

What Business Leaders Need to Know About Global Trade

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Steve Odland: Welcome to C-Suite Perspectives, a signature series by The Conference Board. I'm Steve Odland from The Conference Board and the host of this podcast series. In today's conversation we're going to talk about geopolitics, trade, industrial policy, and how all of these changing alliances are reshaping trade flows and the old assumptions of globalization. Joining me today is Dr. Maria Demertzis, the Center Leader for our Economy, Strategy & Finance Center in Europe. Maria, welcome.

Maria Demertzis: Hi Steve. Nice to see you again.

Steve Odland: So Maria, you and I did a podcast a few months back and some of our listeners may have heard it. We talked about these trade flows and deficits and so forth, and you made some really important points in that. For those of our listeners who haven't heard it, I think we should start with that. Just explain how trade flows. It's goods only. It flows from one, you get surpluses, you get deficits, but there are reverse currency flows as a result, and pros and cons of all that.

Maria Demertzis: It's a very big topic, right? So if I can just begin to unpack it a little bit. Let me start with the most obvious one. And trade is not just about goods; it's also about services. So goods are things that we can touch. Services, we cannot touch them but they exist. If you think about banking services, a bank account, that's also a good, it's just we can't touch it. We can export it. And in fact, there are all these new digital services that are exportable goods. So just to say that trade is not just about goods. It's goods and services.

And then about the trade flows. If you are exporting more than you are importing, then you are a net exporter. And, as a result, your trade position has a surplus and the opposite if you are importing more than exporting. Last time we talked a lot about, I

remember the topic of this podcast was whether trade deficits are good or bad. And I think that's a very important topic to go back to because there is a little bit of a misunderstanding about this but there are important points.

So here, let me start by saying two things. Bilateral positions. So what one country has versus another is simply a reflection of the relative competitiveness.

So let's take the EU as a geographical block, trading block versus the US. The US has a trade deficit with the EU when it comes to goods. That means that it imports a lot that it exports but it has got a trade surplus when it comes to services. Because the US exports a lot of services to the EU that the EU doesn't produce. This is just a reflection of the relative competitiveness-- the US is very competitive when it comes to all these new technological issues and the EU is more competitive when it comes to traditional manufacturing. I think that is maybe a summary of the positions.

But when it comes to global positions, meaning, the US has a deficit with everyone or has a surplus with everyone, that is a slightly more complicated thing. Let me explain what that means. When a country has a deficit it also means that capital is coming in. And this is not an opinion. This is an identity. It's an accounting identity. If you have a deficit, meaning that you import a lot more than you export, there is money that is coming into the economy. So now your question will be, is this good or bad?

It depends on what this money does. If that money that comes into the country finances consumption, then it's not a good thing because it really doesn't get reinvested. And remember, deficits mean lack of competitiveness. But if this money comes into invest, which is very much what happens in the US, then it feeds into productivity, it feeds the growth.

That's really the two main things I wanted to say in the global positions. You have to understand the deficit positions come with a lot of money coming into the country, the flowing of the money.

Steve Odland: These are really important points, Maria, and I appreciate you recapping them because there's a view in the US that a US trade deficit with the EU, for example, is a really bad thing.

There are pros and cons. First of all, those trade deficits are measuring goods, only to your point, not the services. And if you took the US trade surplus in services into account it's much closer to balance. Secondly, though, currency flows are an important part of it. So if there's a trade deficit, there's a US dollar surplus. So what's the result of that? You've got dollars then flowing back to Europe because people in the US are buying European goods with dollars. What's the net impact both in Europe and in the US of those dollars?

Maria Demertzis: Okay, let's just look in the US for a moment and then I'll look at the EU. Effectively, we're talking about the same flows but what do they mean for each of the two

geographies. The US has got a deficit, right? Which means that it imports more than it exports, but that necessarily means that a lot of investments are coming to the US. And I emphasize the word investment because the money that is coming into the US is used for investments, right? The US economy has been the number one destination for investments for a very long time. People just want to invest in the US because the returns are good.

So this is where business goes to make money. The returns on investments in the US have always traditionally been much bigger than in any other parts of the world. So that means that the US can afford to buy goods from abroad because there is money coming into finance of that. And that has given a dynamism into the US economy and growth and consumption.

If you now look it from the other side, the EU has got a surplus on the trade side but actually it means that money's leaving the EU. Money is invested elsewhere in the world. And that's fine. We are an open economy. We are a competitive economy. We believe in open free markets, so the money will go wherever there is return for them.

However, the problem with that is that the EU has got huge investment gaps. We know that we need an X amount of money for the next five years to meet our large objectives. If our businesses are not investing in the EU because they go elsewhere, including the US, then who's going to pay for this investment gap?

Steve Odland: The same thing goes with the EU's trade flows with China and the US' trade flows with China. China, the EU, and the US are the three big trading blocks in the world today. So those are very material kinds of measures. But it's the same principle between those areas. So now you've got a US trade deficit with China. How about the EU? How are they?

Maria Demertzis: Same thing.

Steve Odland: Same thing. This is the situation. And so therefore, the introduction of tariffs from the EU and from the US are not new. And both regions have them against China because they're trying to thwart dumping and they're trying to protect certain industries and so forth, which are meant to be material to their local economies and also national or regional defense. That's the kind of, the new or the most recent discussion of friction on these trade flows, the tariffs.

Maria Demertzis: If I may comment on this, Steve, I just wanted to say I think the important thing between the US and EU's trade position with China is not so much that we have a deficit, is the fact that why we have a deficit. Remember, deficits reflect competitive reposition, trade positions reflect competitiveness position. And the question is, how did China get into this competitiveness position?

This is the issue. It's not the fact that we have a deficit; it's the fact that we've gotten there following some practices that are not, let me use the word, illegal. I don't mean illegal in

the context of the global world but there is a system of rules that we've all agreed to operate in. And if China doesn't follow those rules because it follows a very different business model, then it gets competitiveness that actually leads to persistent positions that are not fair, are not agreed upon.

Steve Odland: And hence the tariffs. The World Trade Organization (WTO) is typically the rules-making body and everybody's joined that, all of these trade partners have joined the WTO. And it was set up in order to try to have fair trade. So that's another overlay to all of this. Now, there were some recent trade announcements between the US and China and recent meetings between the presidents of the two countries. Talk about what materially came out of those talks.

Maria Demertzis: That's, in fact, just yesterday, right, that this happened? An important development here is, first of all, the US and China are talking. I think that's crucial. Without talking to each other there, there's just not gonna be a resolution to this.

And not only they're talking but they have agreed to continue to talk, right? They've planned meetings, visits between the two in the next year. And actually one part of the agreement has been that every year we are going to revisit this. It's just to see progress. So I think that's good news, unequivocally good news.

One of the concrete things then that happens is that the US has agreed to reduce theentanyl-related tariffs on China from 20% to 10%. This is good in terms of allowing trade but I just remind our listeners that still, the average tariff of US on China still is a very big number. It's about 45%, right? So this is not a resolution. It's not going back to free trade.

The other thing, and this I think is critical, the other thing that was agreed was that China has agreed to suspend these export controls on rare earths. And in return, Washington is going to allow the export of some of the US tech that China needs.

These are critical points for the two geographies. The US depends crucially-- just like the EU, by the way-- on rare earths from China. But China needs technology from the US, particularly on the high end. These were used as, kind of, instruments against each other. And one of the good things about the discussions this week was exactly this, that they agreed to relieve that on each other.

So for example, NVIDIA will be allowed to export to China except for the very much more advanced macro electronics. I think that's good news, right? We continue to export to each other and therefore the critical dependencies are satisfied, at least for another year.

Steve Odland: Yeah, it is good. And there's another degree of complexity overlaid on this. The EU and the US are allies, the North Atlantic Treaty Organization (NATO) is the organization. China and the EU and China and the US are, what would we say, geopolitical adversaries. We're not at war but they're adversarial relationships. They're not allied in that regard. So the trade agreements and the trade flows have to be thought of just slightly differently in the context that you don't want to equip China from the EU or

from the US with technology or with capability that could then be used in a hostile act against us. So there's this overlay of thinking on all of these trade flows.

Maria Demertzis: Absolutely. There was a very recent example, just last week, actually, of exactly this argument that you described, Steve, playing out where a semiconductor firm that is housed in the Netherlands-- it rests in the Netherlands but is Chinese owned-- was identified as stealing, effectively, know-how. This has come out in the news and is a company called Nexperia Semiconductor Company. What happened, which had been unprecedented, is that the Dutch government actually took control of the governance of this firm for a year. So this is not expropriation. It took control for a year and actually replaced, through courts order, the CEO of the firm. To do this legally they invoked an act that was a relic of the Second World War and had never been used. So in that respect, it's really unprecedented.

But it goes down to this issue that you just described, you know, how to make sure that our technology is protected, particularly in sectors that are of critical importance for the economy. And of course, semiconductors are really at the center of this. So this was an incredible act that has got huge implications for relations.

China had retaliated by forbidding the parent company from exporting into the EU all the things that the Dutch subsidiary was sending to China. So all of this is an escalation. Where is this going to end?

Steve Odland: It's the same story, or similar story, with the US and TikTok and the use of TikTok to spy on industrial operations and so forth. A lot going on here. There are a couple terms that people use when they're describing these shifting sands of trade, and that's friendshoring and de-risking. Because right now we've got too much-- we meaning the West writ large-- have too much dependency on certain regions, China in particular. There is a trend here to de-risk supply chains. Talk about how that is progressing.

Maria Demertzis: The US is much more advanced in this thinking. There is a lot more de-risking from China in the US than it is in the EU when it comes to supply chains. And I think the supply chains are perhaps the most important in terms of seeing the effects of all of this. I think when businesses think about how do I secure continuity in my production, they're thinking exactly about the supply chains. Businesses really are thinking, should I just shorten my supply chains by means of ensuring continuity. So it's almost like a resilience versus a profit discussion that is going in the minds of the business people and I think that's very important.

But recently we've seen a little bit also on the trade happening. Let me comment on a couple of things. Chinese trade with the US has reduced a lot this year, almost about 30%. Chinese exports to the US have really gone down. That is of course a direct reflection of the tariff. When it comes to the EU, we have seen a little bit of an increase in trade coming from China and that, of course, has raised a few alarm bells here in the EU because it feels very much like what China cannot sell to the US is trying to dump into the EU beyond what the EU needs.

Because of course we have a trade partners. We satisfy the demand for Chinese goods and all of a sudden now we also need to absorb what the US is no longer buying. So there is that fear and we have evidence of that. We've seen it also in the car industry where China has been very quick to adapt what it sells to the EU and what it doesn't sell to the EU as a way of getting rid of what we now know is the excess capacity.

The other thing that we've seen is that China is really pivoting towards its close neighbors, the Asian countries. So the trade with close Asian countries has increased quite significantly this year. It means that China is finding new markets but another thing that it might mean, and that is less easy to establish but we have ways of doing that, is that China is using its neighbors to reach the US.

So it's bypassing the tariffs and it is just using its neighbors for that. And I think the US is trying to tighten up on this. This is why the US also imposed tariffs on neighboring countries to China, simply to try and prevent that from happening.

There are real shifts happening in trade now. And the question is, what's the end game? Will that be good for trade? Will that be bad for trade? All of this is currently playing out.

Steve Odland: We're talking about global trade and the changes going on as we speak. We're going to take a short break and be right back.

Welcome back to C-Suite Perspectives. I'm your host Steve Odland from The Conference Board and I'm joined today by Dr. Maria Demertzis, the Economy, Strategy & Finance leader in our European center. Maria, we were talking before the break about some of the geopolitical overlays. Another aspect to trade is how it's done, what currencies are used. Today the majority of trade is done in dollars. Given some of the occurrences over the past year and the shifting sands, do you think that will continue going forward? Or do you think other currencies will begin to rise, including cryptocurrencies?

Maria Demertzis: I think there are maybe two things to say here. In terms of currency, the dollar is used for two main reasons. One is because it's a good currency. Everybody wants to use it because it is a good store of value. But the other one is a currency as a payment method.

I find it very difficult to believe that the first part, the currency as a store of value, the dollar will be replaced anytime soon, for two reasons. It's a good currency will remain a good currency, but there is not another alternative that can actually take that role and replace the dollar as a store of value. So that means to the extent that what you describe will happen, it will happen slowly.

But when it comes to payment methods, the dollar is a payment method that, here I need to reply that most of the trade that happens, let's say Brazil and China, they pay in dollars, or Chile and India, when they trade with themselves they pay in dollars.

Why do they do that? They do that because they use the infrastructure that the US provides, which is called the settlement. It's a legal infrastructure for settling activities. I think that part, that is changing and it's changing very fast with technology. There are other means that people can use to transfer money from one country to another that can actually bypass the dollar. So I think that part will change.

And you see it also now with the new technological means coming out. Originally was the Bitcoin. There are other things that people can use to do that. And now lately we've seen stable coins. If the stablecoins are dollar-pay stablecoins, you won't bypass the dollar. But if the stablecoins are under Euro or other currencies, then they will bypass the dollar.

So I think that on the store value, the dollar will continue to be what it is. But when it comes to the means, the currency to trade with, that will change because technology will provide some options.

Steve Odland: Yeah, it's really interesting. And the rise of the stablecoin and particularly dollar-based stablecoin is a really interesting thing because it...

Maria Demertzis: Maybe we can talk about this in another podcast!

Steve Odland: Yeah. It just provides the consistency of the dollar but uses a different vehicle, essentially. To your point earlier in our conversation, if you have this surplus of goods coming to the US, then you have a surplus of dollars going to Europe. Those dollars have to go somewhere. You mentioned the European investments back in the US but it also then allows this store value, as you're talking about, and the ability to use it as a reserve currency. All of these subjects are intertwined and fascinating to think about.

We've talked about in our last podcast, the global multilateral system. Multilateral just is a fancy word for many countries involved. Bilateral is just trade between two countries, of course. We've been focused on bilateral trade between the US and China, the EU and China, and the US and EU. How about the whole multilateral system? Do you see that changing dramatically?

Maria Demertzis: I think for the moment it's not functioning very well. It's always doom scenarios that we talk about but let's just talk about some things that are actually still functioning and I think continue to function. We have global health systems and monitoring these that are working better. After the pandemic this was necessary. We have still what we call the global financial safety net. Institutions like the IMF, the World Bank, global development banks, and a number of other different banks, they're increasing their mandate in terms of investing globally.

So there are multilateral actions that are going on that are hopeful. And there's still agreement with those and we are not losing them. Like the G-20, for example. You have the 20 biggest countries in the world come together and they talk that as an institution still functions.

Where we see less good news, if I may, is really on peace and what the UN can do to enforce peace. We see pockets of war closer to where I live that are problematic and how the global community cannot resolve them fast. So I think that's one issue that requires a little more persistence.

And then the other thing is, of course, what you discussed about the World Trade Organization, which is a common rule book for how are we going to do business with each other. And that book, because it was written by the US and Europe with one pen, China came in and said, listen guys, you've written a book for yourself so I want to have a different book. And we are in the process now of what will this new book look like? China wants to hold the pen as well and one can understand this given that it's such a big player.

But for the moment, the global rule book that the rest of us have put forward is just not suited for a country like China. Because they have a complete different way of thinking about things. They're thinking about competition. And of course, it's not a democracy, and that creates problems by itself, which, of course, means that the WTO for the moment is not functioning. And the fact that the US is blocking the appointment of a new judge, it's just a reflection of saying, look, this isn't working.

We need to find a different way of doing business with each other. And the question is, how and who's holding the pen?

Steve Odland: I had no idea that WTO rules were written with one pen. That must have been a pen with a lot of ink in it.

Maria Demertzis: Yeah. It's a metaphor that you shouldn't want stretch.

Steve Odland: Exactly. Exactly. If you could wave your magic wand, Harry Potter-ish speak, what are the top three things that you would change in the policy world today in any of these regions?

Maria Demertzis: Between the US and the EU first, I think we have a lot more in common than we have in differences, and that's what we need to get to. The first thing I would do is I would erase all tariffs so that we have no tariffs between the two parts.

Steve Odland: So you would say that both regions should eliminate all tariffs.

Maria Demertzis: All tariffs, everything. It's not just the US eliminated tariffs, the EU has tariffs on the US too. All of these need to go.

Then the question is the rule book and the common standards. Can we agree at least on some things? So here I'm thinking of the critical technologies which are so critical for advancing with the green transition, but also advancing in terms of reducing some of the dependencies from China. Because both geographies have got uncomfortable dependencies on China when it comes to the critical materials, for example, right?

So we find a common rule book that will recognize each other's standards so that we can cut the red tape and businesses can scale up. This is what I would do, I would sort concentrate on finding common standards. So when it comes to the critical technologies-- and that includes of course, all the regulations around it-- such that businesses in the two geographies don't have to have compliant costs that are exorbitant. This part we do very well in Europe, where we have very complicated rule books and that increases the cost of compliance tremendously.

So that is two things I would certainly do. But beyond that, you cannot ignore -- we, the rest of the world-- you can't ignore China, particularly if you want to deal with big issues like climate. We are not going to-- the US and Europe and, whoever else alone-- solve climate. We need to engage with China. We need to find a way of talking to China and find common ground. What can we do that is common?

China for all the grievances that we have with it, actually's totally solved on the green transition and climate. There you will find a credible partner. And the question is, can we agree on other things such that when we sit around the table we can also advance on climate, the one problem that it really is a global problem?

Steve Odland: It's really true. And so therefore the multilateral agreements are really super important. And we hope we can get back to that.

The US administration's trying to rejigger the fairness and trade flows and so forth. There are reasons for that there. There are defense reasons, security reasons, and so forth. But at the end of the day, you would hope that you could lower tariffs. You made the point before that lower tariffs, freer trade has contributed to a great rise in wealth and removed many billions of people from poverty. We need at some point to return to that.

Maria Demertzis: I totally agree with that. One thing I'll say about tariffs is it's very difficult to remove them. The reason for this is totally political economy and that is that they generate revenue. If you're going to remove tariffs, you'll stop having that revenue. So whatever you were using that revenue for, you need to find other income to replace it. So that the political economy of tariffs unfortunately has what we call locking effects. You're locked into spending the money that they generate. This is why I hope that these tariffs do not get entrenched, so that we can reverse them at some point. Go back to freer trade.

Steve Odland: Yeah, exactly. Last question if you're in a leadership position in a company, in the private sector, watching all of these government actions, regulatory actions, trade actions, and so forth, what steps do you recommend that these companies take to ensure that they end up in a good place?

Maria Demertzis: At the Conference Board, we speak a lot to our businesses out here in Europe. The one thing that comes back over and over again, it's uncertainty. One company was telling us they're having a five-year plan without any numbers. How can you do it as a business? How can you do a five-year plan without having numbers? What about your cashflow? How do you pay salaries? How do you pay the bills? And yet, that

is the reality.

They were telling us that everything is so uncertain and volatile that even if they put numbers, they wouldn't carry, they wouldn't have any confidence that those numbers are really reliable numbers. What do you do then? My view on this is that you need to go back to what you know, businesses know very well, which is scenarios. You need to prepare not just for one thing. You need to prepare for many different things.

Now, here comes an important trade off, and you might have seen this piece I wrote during the summer. This is the message I was trying to convey with that piece that when you prepare for a very wide set of circumstances, you're not very well prepared for either of them. But that's the moment where you are in. You cannot just prepare perfectly for one set of circumstances because they might not materialize. You need to be prepared for many different things. We could have tariffs or we could not have tariffs. The war in Ukraine ends or it doesn't end. China does some crazy things in Taiwan. All of these things are no longer black swans. They're gray swans. And you need to decide how many of these do you want to be prepared for? You can't prepare for everything so you need to come sit down and decide which five, six things you want your business to be able to deal with and survive.

You're going to prepare for a variety of circumstances and you know you're going to care about doing optimal actions of maximizing your profits later on down the line when this uncertainty has ceased. Now the uncertainty is just unnavigable. You just cannot navigate it.

Make sure you survive. Make sure you control, I'm going to use your line here, Steve, control what you can control and prepare for the possibility that many different things can happen. That's what it is, that boils down to, scenario and some choices of what things you want to be prepared for and inevitably what things you cannot be prepared for.

Steve Odland: And you can always turn to The Conference Board-- tcb.org-- and use our Gray Swans tool to model out what those issues could be for your company and, of course, model out contingency plans.

Okay, we're going to leave it there. Dr. Maria Demertzis, thanks for being with us today.

Maria Demertzis: It's great, a pleasure to be here. Thank you for having me.

Steve Odland: And thanks all of you for listening in to C-Suite Perspectives. I'm Steve Odland and this series has been brought to you by The Conference Board.

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