

Mitch on the Markets

Is Trade Killing US Industry?



By Mitch Zacks
Portfolio Manager

The campaign season brought tough and sometimes harsh rhetoric on trade – from both sides of the aisle. A candidate running for president essentially has no choice. In order to reach Rust Belt voters dealing with the real pain of lost jobs and declining industry (as a result of those jobs moving overseas), a politician is required to address how they can bring those jobs back. Failure to address these job losses – and by extension, failure to propose a plan for reviving the manufacturing industry – is the equivalent of political suicide.

When offering up a solution to bring back jobs and the U.S. economy, the favorite political target is trade: *Trade is moving jobs overseas. Trade is killing the manufacturing industry. Trade is hurting the economy.* Though trade is responsible for reshaping how resources and labor are allocated across an economy, this type of rhetoric fails to provide a comprehensive understanding of how trade actually *creates more than it destroys.*

At Zacks Investment Management, we take an economic view – not a political one. And the economic view supports freer trade.

Looking at Trade as a Creator, Not a Destroyer

Statistics are largely to blame for the misconception that trade hurts the domestic economy. Most countries measure trade in “gross trade” statistics, meaning that the full commercial value of the good is attributed to the last country of origin. The iPhone is a perfect example of how gross trade statistics misguide political discourse and the public’s perception.

Using “gross trade” measures, the iPhone does just one thing: *goes from China to the U.S.* But that only tells a fraction of the story! Before final manufacturing, the iPhone is constructed with a French accelerometer, Bluetooth and Wi-Fi from Japan and Taiwan, a Korean touch-screen display, a Japanese memory chip, and flash memory, software and design from the U.S. – amongst several other

components. The notion that an iPhone is solely made in China is a farce.

Looking at the iPhone example, despite the fact that “upstream” supply chain countries (Korea, Japan, Italy, U.S. businesses, and so on) benefit the most from the trade, the value does not show up in trade statistics. Only China gets the credit. The production value and the services-based inputs are left out, and it shows up as a ‘trade deficit’ on our books. Many jobs, wages, and production capabilities – all of which are benefits of trade – are completely absent from the data.

The Importance of Understanding Global Supply Chains

The reality today is that most trade is in what are known as “intermediate inputs.” These are the myriad of screens, chips, semiconductors and design elements that go into a product. Companies divide their operations across the world, from the design of the product and the manufacturing of components to its assembly, marketing, and eventual sale. This creates valuable international production and supply chains, benefiting many countries and businesses along the way. In fact, *over 50% of the goods that trade across borders and over 70% of the services that accompany them (like marketing) are in these “intermediate inputs,” or what you could call “components.”* Rarely do you see a high tech product or appliance produced entirely in one country. It’s not the way the world works anymore.

More and more products are “Made in the World” rather than “Made in the U.S.” or “Made in China.”

When the global supply chain functions seamlessly and components can move from country to country where they are produced most efficiently and with the best technology, everyone benefits. Consumers get cheaper, better goods; factories can specialize and improve their technology; logistics firms see increased demand; corporations can focus more on ideas and the future for new products; and so on.

Disrupting the supply chain with tariffs may ultimately make a country *less* competitive, by increasing input costs and ultimately increasing the cost to the consumer. Higher costs can weigh on demand, thereby creating a negative feedback loop that adversely affects all levels of production.

Bottom Line for Investors

A recent joint initiative by the Organization for Economic Cooperation and Development (OECD) and the World Trade Organization (WTO) is aiming to improve trade statistics. The goal is to more accurately reflect how each country adds value to a product assuming they are part of the supply chain – instead of just giving the last country of origin all of the credit. The metric is known as the Trade in Value Added (TiVA), and the hope is that it will start to provide data for everything that comes with trade – new services,

infrastructure, transportation, marketing, client service, and so on. This can help paint a clearer picture of the true economic value of trade, and perhaps provide a compelling counter-argument to all of the anti-trade rhetoric out there today.

In our view, a trade war is the last thing we want to get involved in, and tariffs are how they start. Raising tariffs on a country would almost certainly mean retaliatory tariffs, and before we know it customs borders will become bottlenecks and production costs will soar. It's not good for corporations or the consumer, which ultimately means it could be a negative for markets, too.

-Mitch

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.



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