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GOVERNMENT

EU-US trade dispute poised to escalate after WTO ruling

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Wine is one of the categories being targeted. Image credit: Mot & Chandon

By SARAH JONES

Goods imported from Europe could soon be subject to tariffs, as the World Trade Organization has approved the United States' request to hit the E.U. with billions worth of retaliatory taxes.

The WTO has ruled in favor of the U.S. in a long running dispute over subsidies given to Airbus, which the U.S. said put its plane manufacturer Boeing at a disadvantage. As part of its decision, the WTO has given the U.S. permission to tax $7.5 billion worth of European goods, potentially making doing business in the large luxury market more challenging.

"The main impact will be on products that have a direct equivalent made domestically or imported from outside E.U.," said Johan Gott, principal in the consumer and retail practice of global management consultant A.T. Kearney and head of its Trade Wargaming initiative. "Luxury goods are insulated from this to a certain degree, as the 'Bordeaux AOC' or 'Made in Italy' label is a central part of the product appeal.

"But for many products, consumers can shift their consumption to products without tariffs," he said. "So this may also cause longer term damage beyond the duration of tariffs if consumers develop taste for those alternative products."

Tariff tit for tat

In April, the Office of the U.S. Trade Representative released a list of European goods that could be subject to tariffs. In total, these proposed categories represented about $11 billion worth of goods.

Among the items listed were wines, leather and patent leather handbags, rugs, blankets, glassware and apparel items such as sweaters and suits.

After hearing public comments on the proposal, the office planned to extend the tariffs to additional product categories, including cheeses, olives, pasta and Scotch whisky (see story).

On Oct. 2, the WTO gave the U.S. permission to levy tariffs on $7.5 billion worth of European imports, marking the organization's largest settlement. While a smaller total than the original list, this could still have significant ramifications if the luxury categories are impacted.

According to *The New York Times*, U.S. Trade Representative Robert E. Lighthizer said he plans to start taxing helicopters and airplanes exported from Europe at 10 percent. Other categories that are being targeted include wines and cheeses, which are part of the agricultural products likely to be taxed at 25 percent.

European wines may become more expensive for U.S. consumers. Image credit: Harrods

"A tariff is a tax on imported goods to be paid as the good enters the country," Mr. Gott said. "Costs will increase for the importer, who will then have to choose whether to pass on that cost to consumers or take it out of its margins.

"In the short term [brands] can try to build inventory on the U.S. side of the border. For the long run they are restricted in their freedom of action to shift source of supply to outside the E.U.," he said. "But they can seek to find consumers in other markets that can pick up any American reduction in demand."

The United States is a significant market for fashion and luxury goods.

While China is catching up, Americans remain the second greatest luxury spenders behind Europeans, according to Bain. The U.S. still boasts the greatest number of ultra-high-net-worth individuals.

"Consumption by luxury buyers won't be affected," said Chris Ramey, president of Affluent Insights, Palm Beach, FL. "At risk are the affluent who aren't traditional luxury buyers. Of course, aspirational customers are also at risk as they get priced out of the market."

Europe has come out against the implementation of tariffs, and it has threatened to implement tariffs of its own in response.

"We remain of the view that even if the United States obtains authorization from the WTO Dispute Settlement Body, opting for applying countermeasures now would be short-sighted and counterproductive," said E.U. Commissioner for Trade Cecilia Malmstrm in a statement.

Ms. Malmstrm noted that the U.S. was also found guilty of disobeying WTO rules about subsidies, and that the E.U. could soon be given permission to impose its own tariffs as countermeasures, a tit for tat that could hurt business on both sides of the Atlantic.

"If [the U.S.'s tariffs are] implemented, all but the strongest luxury brands with the greatest loyalty/covetability will be hurt as consumers will not want to pay the tax and will seek out alternatives and/or opt out," said Marie Driscoll, managing director luxury and fashion at Coresight Research, a New York-based global research and advisory firm specializing in retail and technology. "If the tariff costs aren't passed along to consumers and luxury brands or retailers pay the tax, profit margins will contract.

"This could accelerate the adoption of rental strategies among luxury brands, something that approximately two-thirds of luxury consumers would explore," she said. "Consumers aren't sure where rental costs should land. The proposed tariffs could lift demand in the luxury aftermarket of resale/consignment. It could hasten the otherwise slow death of luxury brands that have lost their relevancy with today's shoppers."

According to Ms. Driscoll, brands can minimize the impact to their own bottom line by looking across the organization at cost reduction opportunities.

Trade wars

The U.S. has used tariffs as a political weapon, entering trade disputes with numerous nations during the Trump administration.

For instance, the trade war between the United States and China continues to escalate, and the impact of the dispute is reverberating to global markets as well as the luxury business.

In August, the nations' trade truce ended as the U.S. issued additional tariffs on $300 billion worth of goods from China and China responded by letting its currency value slip to a decade low. As negotiations between the two largest economies in the world drag on, uncertainties remain for luxury (see story).

The retail landscape in the United States continues to be uncertain, as President Donald Trump announced tariffs on Mexico.

Announced late May 30, a 5 percent tariff policy was threatened on Mexico if the country does not get a handle on illegal immigration to the U.S. (see story).

While intended to put pressure on other nations through their businesses, the tariffs often instead make goods more expensive for U.S. consumers.

"In mass, it's generally accepted that sales decline as prices increase," Mr. Ramey said. "But a properly executed luxury strategy makes price less important. In fact, a higher price should only reinforce the desire a luxury marketer creates.

"However, don't make the assumption that new tariffs mean higher prices on all luxury products," he said. "Larger luxury brands are strategic merchants. And, more than other categories, they have the margins to ensure their products are properly priced to sell."