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Soybeans and Steel – The Tariff Wars

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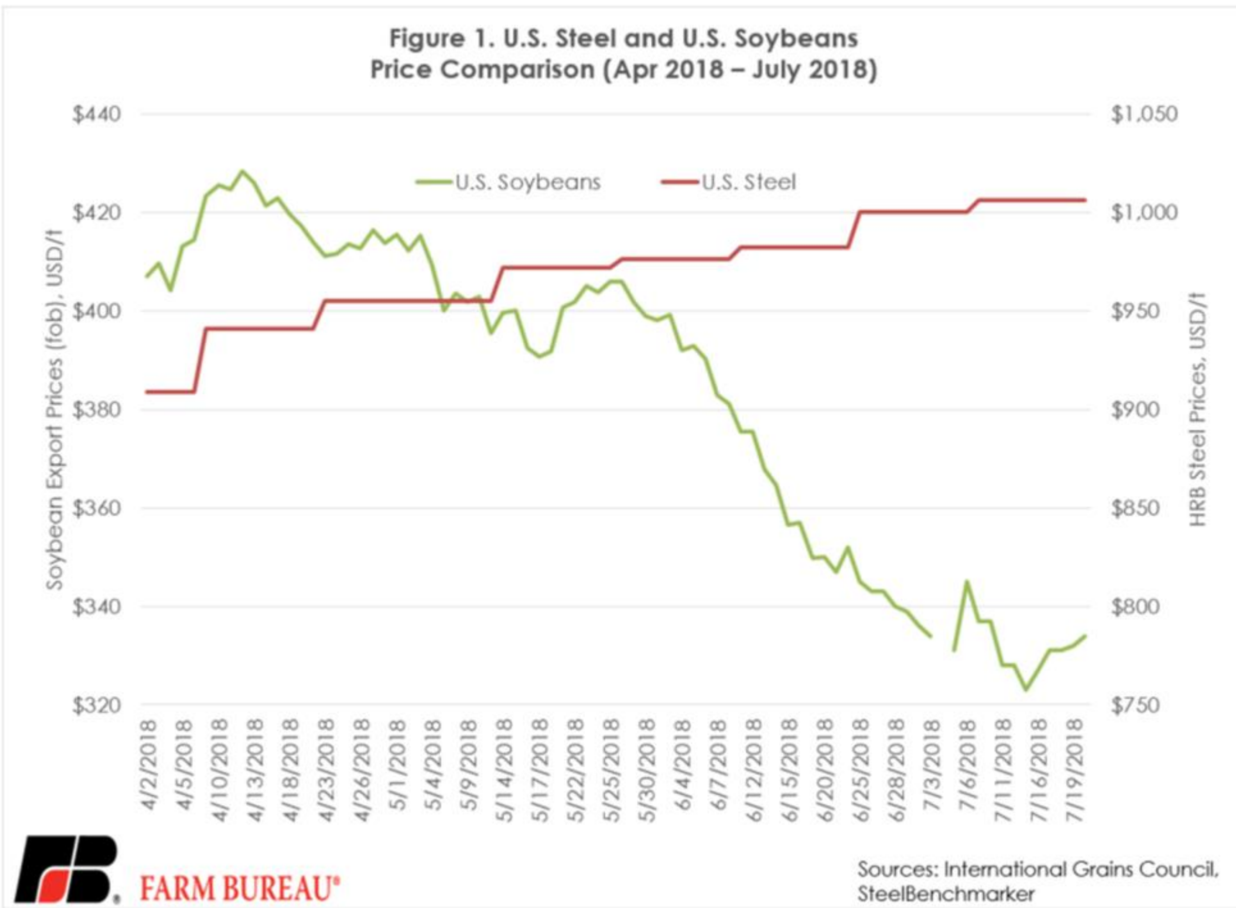
July 30, 2018 By Carolyn Riegler, Managing Director

What do soybeans and steel have in common? They are both integral players in a worldwide trade battle that will likely have far reaching implications for almost every business and resident in the Mid-West. The two products are symbolic of two important industries in the world trade balance equation – Automotive and Agriculture. To understand the relationship between the two products, it is interesting to look at the correlation of pricing over the last four months, as new U.S. tariffs on steel and aluminum imports were implemented.



The reason is simple, for every tariff the U.S. implements, the countries impacted, are implementing retaliatory tariffs on imported goods to strike back at the U.S. trade policy. Thus far, agriculture products have been the U.S. export hit the hardest with export tariffs, while steel, aluminum, and soon automotive and auto parts will be targeted for U.S. import tariffs.

The last 18 months have been a time of uncertainty in world markets as it relates to the balance of trade, tariffs, government subsidies, and quotas. Lets first review what has happened thus far.

1st Quarter - 2018

Section 232 of the Trade Expansion Act of 1962, as amended, gives the executive branch the ability to conduct investigations to "determine the effects on the national security of imports. Within 270 days of initiating any investigation, the Commerce Department issues a report to the President with the investigation's findings, including whether certain imports threaten to impair America's national security".[1] The President has 90 days to determine whether he concurs with the findings and, if so, to use his statutory authority under Section 232 "to adjust the imports" as necessary, including through tariffs or quotas.

In January 2018, the Department of Commerce delivered the Section 232 reports on steel and aluminum to the President. In February 2018, the Commerce Department publicly released Section 232 reports on imported steel and aluminum. The reports concluded that the quantities and circumstances of steel and aluminum imports "threaten to impair the national security," as defined by Section 232. The reports found that United States steel imports were nearly four times our exports, and that aluminum imports had risen to 90% of total demand for primary aluminum. The Commerce Department recommended that President Trump take action to protect the long-term viability of our nation's steel and aluminum industries.

During President Trump's 2016 campaign, he promised voters he would end the unfair trade practices between the U.S. trade partners. He made good on this promise on March 8, 2018. The President issued Proclamations 9704 and 9705 on Adjusting Imports of Steel and Aluminum into the United States, under Section 232 of the Trade Expansion Act of 1962, as amended (19 U.S.C. 1862), providing for additional import duties for steel mill and aluminum articles, effective March 23, 2018[2] estimated to be $16 billion in import tariffs. Initially Canada and Mexico were given temporary exclusions and the department of commerce implemented a product exemption application process.

2nd Quarter - 2018

Five other countries were added to the exclusion list to allow opportunities to negotiate trade deals. By June 1, 2018 four countries (Argentina, Australia, Brazil and South Korea) had agreed to quotas in lieu of tariffs. Tariffs on steel and aluminum imports from all other countries (including Canada, Mexico and the EU) began on June 1, 2018.[3] Over 20,000 product exemption applications were filed by businesses in the U.S., only about 500 have been reviewed thus far, and almost half have been rejected.

In mid-June, 2018 the U.S. administration announced a 25% tariff under Section 301 of the Trade Act of 1974 on $34 billion of imports from China, effective July 6, 2018. Subsequently, the U.S. proposed an additional $200 billion of Chinese imports be assessed an additional 10 percent tariff.

[1] https://www.whitehouse.gov/briefings-statements/need-know-section-232-investigations-tariffs/
[2] https://www.cbp.gov/trade/programs-administration/entry-summary/232-tariffs-aluminum-and-steel
[3] OESA presentation by Katherine Karol, Butzel Long, July 24, 2018 at the MSU Management Education Center

By early in the third quarter there are three separate U.S. Tariff Actions underway.[4]

1. $34 billion total tariff on steel and aluminum directed at China – 818 HTS codes[5]
2. $16 billion tariff on steel and aluminum for all other countries – 284 HTS codes **proposed**
3. $200 billion estimated tariff impacting China on an additional 6,200 HTS codes **proposed** (China)

Meanwhile Back at the Ranch…

At the same time, and in apparent direct response to the steel and aluminum tariffs, China, Canada, Mexico and the EU announced retaliatory tariffs on U.S. products.

U.S. farmers, ranchers and agribusinesses are now at the center of China's retaliatory trade actions, with the latest round of tariffs on $34 billion worth of American products including soybeans, cotton, rice, sorghum, beef, pork, dairy, nuts and produce. The tariffs come on top of those China imposed on about $3 billion in U.S. goods — including fruit, nuts, pork and wine — in April 2018.

Soybeans

Nearly one-third of U.S. soybeans, or about $14 billion, is sent to China each year, where the commodity is primarily used to feed China's enormous pork industry. Now that the commodity is about to become significantly more expensive, Brazil and other soybean exporters will benefit from the escalating tensions, according to agricultural economists and market analysts.[6]

"At the end of the day, these tariffs will increase prices for U.S. soybeans in China, and incentivize production in South America," said Brent Gloy, an agricultural economist at Purdue University who also operates a farm in southwest Nebraska. China could avoid buying U.S. soybeans at least through October, which is somewhat typical for seasonal reasons. But by then, supplies from Brazil will no longer be readily available."[7]

The value of U.S. soybean exports to China has grown 26-fold in 10 years, from $414 million in 1996 to $14 billion in 2017. U.S. soy prices have dropped more than $2.00 per bushel since March in the midst of Tariff discussions.

"Soybeans are the top agriculture export for the United States, and China is the top market for purchasing those exports," said John Heisdorffer, a soybean grower from Keota, Iowa, and

[4] OESA presentation by Ann Wilson of Motor and Equipment Manufacturers Association (MEMA), July 24, 2018 at the MSU Management Education Center

[5] HTS (Harmonized Tariff Schedule) codes are product classification codes between 7-10 digits. The first six digits are an HS code, and the countries of import assign the subsequent digits to provide additional classification.
U.S. HTS codes are 10 digits and are administered by the U.S. International Trade Commission

[6] https://www.politico.com/newsletters/morning-agriculture/2018/07/06/us-farmers-face-china-tariffs-round-2-272349

[7] https://www.politico.com/newsletters/morning-agriculture/2018/07/06/us-farmers-face-china-tariffs-round-2-272349

president of the American Soybean Association (ASA). “The math is simple. You tax soybean exports at 25-percent, and you have serious damage to U.S. farmers.”[8]

Soy growers rely heavily on exports to China: In 2017, China imported 31 percent of U.S. production, equal to 60 percent of total U.S exports and nearly 1 in every 3 rows of harvested beans. Over the next 10 years, China’s demand for soybeans is expected to account for most of the growth in global soybean trade, which underscores the importance of this market for future U.S. soybean sales.[9]

Dairy

Dairy farmers and down line processors will also feel the squeeze of retaliatory tariffs and quotas in 2018; the U.S. export forecast for cheese has been reduced by 6 percent to 334,000 tons.[10]

On July 5, 2018, Mexico continued to phase in their retaliatory tariffs in response to the U.S. Section 232 action. This second phase, which was outlined in the original announcement, raised tariffs further on U.S. pork and cheese products. This does not signal an announcement of new tariffs but is rather a continuation of those announced on June 5, 2018.[11]

On July 6, 2018 China applied tariffs on a number of U.S. dairy products notably SMP (Skim Milk Powder), whey and whey products, and WMP (Whey Milk Powder). These tariffs bring the aggregate rate to 35 percent of the imported value of SMP and 27 percent for whey and whey products.[12]

Other agricultural products impacted include chilled and frozen pork cuts, hams, cheeses, fresh apples, frozen french fries, cranberries and bourbon. Mexican imports of agricultural products subject to retaliatory tariffs totaled nearly $3.1 billion in 2017, with 84 percent or $2.6 billion coming from the United States.[13]

Tariffs on fresh and chilled pork and some cheeses have increased to 20 percent. Tariffs on fresh cheeses and others have increased to 25 percent.

Other Agriculture Products

The chart below summarizes the current state of tariffs on major commodities. The items highlighted in yellow represent the top ten Michigan Agricultural Products. Many other products are impacted in addition to the ones listed below.[14]

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[8] https://soygrowers.com
[9] ibid.
[10] https://www.fas.usda.gov/data/dairy-world-markets-and-trade
[11] https://www.fas.usda.gov/data/mexico-phasing-mexican-retaliatory-tariffs
[12] https://www.fas.usda.gov/data/mexico-phasing-mexican-retaliatory-tariffs
[13]https://gain.fas.usda.gov/Recent%20GAIN%20Publications/Mexico%20Announces%20Retaliatory%20Tariffs_Mexico_Mexico_6-6-2018.pdf
[14] https://apps.fas.usda.gov/GATS/Default.aspx

	Global Trade Millions	New Tariff	
		China	Mexico
Soybeans	$ 21,452	25%	
Corn	$ 9,119	25%	
Wheat	$ 6,062	25%	
Cotton	$ 5,845	25% - 40%	
Rice	$ 1,723	25%	
Sorghum	$ 1,028	25%	
Beef	$ 7,263	25%	
Pork	$ 6,485	25%	20%
Poultry	$ 4,267	25%	
Fish	$ 5,393	25%	
Dairy	$ 5,383	25%	
Nuts	$ 8,478	25%	
Vegtables	$ 2,513	25%	
Cheese	$ 1,448		25%
Apples	$ 970		20%
Cherries	$ 644	50%	
Potatoes	$ 240		20%
Fresh Fruit	$ 4,749	15%	
Dried Fruit	$ 543	15%	
Wine	$ 1,463	15%	

source - https://apps.fas.usda.gov/GATS

What is Next?

Most recent information indicates that automobiles and auto parts will be targeted with the next round of tariffs. According to Ann Wilson, MEMA official, the automotive and auto part tariffs will be based on the Automotive Rules of Origin (ROO) requiring 75% Regional Value Content (RVC) from North America, Labor Value Content (LVC) 40% with $16/hour labor, and a specified percentage of OEM steel/aluminum must be NA sourced. It is also expected the transition to these new rules will be a short time frame of between 2 and 3 years.

At the same time there is an ongoing attempt to renegotiate NAFTA, now expected to be completed in 2019. Key issues which are being addressed include:

- Government Procurement
- Agriculture
- Intellectual Property
- Digital Trade
- Currency
- Autos

In addition, there are ongoing efforts to limit presidential authority limits, and slow down the rule changes.[15] There are four different legislative efforts currently underway as summarized below:

Rep. Davidson	Sen. Lee	Sen. Corker		Rep. Kind
Global Trade Accountability Act				Trade Authority Protection Act
H.R. 5281	S. 177	S. 3013	S. Amdt. 2381	H.R. 5760
cosponsors 12 Rs	cosponsors 4 Rs	cosponsors 7 Rs, 5 Ds	cosponsors n/a	cosponsors 2 Rs, 4 Ds
Requires congressional APPROVAL for any unilateral trade measures, including tariffs, carried out by the executive branch.		Requires congressional APPROVAL for any tariff action under Sec. 232.		Creates Congressional Review Act like process to give Congress authority to DISAPPROVE any trade authorities delegated to Pres. Congress has 60 days to consider action and an expedited process to pass resolution of disapproval.

Relief in Sight?

Agricultural products in the U.S. will continue to be the target of countries impacted by steel, aluminum, automotive and auto part tariffs. The U.S. Department of Agriculture (USDA) announced its plans to authorize up to $12 billion for programs to help farmers and ranchers caught in the tariff war. American Farm Bureau President Zippy Duvall stated "This should help many of our farmers and ranchers weather the rough road ahead and assist in their dealings with their financial institutions. We are grateful for the administration's recognition that farmers and ranchers needed positive news now and this will buy us some time."[16]

The USDA Market Facilitation Program will provide payments to producers of a number of commodities. Also, a food purchase and distribution program through the Agricultural Marketing Service will target unexpected surplus of impacted products for distribution to food banks and other programs.

The timing of the aid will be critical for the agricultural community, its lenders and its customers. An American Bankruptcy Institute (ABI) article, published July 25, 2018, discussed Federal Reserve Chair Jerome Powell's testimony before congress in early July.[17] Powell reminded legislators from both chambers that the Fed's tools are for monetary policy — and that it is they who have the tools to influence trade policy — he made it clear that he did not think tariffs would be good for the economy in the long run.

The ABI article stated it is especially important for community and regional banks in states with a significant number of jobs supported by exports, or those with customers that are importers of products like steel and aluminum, to evaluate the likelihood of job losses and subsequent loan

[15] OESA presentation by Ann Wilson of Motor and Equipment Manufacturers Association (MEMA), July 24, 2018 at the MSU Management Education Center
[16] https://www.fb.org/news/trade-assistance-package
[17] https://www.americanbanker.com/opinion/banks-need-to-brace-for-trumps-tariffs by Mayra Rodriquez Valladares, July 25, 2018

delinquencies. This is also a good time to review loan covenants, along with the quality and price of collateral posted, for existing loans.

Industries dependent on imports or exports that have tariffs levied on them may find it harder and more expensive to take out loans precisely when then need them most. The landscape is changing daily.

What can we Do? How do we Prepare?

No one has a crystal ball to predict which way the future winds will blow, however there are prudent actions that can and should be taken in all industries involved in foreign trade. Some examples include:

1. Evaluate your contracts: (both imports and exports)
   - Pricing and Quantity Terms
   - Term and Termination of Contract
   - Modification Provisions
   - Shipping Terms
   - Taxes/Customs/Tariffs Provisions
   - Change of Laws Provisions
   - Force Majeure Provisions[18]
   - Most Favored Nations Provisions

2. Evaluate your loan covenants, discuss any concerns with your lender.

3. Update your financial projections. Plan for multiple scenarios.

4. Begin discussions with lenders and investors regarding financing and potential impacts on your business.

5. File for tariff exclusions (Imports of Steel, Aluminum, Autos and Auto Parts).

6. Know the impact on both your suppliers and your customers.

Above all, stay informed, be prepared and plan for potential changes that may be necessary. Get involved in trade associations who have dedicated resources to track the trade environment and changes, they will be a wealth of information. Consult with other businesses, experts and attorneys.

[18] *Courts have found "Government Action" leading to FM needs to prevent performance (e.g., and embargo); not just make it more costly. Need to show that the government action was not reasonably contemplated by either party at the time of contracting. (Butzel Long, July 24 OESA Conference)*

Ms. Riegler is a Managing Director at O'Keefe. She utilizes her 30 years of professional experience in financial and operational capacities, to provide clients with financial consulting services, litigation support services, real estate valuation, business turnaround and operational advisory services.

Prior to joining O'Keefe, Ms. Riegler's primary role was as a CFO and COO of multiple privately held businesses. In addition, she worked as a Senior Audit Manager for 10 years with a world-wide CPA firm. Her experience includes advising on complex real estate transactions, including, legal structure development, financial and financing strategy modeling, and budgetary/pro-forma financial analysis. She has teamed with both principals and outside investors to coordinate repurposing/repositioning of assets, new property development and spin off of unprofitable business units. Her skill set allows her to provide a wide array of dispute resolution, litigation support, forensic accounting and financial management consulting services to her clients.

Ms. Riegler is licensed by the State of Michigan as a Certified Public Accountant (CPA) and as a Michigan Real Estate Broker. She is also a Certified Fraud Examiner (CFE), and a Certified Turnaround Professional (CTP). She is a member of the American Institute of Certified Public Accountants (AICPA), the Michigan Association of Certified Public Accountants (MICPA) the Association of Certified Fraud Examiners (ACFE), the American Bankruptcy Institute (ABI), and the Turnaround Management Association (TMA).

O'Keefe is a financial and strategic advisory firm specializing in enterprise consulting, litigation support, strategic advisory, and turnaround and restructuring. Established in 2001, the company has locations in Detroit and Grand Rapids. For more information, visit www.okeefellc.com.

