

global outlook 1

KREAB

2019

International trade under fire

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Executive summary:

Despite a one-off increase in 2017, global flows of goods and services are likely to continue to stagnate, due to several factors:

- **The world is facing an economic downturn;**
- **Institutional factors, such as the failures of the WTO Doha Round and TTIP as well as Brexit point in this direction;**
- **The international ideological climate is nationalist and protectionist, with the US-China trade war as perhaps the most striking expression.**

This globalization backlash may have serious consequences for global supply chains.

Re-industrialization, i.e. bringing back the lost manufacturing jobs, is likely to make advanced economies worse off.

Analysis from Kreab in Washington, Brussels, Tokyo and São Paulo



In the United States, the prospects

for international trade very much depends on the outcome of the 2020 presidential elections.

page 7



Despite Brexit, the EU is likely to continue

to push for international openness, however demanding more reciprocity from its partners.

page 8



In Japan, the government is challeng-

ing vested interests and is calling for increased trust in international trade.

page 9



In Brazil, one of the world's most closed

economies, the government strives to increase trade.

page 10

International trade under fire

By Fredrik Segerfeldt, Kreab Stockholm, with input from Kreab São Paulo, Kreab Tokyo, Kreab Washington and Kreab Brussels

State of play

For a period following the end of the Cold War, global trade grew steadily. From representing less than forty percent of global output in 1990, it reached some sixty percent right before the financial crisis in 2008/2009. For almost a decade, then, the international exchange of goods and services stagnated. In 2016, it was lower than in 2008.¹

True, in 2017 exports and imports rose to some 72 percent of world GDP.² This was most likely a one-off event, based on cyclical corrections.³ Preliminary data indicate that this increase cooled off in 2018.⁴ In the coming years, international trade is likely to fall back into the general pattern of the last decade. Several factors point in this direction.

Three kinds of challenges: institutional, ideological, and related to the business cycle

International trade is facing threats of at least three different kinds. First, the multilateral trading system with the WTO at its heart is being ever more put into question. Second, there is a nationalist, populist trend in large parts of the world that not only questions international openness, but that tries actively to reverse globalization. And third, the world economy is entering a slowdown.

Let us start from the end.

Most experts and indicators point to a coming global economic slowdown. A decline in global trade could be both a cause and a consequence of such a business cycle fluctuation. We are

International trade as share of global GDP, %



Source: World Development Indicators Online.

¹ Please note that this data is trade as share of world GDP. Since global output increased by almost 27 percent between 2009 and 2017, the graph underestimates the growth of world trade.

² World Development Indicators Online.

³ <<https://insights.abnamro.nl/en/2018/03/global-trade-watch-global-trade-has-firmed-but-risks-are-rising/>>

⁴ <<https://think.ing.com/snaps/trade-growth-slowed-to-33-in-2018/>>

at the end of a decade-long expansion and a normal stagnation need not be a cause for any concern beyond the short term. The other two types of challenges are more serious.

The most important expression of the new protectionist attitude is the US-China trade war, a dispute between the two largest economies in the world.

Apart from the election of political leaders such as Donald Trump of the United States, it is in Europe that the rise of populism is the most prevalent. More than one in four voters cast their vote for an authoritarian populist in the last elections. “The combined support for left- and right-wing populist parties now equals the support for Social Democratic parties and is twice the size of support for Liberal parties.”⁵ Support for free trade is bigger in developing countries than in advanced economies.⁶

While the current international climate hardly speaks in favor of further trade liberalizations, the lack of advances, or even the prevalence of backlashes – in this field goes back longer than the last few years of rising nationalist populism.

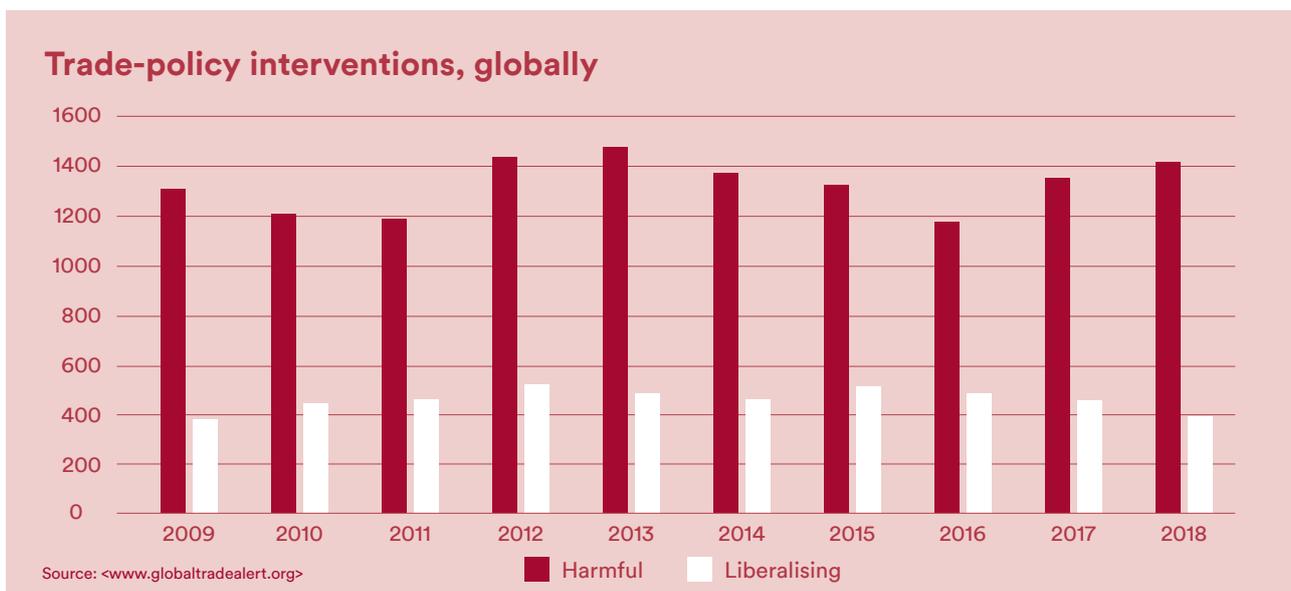
The last successful WTO negotiations on general liberalizations of world trade – The

Uruguay Round – ended in 1995. Since then, the multilateral trading system is being challenged by both isolationism and by bilateral and regional deals. The principle of Most Favored Nation (MFN) on the global scale is being replaced by trade with friends and allies.

Also, during the last decade trade-policy measures that inhibit rather than facilitate international exchange have dominated. Between 2009 and 2018, 17 822 trade-policy measures were implemented globally. The vast majority – around three quarters – of these were protectionist.

Two contemporary developments that reinforce this trend is of course Brexit and the renegotiation of the North American Free Trade Agreement (NAFTA) and its replacement by the US-Mexico-Canada Agreement (USMCA).

As in most policy contexts, there is always a time lag between the public debate, policy proposals, their implementation and their effects. Against this background, we should remember that most tariffs of the current US-China trade war did not come into effect until the second half of 2018.



⁵ <https://populismindex.com/wp-content/uploads/2019/02/TAP2019C.pdf>

⁶ <http://www.pewglobal.org/2014/09/16/faith-and-skepticism-about-trade-foreign-investment/>

Disruption of global supply chains

A slowdown of international trade may have several negative consequences. First, stronger international economic ties clearly lower the risk of armed conflicts between countries. The globalization peace dividend might therefore become weaker when trade goes down. Second, it makes countries worse off by lowering growth when specialization, competition and structural change are limited. Third, consumer choice and freedom for people and businesses are inhibited.

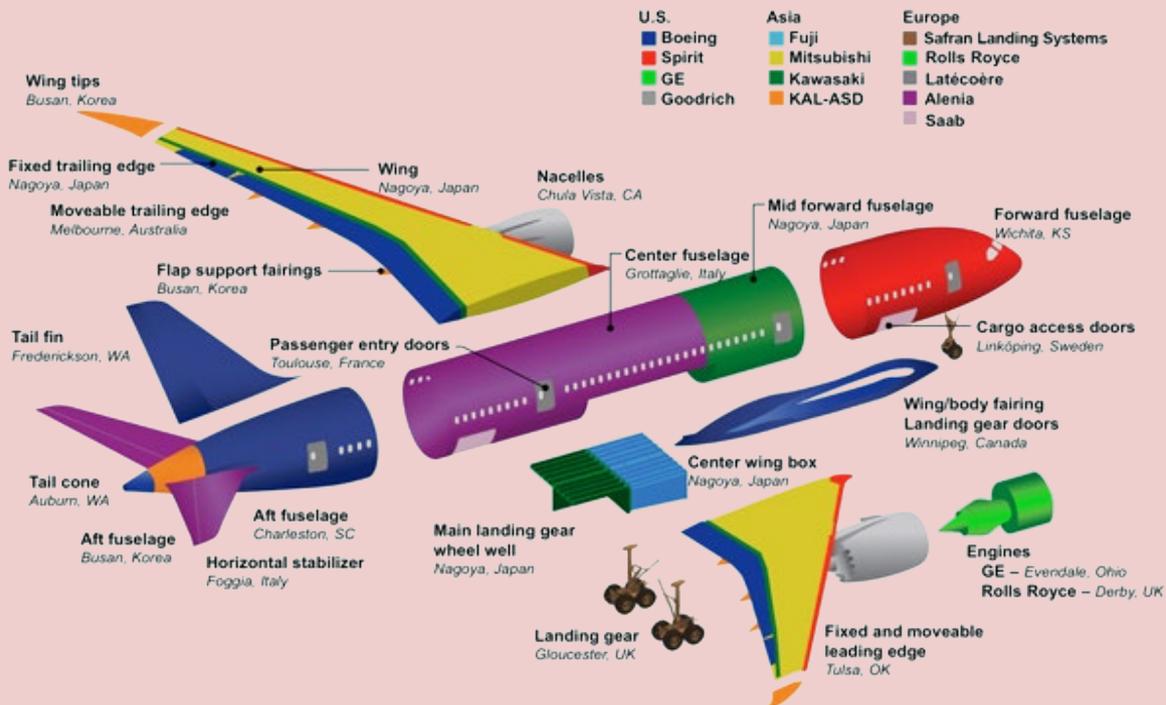
The most important consequence, however, may be the disruption of global supply chains. Four products can illustrate these developments. A famous example is the Volvo V 70, which, when rolling off the assembly line at the Torslanda Plant in Gothenburg, consists of parts from more than 300 suppliers from 41

different countries.⁷ A more recent illustration is a capacitor necessary for a circuit board that helps electronically adjust the seat of the Ford Flex SUV. It crosses the US border five times before it reaches the car dealership.⁸ One could also study the case of the Dreamliner aircraft.

The iPhone is famously assembled in China. However, out of the \$ 240 factory cost, only \$ 8.5 go to China. The country that takes home the largest share of the value-added is ... the United States.⁹

If companies like Volvo, Ford, Boeing and Apple are forced to restructure their entire production strategies, this may be harmful to them, their employees, their customers and to the countries in which they and their suppliers operate.

Boeing 787 Dreamliner structure: parts from around the globe



Source: <https://www.aeronestv.com/en/industry/commercial-aviation/3707-boeing-787-dreamliner-structure-parts-from-around-the-globe.html>

7 <<https://www.dn.se/ekonomi/komponenter-fran-41-lander-blir-en-volvo/>>.

8 <<https://www.bloomberg.com/graphics/2017-trump-protectionism-alters-supply-chain/>>

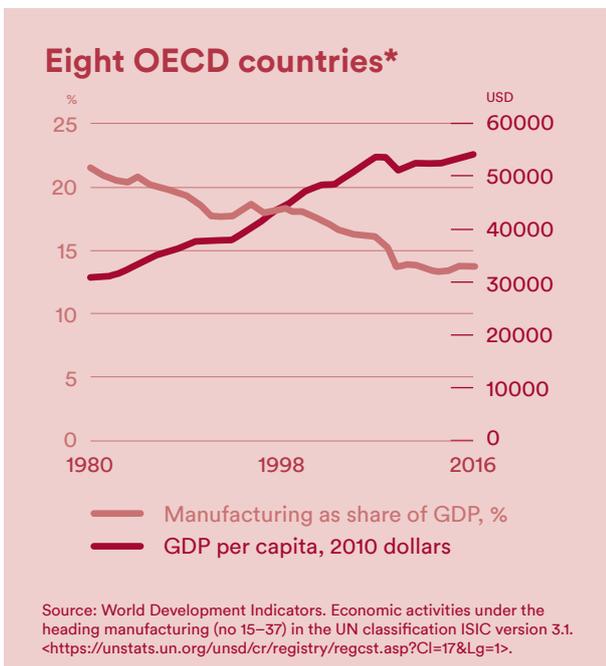
9 <<http://theconversation.com/we-estimate-china-only-makes-8-46-from-an-iphone-and-thats-why-trumps-trade-war-is-futile-99258>>

Bringing back the factories does not seem like a good idea

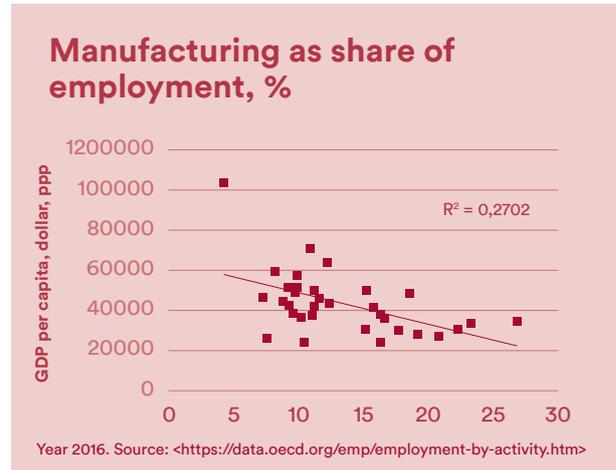
One of the priorities of political leaders like Donald Trump and Marine Le Pen is to stop the loss of manufacturing jobs, or even to try and get those lost jobs back to their countries. First, it is important to keep in mind that it is technology, mainly automation, not the Chinese, that is the main culprit when it comes to the decline of manufacturing as employment generators in the rich world.¹⁰

Also, trying to bring all those traditional plant jobs back may very well make these countries worse off. Several data sets point in this direction.

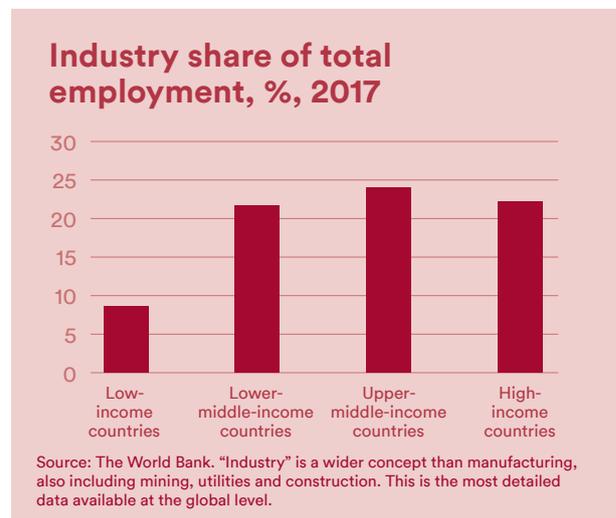
First, let us study the eight OECD countries for which data is available and look at how the decline in manufacturing employment has gone hand in hand with rising incomes over the decades.



Second, let us take a snapshot cross-country view of the same issue. The more manufacturing jobs, the lower the income level in a country.



Third, despite the use of “industrialized” as an adjective for “economically advanced”, the countries where industry dominates the economy are upper-middle income economies, not rich ones.



¹⁰ <https://www.ft.com/content/dec677c0-b7e6-11e6-ba85-95d1533d9a62>

Conclusion

The prospects for global trade are grim. The probable economic downturn is likely to reduce the international exchange of goods and services more than economic growth, as is common in similar cyclical stages. The failures of the multilateral trading system and the problems present in several bilateral commercial relations point in the same direction. As do the overall ideological and political climate.

This extended backlash may have several negative consequences, reducing economic growth and disrupting global supply chains. Many internationally active companies may have to redesign their production and sales strategies, which may cause severe disruptions.

In the US, where the current stance is very much a result of the individual views of President Trump, the policy direction depends on the outcome of 2020 presidential elections. A Trump re-election will mean more of the same, whereas a democratic victory could mean a reinvigoration of international trade.

However, there are counteracting forces. The EU, the world's largest trading bloc, is likely to continue to push for international openness, despite Brexit. Furthermore, in both Japan and Brazil, there are moves towards more and freer international trade.

There may be light at the end of the tunnel.



Analysis from Kreab in Washington, Brussels, Tokyo and São Paulo →



View from Washington

Very much depends on the outcome of the 2020 presidential elections

U.S. policymaking on trade issues has traditionally involved four main players: The Office of the U.S. Trade Representative (USTR), the Department of Commerce, the White House, and Congress. The current administration, however, has centralized decision-making on trade in the Oval Office.

Most of the tariffs imposed on the EU, China and Canada was enacted by Executive Order and therefore do not represent a broad-based consensus among U.S. policymakers, particularly in Congress. So, the future of US trade policy very much depends on the outcome of the 2020 presidential elections.

In the near term, i.e. in 2019, the chances that the U.S. imposes new tariffs on EU goods, including automobiles, have gone up sharply. Also, the prospects for reaching agreement and ratification of a Free Trade Agreement (FTA) with the EU, Japan, and the UK in 2019 are virtually nil. Further, the likelihood of a successful resolution with China is quite small. There may be a face-saving measure that will allow both sides to claim victory, but the substantive issues are very deep and very complex. Chances are high that the tariffs will remain, and that

leading up to the 2020 election, Trump will continue to focus on China. In sum, trade issues are likely to get worse, not better in 2019.

In the medium term, through 2020, it is highly unlikely that any new initiatives on FTAs or other comprehensive agreements will be started. However, negotiations on FTAs with the EU, the UK, and Japan are likely to continue. Given that it's an electoral year, Trump will be eager to show he's even more "tough on trade," raising the prospect that he will use executive power to enact additional tariffs.

In the long term - post 2020 – the outcome of the election will decide the future of trade policy. If Trump wins, there will be more of the same.

However, if Trump loses, tariffs imposed on the EU and Canada will most likely be eliminated. We will probably see closer cooperation with the EU on dealing with China's systemic issues and new initiatives or negotiations on multilateral free trade agreements could take place. There will be enhanced U.S. engagement in international institutions across the board, including the WTO.



President Donald Trump



View from Brussels

Demanding more reciprocity

The EU has a dilemma: how does it stay open when so many others are closed, or closing? Not only is Europe the world's largest internal market, the block has also negotiated over 35 major agreements freeing up trade with more than 60 countries.

Several events in the past two decades, however, have thrown a shadow over the EU's trade liberalization efforts. Firstly, confidence in the WTO was seriously shaken with the failure of the Doha round.

Second, the stalling of the Transatlantic Trade and Investment Partnership (TTIP) talks between the US and the EU was a considerable blow to the EU. Initially, opposition to TTIP had been much more vocal in Europe than in America. But with Donald Trump's election victory, the project was futile. Trade talks between the EU and US now focus primarily on tariff reductions.

Somewhat surprisingly, as a reaction to the policies and attitudes of the US administration, the Chinese ambassador to the EU Zhang Ming, on the record during a June 2018 Kreab seminar in Brussels, called for the EU and China to work together to keep global markets open. Europe's challenge, located between the USA and China, is not to get caught in the cross-fire between the two, and to exert its own power as the world's largest and most powerful single market.

The EU says that it remains open to investment, but a recent investment screening initiative points in the opposite direction. It derives from a sense that it would be naïve to remain so open and unprotected when other markets are less so. Furthermore, the EU has long felt its unquestioning openness removes any leverage it might have on competitors to force them to open their markets to European investment.

Another recent dispute was the suggested merger of the railway businesses of Siemens and Alstom that was blocked by the European Commission on competition grounds. Some argue that the EU needs European giants to be able to compete on the global level. This has spurred discussions around the need to change EU competition law to permit

the establishment of European champions, whereas others fear that the days of picking winners and losers are back.

Brexit was fundamentally a protectionist and isolationist decision, fueled by populism and deep-seated resentment that European integration and globalization had not apparently translated into economic wealth and social wellbeing for any but the wealthiest in Britain. Possibly the most effective slogan of the campaign was "Take back Control!"



Marcello Chelillo / Shutterstock.com

But is the EU also turning inward and becoming protectionist? The European Union's investment screening and industrial policy initiatives, and its more active use of trade defense instruments chime well with the political zeitgeist of today. Senior trade officials in the Commission have told Kreab that in the next 5 years the EU will focus more on enforcing the trade rules that exist in already negotiated trade agreements. During the last Commission mandate much effort was dedicated to concluding new trade agreements.

It is likely that the EU will continue to advocate for open and free trade. Its exporters depend on this. However, it aims to be a little less unquestioning than it has been, and to ensure that its openness is at least reciprocated by its major trading partners. It will not expect all issues to be resolved immediately, but it will be using strong measures and looking for meaningful progress, peu à peu!



View from Tokyo

The government is challenging vested interests

During his speech at the World Economic Forum in January this year, Prime Minister Shinzo Abe implored the audience “to rebuild trust toward the system for international trade.” These words were interpreted by publications such as the Washington Post as a rebuke of the Trump administration, but one could argue that Abe was simply underlining the mid- to long-term challenges faced by Japan in its geo-economic sphere. Exports, specifically those from the manufacturing sector, have been a major driver of economic prosperity, and the Japanese government has traditionally made great efforts to promote exports to other countries while protecting its domestic industries.

However, decreased manufacturing activities, an aging population, stagnation, and rising concerns of a more assertive China have resulted in the prioritization of multilateral free trade agreements, such as the recently implemented Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the Japan-EU Economic Partnership Agreement (EPA), which call for lowered tariffs and liberalization of the Japanese market. While there are domestic forces, particularly those representing agricultural interests, that express concern about reduced protections, Japan Inc. and the Abe administration are particularly interested in the macroeconomic benefits resulting from free trade and have consequently come out in support of the principle.

It is worth noting, though, not less than 10 years ago, the attitude toward free trade was quite different. In 2010, when the possibility of negotiating TPP (the predecessor to the CPTPP) was brought up during the rule of the then Democratic Party of Japan (re-organized as the Democratic Party in 2016), Abe’s Liberal Democratic Party vocally opposed it, an attitude stemming from pressure from constituents in the rural regions to maintain agricultural tariffs. However, after Abe assumed his current position as prime minister in December 2012, the LDP reversed its position. Abe was able to secure the political support necessary to go forward with TPP



by positioning it as an economic booster (a Cabinet Office study in 2015 estimated a GDP boost of 2.6%) as part of his Abenomics initiative and by dismantling JA-Zenchu, the powerful agricultural lobby that was a key force behind the organization of anti-TPP efforts.

While Japan has recently enjoyed its moment in the global limelight as a defender of free trade through the signing and ratification of the CPTPP and the Japan-EU EPA, these agreements still leave protections for the Japanese agricultural sector. This will play a factor in the U.S.-Japan Trade Agreement (USJTA) talks beginning this year between the two countries. Abe is ready to offer the U.S. reductions in agricultural tariffs to CPTPP levels as originally negotiated in the TPP before the U.S. pulled out of the multilateral agreement.

However, the Trump administration, under pressure from U.S. producers nervous about beef imports to Japan from Australia and Canada, is expected to push for further reductions in agricultural tariffs and non-tariff barriers in the USJTA. Additionally, the Trump administration has not indicated any willingness to back down on imposing automobile tariffs. In Japan, the ruling Liberal Democratic Party faces an election in the upper house this July, and a loss of a majority there can weaken Abe’s hand in USJTA negotiations and hamper other policy goals during his last term in office.



View from São Paulo

Government strives to increase trade

Brazilian attitudes toward international trade run counter to the global current. The country's trade openness has hovered around 25 percent (exports plus imports as percent of GDP) for the last decade. In 2017, the last year such data is available, Brazil ranked only second to Sudan out of 143 countries as the world's most closed economy.

Liberalizing the trade agenda was a feature of debates in the 2018 presidential campaign. Brazilians had grown tired of paying exorbitant prices for imported manufactured goods, when over 50 years of inward facing industrial policy have failed to deliver on the promise of home-grown national champions able to compete freely domestically and abroad. Coming at the tail end of Brazil's deepest and longest recession and what looks to be a "lost decade", civil society and the media concurred that for the economy to advance, industrial players would need to better incorporate themselves in global supply chains.

Brazil's isolation behind tariff barriers and non-tariff barriers alike has exacerbated a scenario in which total factor productivity has lagged its contemporaries and according to the World Bank has been a drag on growth since 2000. This further illustrates a lack of competitiveness in the broader economy that implies that any radical moves to open the economy would send shockwaves through the industrial base. While the resounding rejection of the Workers' Party in the election in favor of an explicitly neoliberal approach from President Bolsonaro and

his Economy Minister Paulo Guedes, the discussions are shifting on how Brazil should liberalize in order to minimize negative short-term externalities, namely rising already record high unemployment.

While general opening is the consensus priority, save for the preoccupations of industry associations representing protected industries (e.g: automotive, toys, chemicals, etc.) there are storm clouds on the horizon. The new Bolsonaro administration has linked the trade agenda to the larger issues of Brazil's role in the world and undoing the diplomatic legacy of the Workers' Party. Specifically, the administration is weakening the importance of the BRICS and Mercosur while stating the desire to reduce Brazil's "sino-dependence". Just recently, Foreign Minister Ernesto Araújo said that "Brazil would not sell its soul to export iron ore and soybeans." The broader implication of this shot at Brazil's largest trading partner is that China's emergence as the country's largest market correlates with a period of economic stagnation for Brazil, whose tradeable goods are dominated by low value-added commodities.

Araújo envisions a trade policy that reflects "national values." This all comes on the eve of Bolsonaro's state visit to the United States, with whom he desires to create a much closer trading (and military) relationship. However, the administration's actions are a cause for concern among the powerful mining and agribusiness lobbies back home. Bolsonaro repeatedly criticized the Workers' Party's ideological approach to foreign and commercial policy and now appears to follow the same line but from the other side of the spectrum.

Three months into the new administration and only a week after Carnival, the unofficial beginning of the Brazilian year, there is much to be settled on the trade front. While, there is general agreement on the macro approach the challenge will be to navigate the steps towards liberalization without upsetting entrenched interests, alienating long-time trading partners, or creating short term shocks to the economy.



President Jair Bolsonaro