2017 INTERNATIONAL TRADE UNCERTAINTY:

What's at Stake for U.S. Businesses

Purolator International

Introduction

A mid-February 2017 report by Business Insider detailed the proposed border adjustment tax, currently under consideration in the U.S. Congress, which would impose a 20 percent tax on all goods entering the United States. The report detailed the views of multiple industry analysts and expressed a consensus view that the likelihood of the border tax passing, in its current form, was 30 percent or lower. But at about the same time, Washington, D.C.-based securities firm Height Associates expressed its opinion via Twitter: "We believe #bordertax adjustment has a 75 percent chance of passing the House, but only a 30 percent chance of passing the Senate."

If enacted, the border tax would have significant implications for U.S. businesses, including retailers that rely heavily on imported goods. The tax is predicated on the assumption that higher import taxes will encourage businesses to shop—and manufacture—within the U.S. for components and products currently purchased overseas.

But the widely differing estimates about the tax's likelihood of success are emblematic of the uncertainty that seems to have settled over much of U.S. economic and trade policy. Things that once seemed settled appear to be unraveling.

The Trump administration has vowed to review every existing free trade agreement, including the North American Free Trade Agreement (NAFTA), to ensure maximum benefit for United States workers and businesses. The administration has also suggested it may be willing to impose significant tariffs on certain types of products, such as auto components, as well as on products arriving from countries including China and Mexico.

As the U.S. evaluates its trade priorities, many of our key trading partners are taking steps to strengthen their own positions. Our historically largest partner, Canada, has finalized a free trade agreement with the European Union. Another trade agreement under consideration and being led by China would involve 46 percent of the global population. That agreement, the Regional Comprehensive Economic Partnership (RCEP), is under consideration by the 10 countries that comprise the Association of Southeast Asian Nations (ASEAN) plus China, Japan, Korea, India, Australia, and New Zealand. Neither of these agreements involves the United States.

Research by the Business Continuity Institute, as reported by Bloomberg, asked business executives representing 79 countries to list their biggest

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>
> *Source: Business Continuity Institute*

worries. "For the first time in the study's six-year history, uncertainty related to 'new laws and regulations'—arising from political change entered the list of top 10 business concerns," the article noted.

These concerns appear to be supported by the U.S. National Association of Manufacturers (NAM), which reported that at the end of 2016, manufacturers faced almost 300,000 regulatory restrictions, with 87 percent of manufacturers saying they would invest in hiring, increased salaries and wages, and research and development if the regulatory burden was eased.

So how are businesses responding to this new era of uncertainty? For now anyway, most seem to be taking a wait-and-see approach. National Retail Federation official David French told the Washington Post that his association's members—the nation's retailers—have many other concerns. Specifically, he mentioned the apparel world, where "trends now move at a lightening pace, meaning companies are scrambling to find ways to produce clothing more quickly and closer to the date it will actually land in stores."

U.S. manufacturers face almost 300,000 restrictions on their operations from federal regulations.

Source: National Association of Manufacturers

At the same time, a survey of small businesses by the National Federation of Independent Business found owners more optimistic than they have been since the 1980s. The report "credited the optimism to [then] President-elect Donald Trump's victory, and expectations of policy reform, including tax cuts and the dismantling of the Affordable Care Act."

It seems the one certainty then is change. Livingston International customs brokers see opportunity for smart businesses that are paying attention and prepared to operate in the new environment. To do that, a business will need to proactively examine its capabilities, identify points of vulnerability, and be ready to make a change. This includes having a top-tier customs management program in place, technology-based systems that can easily adapt to new mandates, and complete visibility into the supply chain.

The following discussion will offer insight into some of the current proposals on the table that would affect the status quo for U.S. importers and exporters. The discussion will also offer a "system-wide checkup" for businesses to consider when making adjustments to prepare for the inevitable changes to come.

For U.S. Businesses, What's on the Table?

The election of Republican Party candidate Donald Trump, along with Republicans' success at maintaining majorities in both the U.S. House and Senate, essentially guarantees a shift away from the policies and priorities of the Obama administration. President Trump has pledged to pursue numerous changes, including the repeal of the Affordable Health Care Act, a reduction in corporate taxes and business regulations, renegotiation of all free trade deals, and the possible imposition of new tariffs on imports from certain products and countries.

At this point, during the early months of the new administration, specifics have yet to be released about many of these initiatives or a sense of timing. Also unknown is the extent to which the Congress will support the president's initiatives. It's no wonder then that the eyes of the world are on Washington, D.C. these days. Following is a brief overview of some of the issues under consideration with direct implications for the U.S. trade community:

Regulatory Relief

One of President Trump's first official acts was to sign an executive order requiring two regulations be eliminated for every new one implemented. The order was seen as the president's opening salvo in fulfilling his promise to dramatically lower the regulatory burden on the nation's businesses.

For many, this relief can't come fast enough. The National Association of Manufacturers estimates excessive and unwarranted federal regulations cost U.S. businesses more than $2 trillion annually and place a disproportionate burden on small businesses and manufacturers.

According to the New York Times, the administration is likely to seek regulatory relief across multiple industries, including banking, health care, and energy. Significant rollback of Environmental Protection Agency regulations implemented during the Obama administration is expected as well as substantial changes to the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act.

The Times notes the president is likely to find support from the Congress, with both Speaker of the House Paul Ryan (R-WI) and Senate Majority Leader Mitch McConnell (R-KY) expressing strong support for regulatory relief.

Corporate Tax Reform

The United States has the third highest general top marginal corporate income tax rate in the world at 39 percent, topped only by Chad and the United Arab Emirates. Further, the Tax Foundation notes, the U.S. has maintained this high level of taxation at a time when, over the past 12 years, every region in the world has seen a decline in its average corporate tax rate. "As the rest of the world's economies mature and their tax rates on corporate income continue to decline," the analysis

Many EPA regulations implemented during the Obama administration are expected to be rolled back.

notes, "the United States risks losing its competitive edge due to its exceptionally high corporate income tax rate."

Table 1.
Twenty Highest Top Marginal Corporate Tax Rates in the World

Country	Top Rate	Region
United Arab Emirates	55.0%	Asia
Chad	40.0%	Africa
Puerto Rico	39.0%	North America
United States	39.0%	North America
Argentina	35.0%	South America
Congo, The Democratic Republic Of The	35.0%	Africa
Equatorial Guinea	35.0%	Africa
Malta	35.0%	Europe
Sudan	35.0%	Africa
Virgin Islands, U.S.	35.0%	North America
Zambia	35.0%	Africa
India	34.6%	Asia
Sint Maarten	34.5%	North America
Suriname	34.5%	South America
France	34.4%	Europe
Brazil	34.0%	South America
Venezuela	34.0%	South America
Belgium	34.0%	Europe
Saint Lucia	33.3%	North America
Cameroon	33.0%	Africa
Worldwide Average	22.9%	N/A
Worldwide Weighted Average (by GDP)	29.8%	N/A

Source: The Tax Foundation

Both President Trump and Congressional leaders have listed corporate tax reform as a top priority. President Trump has pledged to lower the tax rate to 15 percent, while Speaker of the House Ryan has outlined a plan to bring the rate down to 20 percent.

Although both sides agree on the need for reform, extensive debate and negotiation will be needed to arrive at a deal all sides can support. In a show of optimism, Treasury Secretary Steven Mnuchin said in late February that he expects passage of comprehensive tax reform—both individual and corporate—as early as August.

Border Adjustment Tax

Integral to the debate over reducing the corporate tax rate, of course, will be discussion about how to pay for it. While President Trump has yet to offer a detailed plan, House Speaker Ryan is promoting a "border adjustment tax (BAT)" that would impose a 20 percent import tax on all goods entering the United States. As currently proposed, the tax seeks to incentivize manufacturers to produce parts and products within the United States by making it prohibitively costly to import goods from abroad. At the same time, the tax would not apply to exports, providing a boon for U.S. exporters to sell to overseas markets.

Following is an overview from Fortune magazine about how the BAT would work:

"Take the example of a European carmaker that today manufactures in its home country, or any other country, and ships its vehicles to the U.S. Let's say their luxury sedan costs $30,000 to make in Frankfurt, and sells in the U.S. for $50,000. Today they'd pay our 35% corporate tax on the profit of $20,000, sending the Treasury $7,000.

Under the House plan, the U.S. tax would drop from 35 percent to 20 percent but the foreign automaker would still be far worse off. That's because all importers would pay the

20 percent rate not on their profits, but on every dollar in revenue they collect—in this case, the full price of the car, $50,000. Hence the tax bill rises to $10,000 ($20,000 in profit less tax of $10,000). If it manufactured those cars in the U.S., it would pay just $4,000 in taxes (20 percent of its $20,000 in profits), and its margin would jump to $16,000 per vehicle, an increase of 60 percent."

If implemented, the tax could generate more than $1 trillion in revenue for the government, which could be used to offset the cost of reduced tax rates.

The concept is highly controversial. Not surprisingly, import-reliant industries, including retailers and consumer goods companies, are strongly opposed. "We oppose any border adjustment tax because it will increase the cost of clothing, food, medicine, gas, and other essential items that Americans rely on," a coalition of retailers and trade associations—Americans for Affordable Products— said in a statement.

Manufacturers, on the other hand, have formed a coalition of their own—the American Made Coalition—to support the border tax.

NAFTA

The North American Free Trade Agreement took effect in 1994 and essentially eliminated tariffs on domestically produced goods moving between the three signatory nations—the United States, Canada, and Mexico. NAFTA also provided for the elimination of virtually all barriers to cross-border investment and facilitated the movement of goods and services among the three nations.

During the 2016 presidential campaign, then-candidate Donald Trump called NAFTA "the single worst trade deal ever approved in this country" and a "U.S. job killer," with most of his vitriol directed at Mexico. He vowed to renegotiate the deal and gain terms more favorable to the U.S. or, if Canada and Mexico were unwilling to reopen the agreement, to withdraw entirely.

Since taking office, President Trump has yet to offer details about how he will seek to modify the trade agreement. In a late-January meeting with Canadian Prime Minister Justin Trudeau, President Trump called the U.S.-Canada trade relationship "outstanding" and seemingly in need of only minor changes: "We'll be tweaking it," he said. "It's a much less severe situation than what's taking place on the southern border."

Analysis by Bloomberg speculated that the agreement's "rules of origin," which set domestic content requirements for benefit eligibility, may be subject to a "tightening" as a way to "limit content from cheaper producers, especially from Asia." If so, Bloomberg believes manufacturers will be particularly vulnerable since the cost of imported components would increase if a large number of products were to lose NAFTA eligibility.

Bloomberg's analysis also highlighted "American companies importing vehicles and their parts, electronics, and fruit from south of the border" as highly susceptible to any changes since these industries take the greatest advantage of NAFTA benefits. "The U.S. has abnormally high tariffs on trucks from non-NAFTA countries," Caroline Freund, a senior fellow at the Peterson Institute for International Economics told Bloomberg. "If the agreement fades away, more than $20 billion of the vehicles imported from Mexico could be subject to a 25 percent tariff."

Free Trade Agreements (FTAs)

President Trump has pledged to review each of the 14 free trade agreements (FTAs) the United States currently maintains with 20 countries. Those countries include: Australia; Bahrain; Chile; Columbia; DR-CAFTA (which includes Central American countries Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic); Israel, Jordan, Korea, Morocco; NAFTA (Canada and Mexico); Oman; Panama; Peru; and Singapore.

According to White House Press Secretary Sean Spicer, each FTA will be evaluated "to make sure they continue to benefit America and American workers." Spicer also said the agreements, some of which were negotiated two decades ago, would be evaluated to ensure they are "the most up-to-date and they address the technological advances that have occurred, and look at the various services –whether it's financial services or manufacturing—and that they reflect the current state of play."

Although President Trump expressed a desire to begin a comprehensive FTA evaluation immediately after taking office, the Wall Street Journal reports those efforts have been stymied by confirmation delays for both Commerce Secretary Wilbur Ross and U.S. Trade Representative-nominee Robert Lighthizer. Further, the paper notes, the president is legally required to provide Congress with a 90-day notice before entering into any formal negotiations.

U.S. Trade Partners Pursue FTAs of Their Own

The whole world, of course, is watching as these issues—among many others—are debated within the United States. With regard to international trade, U.S. partners are especially interested in protecting their access to U.S. markets and avoiding any uncertainty in their trade relationships. Important to note is that while the U.S. has been immersed in its own presidential election and transfer of power, many of our leading trade partners have been pursuing agendas of their own, which could have implications for U.S. importers and exporters.

Canada

Canada lost its status as the largest trading partner of the U.S. in 2015 when China assumed that role. But despite losing its top ranking, Canada remains a vitally important trading partner, with $1.5 billion worth of goods crossing the border each day. According to CNN, the U.S. accounts for roughly 60 percent of Canada's overall trade, while Canada accounts for 15 percent of overall U.S. trade.

Over the past few decades, Canadian officials have recognized the importance of developing trade relationships beyond the U.S. and actively sought favorable trade agreements with dozens of countries.

Most recently, in late 2016, Canada finalized a trade agreement with the European Union—the Comprehensive Economic and Trade Agreement (CETA)—which, as reported by the Wall Street Journal, eliminates duties on goods moving between Canada and the EU nations and also promises to open up competition in the services sector, including banking and insurance.

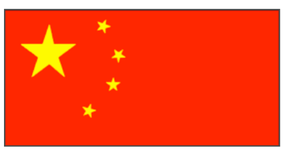
"This is an important deal for Canada," KPMG wrote in a recent analysis, "particularly due to increased concerns over the country's reliance on the U.S. economy. The CETA will provide Canadian companies with easier access to 28 countries and 500 million consumers in the EU, making Canada the only G-8 country to have preferential access to the world's two largest and most affluent markets, the EU and the United States."

The Canadian government has also apparently set its sights on re-creating a "Trans-Pacific Partnership-like" agreement in the aftermath of that proposed agreement's demise. According to Toronto's the Globe and Mail, Prime Minister Justin Trudeau has already spoken with Japanese Prime Minister Shinzo Abe about a bilateral Canada-Japan trade deal. Canada's International Trade Minister François-Philippe Champagne stated that any deal with Japan would "just be one piece of the larger trading puzzle of how Canada engages with Asia."

At the same time, Canadian officials remain strongly committed to the North American Free Trade Agreement (NAFTA) and optimistic that any changes to the agreement will not significantly impact its U.S. trade relationship. Prime Minister Trudeau and Canadian officials were reportedly reassured after meeting in early February with President Trump in Washington, D.C. that any changes to trade between the two nations would be minimal. "Trump pledged publicly to only 'tweak' Canada's side of the North American Free Trade Agreement and ease the flow of goods along the northern border, while saying he'd focus instead on the 'unfair' U.S. commercial relationship with Mexico to the south."

Since then, according to the Globe and Mail, Canadian officials have said that any future talks on NAFTA should involve all three member nations, including Mexico. This would seem to be a change away from the bilateral talks that Messrs. Trump and Trudeau reportedly discussed in Washington, D.C..

China



China is a leading supporter of the proposed Regional Comprehensive Economic Partnership (RCEP) free trade agreement, currently under consideration between the 10 member states of the Association of Southeast Asian Nations (ASEAN)—Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam—and the six countries with which ASEAN maintains free trade agreements—Australia, China, India, Japan, South Korea, and New Zealand.

China had not been included as a member of the now-defunct Trans-Pacific Partnership, and many have speculated that RCEP came about as a "protest" against an American-led push into Asian trade. According to Bloomberg Markets, RCEP "would lower tariffs and other barriers to the trade of goods among the 16 countries that are in it or have existing trade deals with ASEAN. Unlike the TPP and other U.S.-led trade deals, however, the RCEP wouldn't require its members to 'take steps to liberalize their economies, protect labor rights and environmental standards, and protect intellectual property.'"

Talks have been underway since 2012, with many expecting final authorization in late 2016. That did not happen, and work continues. If implemented, the agreement, which would not include the United States, would affect approximately 3.4 billion people and roughly 30 percent of the world's GDP.

With regard to the U.S.-China trade relationship, tensions continue to simmer following a highly charged presidential campaign, during which then-candidate Trump accused China of being a currency manipulator and of engaging in unfair trade practices that resulted in the loss of American manufacturing jobs. Since then, President Trump has threatened to impose a 45 percent tariff on imports from China, seemingly raising the stakes of an all-out trade war. And, in his late-February address to a joint session of

Congress, President Trump stated that 60,000 U.S. factories had been lost since China joined the World Trade Organization, a claim China quickly refuted.

According to CNBC, the Chinese government has not responded directly to Trump's trade threats, "although Beijing is quietly considering possible retaliatory measures against the U.S. if a trade war breaks out, including targeting well-known U.S. companies with tax or antitrust probes."

For now, the two sides seem to be in somewhat of a cooling-off period, with President Trump speaking highly of a mid-February phone call with China President Xi Jinping. Further, President Trump also met in Washington, D.C. with China's top diplomat Yang Jiechi, who also met with Secretary of State Rex Tillerson where the two affirmed their commitment to a "constructive bilateral agreement."

Mexico

With more than $525 billion worth of goods crossing the U.S./ Mexico border during 2016, Mexico is the United States' third-largest trading partner. Mexico is largely dependent on the United States, with roughly 80 percent of its exports sold to U.S. interests.

That relationship has come under scrutiny by President Trump, who has suggested that NAFTA disproportionately benefits Mexico at the expense of U.S. businesses and workers. President Trump has pledged to open up the agreement and renegotiate terms to achieve a more favorable outcome for the United States. The president has also suggested a 20 percent tax on Mexican imports as a way to force Mexico to pay for a new border wall between the two countries.

Not surprisingly, Mexico rejects these claims, with Mexico's economy minister Ildefonso Guajardo telling Wall Street Journal columnist Mary Anastasia O'Grady: "I cannot accept the claim that only Mexico has been winning" with NAFTA. Rather, "the facts prove that Mexico has been part of the solution for U.S. competitiveness."

Nevertheless, Minister Guajardo did accept the possibility of new NAFTA discussions: "An agreement that is more than 20 years old has room for improvement and modernizing," he told the Wall Street Journal's O'Grady.

According to Latin Finance, Mexico is open to potential changes in NAFTA with regard to digital commerce, energy, environmental, and labor issues. But the government has expressed vigorous opposition to the idea of a 20 percent tax, calling it "counterproductive" and a violation of World Trade Organization (WTO) rules.

U.S. Businesses Plan for Change, and Wait…

With so much change afoot, it's hardly surprising that a Bloomberg survey of international business executives found that next to the threat of a cyberattack, managers are most worried about "uncertainty related to 'new laws and regulations,' arising from political change."

The situation is exacerbated for businesses that rely on international trade, with established trade principles and agreements now suddenly subject to change.

How are businesses responding?

Some, including U.S. companies Black & Decker, Ford, Carrier, Apple, General Motors, and Walmart, have announced they will be scrapping plans for international investment in favor of expanding within the United States. These manufacturers are joined by non-U.S. companies including Hyundai, Kia, and Foxconn, which have announced plans to invest in U.S. facilities.

In announcing his company's plans to invest in a U.S. manufacturing facility, toolmaker Stanley Black & Decker CEO James Loree said the move was consistent with the company's philosophy to '"make where we sell wherever possible."

And in an apparent reference to statements from President Trump in support of import taxes on products made overseas by U.S. companies, Loree added, "It's going to be advisable to have more manufacturing in the U.S."

But for most businesses, it has been a period of "wait and see" uncertainty, as businesses try to keep abreast of rapidly changing developments. White & Case international law firm compiled a checklist for businesses to use in preparing for possible changes to U.S. trade practices. Suggestions on that checklist include:

Learn the most potentially disruptive U.S. trade policy changes

The first step in any preparation is to be aware of what specifically is under consideration. As the previous discussion has made clear, potential changes to existing trade policy include:

- Renegotiation of NAFTA
- Possible renegotiation of other existing free trade agreements
- Border adjustment tax
- Possible import tariffs on goods from Mexico and China

Understand the most potentially likely trade policy changes

As White & Case points out, the Trump administration "may be more likely to take less controversial actions," which may include attempts to:

- Aggressively encourage the U.S. Department of Commerce and the U.S. International Trade Commission to seek trade remedies and enforcement actions under current U.S. anti-dumping and countervailing duty laws

- Attempt to renegotiate NAFTA either through non-controversial issues (i.e., eCommerce or consultations) or through more contentious issues (i.e. country-of-origin determination, lumber trade, bilateral trade balances)
- Formally designate China as a "currency manipulator."
- Bring World Trade Organization (WTO) disputes more actively and frequently (for example, against China)
- Expand efforts to enforce provisions of existing bilateral and regional FTAs
- Reduce the U.S. role in negotiating new multilateral trade agreements in the WTO and limit U.S. involvement at the WTO to dispute settlement (which would be a significant change to long-standing U.S. trade policy)

Identify your risks and opportunities in likely U.S. trade policies

Based on the information contained in this analysis, a business should have a good understanding of its vulnerability to any changes in existing trade practices. For example, if your business is heavily dependent on trade with Mexico, or China, then you should carefully consider how your business might be impacted should imports from these countries suddenly be subject to new tariffs.

And since President Trump's stated objective in each of his trade proposals is to strengthen U.S. businesses, it's important to anticipate favorable outcomes and new opportunities.

Develop a plan based on careful analysis

Based on your assessment of potential vulnerabilities—and opportunities— White & Case recommends seeking professional guidance to "analyze your specific situation and brainstorm strategies." Such plans could include:

- Alternative supply chain options, if current procedures are determined to be at risk.
- Educate yourself about proposed trade policy changes by communicating with industry peers and government officials.
- Talk to your federal elected officials about your situation and seek out support and assistance.

Conclusion

U.S. businesses, especially within the manufacturing sector, were likely encouraged when Dow Chemical CEO Andrew Liveris emerged from a meeting with President Trump and senior administration officials and declared: "Some of us have said this is the most pro-business administration since the Founding Fathers. There is no question that the language of business is occurring here at the White House." Liveris was part of a group of 24 CEOs representing the nation's largest manufacturers, including Dow Chemical, General Electric, Lockheed Martin, and Ford.

While there is certainly a degree of optimism within the U.S. business community, as evidenced by a 12-year high in the National Federation of Independent Business (NFIB) small business optimism index, there is also an undeniable sense of uncertainty, as businesses wait for resolution from Washington, D.C. on many critical issues.

Until that resolution comes, businesses will continue to make decisions based on best-available information. And with information changing rapidly—almost daily—a business must have in place trusted internal and external advisors to provide timely and accurate updates, along with reliable assessments about how any changes will affect operations. Keep in mind, many changes afoot may be positive and result in new opportunities. Savvy businesses will anticipate these changes and have their supply chains ready to pursue all new trade opportunities.

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