

## RTA EXCHANGE NEWS DIGEST

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#### INTRODUCTION

Press news and reports on regional trade agreements these past weeks have been strongly influenced by the decisions taken by the new US president, the “navigation” of the Brexit debates through the British parliamentary system, and the possible consequences that these “new” approaches to trade policy would have on international trade cooperation and global markets.



*Source - Matt Kenyon, The Financial Times*

In one of his first official acts, [President Trump signed](#) an executive order removing the United States from [the Trans-Pacific Partnership \(TPP\)](#), a 12-nation trade deal whose negotiations commenced under President George W. Bush and were concluded under President Obama; in another executive order President Trump signalled his intention to renegotiate [the North American Free Trade Agreement \(NAFTA\)](#). Together with his approach to immigration – including the building of a “wall” along the US - Mexican border – these decisions have led many to worry about the possible re-orientation of US trade policy, moving away from regional and multilateral initiatives towards bilateral ones.

Removing the US from the TPP and revisiting NAFTA also increase uncertainty about the reliability of the US across a range of foreign, economic, and security matters. President Trump has also suggested that protectionism would make the US stronger. However, as pointed out by Joshua Meltzer and Mireya Solis in a [Brookings paper](#), the damage here in terms of lost trust will outlast the Trump administration and will be hard to rebuild. History and economics have demonstrated repeatedly that protectionism has severe costs, they concluded. But as pointed out by the Financial Times columnist, Philip Stephen, the danger with nostalgia is that [it can blind you to progress](#).

Through the 1980s and 1990s many developing countries embraced open markets and reduced the role of government in economic policies. [This led to an economically interdependent](#) and more globalized world while at the same time paving the way for regionalism and increasing the number of regional groupings in the 1990s. Some of these regional groupings were inspired by the successful European economic integration process, and led to the formation of similar customs unions and free

trade areas, such as ASEAN, Mercosur and NAFTA that facilitated trade between members through the removal of trade and non-trade barriers.

In addition to these regional arrangements, mega-trade agreements were negotiated, which included the TPP and [the Transatlantic Trade and Investment Partnership \(TTIP\)](#) between the US and the European Union, an initiative launched officially in 2013. China eventually entered the fray through a China-led mega-trade agreement, [the Regional Comprehensive Economic Partnership \(RCEP\)](#) that brings together 16 countries.

Although it is too early to reach definitive conclusions from these rather recent decisions and processes, countries need to start considering seriously not only how to react to them, but also the alternative options that can be put in place to keep and consolidate their development strategies, and to continue fomenting their reciprocal trade arrangements.

Also, [as pointed out in these pages before](#), after years neglecting the value of [the World Trade Organization \(WTO\)](#), it is time to reconsider the important function the institution could play under the current circumstances. As stressed recently by [Arvind Subramanian](#), the time may have come for “emerging” countries to revalue the role of the WTO as the place where their development options, which include open markets and liberal economic policies, could be fostered and, indeed, promoted. But a WTO’s revival will not happen automatically. Willing stakeholders must actively pursue it and the most obvious candidates for the job, in the view of Subramanian, are the mid-size economies that have been the greatest beneficiary of globalization, Thus, the champions of multilateralism should include countries such as Australia, Brazil, India, Indonesia, Mexico, New Zealand and South Africa, among others. Because none of them is large enough, they must work collectively to defend open markets and multilateral deals. Let’s hope they do so.

### IS THE US EMBRACING BILATERALISM?

Trade policy under the new US administration may undergo significant changes. Multilateral and regional trade deals do not seem to be highly appreciated in the new US Administration. One of the first “executive orders” signed by President Trump was to withdraw the US from the TPP agreement, which was under process of ratification by its 12 participating countries. President Trump has also called for the renegotiation of the NAFTA, the first significant free trade pact in which the US participated in, more than twenty years ago.

So far, President Trump has used Executive Orders to implement his proposed policies, and has not signalled any interest in engage in new trade agreements. It would be a grave mistake to underestimate the power of the US presidency – or to exaggerate the ability of checks and balances to rein in radical policies, [according to Gary Hufbauer](#), a leading expert on US trade policy. Although written before the US presidential elections last year, Hufbauer analysis is even more relevant now that President Donald Trump is busy implementing the trade promises from his campaign. Would President Trump have the powers to carry out these actions without Congressional consent? Would the courts stop him? The simple answers are that he would have such powers, and he is not likely to be derailed by the judiciary, according to Hufbauer.

As reflected in a recent Brooklyn publication, President Trump has made clear that [he believes bilateral trade deals are better than regional or multilateral agreements](#). President Trump’s embrace of bilateral negotiations is borne out of his understanding of the global economy as a zero-sum game. From this

starting point, it follows that [the key question in assessing any trade deal](#) is not whether it creates overall economic gains, but how its benefits are distributed between countries—who's getting the biggest slice of the pie.

Abandoning regional and multilateral deals for a bilateral worldview could institutionalize President Trump's mercantilist approach to the international trade system, in which countries are locked in zero-sum competition to win market shares, rather than cooperating to improve economic efficiency. Over the long term, the risk is that the rules, norms, and laws that govern trade relations will erode, along with the effectiveness and legitimacy of the WTO.



*Source - Doug Mills, The New York Times*

As pointed out recently by Lawrence Summers<sup>1</sup> in the Financial Times, trade agreements have been central to American politics for some years. The idea that [renegotiating trade agreements](#) will “make America great again” by substantially increasing job creation and economic growth swept Donald Trump into office. More broadly, the idea that past trade agreements have damaged the American middle class is now widely accepted in both major US political parties.

However, it is inconceivable that multilateral and or regional trade agreements, such as NAFTA, have had a meaningful impact on US wages and jobs for the simple reason that the US market was almost completely open before entering into any of the controversial agreements.

American tariffs on Mexican goods, for example, averaged about 4 per cent before NAFTA came into force. China had what was then called “most favoured nation” trading status with the US before its accession to the WTO and received the same access as other countries. Before the Korea Free Trade Agreement, US tariffs on Korea averaged a paltry 2.8 per cent.

The reason for the rise in US imports is not reduced trade barriers. Rather it is that emerging markets are indeed emerging. They are growing in their economic potential because of successful economic reforms and [greater global integration](#). These developments would have occurred with or without US trade pacts, though the agreements have usually been an impetus to reform.

Thus, a strategy of returning to the protectionism of the past and seeking to thwart the growth of other nations is untenable, and would likely lead to a downward spiral in the global economy. The right

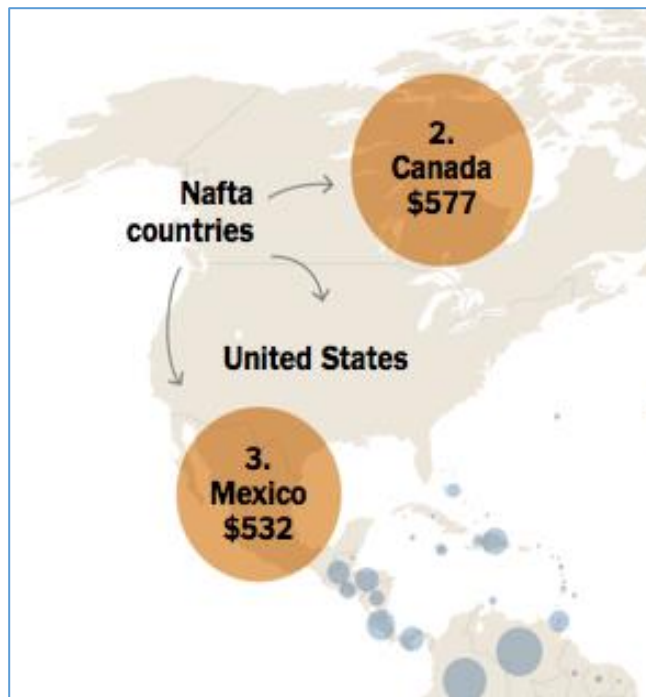
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<sup>1</sup> Lawrence Summers is Charles W. Eliot University Professor at Harvard and a former US Treasury secretary

approach, concludes Mr. Summers, is to maintain openness while finding ways to help workers at home that have been or will be displaced by technical progress, trade or other challenges.

During its first month in office, President Trump has taken adversarial positions with major US trade partners, with the possible exception of the United Kingdom and, perhaps, Japan. In [Mexico](#), for example, government officials are scratching their heads about what President Trump hopes to achieve by threatening to walk away from the trade agreement that has cemented bilateral relations for the last quarter-century. “What is a better NAFTA?” asked Douglas Irwin, a trade historian at Dartmouth College, “he hasn’t said.”

Though Canada is not the focus of President Trump’s criticism of NAFTA, it will be affected by whatever renegotiation of the agreement takes place, which is why Canadian Prime Minister Justin Trudeau has focused on his country’s more than \$500 billion trade relationship with the US when he met President Trump for the first time in mid-February. While Canadian-US trade is roughly balanced, [Canada is the biggest trade customer](#) to 35 US states, including most of the Midwest manufacturing belt that helped secure President Trump his election victory.



Source - *The New York Times*,  
Total goods traded with the US in 2015

With regards to the European Union, the desire of some in President Trump’s administration is somewhat unclear. [Mr. Peter Navarro](#), an economics professor appointed to head the newly created National Trade Council, said that Mr Trump regards the TTIP, the still in the making trade pact with the EU, as in effect a multilateral deal since it involves a variety of different countries. Hope among European leaders that President Trump would take a softer tone than the one expressed during his campaign, leading to [a more temperate one as commander in chief](#) are dissipating, replaced by a mounting sense of anxiety and puzzlement over how to proceed.

As far as China is concerned, leading US China experts have apparently endorsed Donald Trump’s tough [approach to trade with Beijing](#), contending that an increasingly unbalanced economic relationship requires a change in Washington’s policy. The call by a task force of academics and former US officials comes amid fears that the new President could set off a [destructive trade war](#) between the world’s two largest economies.

In their report, the experts argue that an increasingly protectionist and mercantilist China has left the US no other option but to get tough after the failure of diplomacy and more moderate trade actions. “The relationship in many realms is grievously out of balance and nowhere is this more evident than in trade and investment,” [said Orville Schell](#), a China expert at the Asia Society and one of the report’s authors. The [figures](#) released recently showed the US trade deficit in goods with China represented almost half the US’s \$763bn overall US trade deficit in goods.

Thus, expect [tensions between China and the US to be high](#). Xi Jinping, the Chinese president, reminded global elites assembled at Davos that “no one will emerge as a winner in a trade war”. If America targets Chinese trade, China will hit back. So what might a trade war between the two economic powers play out?

As referred to by [The Economist](#), there are two ways in which talk might translate to action. President Trump might try simply to enforce the rules of global trade in the courtrooms of the World Trade Organisation (WTO). Since the United States has no bilateral trade deal with China, WTO rules define what is and is not allowed in their bilateral trade relations and recourse to the WTO is a normal way of dealing with trade irritants; the rules of the WTO are designed specifically to handle this kind of dispute, and if the system works as it should, any recriminations would be contained.

But the big fear is that President Trump decides to bypass WTO rules, or ditch them altogether after a decision does not go his way. A blanket tariff of 45% on Chinese imports, for example, would clearly violate WTO rules, and the Chinese would not wait for an official ruling to retaliate. There would be some winners from a trade war, and the biggest casualty may not even be the American consumer.

After the Second World War, rich countries coordinated to avoid a race towards higher tariffs, creating the General Agreement on Tariffs and Trade (GATT), which in 1995 grew into the WTO. In coming together, they recognised the destruction of the 1930s, when countries erected trade barriers to protect their domestic economies but ended up harming themselves as a result. A trade war would mean abandoning an institution that recognises that countries are stronger when they work together.

“The idea of trade wars these days, what politicians have in mind is really a 19th-century or early 20th-century conception of trade,” said Gianmarco I.P. Ottaviano, a trade economist at the London School of Economics. President Trump owes his office in no small measure to factory workers who have come to [view global trade as a mortal threat](#) to their livelihoods. But their sentiments are grounded not in ideology, but in a desire for jobs at decent wages. If President Trump impedes imports, he could put some of these voters out of work.

For his part, the WTO Director General Roberto Azevedo said he is confident the WTO could cope with any new US trade policy. Azevedo said he did not know what trade policy President Donald Trump would adopt but had heard his concerns about “unfair trade” and his comments regarding a possible [withdrawal from the NAFTA and maybe the WTO itself](#). The WTO, a forum for resolving trade disputes and negotiating new trading rules, offers the tools to address many of concerns that had been raised, Azevedo said, and he is confident other [WTO members wanted to find a path forward](#).

## BREXIT: THE FINAL COUNTDOWN

The Brexit controversies – “Brexit means Brexit”, “hard” and “soft” Brexit, Brexit “first” and then agreements with other countries – have dominated the British political scene ever since the Brexiteers won the referendum in June last year. They have entered into a new, decisive stage with the UK parliament debating and defining its role on this key, historic initiative.

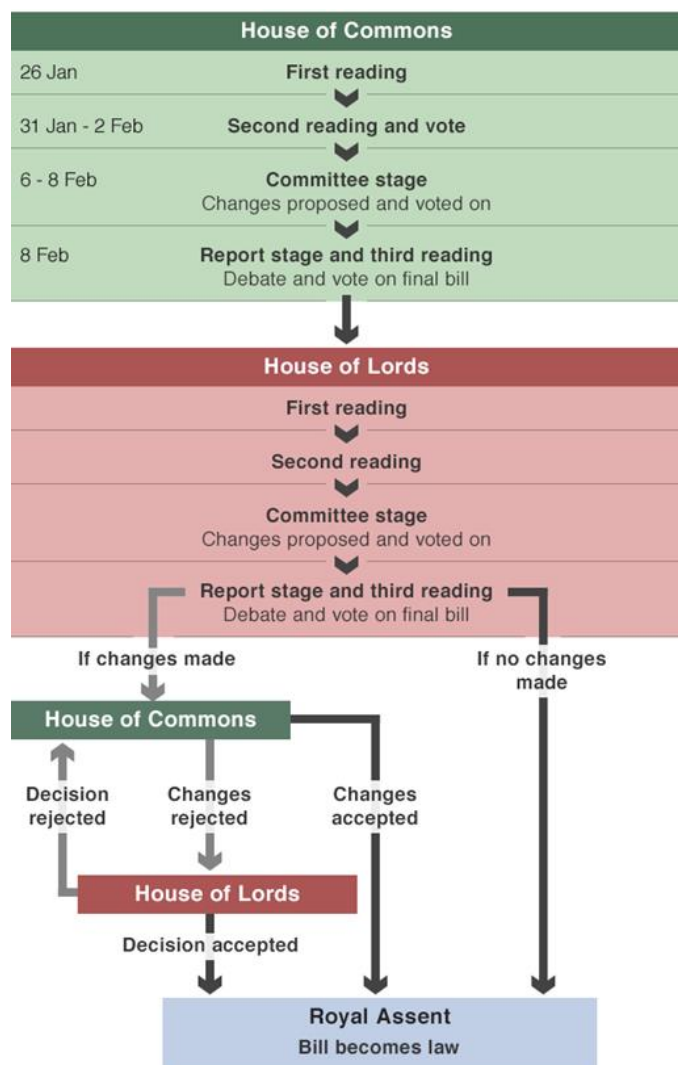
On February 8, the House of Commons [overwhelmingly agreed](#) – by 494 votes to 122 - to let the government begin the UK's departure from the EU. The draft legislation then moved to the House of Lords where it should face no major impediments. Prime Minister Theresa May is expected to trigger formal Brexit talks by the end of March.

Despite facing in the House of Commons, a series of amendments could have watered down the bill or forced the government into greater parliamentary accountability, none was passed and the bill went through un-amended. These amendments include giving EU nationals [the automatic right to remain](#) in the UK so as to guarantee their rights before Article 50 of the Treaty of Functioning of the European Union is triggered. The amendments also called for a second EU referendum before Britain leaves the EU.

Thus, the last few weeks were devoted [almost entirely to clarifying the paths and procedures](#) that the UK government needed to follow to start the EU exit negotiations (i.e., to materialize Brexit). The rather complex Brexit legislative approval is better understood by looking at the graph below.

Getting the support of the UK parliament to kick-start the Brexit process is just the beginning of a debate that will continue for the next few years. [As underlined by Martin Wolf in a recent article](#), the UK wants, rightly so, an amicable divorce “to continue to trade with the EU as freely as possible, to cooperate to keep our countries safe, to promote the values the UK and EU share — respect for human rights and dignity, democracy and the rule of law both within Europe and across the wider world, to support a strong European voice on the world stage, and to continue to encourage travel between the UK and EU.”

Yet, driven by its desire to control immigration and free itself from the European Court of Justice, both presumed to reflect the “will of the people”, the UK government plans to leave the single market and the customs union. So is it likely to be able to reach a deal? To do so, the UK has to cope with five daunting challenges: lack of time, divergent interest, divergent negotiating priorities, money (the “exit” bill), and complexity. In all, the chances that a deal will not be reached in time could be high.



Source - [Parliament.co.uk](#) and [BBC Analysis](#)  
Brexit Bill: How it Moves through the Parliament

Martin Wolf concludes, with a mix of pessimism and nostalgia, “the UK has committed itself to becoming “global Britain”. Getting there successfully will be a big challenge. In her preface to the white paper, Theresa May claims that Britain is coming together. The prime minister is right that the majority of “remainers” hope her form of Brexit will work: this is our country, too. Yet most of us still believe that the path on which the UK is launched is deeply against its interests. We must hope we are wrong.



Source - *The Financial Times*

Also, as stressed by [The Economist](#), a different sort of Brexit bill is approaching, which will be harder to manage, and has so far been very little discussed in Britain. This bill for departure, being drafted by EU officials in Brussels, would put Britain’s contributions in amounts close to its membership fees for several years after it leaves, contrary to what the promoters of the “leave” campaign had indicated. [A report from the Centre for European Reform](#) estimates the cost at anywhere between 24.5 billion Euro (\$26.1 billion) and 72.8 billion Euros. For his part, the EU Commission negotiator, Michel Barnier, is said to consider that the bill stands between 40 and 60 billion Euros. [It is too early though to draw conclusions](#) on this issue, which so far has been very little discussed in Britain, but lack of discussion will not make it disappear.

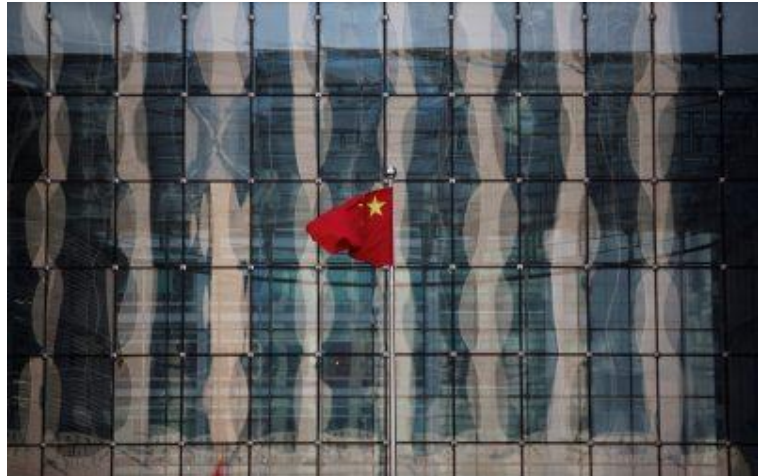
#### *Searching for new trade partners:*

While leaving the European Union after 44 years of membership, [the UK is planning to redesign its trade relationship](#) with the rest of the world. It is not going to be easy. Not only is the UK breaking up from its biggest trading partner, but it is doing so when its next largest trade partner (United States) is probably moving towards protectionism. Also, the UK is part of a global — but most of all European — value chain and has a relatively weak trade position in other markets.

Indeed, UK’s trade ties with the EU are substantial. The EU is by far the UK’s largest market. The value of UK goods exported to the EU is about the same as its exports to the rest of the world. Imports from the EU total more than that from all other countries combined. Also, as part of a global — but mostly European — supply chain, about 60 per cent of [UK exports](#) are intermediate and capital goods, or raw materials, not final consumer goods.

But exports of goods are only one part of the UK trade story, and not the most profitable. The UK exports almost as much in services as in goods. In 2015 they amounted to £230 billion and £266 billion respectively, but it imports nearly three times the value of goods than that of services. This leaves the country with a large and widening goods trade deficit and a similarly large and widening surplus in services trade.

As argued by Jim Rollo, a former trade adviser to the British government, Britain still has some cards left to play. One reason that trade deals with the EU take so long to negotiate (18 years and counting in the case of the EU-Mercosur deal) is that [European agriculture is strongly protected](#). Once outside the EU, Britain could abolish the EU external tariff on many food imports and gain concessions in return. The freedom to sign trade deals with any country offers a world of potential. But even replacing the deals that Britain will lose on dropping out of the EU will take many years, and new opportunities may be harder to realise than they look.



Source - ANU

To start with, the UK and the EU27 governments now face two negotiations. First come the divorce proceedings, which will start when Britain invokes Article 50 of the TFEU (by the end of March 2017) and are required to not exceed two years. Second, they will have to negotiate under Article 218 of the TFEU on all aspects of the future relationship between the UK and the EU as a whole. These negotiations will be hugely complex because, one way or another, the UK will continue to be deeply integrated with its former EU partners.

From the EU27 side, the task is doubly complicated. Each government must decide what it wants and what it could be ready to concede. Then all 27 governments and the European Parliament must negotiate among themselves what their collective position will be for the negotiations with the UK. These various dilemmas are discussed at length in [a new eBook](#) aimed at contributing to the significant challenges that lie ahead.

#### *Moving to a multi-speed Europe:*

It is mildly ironic that Paolo Gentiloni, Italy's prime minister, chose London, the capital of Brexit, to [give a speech about the EU's future](#). "We have to move forward in a much bolder way with the member states that are willing to do so," he told a conference at the London School of Economics. This approach would allow all countries to find a place and a suitable degree of integration within the EU. We need a flexible, reformed and united EU in which different degrees of policy integration can coexist successfully.

The desire for a renewed push on European integration is sincere. At least four factors are behind it. First, Brexit removes from the scene a country long seen as an obstacle to closer integration. Second, the Trump administration's unnerving steps in economic and foreign policy are driving EU policymakers to the conclusion that Europe must stand more firmly on its own feet. Third, Russian pressure makes advisable a stronger, more united Europe. Finally, as Mr Gentiloni suggests, a more effective EU would in principle be a powerful response to what he calls "the apparently irresistible rise of reactionary populism" in European democracies. Thus, the objective is clear. The tricky part, as always with the EU, is how to attain it.



## REGIONAL TRADE AGREEMENTS ELSEWHERE

While world attention to the “new” US trade policy and the Brexit debates dominate the news, elsewhere in the world, RTAs continue their own dynamics, and may even profit from these largely unexpected developments. It’s too early to reach final conclusions on the consequences that an emphasis on bilateral deals and more protectionist policies in the US, and the increasing attention that the Brexit “negotiations” would require from the EU institutions would have on other countries, but they will not go unnoticed.

Mexico and the NAFTA agreements would be under strong pressure from US policy makers and may undergo significant changes in the future. In other Latin American countries, [the effects would probably differ](#). There is talk of a rapprochement between the Pacific Alliance – which includes Chile, Colombia, Peru and Mexico – and a reinvigorated Mercosur – with Venezuela out of the group and Brazil and Argentina working together to remove barriers within the group and [to strike trade deals beyond it](#). Japan, a signatory of the TTP, from which the United States has now withdrawn, says it is interested in a deal with Mercosur. The European Union as well has hinted that it would like to conclude a long-delayed [agreement with Mercosur](#) this year.

In Africa, preparations for the negotiations of the Continental Free Trade Area Agreement have continued at the technical level, and [a meeting of the negotiations group](#) was held in late February in Addis Ababa. This was preceded by a roundtable discussion in South Africa, where countries from the region had the opportunity for reflection and frank discussion about recent developments and future prospects in light of key decisions (including Brexit in June, and the US election in November) and the way they may affect their future integration policy, [geopolitical and development trajectories](#).

RTAs in Asia as well would not be immune to current developments, and all eyes are now turning to the Regional Comprehensive Economic Partnership (RCEP) agreement. The RCEP is comprised of the 10 Southeast Asian members of ASEAN, and Australia, China, India, Japan, New Zealand and South Korea, but has received much less attention than other agreements, and until now has been studied very little.

A big misconception is that RCEP is China-led or China dominated. However, China only one spoke in the wheel, with ASEAN at the hub. The RCEP was built to consolidate ASEAN’s five separate free trade agreements with China, South Korea, Japan, India and Australia–New Zealand. The second misconception is that RCEP is a low-standard agreement that will not shape commerce to any serious extent within the participating countries, let alone beyond it. But that is yet to be determined and [completely misreads the potential of the agreement](#).

Strategically, how RCEP evolves will determine whether trade becomes a force for cooperation and integration across the wider Asia-Pacific region, or a cause of rivalry and economic fragmentation. According to the authors, the RCEP is now the best path towards a Free Trade Area of Asia and the Pacific.