



Global Business

WHAT THE FUTURE HOLDS FOR WORLD TRADE

Dr. Mike W. Peng, O.P. Jindal Distinguished Chair of Management

DEALING WITH



Mike W. Peng

Jindal Chair of Global Strategy, Jindal School of Management
The University of Texas at Dallas

UT System Chancellor's Council Executive Committee, February 1, 2019

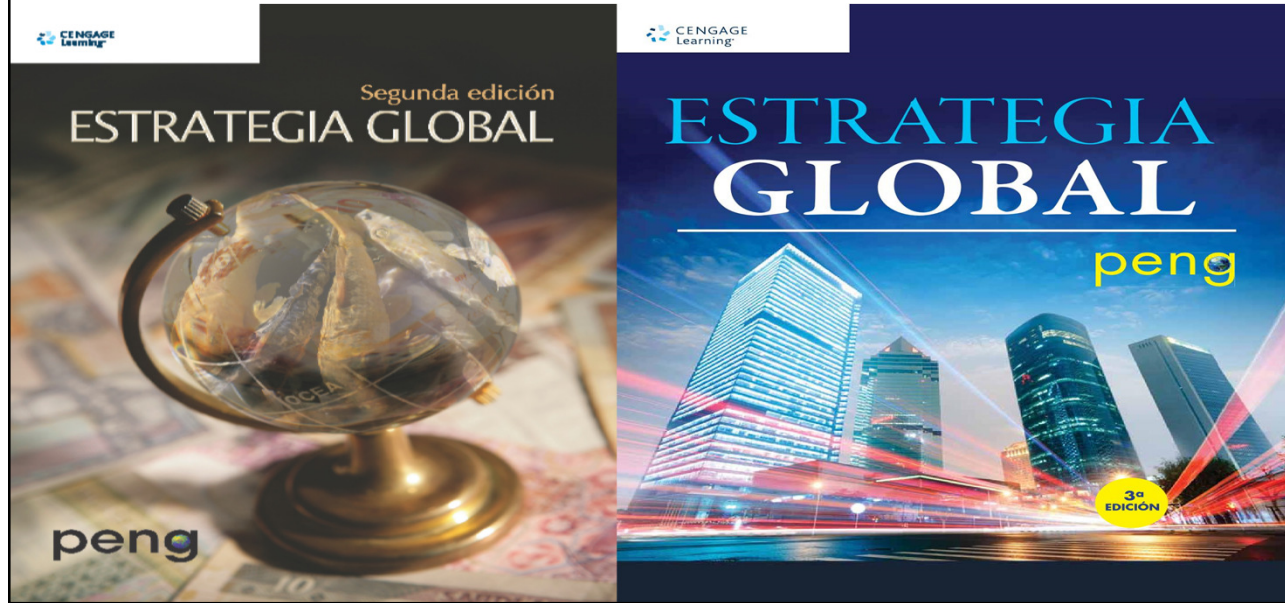
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**Mr. Global Strategy welcomes you!
(3E ©2014 & 4E ©2017)**



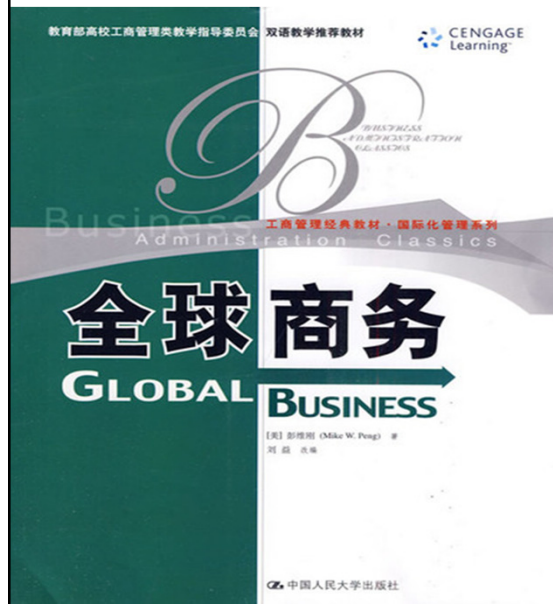
Spanish: GS 2nd and 3rd editions



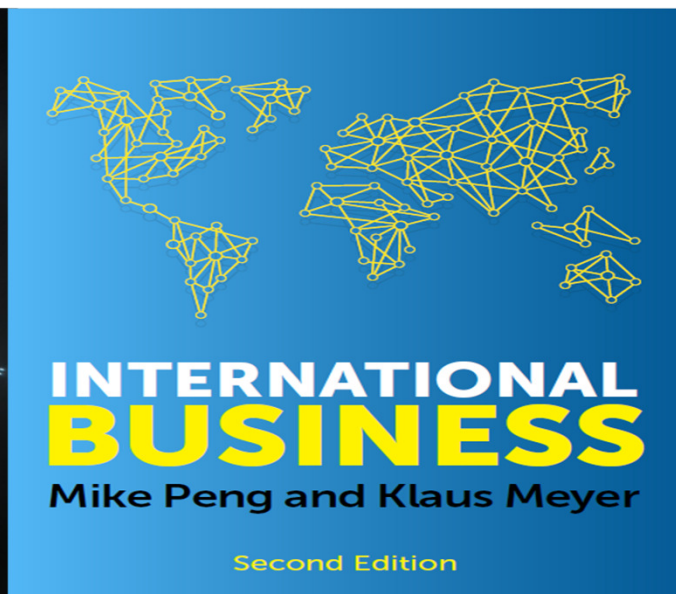
GS1E Portuguese (©2010) and GB3E (©2014)



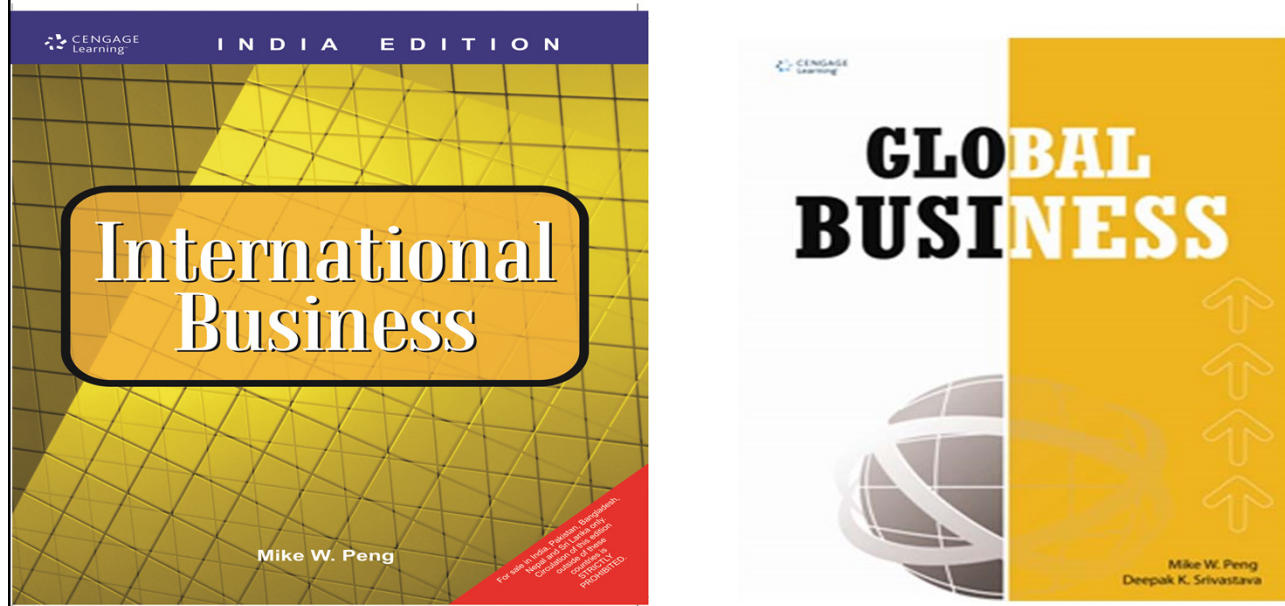
Chinese: GB2E (@2012) and GB3E (@2016)



European (EMEA) adaptation (Peng & Meyer) IB 1E (@2012) and IB 2E (@2016)



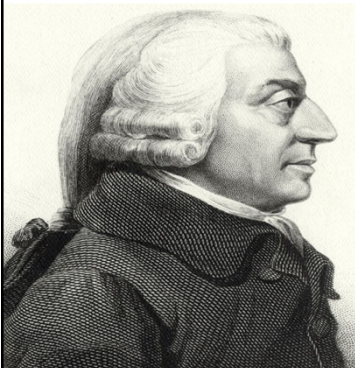
Global Business in India (Peng & Srivastava)



DEBATES ON INTERNATIONAL TRADE

Mercantilism:

- Jean-Baptiste Colbert
(1661-83, served as King Louis XIV's finance minister)



Free trade:

- Adam Smith
(professor at the University of Glasgow; published *The Wealth of Nations*, 1776; theory of absolute advantage)
- David Ricardo
(member of Parliament; published *On the Principles of Political Economy and Taxation*, 1817; theory of comparative advantage)

THE UNITED STATES EXPORT PERFORMANCE IS NOT BAD

Top 5 global merchandise (goods) exporters:

- 2008: GER, CHN, USA, JPN, NED
- 2011: CHN, USA, GER, JPN, NED
- 2013: CHN, USA, GER, JPN, NED
- 2015: CHN, USA, GER, JPN, NED
- 2017: CHN, USA, GER, JPN, NED

* Every year the United States is the global *champion* in service exports

* A silver medal in goods and a gold medal in services

* **CASE:** Why are U.S. exports so competitive?

QUIZ

What is the largest *merchandise* exporting state among the top 10?

[Trade has two categories: (1) merchandise/goods and (2) service. This question focuses only on No. 1.]

A: California

F: New York

B: Florida

G: Ohio

C: Illinois

H: Pennsylvania

D: Louisiana

I: Texas

E: Michigan

J: Washington

QUIZ ANSWER

(2017 TOTAL U.S. EXPORTS: \$1.547 TRILLION)

What is the largest *merchandise* exporting state among the top 10?

A: California #2 (\$172B / 12%)

F: New York #4

B: Florida #8

G: Ohio #9

C: Illinois #5

H: Pennsylvania #10

D: Louisiana #7

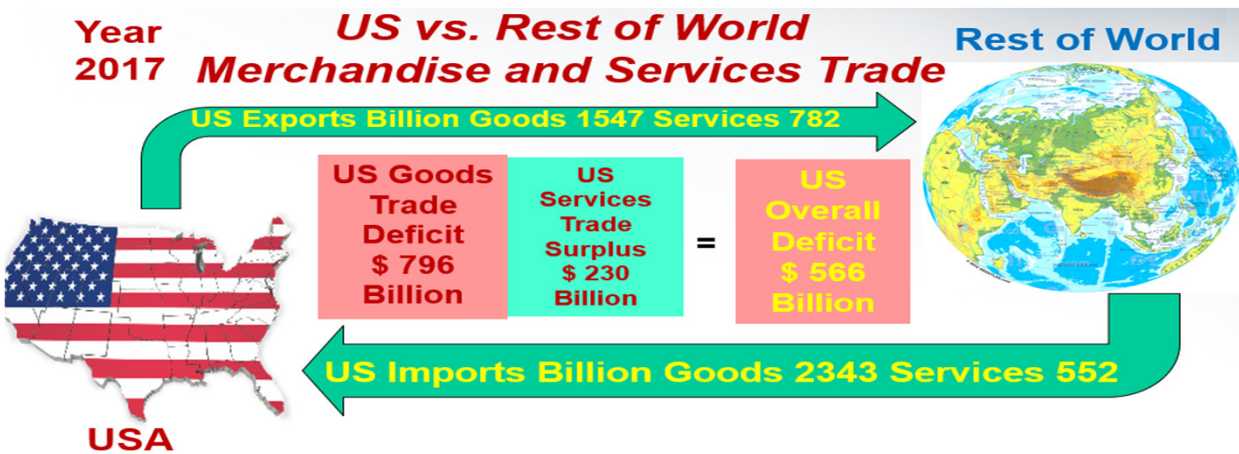
I: Texas #1 (\$264B / 18%)

E: Michigan #6

J: Washington #3

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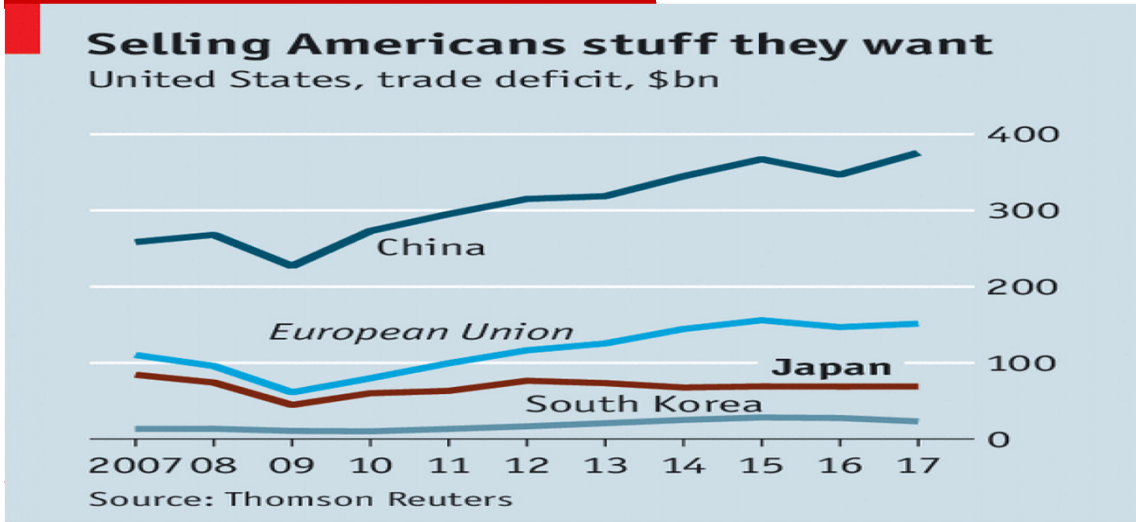
UNBALANCED TRADE



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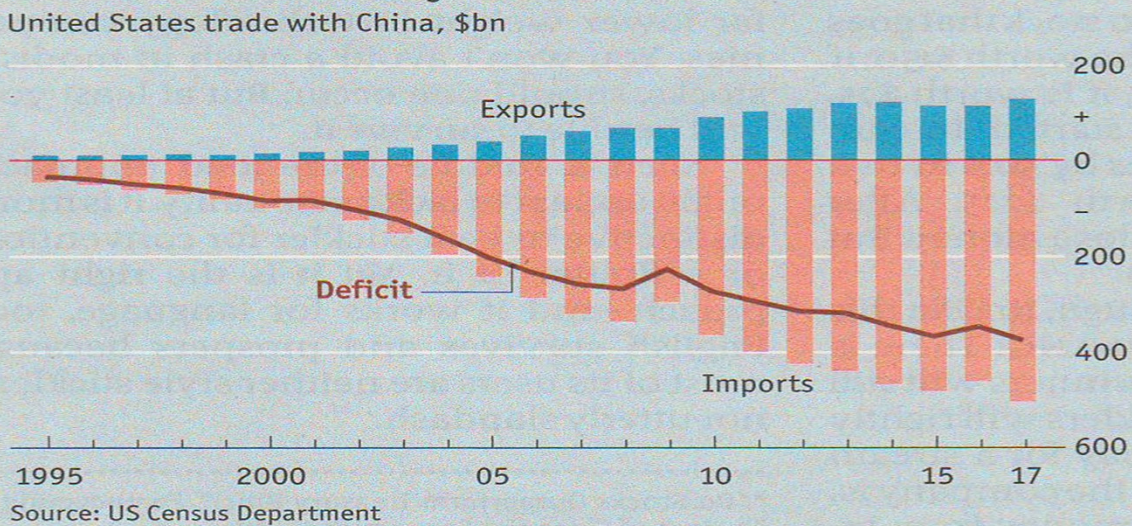
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THE U.S. RUNS TRADE DEFICIT WITH ALL MAJOR TRADING PARTNERS (Economist 9/8/18, p.33)



The Economist

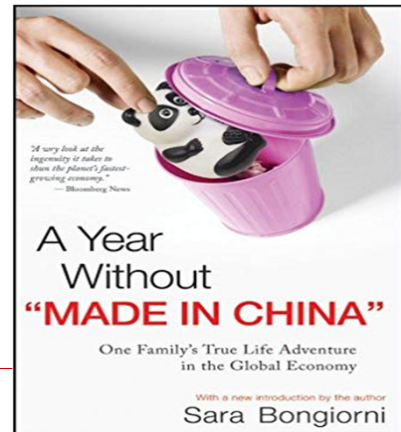
THE MOST TROUBLED OR MOST THRIVING RELATIONSHIP



AN AMERICAN FAMILY SPENDS A YEAR WITHOUT "MADE IN CHINA" GOODS

- ❑ Life is possible, but extraordinarily challenging.
- ❑ No more cheap toys, shoes and Halloween costumes. Young kids and grandma were not happy. ☹
- ❑ Had to boil water after coffee maker broke.
- ❑ Discovered "Made in USA" lamps all had made in China parts.
- ❑ The family was thankful their ancient TV did not break down.
- ❑ Would the family like to do the experiment again? "Not a chance!"

SOURCE: S. Bongiorno (2007), *A Year without "Made in China"* (Wiley).

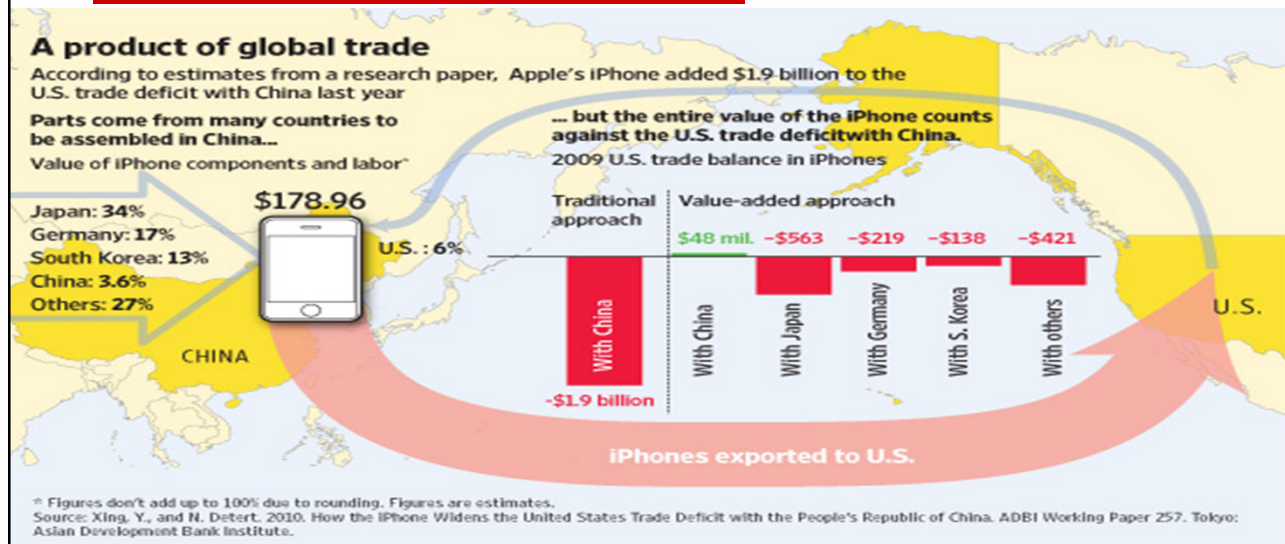


BUT THE TRADE DEFICIT WITH CHINA IS OVER-STATED

- ❑ Most of the "Chinese exports" are produced by non-Chinese multinationals operating in China via FDI (including many U.S. firms).
- ❑ China only contributes **two-thirds** of domestic content (value-added) of its exports.
- ❑ The United States contributes **90%** domestic content of its exports.

SOURCE: H. Kee & H. Tang (2016), Domestic value added in exports: Theory and firm evidence from China, *American Economic Review*, 106(6) 1402-1436.

CASE: Apple iPhone



DEBATE

Should the German trade surplus be of concern?

- 8% GDP \$300B (vs China's \$200B)
- Even a pro-free-trade magazine says YES

(Economist 7/8/17)

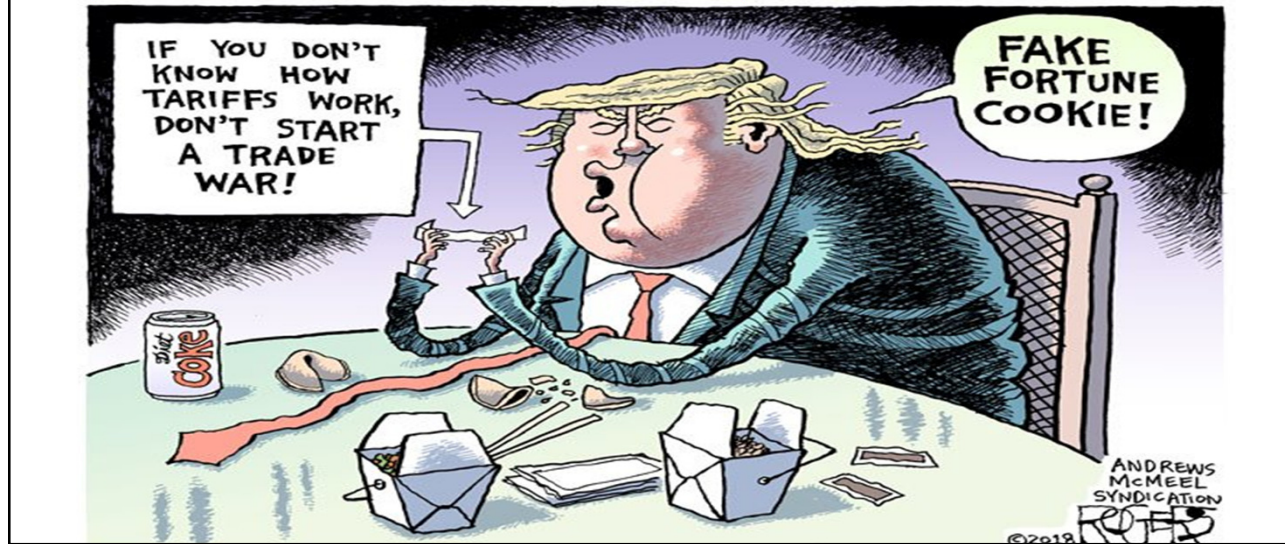
The Economist
 JULY 8TH - 14TH 2017

Hard truths about North Korea
 The sad decline of the summer job
 What comes after Mosul falls?
 A special report on the young old

The German problem
 Why its surplus is damaging the world economy

Current-account balance % of GDP

UNDER THE INFLUENCE OF THE THEORY OF MERCANTILISM



TRADE WARS
EPISODE I
THE TRUMP MENACE

Never-EruffArmmo

- Feb 18: Solar panels and washing machines
- Mar 18: Steel and aluminum
- Jul 18: \$200B
- Aug 18: \$16B
- Sep 18: \$200B
- ... last 3 rounds on Chinese imports
- Dec 18-Jan 19: talks

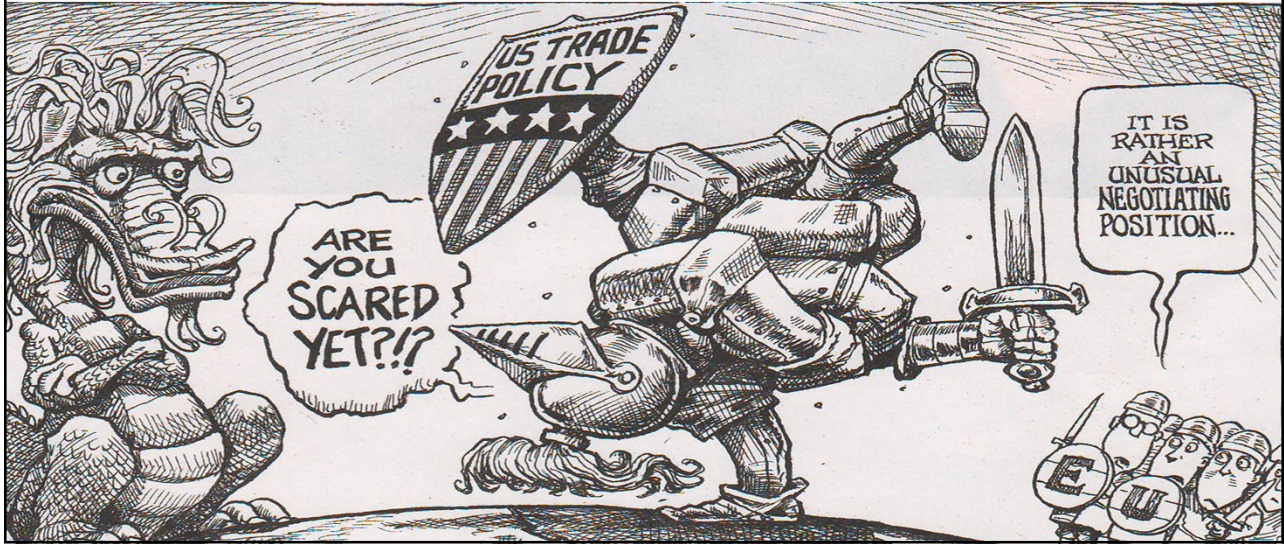
© Economist (03/10/2018)

The Economist

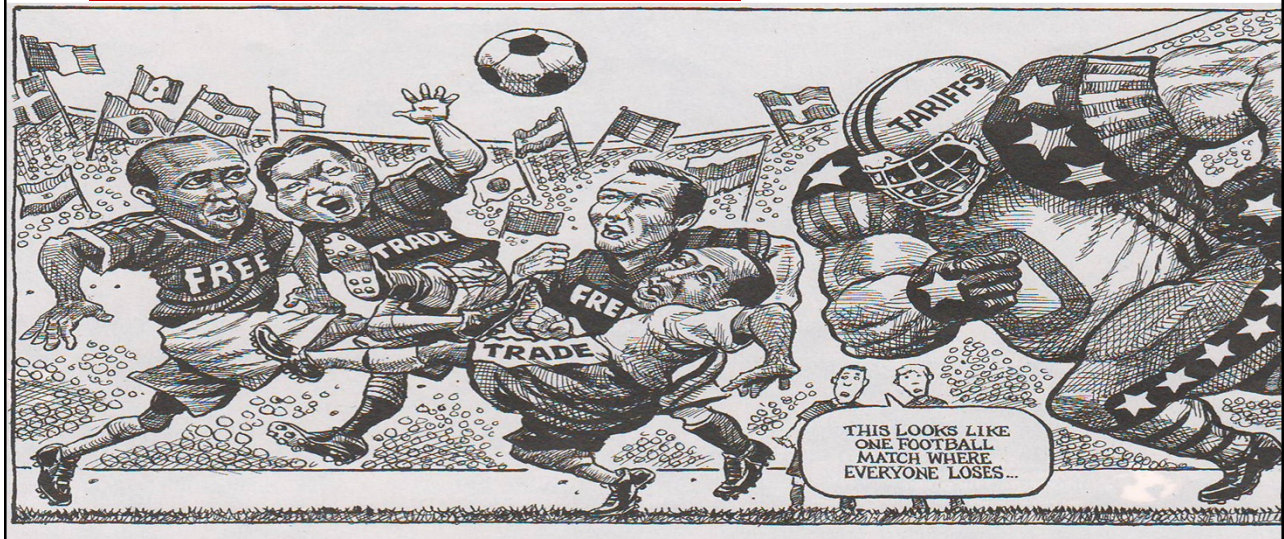
Italy votes for irresponsibility
Russian spies and the assassin's creed
Warren Buffett loses his touch
TECHNOLOGY QUARTERLY: The ocean

The threat to world trade

THE REST OF THE WORLD: CONFUSED INITIALLY



REALIZING THE CLEAR AND PRESENT DANGER



RESPONSES ARE SWIFT AND PREDICTABLE



RESPONSES



CANADA TARIFF RETALIATION AGAINST U.S.



China strikes back

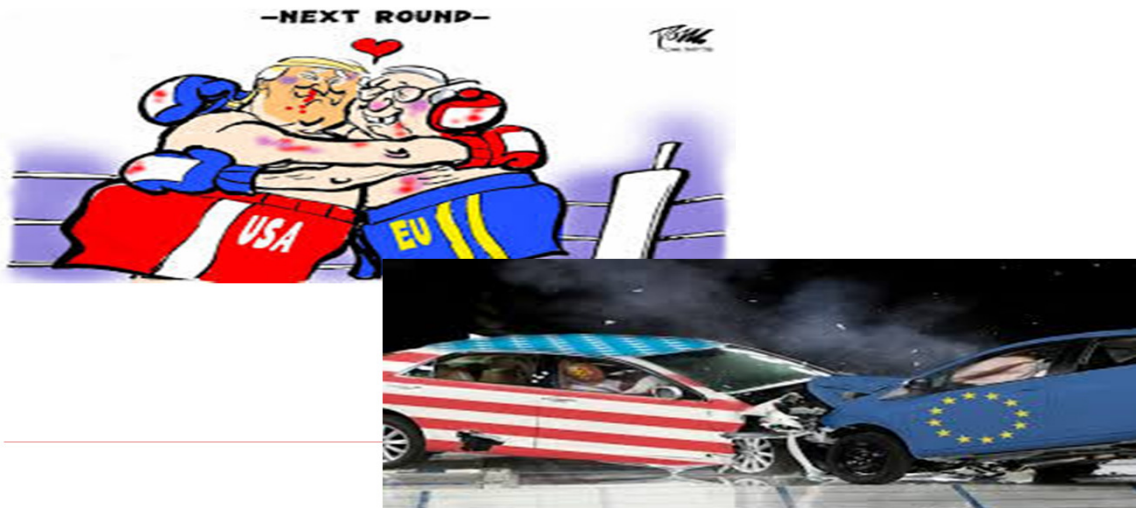
CNBC

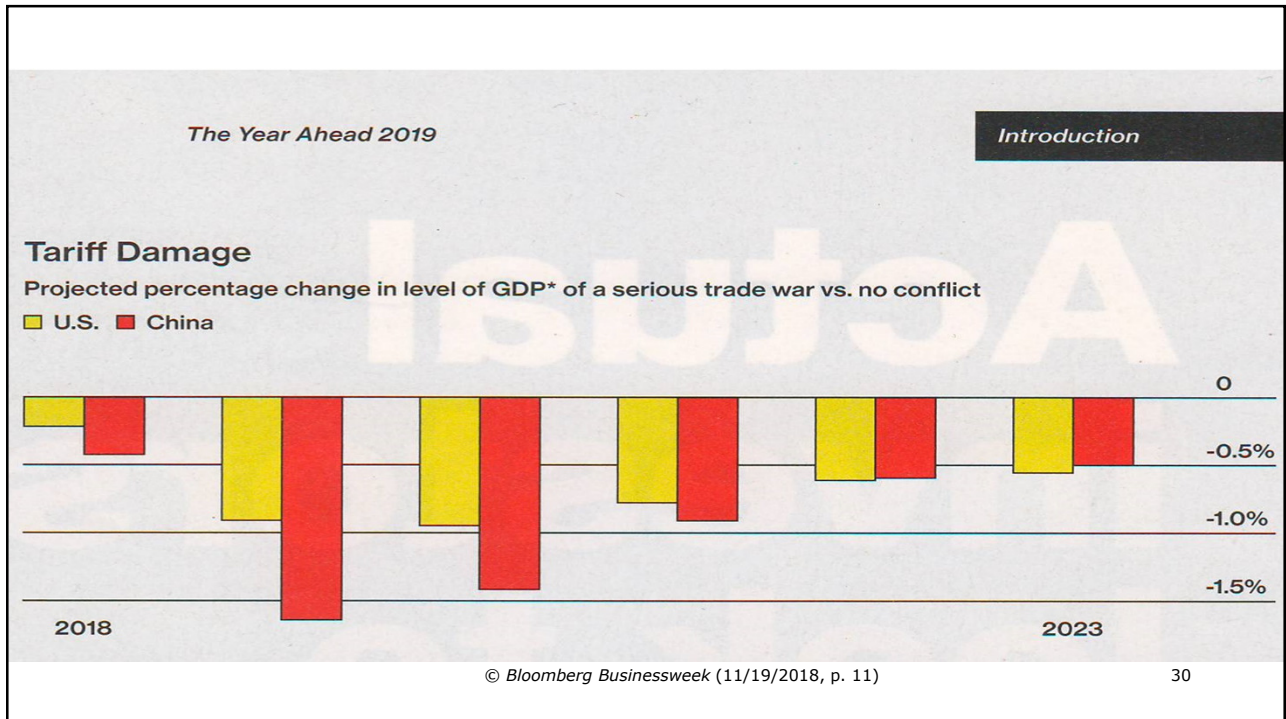
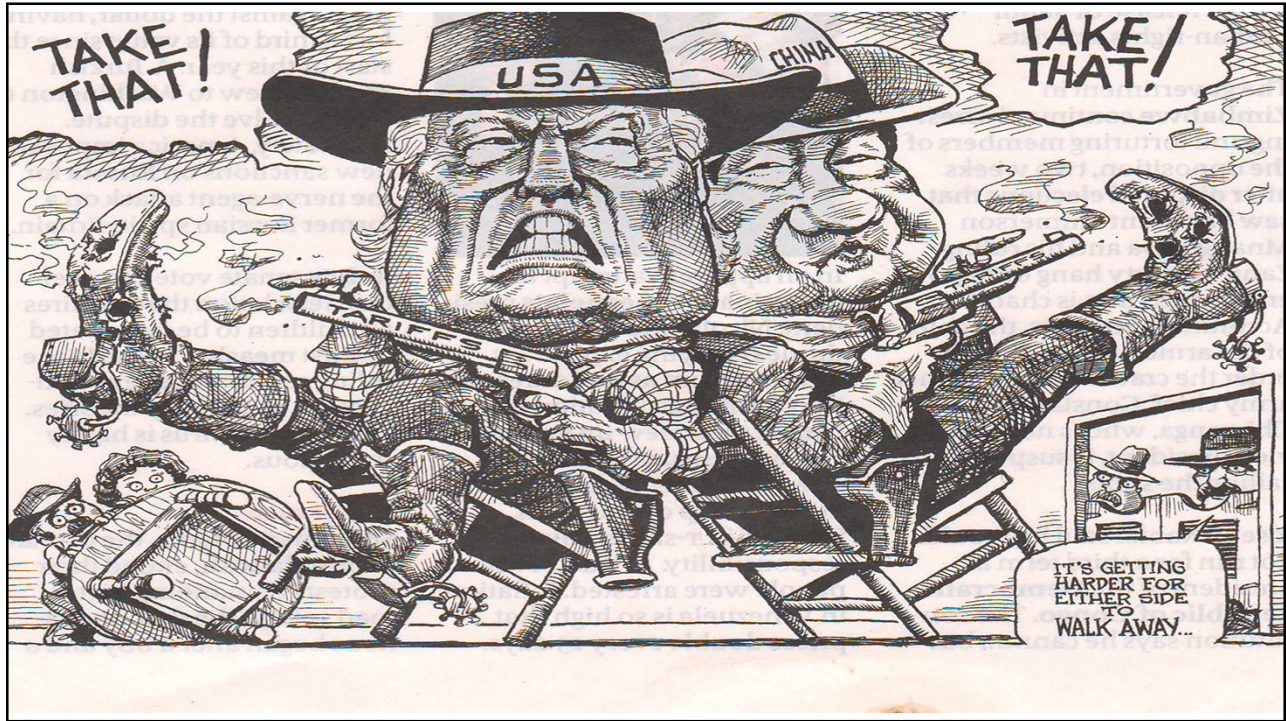
China is retaliating against U.S. trade tariffs by boosting duties on U.S. imports.

Category	Import value (2016, USD)
Soybeans	\$13,764M
Aircraft	\$12,584M
Cars	\$11,876M
Computer chips	\$8,696M
Jet engines	\$3,025M
Gold	\$2,384M
Medical instruments	\$2,320M
Chip making equipment	\$2,274M
Scrap paper	\$2,263M
Chemical instruments	\$1,984M
Aluminum scrap	\$683M
Fresh/frozen pork	\$409M
Ethanol	\$387M
Fruit	\$356M
Nuts	\$318M
Steel pipes	\$96M
Wine	\$60M
Plants (incl ginseng)	\$15M

SOURCE: International Trade Centre

TRADE WARS ARE LOSE-LOSE





WHO ARE PAYING FOR THE TARIFFS?

- ❑ President Trump: “China is now paying billions of \$\$ in tariffs.”
- ❑ That would be the case, if Chinese exporters indeed absorb the *entire* additional cost of tariffs without raising prices.
- ❑ Otherwise, U.S. importers and ultimately consumers are eating up the tariffs.
- ❑ U.S. firms and workers in sectors being retaliated against are also paying.

SHARE THE PAIN, BUT WHERE IS THE GAIN?

- ❑ Midwestern soybean farmers lose their China market to Brazilian rivals.
- ❑ Maine lobsters get “cooked.”
 - The \$1.5B industry face new Chinese/EU tariffs of 25% and 8%, respectively, but their Canadian rivals can ship their catch duty-free.
- ❑ Harley-Davidson is moving some production (and jobs ☺) to Europe to avoid EU tariffs.
- ❑ The *largest* U.S. auto exporter to China, BMW is moving some X3/X5 production (and jobs ☺) from Spartanburg, South Carolina, to China to avoid the 40% duties.

RESHORING (MOVING JOBS BACK) IS CHALLENGING

- In 2015, GE Appliance Division tried to “reshore” manufacturing back to the States.
- The rising Chinese labor cost + superb U.S. worker productivity → overall labor cost to be competitive.
- But parts suppliers had disappeared from the U.S., and shipping parts from China made the final product prohibitively expensive.
- In 2016, GE sold the division to Haier (\$5.4B)

SOURCE: F. Contractor (2017), What is at stake in China-US relations? *Rutgers Business Review*, 2(1): 1-22.

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WHO ARE GAINING?

- In 2018, China, in response to U.S. complaints about “forced tech transfer” through joint ventures, relaxed long-standing JV requirements for aerospace and auto firms.
 - The biggest winner is Tesla, which will have a *wholly owned* factory in Shanghai — the first in China.
 - In China, Tesla’s “made-in-USA” cars had to cut prices by 12% to 26%.
- Reversing globalization helps the few and harms the many.
Please let me know if you have other examples of companies that are gaining.

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DEBATE: SHOULD THE U.S./CHINA TRADE DEFICIT BE OF CONCERN?

- No: Based on classical free-trade theories, the U.S. and trading partners mutually gain from a deeper division of labor.
 - Every American household gains \$2,380/year
 - 1 Boeing 737 = 6 million pop-up toasters
 - An “All-American” made iPhone = \$2,000+
 - China reinvests the surplus \$ into U.S. assets — mainly Treasury securities

- Yes: Based on the theory of mercantilism, large and increasing deficits are not sustainable.

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DÉJÀ VU

What happened to the “Japan on steroids” literature (*Japan as No. 1* — 1979)?

Did Japan “take over” America (circa 1989)?



Amazon.com: Japan as Number One: Lessons for America (9781583484104): Ezra Vogel... Page 1 of 5



Frequently Bought Together

Customers buy this book with *The Four Little Dragons: The Spread of Industrialization in East Asia (Klein O. Baischauer Lectures)* by Ezra F. Vogel

Price For Both: \$33.42

Show availability and shipping details

Customers Who Bought This Item Also Bought

Page 1 of 10



THE GREAT RIVALRY

- * Is this the end of (constructive) engagement? (*Economist* 10/20/18)
- * But President G. W. Bush labeled China a “strategic competitor” 17 years ago. (2001)
- * Even today, U.S.-Russian space cooperation remains strong.

The Economist

Weakness at the heart of Europe
The Saudi sand trap
Progress in America's prisons
Will quantum break the internet?

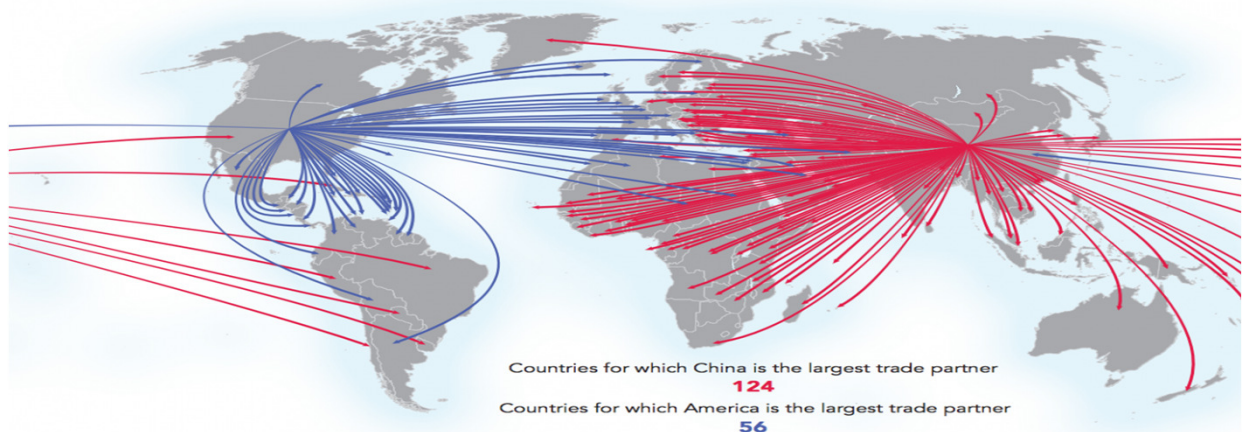
OCTOBER 20TH 2018 £5.00

China v America

A dangerous rivalry



THE FIGHT FOR GLOBAL DOMINANCE



My belief (and hope):
The current trade wars will
not last long, because the
ODD COUPLE (the G2) will
have to work (sleep!)
together.

Unlike some (human) couples,
divorce is not an option. 😊

(*Economist* 10/24/2009)



The best (and most profound)
recent China book I'd
recommend:
Kissinger:
On China (2011)

“Conflict is a choice,
not a necessity.”



New York Times Bestseller

Henry Kissinger On China

with a new afterword



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DEBATE: WHAT HAPPENS IF NAFTA GOES AWAY?

- ❑ The three neighbors will still trade, but gains will diminish.
- ❑ NAFTA preserves more U.S. jobs because 40% and 25% of import value from MEX and CAN is made in USA.
 - Only 10% of import value from CHN is made in USA.

SOURCES: M. W. Peng (2017). What happens if NAFTA goes away, *Texas CEO*, Jan; What happens to Texas if the US withdraws from NAFTA? *Dallas Morning News*, May 9.

DEPT

Internal memo
by Mike W. Peng

WHAT HAPPENS IF NAFTA GOES AWAY? Free Trade is Not Free



In effect since 1994, the North American Free Trade Agreement (NAFTA) has caused an average of 2 million jobs to be lost in the U.S. economy. Free trade is not free. It would lead to a "great sucking sound" sucking American jobs to Donald Trump's neighbors of the agreement as a "blowout" and "the worst trade deal" in U.S. history. It is time to re-examine a previously unshakable economic truth: What happens if NAFTA goes away? The answer to the question boils down to what NAFTA has brought to the United States — and to Texas.

What Has NAFTA Brought To The Country?
In two decades, millions of manufacturing jobs have been lost in the United States. In 1994, there were 17 million manufacturing jobs in the U.S. In 2017, there were 12 million. The loss of 5 million jobs is the result of NAFTA. The loss of 5 million jobs is the result of NAFTA. The loss of 5 million jobs is the result of NAFTA.

What About Texas?
Texas has been the beneficiary of NAFTA. Texas has been the beneficiary of NAFTA. Texas has been the beneficiary of NAFTA. Texas has been the beneficiary of NAFTA. Texas has been the beneficiary of NAFTA.

The Dallas Morning News

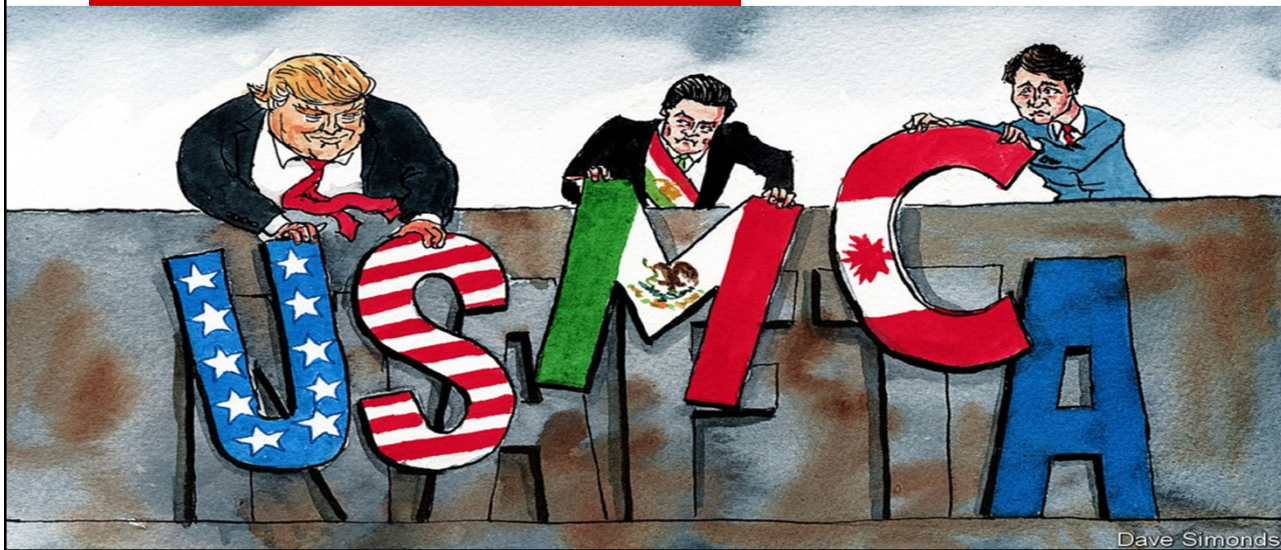
Published, May 9, 2017, page 13A (first appearance only) <https://www.dallasnews.com/business/2017/05/09/what-happens-if-nafta/>

What happens to Texas if the U.S. withdraws from NAFTA?

by Mike W. Peng

What happens if the United States withdraws from NAFTA? The answer obviously boils down to what NAFTA has brought to the United States — and to Texas. In two decades, manufacturing trade among the three member countries grew from \$200 billion in 1994 to \$1.3 trillion in 2018 — a nearly 600 percent increase. An astounding \$2 trillion of goods and services cross the border every year. Mexico alone exports more to the U.S. than China, and accounts for more than 10 percent of U.S. imports. Canada exports more to the U.S. than Mexico, and accounts for more than 10 percent of U.S. imports. The loss of 5 million jobs is the result of NAFTA. The loss of 5 million jobs is the result of NAFTA. The loss of 5 million jobs is the result of NAFTA.

SOLUTION: FROM NAFTA TO USMCA



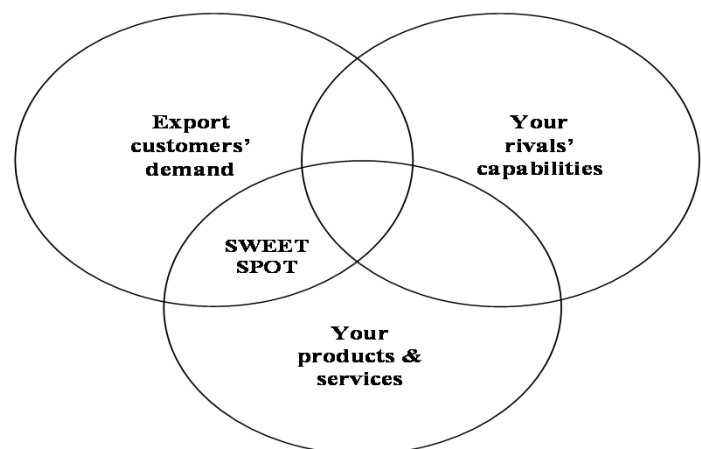
Dave Simonds

MANAGEMENT SAVVY (I)

- INSTITUTION-BASED VIEW: Free trade is *not* free
 - Requiring commitment and sacrifice to demonstrate, safeguard and advance the gains from trade
- Don't abandon your largest (foreign) market
 - CHINA: Apple, Boeing and GM... Google is trying to go back
- Don't be a pure exporter—engage in foreign direct investment (FDI)
 - Consider FDI as *strategic pre-positioning* (in military terms) or *real options* (in financial terms)
 - Maine lobstermen who have invested in Canadian warehousing and logistics can respond quickly to tariffs
 - BMW have plants in both the U.S. and China
 - Tesla is currently starting its first FDI project in China

MANAGEMENT SAVVY (II)

- RESOURCE-BASED VIEW:
Leverage valuable, unique,
knowledge-based deep niches
—SWEET SPOT
 - Denmark in specialty toys
 - Sweden in car carriers
 - Switzerland in watches
 - Minnesota in medical needles
 - Texas in fighter jets (from F-16 to F-35)



MANAGEMENT SAVVY (III)

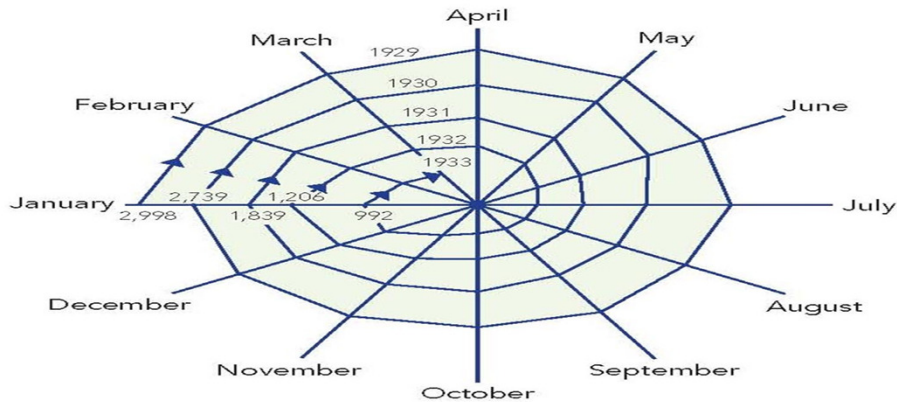
- ❑ The *ultimate* corporate social responsibility (CSR)
- ❑ Promote peace by strengthening trade and investment linkages



CAN SOMEONE REALLY WIN TRADE WARS?

FIGURE 8.1

DOWN THE TUBE: CONTRACTION OF WORLD TRADE DURING THE GREAT DEPRESSION (1929-1933, MILLIONS \$)



Source: C. Kindleberger, 1973, *The World in Depression* (p. 170), Berkeley: University of California Press.

FROM TRADE WARS TO ANTITRUST WARS

- ❑ As China may soon exhaust U.S. imports to retaliate, expect retaliation in *non*-tariff areas.
- ❑ U.S. firms in China may expect tax audits, environmental scrutiny, admin delays ... consumer boycotts.
- ❑ If U.S. firms in the U.S. (or EU) want to merge and clear U.S. (and EU) antitrust clearance, expect Chinese trustbusters to clip their wings.
 - EXHIBIT A: Qualcomm's \$44B merger with NXP (Netherlands) was killed by Chinese antitrust authorities (July 2018)

THE OTHER TYPE OF TRADE WARS: SANCTIONS

- ❑ The record is sobering: Not very effective
- ❑ Cuba, Iran, North Korea, Russia and Venezuela
- ❑ More effective cases: South Africa (before 1994) and Libya (before 2003)
- ❑ Smart economic statecraft “will require an honest reckoning on the part of U.S. policymakers with the limits of American power”
(Lew & Nephew, 2018, p. 149)

GET REAL WITH INTELLECTUAL PROPERTY RIGHTS (IPR) IN CHINA ... AND AMERICA

- Complaints about China's IPR are legitimate.
- But demanding China to stop the "Made in China 2025" policy is not realistic.
- Our *counterintuitive* policy advice based on the U.S. IPR history: *Help "MIC2025" to foster indigenous stakeholders interested in IPR.*
 - Between 1790 and 1891, violation of foreign IPR was *legal* in the U.S. ... but then the U.S. voluntarily changed IPR policy by 1891. What happened?

SOURCE: M. W. Peng et al. (2017), An institution-based view of global IPR history, *Journal of International Business Studies*, 48(7): 893-907.

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