Hot Topics Briefing: An Update on the Trade War and its Effects on the Food Service Industry

Supply Chain Scene

Since we published the initial Hot Topics article on trade issues and the effects on the food service industry in May, the story has taken many twists and turns. This brief provides a summary of where things currently stand.

Broadly speaking, the current trade war has four distinct fronts (Brown and Kolb 2018):

1. Tariffs on solar panels and washing machines
2. Tariffs on steel and aluminum
3. Tariffs in response to unfair trade practices, forced technology transfers, and IP theft by China
4. Tariffs on cars and car parts

Of these battlefronts, the steel and aluminum tariffs and the tariffs related to Chinese trade practices are perhaps the most relevant to the food service industry. At the same time, President Trump has renegotiated the North American Free Trade Agreement (NAFTA) with Canada and Mexico which also stands to be of noteworthy impact. Each of these will be discussed below.

Steel and Aluminum - Section 232 Tariffs

On March 23, 2018, President Trump implemented tariffs of 25% on imported steel and 10% on imported aluminum, citing national security concerns under Section 232 of the Trade Expansion Act of 1962. (This is why one will often see "Section 232" referenced in discussions of these tariffs). Canada and Mexico were initially exempt under NAFTA, and further exemptions were granted to the European Union, South Korea, Brazil, Argentina, and Australia, but only temporarily. Each nation was to negotiate long-term agreements with the U.S. or their products would become subject to the tariffs. Most of these countries reached such agreements, however on June 1, the U.S. ended exemptions for the EU, Canada and Mexico. In addition, on August 10, President Trump doubled the steel and aluminium tariff rates to 50% and 20% for Turkey.

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Impacts

Since the implementation of the Section 232 tariffs, steel prices have surged (O'Hara 2018). While imported steel has been made more expensive by the artificial tariff increase, domestic steel producers have simply been raising their rates to take advantage of the reduced level of foreign competition in the marketplace (Benning 2018; O'Hara 2018). The result has been an increase in input costs for downstream steel users. For example, prices for kitchen equipment from at least one major manufacturer, including grills, refrigerators, ovens, and ranges, have increased between 3% and 12% (Benning 2018). Across the industry, firms are deciding how much cost to absorb and how much to pass on to the customer.

Meanwhile, U.S. steel producers are experiencing record earnings (O'Hara 2018). Responding to this new prosperity, unionized steel workers at ArcelorMittal and U.S. Steel are threatening to strike, arguing that they deserve a larger share of this windfall (Stein 2018). Such action could threaten the supply of steel in the market, leading to further increases in price.

Where are things headed?

Indications are that the metal tariffs will remain in place for the foreseeable future. While the U.S. is currently in the final stages of implementing a revised trade agreement with Mexico and Canada to replace NAFTA, the removal of the Section 232 tariffs on steel and aluminum are not part of the discussion (Coyne 2018). As a result, food service industry professionals should expect equipment prices to remain at increased levels.

Chinese Imports - Section 301 Tariffs

In August 2017 President Trump instructed the Office of the U.S. Trade Representative (USTR) to investigate unreasonable or discriminatory Chinese laws, policies, and practices that might be harming American businesses (Brown and Kolb 2018). The investigation is under the authority of Section 301 of the Trade Act of 1974 – hence, the resulting tariffs are often called "Section 301 Tariffs." On March 22, 2018 the USTR published its findings, which detailed a series of abuses related to intellectual property theft, unfair partnership requirements, and forced technology transfers (USTR 2018a). In response, Trump announced plans to implement a punitive 25% tariff on $50 billion worth of Chinese products, primarily machines, appliances, and industrial equipment. Consumer products were intentionally avoided. While it was not clear at the time, those actions began an all-out trade war with China (Brown, Jung and Lu 2018).

How Much Will This Cost?

Chinese Tariffs on U.S. Agricultural Products:
25 % Retaliation List
20% Retaliation List
10% Retaliation List
5% Retaliation List

Seafood Price Updates

Crabmeat, Haddock, Pollock, and Tuna Price Estimates

Within hours of the March announcement, China responded by pledging to impose an equivalent 25% tariffs on $50 billion of U.S. products, primarily vehicles, aircraft, and soybeans. Both the U.S. and China implemented these threatened tariffs in two stages, occurring in July and August.

Due to China's retaliations against the initial Section 301 tariffs, Trump followed up with a second phase of tariffs, implemented on September 24. These tariffs impose a 10% rate on an additional $200 billion of Chinese imports, with the rate increasing to 25% on January 1, 2019. This effectively imposes a tax of nearly half of all items American businesses import from China (Lynch 2018). (See Food Politics for a useful list of affected food items and estimated tariffs. Further, Trump promised a third phase of tariffs on another $267 billion of Chinese imports if China retaliates again. China did indeed retaliate again, but only went as far as to apply the additional tariffs to $60 billion of U.S. goods. So far, President Trump has yet to announce whether or not he will implement Phase 3 (Pramuk 2018).

Impacts

The initial tariffs primarily target industrial goods, including machines and appliances such as stoves, refrigerators, cash registers, and dishwashers (Docket Number USTR-2018-0005). Phase 2 tariffs will raise prices on additional equipment, but will also include meats, seafood, produce, and cleaning supplies (Bryan 2018). In addition, the tariffs will likely reduce disposable income as increased costs inevitably trickle through to consumers. Dining out is among the first things people forgo when budgets are tightened (CBS/AP 2008). Further, because most non-consumer goods have already been targeted, Trump's Phase 2 tariffs will also affect many consumer goods. Major retailers such as Walmart, Target, Ace Hardware and Joann are lobbying the administration to reconsider its decision and find a resolution to this trade war (Meyersohn 2018).

> "…the tariffs will likely reduce disposable income as increased costs inevitably trickle through to consumers. Dining out is among the first things people forgo when budgets are tightened."

Outlook for the Future

How Much Do We Really Import from China?

> "…the Chinese government is well-prepared for a lengthy "cold war" on trade…"

There seems to be no end in sight on the Section 301 battlefront. Jack Ma, chairman and co-founder of Alibaba Group, recently warned that he expects this trade war to last for 20 years or more (Landler 2018; Pham 2018). Former Australian Prime Minister, Kevin Rudd, echoed these sentiments, commenting that the Chinese government is well-prepared for a lengthy "cold war" on trade, and that the challenge at this point will be finding a resolution that meets U.S. objectives without causing China to "lose face" or appear to its people to be backing down to U.S. pressure (Greber 2018). The earliest some analysts believe that the U.S. and China can even begin fresh discussions on the matter is after the U.S. midterm elections in November, at which point the Chinese will know whether Trump is negotiating from a position of strength or weakness within his own government (Greber 2018; Landler 2018).

While neither country can avoid pain in this trade war (Paquette 2018a,b), and public outcry is rising, there are a few glimmers of hope. Roberto Azevedo, Director General of the World Trade Organization, has offered to mediate discussions between the U.S. and China (Elliott 2018). Also, China's mild retaliation to Trump's Phase 2 Section 301 tariffs can be viewed as a sign that Beijing is attempting to avoid escalating the conflict.

NAFTA Renegotiations

President Trump had been highly critical of the North American Free Trade Agreement (NAFTA - enacted in 1994) and made renegotiating the agreement one of his top legislative priorities. In late August, the Trump administration reached an agreement with Mexico regarding a revision; however, things did not progress quite as smoothly with Canada. The main hold-up relevant to the food service industry was the Canadian dairy industry. Canada restricts its milk supply to keep prices high for dairy farmers, and the U.S. insisted on seeing some of those barriers removed (Long 2018a). In addition, Canada wanted Section 232 tariffs removed, an issue the Trump administration insists on addressing as a separate matter. Neither side seemed willing to budge, which was concerning because a new president takes office in Mexico on December 1 who is not likely be as friendly toward a new NAFTA as the outgoing administration. Thus, a deal needed to be reached by October 1 to ensure a trilateral agreement could be implemented before the Mexican presidential inauguration.

A breakthrough in negotiations took place on September 30 with an announcement of a new agreement (Schlesinger et al. 2018). The new title is the U.S. Mexico Canada Agreement, or USMCA. While there are some changes compared to NAFTA, (mainly affecting cars, intellectual property protection, and labor rights, as well as some concessions from Canada regarding its dairy industry (Lynch 2018b), the deal leaves the original NAFTA agreement largely unchanged (Van Dam 2018; Tomlinson 2018). However, there is still some uncertainty regarding the future of this agreement because the USMCA must be ratified by legislatures from all three countries. Legislative approval is not guaranteed– even in the U.S. (Gertz 2018).

Why does USMCA Matter?

Canada and Mexico are the second and third largest U.S. trading partners respectively, accounting for over $1.1 trillion in combined exchange of goods and services, (U.S. Census Bureau 2017). After being in place for 24 years, the impacts of the original NAFTA across all industries are deep and complex. The agreement directly affects the price of an immense variety of raw materials, intermediate goods, and finished products. Relevant to the food service industry, the U.S. imports nearly 50% of all fresh fruit and 35% of vegetables sold in the country. Of those imports, 46% come from Mexico (Karp 2018). Canada also supplies a significant portion of agricultural products to the U.S., notably red meats and vegetable oils (USTR 2018b). Additionally, as NAFTA influences manufacturing locations and entire supply chains (Angell 2018; Parilla 2017), prices decrease for an immense variety of items (Aronhalt 2018; Schwartz 2018). Had a deal not been reached, President Trump had threatened to terminate NAFTA entirely, (Long 2018b), putting the availability of countless agricultural products and consumer goods at their current low prices in jeopardy.

Impacts Going Forward

Assuming that the USMCA is eventually ratified, the resolution of this issue frees diplomats and lawmakers to focus on addressing Section 232 tariffs with Mexico and Canada, and resolving the Section 301 disputes with China. Similarly, it allows attention to be paid to other disagreements with trade partners such as the E.U. and Japan, and hopefully address them before they turn in to new fronts of this ongoing trade war (Kicklighter 2018).

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