Opinion **US trade**

America must expand its friendship group in the interests of trade

Restricting supply chains to trusted countries is fraught with danger

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Gillian Tett YESTERDAY

Almost exactly a year ago, just before the IMF's spring meeting, Janet Yellen, US Treasury secretary, launched a new buzzword: "friend-shoring".

The idea was that in a world of rising US-China tensions (and western hostility to Russia), American companies should move their "supply chains to a large number of trusted countries" — or friends. It initially sounded almost cuddly. After all, who can object to celebrating friendship, particularly if aggressive isolationism is the other option?

Fast forward to 2023, however, and "friend-shoring" is sparking rising angst, for at least two reasons. One was on public display at this week's spring meeting, where the IMF's latest economic report lobbed an unusually forthright potshot at Yellen.

More specifically, the IMF's economists have crunched foreign direct investment data and concluded that these flows are splintering into politically aligned blocs. This started after 2008. But the "trend of geoeconomic fragmentation" is now accelerating, they say.

If this continues, they calculate, it could reduce overall global economic output by around 2 per cent, with big damage to some emerging market countries. It could also produce financial jolts since "a rise of political tensions could trigger a reallocation of capital flows".

However, there is a second, less visible, issue haunting some of the executives at the spring meetings this week: how do you define a "friend" when you are making decades-long investment plans?

In theory, the boundaries of Yellen's would-be clique are clear: countries in Nato, the "five-eyes" security framework, North American Free Trade Agreement, and nations which seem pro-US and are wary of China, such as India or Vietnam.

But the problem, as the British statesman Lord Palmerston observed back in 1848, is that states "have no eternal allies, and . . . no perpetual enemies". And right now the world is in geopolitical flux. After the four-decade-long cold war era, and the three-decade-long globalisation phase, a new fragmentation is afoot, which is also likely to last decades.

But the contours of this new dispensation are still being defined. "We don't even know what to call this yet," as Michael Froman, former US trade representative and Mastercard executive, observed this week in Washington.

Hence the uncertainty about "friends". Take, for example, America's Inflation Reduction Act. Before this was announced, European policymakers assumed they were in Yellen's clique. So they were shocked when the IRA excluded Europe's companies from green subsidies, and are now retaliating with their own Net Zero Industry Act.

Thankfully, both sides are now trying to lessen the diplomatic damage. But this shock "will not be forgotten quickly", one European chief executive tells me, noting that it has sparked "a lot of 'what-if' conversations at our board level". If Donald Trump runs for US president in 2024 that will become even more intense.

So, too, with Nafta. Yellen's embrace of friend-shoring has created a "lifetime opportunity" for Mexico, as a Bank of America report noted late last year, since enterprises ranging from Apple to Ford are shifting some operations out of China. Indeed, government ministers have suggested that more than 400 American ventures are considering Mexican investments — on the assumption that it will always be a "friend".

One hopes so. But Mexico's leftward lurch shows how unpredictable politics can be. The election of Trump as US president in 2017 underscores this: just before he won the vote, he threatened to rewrite Nafta, causing the share price of companies such as

Kansas City Southern railroad (a transport group central to Mexican-US trade) to slump.

Thankfully, Trump's threat turned out to be toothless, and Kansas City Southern's share price rebounded. Indeed, company executives say that business is booming, and appear convinced that there is no chance of Mexico ever being kicked out of Yellen's friend-shoring clique, given how tightly the economies are entwined.

But that 2017 share price swing should give corporate boards pause for thought, nonetheless. And when executives consider how places such as India, Indonesia or Vietnam might develop, it is clear that those "what if" scenarios need to be particularly imaginative — especially given the speed at which companies had to evacuate from Russia after the invasion of Ukraine.

Is there any solution? The one that the IMF proposes is for nation states to play nice with everyone again, and re-embrace globalisation. That would be wonderful. But it seems highly unlikely now.

So the only practical option for companies is to hedge these geopolitical risks by placing production with multiple different friends and/or to bring it onshore. And they are doing this. A survey by Capgemini late last year shows that over half of global companies have reorganised production in the last two years — and three quarters plan more "onshoring and reshoring".

But, as the IMF stresses, hedging carries a cost in terms of lower efficiency and higher prices. Which is one more reason to be sceptical that we will return to an ultra low-inflation world any time soon — even if Yellen herself is unlikely to give a friend-shoring speech that honestly acknowledges that.

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