access to a new market and earns foreign currency through a willing buyer-seller relationship.

But now the US government has implemented a unilateral tariff policy on surplus nation A to pressure it into negotiating a "fair trade" agreement. This contradicts free trade practices.

On a micro level, this is similar to a deficit firm forcing a surplus firm to invest part or all of its profits into the loss-making firm.

At a macro level, under normal circumstances, this trade deficit issue can be addressed by the flexible exchange rate system. This means the deficit nation's currency will depreciate, making it more competitive and gradually narrowing the deficit gap over time.

> Country A, a developing nation, operates a low-value-added economy. The tariff will significantly impact Country A.

For example, Country A performs the final assembly of laptops for export to the United States. It imports all components from different countries: motherboard and central processing unit from Country B, random-access memory and storage devices (for instance, solid-state drive or hard disk drive) from Country C, and keyboard and battery from Country D.

Assume the laptop is worth US$1,000, with the following value-added (supply chain) breakdown: Country A (US$200), Country B (US$300), Country C (US$300), and Country D (US$200).

This indicates that Country A adds only US$200 value along the supply chain. However, it is recorded as a 100% domestically manufactured good exported to the United States, overstating Country A's export value.

Worse yet, if America is the primary value-added supplier in this supply chain, whether domestically or through offshore franchises, Country A will likely face exploitation in this "fair trade" negotiation.

> What if the supply chain's value-added components are often controlled by American companies worldwide? If this is true, developing Country A could face exploitation by America, as American companies reap most of the profits while Country A bears the brunt of higher tariffs.

This could harm local exports and the related sectors. To prevent this, developing nations must advocate for free trade, understand international trade dynamics, and oppose poorly planned unilateral tariffs that negatively impact all trading nations.

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SUMMARIES

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