

ARTICLE FOR THE EDGE

HOW SERIOUS IS THE THREAT OF PROTECTIONISM?

US President Trump used his State of the Union speech to reiterate his hard-line views on trade, vowing that the “era of economic surrender is over” and that his administration would “fix bad trade deals”. Only days before the speech, his administration had imposed tariffs on solar panels and washing machines which directly hurt Chinese and South Korean producers but also those producing components for those producers such as manufacturers in Malaysia. Over the past year, the Trump Administration has also blocked the re-appointment of judges to the appellate tribunal of the World Trade Organisation (WTO)’s dispute settlement body, a strategy that would severely compromise the WTO’s ability to act as a neutral arbiter of trade disputes. It has also pursued an uncompromising line in negotiations on both the North American Free Trade Area (NAFTA) as well as the Korea-US FTA (KORUS).

The problem is that this questioning of the benefits of free trade is not only confined to the United States. Unfortunately, there is a growing nationalistic and inward-looking mood in many parts of the world. In India, officials are reported to be questioning the benefits of trade agreements that India has entered into, with many blaming the large expansion of India’s trade deficits on such agreements. In China, policy makers seem to be supporting a new economic model that emphasises the development of indigenous companies and home-grown technologies. As a result, both American and European business lobbies are growing vociferous in their complaints about China’s increasingly nationalistic policies.

Our view is that trade tensions will tend to worsen in coming months, with China a major target. While other Asian exporting nations may not be a direct target, the China-centred supply chains involve many component producers from East and Southeast Asia. Thus, protectionism directed at China will have wider ramifications across Asia.

Still, we believe that this threat to the global trading order that Asian economies depend on, is likely to be contained to some extent by the judicious responses of other major trading nations and the lobbying efforts of internationally-minded American businesses. The net effect will be that trade restrictions could increase but it is unlikely that there will be a trade war or that the ongoing expansion of global trade will be reversed.

Expect a rash of trade restrictions in the near future

Recent statements by senior American officials clearly indicate what we must expect. Treasury Secretary Mnuchin said that he “absolutely” expected to see an acceleration of trade measures during 2018. His cabinet colleague, Commerce Secretary Wilbur Ross added his own warning that some big trade initiatives launched in 2017 “will come to fruition” in 2018.

There are many reasons why trade issues will become more contentious in coming months.

First, there is the effect of simple bureaucratic momentum. When the Trump Administration took office, it initiated a series of investigations into trade issues which are now reaching the point where the studies have been completed and policy actions have to be taken. One example is how America's International Trade Commission has agreed that American producers have been "materially injured" by imports of Chinese common alloy aluminium sheet. That means that the US Department of Commerce will probably impose anti-dumping duties by April. April is also when the administration has to decide on actions on the Commerce Department's investigations into whether steel and aluminium imports threaten US national security. In addition, there is also a so-called "Section 301" investigation into Chinese policies on intellectual property rights protection.

Related to this will be the timetable for negotiations over NAFTA and KORUS. The US side has complained that its NAFTA partners, Canada and Mexico, are not showing enough flexibility or urgency in addressing American complaints about NAFTA. With mid-term Congressional elections due in America in November and Presidential and legislative elections due in Mexico in July, compromise may not be easily achieved, raising the risk that one side breaks off the talks to demonstrate its toughness.

Second, the political pressures for trade actions will grow. Currently, the single most important national security issue for the United States is the likelihood that North Korea would, by the end of this year if not sooner, possess a credible capacity to deploy nuclear weapons against the US mainland. American officials insist that such an outcome is utterly unacceptable and that the US will act to prevent it. But, whatever American officials might say, the fact is that there are virtually no viable military or diplomatic options to achieve this aim – and it is clear that sanctions are not working. As the evidence of North Korea's growing nuclear potential grows, the Trump Administration's rising frustration over its impotence will be taken out on China, which the US sees as North Korea's main supplier of fuel and materials.

Third, the economic case for trade retaliation may also grow in time. The US economy is probably growing a tad above its potential, as low interest rates keep demand ahead of the economy's supply potential. The recent tax cuts in the US will add to that, by boosting demand even more. Inevitably, imports will have to rise to satisfy this growing domestic demand and that will mean an expanding trade deficit which President Trump detests and tends to blame on trade malpractices of other nations than the failings of US domestic policy.

But, are things all that bad?

The threat to global trade is real. What is encouraging, however, is that there are countervailing forces at work.

One of these forces is the strong recovery in world trade. While this is largely cyclical in nature, the expanding benefits of growing trade will create a better political mood in favour of trade while incentivising beneficiaries to organise themselves to fight off protectionist threats.

Another reason for optimism is that, despite the Trump Administration's measures, the overall momentum of trade restrictions appears to be diminishing. The WTO's latest World Trade Monitor provides hard evidence for this. It found that an average of 9 restrictive measures per month were implemented globally in the year to mid-October 2017 compared to 15 in the mid-October 2015 to mid-October 2016 period.

More importantly, other influential trading powers are mobilising, with surprising effectiveness, to protect globalisation and a liberal trade order. The most encouraging result of this is the signing of the Comprehensive and Progressive Trans-Pacific Partnership agreement (CPTPP). There are several features of this agreement that should give comfort to proponents of trade and globalisation:

- First, Japan demonstrated real leadership, without which the CPTPP would probably not have materialised. Prime Minister Abe was personally involved in directly lobbying leaders of partner countries while his trade diplomats energetically travelled the region devising solutions to obstacles that stood in the way of an agreement. Almost for the first time since the 1930s, we have a Japan that is willing to provide global leadership and with a diplomatic capacity to bring about results. With powerful nations such as Japan and, in future, the European Union (EU) mobilising counter-moves against protectionism, there is a better chance that the various threats to the world trade order can be contained.
- Second, the smaller nations in the CPTPP can face a protectionist America with somewhat more confidence. For example, the CPTPP strengthens the hands of Canada and Mexico as they re-negotiate NAFTA and South Korea as it discusses KORUS with the US.
- Third, the creation of a massive new trading bloc, with 550 million consumers and economic output representing 13.5% of world GDP will, over time, unleash a new engine of growth in flows of goods, services, investment and people. Various studies show that all the eleven members of the CPTPP will benefit, with Vietnam, Malaysia and Singapore identified as the biggest winners. These studies also suggest that the trade competitors of these eleven nations could lose market share. That provides an incentive for them to join the CPTPP as well. It is quite possible that Korea and Thailand might apply to join the CPTPP.

There are many more examples of major trading blocs working hard to sustain global trading agreements. The EU and Japan have concluded negotiations for their Economic Partnership Agreement, which could enter into force by November next year. The EU is also negotiating major trade agreements with Latin American countries as well as with some ASEAN countries. In other words, despite the challenges posed by an increasingly inward-looking America, other powerful nations are taking the initiative to preserve the momentum of global economic cooperation.

Another major source of pushback against protectionism is coming from business lobbies. In the US, most large business and trade associations support NAFTA and are reported to be

lobbying the administration as well as their Congressional allies hard to ensure that President Trump does not pull the US out of NAFTA as he has threatened to.

So, what is the bottom line?

It is more than likely that there will be a proliferation of restrictive trade measures issued by the US in coming months. It is also possible that the Trump Administration will play hard ball with Canada and Mexico over NAFTA in order to force them to concede to its demands.

However, the pushback against protectionism is also growing. It looks like Japan and the European Union are prepared to take up the leadership mantle – and be more effective in their counter-moves than many of us had expected. American business associations are also becoming more vigorous in lobbying against threats to trade and FTAs. In other words, the those who have benefited from trade and globalisation now recognise how serious the threat is and are becoming better at organising an effective response. For the export-oriented economies of Asia, this is good news.

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