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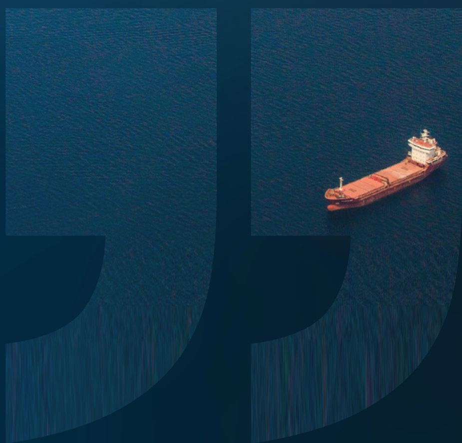
TRADING PLACES
RECENT DEVELOPMENTS IN INTERNATIONAL TRADE



– THOUGHT LEADERSHIP

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TRADING PLACES: RECENT DEVELOPMENTS IN INTERNATIONAL TRADE

Events over the past 18 months have put trade at the centre of international economic diplomacy and may potentially lead to dramatic shifts in the global trade order.

On the one hand, significant developments have occurred that suggest that barriers will now emerge where trade has flowed freely. For example, the United States – traditionally the dominant voice in international trade – is seeking to rebalance U.S. trade policy through vigorously pursuing an "America First" policy in the name of restoring a level playing field and defending U.S. workers. Similarly, Brexit may lead to fundamental changes in the trade relationship between the United Kingdom and the European Union, creating barriers where none have existed for four decades.

On the other hand, the United Kingdom has argued that Brexit is a precursor to its launching a highly ambitious plan to forge free trade agreements with countries across the globe. Other countries are also advancing the free trade agenda. The European Union is actively pursuing trade agreements with its key trading partners, having agreed landmark deals with Canada and Japan, and has other significant negotiations underway, including with Australia and Mercosur.

China has placed momentum behind establishing a regional trade agreement, the Regional Comprehensive Economic Partnership (RCEP), which, once finalised, is estimated to account for almost half of the world's population, about 30 percent of global GDP and a quarter of world exports.

These developments could lead to significant changes in how cross-border trade is conducted and, therefore, merit careful attention from businesses engaged in global trade. We review some of these dynamics below and provide context to help to explain why they are occurring.

The Trump Administration and U.S. Trade Policy: an evolving situation

One of President Trump's first actions in office was to fulfil his campaign commitment to withdraw from the Trans-Pacific Partnership (TPP). For many, this move and his subsequent rhetoric about pulling out of existing trade agreements and "putting America first" appeared to signal that the United States may give up its traditional position as the champion of free trade. However, several months into the Trump Administration, it is still unclear whether the trade-related threats will have more bark than bite.

Levelling the Playing Field and Protecting the American Worker

The Administration has provided broad guidance on the objectives that it intends to achieve in its trade-related actions, namely, to level the playing field and to protect and promote American manufacturing and the American worker. Two executive orders signed by the President in March 2017 carry through these goals.

The first executive order directs the Department of Commerce and the U.S. Trade Representative to focus on the U.S. trade deficit in goods and to identify areas where trade practices and market barriers contribute to this deficit, as well as the impact of trade relationships on U.S. manufacturing, employment and wage growth. Reducing or eliminating the trade deficit has been a central plank of the Administration's demands of Mexico and South Korea in the ongoing discussions about renegotiating the North American Free Trade Agreement (NAFTA) and the United States-Korea Free Trade Agreement (KORUS). As

Key issues

- Developments over the past 18 months have cast a spotlight on international trade and its changing dynamics
- The Trump Administration's rhetoric suggests a change in the U.S. position as the champion of free trade
- However, businesses are still waiting to see whether the trade threats will materialise into concrete action
- In the Asia-Pacific region, the U.S. withdrawal from TPP has disrupted the long-standing trade position
- Asia-Pacific economies have several options for regional integration through TPP-11, RCEP and potentially bilateral deals with the U.S.
- The European Union is pressing forward with landmark trade deals, including JEEPA

Vice-President Pence said in an early visit to Seoul, the United States intends to renegotiate KORUS to address the concern that the "U.S. trade deficit with South Korea has more than doubled since KORUS came into effect".

The second executive order requires the rigorous enforcement of trade remedies to combat the unfair trade practices of foreign importers. The Commerce Secretary, Wilbur Ross, in a recent Wall Street Journal op-ed confirmed that "[t]he Trump Administration believes in free and fair trade and will use every available tool to counter the protectionism of those who pledge allegiance to free trade while violating its core principles. The U.S. is working to restore a level playing field, and under President Trump's leadership, we will do so".

Since taking office, the Trump Administration has launched a number of trade-related investigations. For example, the Commerce Department, acting on the President's direction, initiated investigations under Section 232 of the Trade Expansion Act of 1962 to determine the effects on the national security of aluminium and steel imports. Neither investigation has yet concluded, but – if the Secretary of Commerce and the President determine that the imports do threaten to impair U.S. national security – the President can impose trade remedies such as tariffs and quotas.

The Administration, through the U.S. Trade Representative, Robert Lighthizer, has also commenced an investigation under the rarely-used Section 301 of the Trade Act of 1974 into "Chinese laws, policies, and practices which may be harming American intellectual property rights, innovation or technological development". This investigation may take a year to conduct and it is unclear what, if any, unilateral trade action the Trump Administration would take in response to a finding of actionable conduct. However, the US Trade Representative has made clear that China is more generally a focus of the Administration as it presents "one challenge on the current scene that is substantially more difficult that those faced in the past".

U.S. companies have also turned in increasing numbers to seeking trade remedies, possibly in the hope of a sympathetic Administration. For example, solar panel and washing machine manufacturers have used another infrequently invoked provision – Section 201 of the Trade Act of 1974 – seeking the imposition of duties on imports from China and other countries. The U.S. International Trade Commission recently determined that imports of solar panels and washing machines cause injury to those U.S. industries, leaving it to the President to decide by early 2018 whether to impose tariffs or quotas on such imports.

In the high profile and highly politicised Boeing-Bombardier dispute, the Department of Commerce preliminarily determined that Bombardier receives countervailable subsidies in relation to its C Series jets of nearly 220 percent, and subsequently proposed anti-dumping duties at a rate of about 80 percent. Final decisions on the countervailing and anti-dumping duty investigations are due in December. The impact of a decision to impose duties was expected to have impacts beyond Bombardier's home country, Canada, and potentially to lead to job losses in Northern Ireland, where components of the relevant aircraft are made. However, a recent deal among Airbus and Bombardier on the production of the C Series aircraft in the United States may bring into question whether the trade remedies will be imposed.

Although these various investigations have yet to give rise to concrete action by the Administration, if penalties are ultimately imposed by the United States, it raises the spectre of a trade war with threats of retaliation being made by China, Canada and others.

Renegotiation of – or Possible U.S. Withdrawal From – NAFTA

The trade issue currently at the front of many U.S. businesses' minds is the

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renegotiation of NAFTA. The trade pact has been a linchpin of North American trade since coming into effect 23 years ago. Since then, it is estimated that U.S. trade with Canada and Mexico has tripled and that Canada and Mexico together are the United States’ leading trade partners. Importantly, the tariff free trade among the NAFTA parties has enabled the development of sophisticated supply and production chains across the North American continent, and facilitated competition with manufacturing centres in Asia.

Candidate Trump campaigned on a commitment to scrap NAFTA, calling it “the worst trade deal ever”. As President, he softened his stance, stating that instead he would bring the agreement up to date through renegotiation. In July 2017, the U.S. Trade Representative released the United States’ negotiating objectives for the renegotiation of NAFTA, including to fulfil President’s Trump’s promise to “get a much better agreement for Americans” and to reduce the U.S. trade deficit.

The NAFTA negotiations are being conducted in secrecy, but many expect that some aspects of the revised deal will resemble the provisions of the Trans-Pacific Partnership Agreement, the negotiations for which included all of the NAFTA parties. The negotiations were proceeding at what the U.S. Trade Representative described as “warp speed”, because of upcoming elections in Mexico and the United States. However, a more extended timetable has recently been agreed to allow the parties to consider the issues on the table. The U.S. Trade Representative has cautioned that “we don’t know whether we’re going to get to a conclusion, that’s the problem”.

A number of reported U.S. demands may be considered as “poison pills” by Canada and Mexico. For example, U.S. proposals regarding a five-year sunset provision, a U.S.-only 50 percent content requirement for automobiles, elimination of NAFTA’s current trade remedy dispute provisions, and potential weakening of the existing investor-state dispute settlement protections. In the event that agreement cannot be reached on these issues, a NAFTA withdrawal by the United States may still be on the table. If the United States does decide to withdraw, the advantages of NAFTA for businesses and consumers would be threatened. Following withdrawal, tariffs on almost all products would be applied. These tariffs would in turn impact the supply chains of auto manufacturers and others, who have organised production across North America around cost efficiencies and resources. Consumer prices would increase and companies could ultimately decide to shift manufacturing out of North America entirely.

It is worth keeping in mind in relation to each of these trade issues that the authority available to the President on trade is not unlimited and there are some practical constraints on his executive powers. In so far as he depends on Congress to move forward his legislative agenda in other areas, there may also be political limits on what he can do with trade. Finally, the Administration will also need to confront the multitude of constituencies – including U.S. farmers, businesses, manufacturers and consumers – who depend on or benefit from trade agreements and are becoming increasingly vocal about their concerns.

A new trade pact between the European Union and Japan

In July 2017, the EU and Japan announced an agreement in principle on a new trade deal, the Japan-EU Economic Partnership Agreement (JEEPA). The Japanese Prime Minister, Shinzō Abe, presented the agreement as “a model for the 21st century order” and “the birth of the world’s largest free advanced industrialised economic zone”. The European Commission described it as “the most important bilateral trade agreement ever concluded by the EU”.

From a political perspective, the announcement of JEEPA was intended to send a strong message in response to the Trump Administration’s perceived retreat from championing global trade. As Commissioner for Trade, Cecilia Malmström, stated: "[w]e are demonstrating that the EU and Japan, democratic and open global partners, believe in free trade. That we believe in building bridges, not walls". Having taken over four years to negotiate, the timing of its announcement was also opportune, taking place on the eve of the G20 meetings.

Estimates are that JEEPA will cover nearly 30 percent of global economic output and 40 percent of global trade, creating a trading bloc to match that formed by NAFTA. Japan is the EU's sixth largest trading partner and the EU is Japan's third largest. Commentators forecast that the agreement will boost EU exports to Japan by 34 percent and Japanese exports to the EU by 29 percent.

JEEPA will substantially lower tariffs on a broad range of products, including, according to the Commission's estimates, 85 percent of European agriculture and food exports. Dubbed as the "cars for cheese" agreement, tariffs on EU agricultural product exports to Japan, including wine, and on Japanese car imports to the EU will be eliminated or reduced; the agreement also provides for protection in Japan of over 200 European Geographical Indications.

JEEPA also makes substantial headway towards trade liberalisation in a number of other key areas, including:

- Addressing non-tariff measures, including the removal of certain regulatory barriers;
- Expanding the coverage of mutual recognition agreements in relation to certain manufacturing practices, for example, for pharmaceutical products;
- Opening up aspects of the services market, including in relation to financial services and telecommunications; and
- Allowing access for European businesses to large parts of the Japanese procurement market.

For the United States, which – following withdrawal from the TPP – indicated that it intends to focus on bilateral trade relationships, JEEPA may weaken its hand in future negotiations for a Japan-United States free trade agreement. It may also be bad news for U.S. agricultural producers and others who will not benefit from tariff reductions and may be forced to adapt to any new regulatory standards adopted by the EU and Japan during the ongoing technical discussions.

The President of the European Commission, Jean-Claude Juncker, has expressed hope that JEEPA can take effect in early 2019. However, a number of issues remain to be resolved before then, including whether to address investor protection and data flows. Any final agreement would also need to be ratified by the European Parliament and by EU Member State national and regional governments, as well as by Japan's National Diet.

Asia-Pacific

Notwithstanding the reversals in trade policies taking place around it, the Asia-Pacific region remains a strong hub of free trade activity.

The withdrawal of the United States from the TPP has left the remaining members – the "TPP 11" – considering whether to move forward with the TPP in its existing or amended form. An attempt to secure a new deal among the remaining TPP nations has grown momentum and there are statements expressed by some members that this may happen in November 2017. This timing may seem ambitious, but there are realistic expectations that a new TPP deal eventually will be signed. However, to get there, significant differences still need to be resolved. Australia, Japan and New Zealand would like to proceed by adopting a new agreement in much the same terms as were agreed when the United States was a party. Vietnam and Malaysia, on the other hand, argue that, since they will no longer have access to the extensive U.S. market under the new deal, why should they still agree to

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compromises made on areas such as labour and environmental protections?

In parallel with the TTP re-negotiation, six TPP nations are also negotiating parties in the RCEP trade deal. This is a trade deal that involves 16 states, including all 10 ASEAN nations, Japan, South Korea and, importantly, India and China. This will be the first trade agreement between the latter two countries – a monumental step for free trade in the region. While negotiations are confidential, reports highlight that RCEP will be a very different agreement to the original TPP. The progressive provisions that the Obama administration fought so hard to include in the TPP, for example, on the environment, state-owned entities, and labour, are not expected to feature in the RCEP. And India, with its new-found scepticism towards investor-state dispute settlement (it has terminated dozens of its investment treaties over the past year) will be pushing back against many states, such as Japan and China, who will require strong dispute resolution provisons to protect their outbound investors. Despite the differences, however, optimism remains strong and some governments have called for RCEP to be concluded before the end of this year (an aspirational rather than realistic goal).

Finally, the future trade winds from the east will be influenced by China's Belt and Road Initiative, a development strategy aimed at filling the infrastructure gap that exists between China and Europe. The Initiative envisions the building of roads, railways, ports and airports on a massive scale that will require hundreds of billions of dollars of long-term capital investment. The Asian Infrastructure and Investment Bank and the Silk Road Fund have been estabilished specifically for the Belt and Road Initiative and aim to inject upwards of U.S.$150 billion into infrastructure projects in the region. Trade and investment treaties in the region are likely to become an important factor in the development of the Belt and Road.

Key takeaways

For business, this shifting landscape means that there is still significant watching and waiting to be done. In practical terms, it is important to plan for different outcomes so as to minimise the disruption that may result from impacts on production and supply chains, transaction costs, logistics and pricing. It is also crucial to engage with government directly or through trade associations on issues significant to your business, to ensure that your concerns and requirements are taken into account in ongoing and future negotiations. We are available to guide you through the potential implications for your business that may result from changes to the legal and regulatory landscapes in light of trade developments.

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