



Trade War

The trade war has been dominating headlines this week, so I thought I would chime in with a few thoughts and insights.

First, a little background...

The idea behind free trade is we should all specialize in whatever we can do better and cheaper than anyone else and then trade to get the things others produce more efficiently. Personally, I love that Chinese-manufactured toys are so cheap because I feel less bad when my kids only play with them once or twice before losing interest. Anyway, this principle ([comparative advantage](#)) has been widely accepted by the world's largest economies and has led to a remarkable increase in living standards worldwide over the past 50 years.

Each country or trading partner needs to play by the same, or at least agreeable, rules for free trade to work. Global trade protocols are a set of rules participants would like other countries to follow in order to guarantee a fair system. The goal is for private companies and investors to move as freely as possible across the globe in search of profit.

The [World Trade Organization \(WTO\)](#) helps facilitate this system of global trade through regulation of trading partners. The WTO tries to build consensus for rules, but it is not totally effective in getting countries to follow them. China was admitted to the WTO in 2001. Its admission to the WTO was (and still is) controversial. The expectation was that the WTO would steer the large communist country toward a freer market economy. However, 18 years later, the United States and Europe feel the WTO has enabled China to get away with unfair trade practices.

The Current US-China Trade War

A trade war occurs when one country raises tariffs (taxes on imported goods) or otherwise restricts trade and the other country retaliates with tariffs of its own. Increased protection causes both nations to reduce the amount of goods traded between the two countries. The current trade war with China began in January 2018.

The Trump administration has taken a hard line with China because it has proven resistant to changing the current system. The current system has been much more beneficial for China than the US, and Trump has stated that China has much more to lose in a trade war. This seems to be true since the US buys around \$540 billion in goods and services from China, whereas China only buys \$120-\$140 billion from the US.

3 Must-Have Reforms

The United States has three major reforms it is requiring from China:

- 1) China must crack down on intellectual property theft.
- 2) China must stop requiring foreign companies who set up operations in China to partner with a Chinese firm—which almost inevitably entails giving up technological know-how and trade secrets.
- 3) China must cut back on subsidies the Chinese government provides to various companies and industries, which gives them an unfair advantage over US firms.

How will the trade war end?

Most people think a deal will be struck because it is in both countries' best interests. A deal appeared to be close last week, but the Trump administration did not react well when the Chinese were backsliding on some aspects that they (allegedly) had already agreed to. The tricky thing will be finding an agreement that enables both leaders (Trump and Xi Ping) to save face. In the meantime, the Trump administration increased tariffs this past week from 10% to 25% on \$200 billion in Chinese goods, and threatened tariffs on \$300 billion more. The Chinese retaliated by placing tariffs on \$60 billion in US goods. The effect of these tariffs will be higher prices for consumers and businesses in both countries in the short term. Eventually, if the tariffs remain, companies will find new suppliers in other countries (e.g., Vietnam, Mexico, and the Philippines).

The stock market does not like the trade war, but we are only 4% off all-time highs, indicating that the millions of market participants expect a deal to be completed. One interesting aspect of all this is that standing up to China on trade seems to be one of the rare issues that has some bipartisan support in Washington, and it is widely viewed as being overdue.

What do you think about this trade war? Email me your thoughts or insights.

Have a great week.

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