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Trade policies that can shape the consumer products industry

The United States: A global leader in imports and exports

Through a complex network of trade agreements with a wide range of countries across the globe, the United States is a global leader in imports and exports. To help ensure a free, fair, and orderly execution of trade deals, the United States has enacted many trade agreements, including the more recent United States Mexico Canada Agreement (USMCA) and the proposed bilateral trade agreement with China. The USMCA is proposed to replace the North American Free Trade Agreement (NAFTA) but must be approved by the legislatures in these countries.

At present, there is much discussion on potential modifications to US trade policies. Consumer products (CP) companies that rely on trade to produce and market their products may be impacted by these potential changes. To strategize for the uncertainties ahead, it is important for CP companies to understand the pros and cons of their particular circumstances with regards to the significant agreements the United States has entered. Outlined in the discussion that follows are high-level details on NAFTA, USMCA, and the US-China Trade Agreement.

To better prepare for potential changing trade policies, CP companies would likely benefit from developing a number of interdependent strategies such as:

- **Staying nimble through scenario planning** by developing processes to be able to quickly respond to changes in trade agreements. This can be accomplished by deploying special teams to continuously monitor shifts in tariffs, identifying alternative sources for raw materials and alternative markets for US exports, as well as working toward developing more competitive labor costs.
- **Investing in automation** to better manage US production and labor costs.
- **Investing in STEM talent** to facilitate automation and smart manufacturing.
- **Optimizing supply chain** by continuously scouting for more cost-effective and reliable alternatives to their existing supply chain.
- **Investing in innovation** to help reduce US dependence on trade and foreign-made products.

Fundamentals of trade agreements

To help ensure most favored nation trading status, the United States has a range of trade agreements in place. Trade agreements help ensure that nations have access to each other's markets with an objective of increasing trade and economic growth of the participating nations. A typical trade agreement consists of five thematic areas:

1. Eliminating tariffs and trade taxes
2. Refraining from unloading cheap products
3. Refraining from using unfair subsidies
4. Standardizing and implementing trade policies, labor standards, and environmental protections
5. Adhering to patents, copyrights, and intellectual property rights

The benefits and downsides of trade agreements

Trade plays an important role in the prosperity of the United States in terms of fueling economic growth, creating jobs, and raising the standard of living of its people. For example…

- Approximately 36 million US jobs are dependent on trade, which means that one in every five US jobs is linked to exports and imports of goods and services.[1]
- US trade is responsible for the growth in real manufacturing output, which has grown by 80 percent over the last 25 years.
- US exports of goods for 2018 were at $1.67 trillion, accounting for nearly 67 percent of overall exports, while US exports of services were at $828 billion,[2] making the United States the largest exporter of services.[3]
- America's farmers and ranchers are greatly dependent on exports. About one in three acres of farms in America is planted for exports. More than half of crops like wheat and almonds are sold outside of the United States, and about 25 percent of US farm produce by value is exported each year.[4]

On the other hand, there have been consequences to economic trade related to the loss of American jobs, unfair pricing practices that favor foreign products, and the mounting US trade deficit.

Lower-cost labor and its impact on the United States

Because countries such as Mexico and China can generally produce finished products at a lower cost primarily due to lower-cost labor, the US exports raw materials such as iron, steel, and clothing material to these countries, then imports finished products made from these materials, including cars and apparel. Some of these transactions have led to the loss of US jobs as well as to concerns that these countries often sell their products directly to US consumers, thus undercutting the cost of similar products made in the United States. This can result in the depression of the costs of US goods, which curtails the ability of companies to reinvest in their products, hire new employees, and give back to their shareholders.

However, it's important to note here that although the USMCA has been agreed upon by the US, Canada, and Mexico, it still needs the approval of US Congress to be passed as a bill.

The US trade deficit

The United States is one of the largest "consumption economies" and the demand for products catering to the consumption needs of the US population is high. This has translated into dependence on foreign imports to meet the demand. For more than three decades, US imports have consistently exceeded US exports resulting in a trade deficit.

- In 2018, the trade deficit for goods and services was $622 billion with imports at $3.122 trillion and exports at $2.5 trillion.[5]
- The primary drivers of trade deficit are consumer goods and automobiles. In 2018, the US imported approximately $648 billion in drugs, televisions, clothing, and other household items. However, the US managed to export only $206 billion of these consumer goods. The imbalance translated to $442 billion to the deficit. During this time, the US imported automobiles and parts worth $372 billion while exporting only $159 billion, adding $214 billion to the deficit.[6]
- The trade deficit for goods alone was $891 billion, with imports at $2.563 trillion and exports at $1.672 trillion.[7]

Some concerns about the growing US trade deficit center around the United States being highly dependent on importing goods from other countries while exports have not grown at the same pace. Further, the trade deficit is often financed by debt, which is a great concern to fiscal conservatives. This has contributed to trade policies that aim to shut out unfair imports and renegotiate existing US free trade agreements like NAFTA. The USMCA is an outcome of the efforts to renegotiate NAFTA. The US is also considering renegotiating tariffs on specific items that China exports to the US.

NAFTA

The North American Free Trade Agreement between the United States, Canada, and Mexico is the world's largest free trade agreement. The gross domestic product of its three members is estimated to be more than $20 trillion. In force since 1999, NAFTA is the first time two developed nations (United States and Canada) signed a trade agreement with an emerging market (Mexico).[8] There have been many positive outcomes and negative consequences from the United States' involvement in NAFTA. As such, there has long been talk of the need to renegotiate the agreement with Mexico in light of the fact the United States has one of the highest trade deficits with Mexico, second only to China.[9]

Positive outcomes of NAFTA

- **Rapid growth in trade:** From 1993 to 2017, trade between the three members quadrupled from $297 billion to $1.23 trillion.[10]
- **Lower grocery prices:** Food imports totaled $50 billion in 2018, up from $33 billion in 2008. Food imports with lower tariffs under NAFTA helped in lowering the prices of fresh vegetables, chocolate, fruit (except bananas), and beef. This helped in reducing overall US grocery prices.[11] NAFTA was successful in increasing US farm exports because it helped eliminate high tariffs in Mexico, which happens to be the top export destination for US beef, rice, soybean meal, corn sweeteners, apples, and beans. That boosted economic growth, profits, and jobs for all three countries. In the long run, it also helped lower food and grocery prices for consumers.
- **Increased economic growth:** NAFTA is estimated to have resulted in an increase in US economic growth by about 0.5 percent a year. Sectors benefitting the most were agriculture, automobiles, and services. Canada and Mexico emerged as two of the largest farm export destinations for the United States, with total farm exports of $43 billion in 2016, and supported 20 million jobs in the US.[12] From 1993 to 2016, US farm exports to Canada and Mexico grew 327 percent.[13]
- **Job creation:** US exports to Canada and Mexico under NAFTA are estimated to have created 5 million new US jobs. Most of those jobs went to 17 states, but all states saw some increases.[14]
- **Increased Foreign Direct Investment (FDI)**: Since NAFTA was enacted, US FDI in Canada and Mexico has reached approximately $500 billion by 2017 (latest statistics available).[15] This helped boost profits for many US businesses by giving them more opportunities to develop and more markets to explore. Canadian and Mexican FDI in the United States grew to $471 billion in 2017 from $219.2 billion in 2007.[16] Most of this additional investment went into US manufacturing, finance, insurance, and wholesale trade.
- **Reduced government spending:** NAFTA allowed firms in member countries to bid on all government contracts. That created a level playing field for all companies within the agreement's borders. It cut government budget deficits by allowing more competition and lower-cost bids.[17]

Negative consequences of NAFTA

- **US jobs lost to lower-cost labor:** Within the NAFTA domain, Mexico offers lower-cost labor, which resulted in many manufacturing industries withdrawing their US operations and moving them to Mexico. Between 1994 and 2010, it is estimated that more than 600,000 jobs moved.[18]
- **Lowering of US wages:** One consequence of moving many manufacturing jobs to Mexico has been the lowering and suppression of US wages. For US companies that continued to manufacture locally, it was typically necessary to cut down on their labor costs to match the lower costs associated with relatively cheaper labor in Mexico and to stay competitive.[19]

It is important to discuss the positive and negative consequences of NAFTA because the agreement is likely to be in vogue for at least a year or even longer until a renegotiated deal replaces it.

USMCA

Despite many advantages of NAFTA, the United States, Mexico, and Canada renegotiated NAFTA and signed a new deal in November 2018 called the United States-Mexico-Canada Agreement (USMCA). This new agreement needs to be ratified by the legislatures of each country before it can be implemented, which is likely to happen in 2020, until which time though NAFTA will continue to be in play.[20] The United States International Trade Commission has estimated that the USMCA will help increase the US real GDP by $68.2 billion (0.35 percent) and US employment by 176,000 jobs (0.12 percent).[21]

The changes proposed in the USMCA over NAFTA have a wide range of implications for multiple industries. The following is a brief discussion of some of the likely implications for the consumer products industry.

Opening up new markets

Under USMCA, Canada will have to open its dairy market to US farmers. Further, Canada will have to do away with the pricing scheme for its Class 7 dairy products, which includes infant formula, skim milk powder, and milk protein concentrate. This creates a new market for US farmers and allows them to sell the above-mentioned dairy products in Canada. In return, Canada will be allowed to market certain types of cheese in Mexico and the United States.[22]

Subsidies and domestic support

For agriculture, the USMCA has provisions that do not allow for any party to adopt export subsidies on any agriculture good that is likely to be sold to another country within the purview of the USMCA. The USMCA also stipulates that parties should limit or reduce domestic support so that there are minimal or no trade-distorting effects or effects on production.[23]

Tariff rate quotas

An important provision in the USMCA is that of tariff rate quotas, which allow countries to let only a specified metric ton of grains or produce enter the country. As this limit is crossed, the country is free to apply a substantially high tariff to protect its farmers and producers from bearing any loss.[24]

US-China trade agreement

In 1999, the United States and China signed the World Trade Organization (WTO) agreement focused on reducing tariffs on industrial products as well as agriculture products such as pork, cheese, poultry, wine, grapes, and beef. Since the signing of this agreement, both countries have experienced a boom in bilateral trade:

- From 1999 to 2018, exports to China increased ninefold, from $13.1 billion to $120.3 billion.[25]
- During the same time, US imports from China increased sixfold, from $81.8 billion to $539.5 billion.[26]

Just as with NAFTA, however, there have been both positive and negative consequences.

Positive outcomes of US trade with China

China is a major export and import market for the United States:

- In 2018, China was the third-largest goods export market for the United States. The top categories exported to China were aircraft, machinery, electrical machinery, optical and medical instruments, and vehicles.[27]
- As of 2018, China was the fourth-largest export market for US agricultural products, which includes soybeans, cotton, hides and skins, pork and pork products, and corn.[28]
- China was the largest US supplier of imports in 2018. The top import categories in 2018 were electrical machinery, furniture and bedding, toys and sports equipment, and footwear.[29]
- China was the third-largest supplier of agricultural imports for the United States after Canada and Mexico in 2016. Leading agricultural product categories that China exports to the United States include processed fruit and vegetables, fruit and vegetable juices, snack foods, fresh vegetables, and tea.[30]

Negative consequences of US trade agreement with China

Just like Mexico, China possesses the ability to produce consumer goods at a lower cost than most other countries due to the availability of lower-cost labor. Consequently, many US companies are unable to compete, and US manufacturing jobs have been lost to China.[31] Further, the growing trade deficit with China has cost 3.4 million US jobs between 2001 and 2015. Nearly 2.6 million (three-fourths) of such jobs lost were in the manufacturing sector during this period.[32] In addition, Chinese imports to the United States have far exceeded exports, resulting in an increase in the trade deficit—in 2018, the US trade deficit with China reached $419 billion.[33] As a result of these issues, talk of a "trade war" with China escalated in the first quarter of 2018. As of this writing, both countries continue to negotiate future trade agreements, while in the interim, either enacting initial tariffs or proposing significant changes in their trade agreements. The outcome of extensive talks between the countries' presidents has yet to produce an agreement that both countries would be happy with.

New or proposed tariffs between the United States and China

- In February 2018, the US administration imposed tariffs and quotas on imported solar panels and washing machines.[34]
- A month later (March 2018), a 25 percent tariff on steel imports and 10 percent on aluminum imports were imposed on China, whose economy depends heavily on steel exports.[35]
- In response, China imposed tariffs worth $3 billion on US fruits, nuts, pork, and wine.[36]
- The United States followed up by identifying about 1,300 Chinese exports in the area of industrial technology, robotics, aerospace, transport, and medical products that could face additional tariffs amounting to $50 billion.[37]
- China quickly followed up with tariffs on more than 100 US products including soybeans, cars, and whiskey that could amount to $50 billion annually, although the timeline for implementation of the tariffs has not been laid out.[38]
- The US has imposed tariffs on China to the extent of more than $250 billion so far.[39] Further, the United States has laid out tariffs worth $267 billion that it could impose on China. On the other hand, China has imposed tariffs on the United States to the extent of $110 billion. Since then, both countries have backed off from imposing additional tariffs and are exploring measures to de-escalate the trade-war-like situation between the two countries. Both countries are now exploring a trade deal and have agreed to establish enforcement offices that would oversee the implementation of the trade deal.[40]

How can the CP industry prepare and adapt to changing trade policies?

Many CP companies are currently operating under considerable levels of uncertainty as the national conversation focuses on the actual implications of USMCA and the likely timeline of its implementation. In the short term, NAFTA continues to be in vogue, and CP companies will need to plan their strategies around this fact. However, in the medium to long term, CP companies would likely benefit by focusing on a complex set of interdependent strategies, which can include:

1. Staying nimble through scenario planning.
CP companies would likely benefit by being hypervigilant through:

- Developing complete transparency around physical trade flows in their supply chain
- Monitoring potential changes in tariffs with the countries they trade with

To potentially lessen overall increases in production costs (related to supply chain, labor, etc.) that may result from any changes to the status quo, CP companies could prepare mitigation strategies through scenario planning such as customs value planning, tariff engineering, bonded regime utilization, or preferred sourcing options.

This can be accomplished by:

- Deploying special teams to continuously monitor changes in tariffs
- Identifying alternative sources for raw materials and alternative markets for US exports
- Working toward developing more competitive labor costs

The inputs from the special team and scenario planning could allow CP companies to focus on the highest value-add activities, such as:

- Planning proactively to reduce duties and operational burdens
- Supporting sales through certification of products or satisfying government programs
- Helping CP companies understand the cost of cross-border supply chains

For example, recently the United States was able to identify alternative markets for exports. Traditionally, the bulk of US soybean exports went to China.[41] Following the announcement of tariffs on soybeans by China in March 2018, it was assumed that a large surplus of soybeans would go to waste, negatively impacting farmers who rely on exports to China. However, a number of European countries have stepped forward to purchase soybeans from the United States, averting the potential glut of soybeans and its negative impact on farmers.

According to the American Apparel & Footwear Association, about 41 percent of clothing, 72 percent of shoes, and 84 percent of accessories sold in the United States are procured from China. With the ongoing trade impasse, US-based footwear companies are exploring procurement opportunities from Vietnam and Indonesia.[42]

Questions CP companies might consider asking themselves

1. Have we mapped our physical supply chain flow(s)?
2. If we make value chain changes (structural, footprint, etc.) as a result of US tax reform, have we considered trade impact?
3. How much do we currently pay in duties? In the United States? Regionally? Globally?
4. What would be the change in duties payable due to the proposed changes in the USMCA?
5. Are we positioned to act quickly to minimize the financial impact of trade barriers?

2. Investing in automation to optimize both manufacturing and trade processes.
As it relates to the manufacturing of consumer products, CP companies wishing to reduce manufacturing of finished products outside the United States and minimize dependence on foreign labor can invest in automation and advanced production processes for operational efficiencies.

To provide better line of sight to the impact of changes in trade policy, automation can monitor the movement of products across markets and to costs associated with current and future tariffs. For example, automation can be used to support tariff classification assignment processes, particularly in the consumer products and retail sectors where companies are managing large volumes of product SKUs on an ongoing basis. Robotics can be used to support various free trade agreement documentation processes, such as requesting and receiving documentation from suppliers.

Deloitte's recent publication, *The adoption of disruptive technologies in the consumer products industry*, describes in detail a range of use cases around technologies like blockchain,[43] artificial intelligence,[44] digital reality,[45] and cloud computing,[46] and how they can help CP companies develop a competitive edge in automating manufacturing processes.

Deloitte's publication, *Industry 4.0: Are You Ready?,* addresses in more detail how the onset of the fourth industrial revolution (Industry 4.0) is changing the way businesses function. Smart, connected technologies are helping transform how parts and products are designed, made, used, and maintained. Productivity improvements are often the most visible and are driven by maximizing asset utilization, minimizing downtime, driving labor efficiency, and better managing supply chain networks. Industry 4.0 helps ensure risk reduction through raw material availability and mitigating geographical risks. Incremental revenue growth can be ensured through growing revenue streams, deepening customer understanding and insights, and creating new products and services.[47]

3. Investing in STEM talent to facilitate automation and smart manufacturing.
As manufacturers develop and deploy automation and production processes (to better manage costs of goods and labor costs and to monitor the cross-border movement of products), it is becoming increasingly important for CP companies to invest in recruiting and training existing science, technology, engineering, and math (STEM) talent to help enable them to work with technology and machines and improve productivity. Increasingly, US youth are preferring careers in the service sector vs. in manufacturing.[48] This trend has helped impact CP companies, often forcing them to outsource a part of the manufacturing process to more cost-efficient locations such as China and Mexico. Advanced industries that deploy a large proportion of workers with STEM talent have witnessed a faster rate of growth than other industries that do so to a lesser extent.[49]

4. Optimizing supply chain.
CP companies could benefit by continuously scouting for more cost-effective and reliable alternatives to their existing supply chain. In addition to the soybean example previously cited in which several European markets stepped in to purchase products typically sold to China, tariffs on steel and aluminum have resulted in unexpected cost savings. Following the announcement of tariffs on steel and aluminum, a number of US food, beverage, and beer companies were concerned that it would lead to a rise in packaging costs. However, companies sourcing steel and aluminum within the country have found the cost to be as much as 3 percent lower. Further, a number of countries with a surplus in steel and aluminum have stepped forward to export to the United States, thus reducing the market rate.

5. Investing in innovation.
To help reduce US dependence on foreign-made products, CP companies would likely benefit from further investments in innovation, in part facilitated by the strategies outlined above. Investment in innovation potentially will have a ripple effect upon the US economy and job creation. As discussed in Deloitte's 2019 Consumer Products Industry Outlook, in today's rapidly changing market environment, technology is driving innovation and shaping newer consumer trends. CP companies will need to be proactive in identifying newer technologies and specific use cases and adopting them to gain competitive advantage.[50]

And lastly, CP companies could potentially focus on innovation by deploying their STEM talent to solely focus on research and development of new products dependent on efficient and cost-effective manufacturing processes.

Closing thoughts

If changes in trade policies occur, being proactive and agile are keys to competitive success in this dynamic situation. Taking this approach will likely benefit CP organizations and their global trade departments who are tasked with the dual roles of carrying out strategic trade and duty planning as well as overseeing the day-to-day regulatory compliance issues associated with importing and exporting goods through automation, robotics, and strong processes. The good news is that with advancements in supply chain management and data analytics, there is a proliferation of insights to optimize planning and management around trade issues, helping CP companies manage through this period of transition.

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The Deloitte Center for Industry Insights (the Center) provides premiere insights based on primary research on the most prevalent issues facing the consumer business and manufacturing industries to help companies run effectively and achieve superior business results. The Center is associated with the Deloitte US firms' Consumer & Industrial Products practice, which benefits from the insights of more than 12,000 multi-disciplined professionals with a wide array of deep, hands-on industry experience.