Leading in the New Reality

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Last August, I asked Nikolaus Lang, head of BCG's Global Advantage practice, to take over my Weekly Brief and get us up to speed on the fast-changing state of global trade. I'm so pleased that he agreed to step in again to give us an update, this time from a European perspective. I know you'll find his insights very interesting.

To BCG's network around the world,

Since we hear so much about the trade frictions between China and the US, I thought it would be useful to see how Europe fits in to these tectonic shifts in global geopolitics and how business leaders can prepare.

First off, global trade will rebound to prepandemic levels more quickly than previously thought—likely as soon as next year. By 2023, there will be around $1 trillion more in global trade than we saw in 2019, largely driven by the rapid comeback of the Chinese economy as well as the resilience of other key economies under pandemic restrictions.

The changes within this positive global trade landscape will, however, be mixed. Based on a comprehensive analysis of macroeconomic, geopolitical, and operational factors, we foresee that US-China trade will reduce in value by about $80 billion by 2023 as firms reshape their supply chains and the US-China decoupling continues. Over the same period, EU-China trade will see smaller-than-expected growth, of about $20 billion. Trade within Asia-Pacific, meanwhile, will see strong growth, with China-ASEAN trade, for example, up by approximately $80 billion by 2023. This growth will be partially driven by the new Regional Comprehensive Economic Partnership (RCEP) in Asia-Pacific, the world's largest free-trade zone.

With all that in mind, I think there are four important questions business leaders should consider.

1. How will the US-China relationship develop, and what effect will that have on EU-China trade?

The Biden administration will seek to ensure sustained US competitiveness in semiconductors and reduce US economic dependency on China, particularly in sectors such as pharmaceuticals, high-capacity batteries, and critical minerals. And while the US hopes to draw its traditional allies into broad alignment on foreign policy and trade relations with China, the rapid changes in the global trade landscape and in Europe—combined with decreased trust in the US from the past four years—will make this a difficult goal.

The trick for the EU will be maintaining, and even deepening, its overall trading relationship with China while protecting its own industries. European companies need to navigate a world made up of strongly diverging digital, industrial, and operational standards amid increased scrutiny on issues such as climate, environment, labor, and human rights.

2. What developments can we expect in the US-EU and US-UK trading relationships?

We might see the removal of some punitive US import tariffs on EU products, such as steel and aluminum, in return for broader EU-US cooperation on other global topics. But the EU and US will likely clash over the EU's plans for a digital services tax, expected this summer, as well as more stringent regulations within EU member states regarding social media and digital services. This combination of higher taxes and stricter regulations in the EU will redraw the digital business landscape in Europe, from streaming to e-commerce.

3. How will trade policies related to climate affect business?

The EU—and, to some extent, the US—is looking to carbon border taxes and tariffs to discourage the import of CO_2-embedded products, which principally come from China. Such moves will level the playing field between domestic production and imports. Organizations whose supply chains include inputs such as steel, aluminum, chemicals, and crude oil will feel strong pressure on their cost base, and business leaders need to be prepared with a quick and effective response, including adjustments to their supply chains that will keep them cost competitive.

4. What are the opportunities and risks for European companies investing in China?

Among the biggest trends is the EU-China Comprehensive Agreement on Investment (CAI), which, if implemented by China, gives EU manufacturers preferential investment terms, among other important benefits. The effect of CAI and the huge free-trade zone of RCEP might make it more attractive for European companies to directly invest in China in order to serve the wider Asia-Pacific region instead of relying on traditional trade relationships—another major shift in the global trade landscape.

The uncertainty and dynamism of global trade will continue for the foreseeable future. To be prepared for the changes to come, business leaders need to keep their organizations as agile and resilient as possible, understanding the implications of various policy options and staying ahead of the game by adjusting supply chains for a new reality.

Please see below for some of our latest thinking on related topics.

Best wishes,

Nikolaus S. Lang
Managing Director and Senior Partner
Global Leader, Global Advantage Practice

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The new administration will fight to advance and protect US economic interests—but America will no longer go it alone.

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