NAVIGATING THE GLOBAL TRADING SYSTEM CRISIS: WHAT BUSINESSES NEED TO KNOW

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Executive Summary

A convergence of political and economic forces has created a crisis in the global trading system. U.S. President Donald Trump is an embodiment and now a significant driver of this crisis, though its roots reach back to long before his election.

While the threat posed by the Trump administration's policies is real and significant, broader structural and political forces have been undermining the system for quite some time.

Globalization and technology have accelerated the pace of economic change in both established and emerging economies. This phenomenon has brought many benefits, but it has also caused economic disruption. This disruption has undermined the domestic political coalitions that historically supported the creation and expansion of the multilateral, rules-based trading system.

The increased economic importance of emerging economies, including those with different economic models, has placed new strains on the World Trade Organization (WTO). The organization has struggled to accommodate this more diverse set of views and interests, while maintaining a sense of a level playing field. This has made multilateral trade negotiations substantially more difficult to conclude, with the collapse of the Doha Round as a prime example, and has led to a proliferation of dispute settlement cases.

We are confronting a new era in the global trading system, defined by heightened protectionism and trade conflict, a broad deterioration in the observance of multilateral trade rules, and a balkanization of trade spurred by an increased focus on bilateral and regional trade agreements.

Within this context, governments, companies and investors must navigate a less certain and more difficult trade and investment environment for the foreseeable future.

Companies and investors that depend on global markets need to be more effective in (1) advocating for open trade and investment policies with their home governments, and (2) developing and executing their own foreign policies for each market of interest. This means the ability to understand the impact of geopolitical developments, to develop relationships with core government decision-makers and other stakeholders, and to communicate how the firm's value proposition aligns with stakeholder interests.

In the absence of U.S. leadership, other key WTO members, such as Japan, China, the European Union (EU), and countries in the Association of Southeast Asian Nations (ASEAN), need to invest more in identifying necessary, feasible reforms and in building support for such reforms. While it will be highly difficult to execute wide-ranging reforms, such an effort will help to prevent the WTO from sliding into further decay. Given ASEAN's experience with building consensus among countries with varied economic models and levels of development, ASEAN members can play a key role in fostering these dialogues.

This short paper, published to coincide with the Singapore Summit, seeks to explain how we, as leading players in the trade politics of the last two decades, believe it has reached a crisis point, and how governments and the business community can best navigate this less certain and more difficult global trade and investment environment.

How We Got Here

After World War II, the U.S. led a group of countries in promoting international trade through a reduction in at-the-border barriers such as tariffs and quotas on goods.

Today, this system is governed by the WTO, which acts as the guardian of a comprehensive rulebook for trade in goods, services, and intellectual property (IP). Since 1995, WTO members have updated commitments in areas such as government procurement, and reached plurilateral agreements in new areas such as information technology. Importantly, the WTO also provides members with a forum for settling international trade disputes related to WTO rules and obligations.

U.S. leadership was indispensable to the development of this open, rules-based international trading system, supported by the states of Europe and then the EU, among others. In addition to championing greater multilateral liberalization, past U.S. administrations have also negotiated fifteen bilateral and regional free trade agreements (FTAs) since 1985. As a result of the commitments made under these agreements, the U.S has levied, on average, some of the lowest tariffs in the world. The U.S. has also invested diplomatic capital in encouraging other countries to raise their own level of ambition in creating trade agreements that open trade, set higher shared standards, and drive regional economic integration.

While this trade and investment liberalization has been highly beneficial to developed and developing economies alike, it has caused economic disruption. In the U.S., Europe, and elsewhere, globalization, technological change, and increasing competition have caused lower-skilled manufacturing jobs to decline. A decade of economic uncertainty and volatility since the 2008 financial crisis has contributed to a sense of insecurity. Policymakers have struggled to find appropriate responses to address the frustrations and rising economic anxieties of voters who face stagnant wages and greater uncertainty about their employment.

In addition, policymakers are increasingly sensitive to competition from newly-developed and developing markets, particularly China, which has become the second largest economy and largest trading nation in the world. This sensitivity is particularly acute with respect to high-technology industries, especially ones that involve leading-edge technologies such as artificial intelligence and robotics or advanced information technology. Privacy and cybersecurity concerns strengthen this dynamic.

Policymakers in the U.S., EU, and elsewhere have raised concerns with China's maintenance of market access barriers, large-scale use of industrial policies, forced technology transfer, and inadequate enforcement of IP. In addition, China's rapid emergence as a major global foreign investor has raised questions about Chinese companies' growing acquisitions of U.S. and European companies with high technology assets. These concerns have resulted in China becoming a frequent target of WTO dispute settlement cases and anti-dumping and anti-subsidy measures in developed and developing countries alike (see side box), and have spurred efforts to tighten inbound investment review regimes in the U.S. and EU.

Increased Use of Anti-Dumping and Anti-Subsidy Measures

While anti-dumping and anti-subsidy measures are well-established tools of U.S. and European policymakers in their oversight of import competition, they take on new relevance in a period of trade tension. As the WTO noted in its 2017 annual review of global use of trade defense instruments, the U.S. initiated 49 anti-dumping investigations in the period June 2016 to July 2017 – up from 23 and 19 in the two previous twelve months periods. Add to this the 19 newly initiated anti-subsidy investigations by the U.S. and there is a material shift in U.S. trade defence posture, overwhelmingly targeted at industrial inputs from China.

The EU's use of trade defense instruments has remained a lot more stable and modest – Brussels initiated 13 new anti-dumping and anti-subsidy investigations in 2017. However, the system continues to be largely focused on policing Chinese imports, and the EU's decision not to award China Market Economy Status in 2016 and to retool its trade defense system to make it possible to continue to assess goods from economies the EU judges to be distorted by state intervention is a clear signal of the EU's concern about what it sees as unfair import competition. The EU's reform of its trade defense toolkit has also seen it suspend in certain areas the use of its 'lesser duty rule' – a measure that has seen the EU consistently impose lower duties than the U.S., especially at the provisional phase of investigations.

Suppliers serving goods customers in Europe and the U.S. need to monitor these trends closely, especially if they are operating in sectors where productive overcapacity or state support are viewed as price-distorting in the EU and the U.S. and/or import competition is placing domestic, politically-sensitive producers under pressure.

The increased economic importance of emerging economies, including those with different economic models, has placed new strains on the WTO. The organization has struggled to accommodate this more diverse set of views and interests, while maintaining sense of a level playing field. This has made multilateral trade negotiations substantially more difficult to conclude, with the collapse of the Doha Round as a prime example, and has led to a proliferation of dispute settlement cases.

There have always been differences among WTO members in terms of their level of development and their openness to trade and investment. Unlike in the past, however, there are now systemically important WTO members that maintain economic models that are quite different from the mainstream. China poses a particular challenge because of the central role played by state-owned enterprises, the scale of its industrial policies, and its inadequate IP enforcement regime. As a result, China's rise to become the second largest economy and largest exporter in the world has fueled questions about whether WTO rules are adequate to ensure a level playing field for international trade.

Given this context, Trump's trade strategy can be seen as an extreme reflection of these structural and economic trends that have undermined the domestic political coalitions that historically supported free trade in many countries.

President Trump has built much of his political brand around claims that globalization has been harmful for the U.S. and that bad trade deals have led to job losses and undermined U.S. economic competitiveness. His core objectives are to strengthen domestic manufacturing and reduce or eliminate the overall U.S. trade deficit, as well as the largest bilateral deficits. His strategy for meeting these objectives is to leverage U.S. political and economic power to extract concessions from trading partners.

This strategy rests on two key assumptions: 1) trade deficits and domestic manufacturing output and employment are largely the result of trade policy rather than macroeconomic factors, and 2) its economic and military power relative to other countries gives the U.S. the ability to fundamentally dictate outcomes, either by compelling trading partners to make concessions, or by using trade policy tools, particularly tariffs, to generate the desired outcomes through unilateral action. Trump believes that past administrations lacked the vision to choose the right objectives and have had neither the will nor the negotiating ability to use U.S. power effectively.

This strategy requires that the Trump administration demonstrate that it is prepared to close off the U.S. market if it does not win desired concessions from other countries. This is the motivation behind the administration's immediate withdrawal from the Trans-Pacific Partnership (TPP), unilateral imposition of Section 232 tariffs on steel and aluminium, and threats to impose tariffs on autos, imposition of tariffs on $50 billion worth of Chinese imports (and plans to impose tariffs on an additional $200 billion), and threat to pull out of the North American Free Trade Agreement (NAFTA) if Mexico and Canada do not agree to key U.S. demands in ongoing NAFTA renegotiations.

This strategy also requires that the U.S. free itself of constraints on the use of U.S. market power. This logic has fueled the Trump administration's efforts to undermine the WTO dispute settlement system and call into question the broader legitimacy of international trade rules and norms that could constrain unilateral U.S. trade actions; demand for the removal of dispute settlement provisions from NAFTA; and revival of long-dormant authorities granted to the executive branch by Congress to justify unilateral tariff actions in the name of national security.

It is easy in the context of such a sharp shift in U.S. policy to understate the extent to which similar tensions around trade and investment are playing out in European trade policy. While the EU has positioned itself in broad opposition to the Trump agenda and as a defender of open global trade and multilateralism, under the surface of EU policy, there are many of the same popular anxieties that have shaped trade politics in the U.S. Iterations of the EU's trade policy strategy in 2017 and 2018 put as much emphasis on upholding EU standards in the face of trade competition as they did on opening markets abroad. In addition, one of Brussels' greatest frustrations with the Trump administration has been the way that U.S. trade policy has driven a wedge between Europe and the U.S. when the EU would prefer to mount a joint strategy, together with Japan, to engage China on shared concerns regarding Chinese subsidies and other industrial policies.

What You Can Expect…

Given these dynamics, we provide our near-term outlook for the global trade and investment environment.

Decreased U.S. Influence

The Trump administration's abandonment of a leadership role in the multilateral trading system and use of protectionist trade measures will likely result in further trade and investment diversification away from the U.S. While the future of the NAFTA renegotiation remains uncertain, it is possible that the administration will be able to avoid the collapse of the agreement. That being said, the administration's policies and actions (e.g. withdrawal from the TPP, intensifying trade war with China, and continued trade tensions with other trading partners over steel and aluminum tariffs, and potentially autos) will place the U.S. on the sidelines while other economies move forward with preferential trade arrangements that do not include the U.S., such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), Japan-EU FTA, and Regional Comprehensive Economic Partnership (RCEP), among others. Not only will this place U.S.-based companies at a disadvantage in terms of market access, but it will reduce the influence of the U.S. in rule-setting.

Continued U.S.-China Trade Tensions

The U.S.-China trade relationship tops the Trump administration's trade agenda. The administration has been focused on generating leverage to compel China to make fundamental changes to its economic policies and rebalance the bilateral trade relationship. While the Trump administration has threatened to impose tariffs on all of China's exports to the U.S., it remains unlikely that China will capitulate. This strategy did not work with Japan in the 1980s and 1990s, when U.S. leverage was far greater than it is today with China. Unlike Japan, China is not beholden to the U.S. for its security and increasingly views the U.S. as a strategic competitor.

There is little near-term prospect of a comprehensive, negotiated settlement that would allow both sides to step back from the imposition of large-scale tariffs and return to the status quo ante. In addition, the U.S. is in the process of strengthening its national security review process for inbound investment, with China as the primary target.

WTO in Decline

While the Trump administration is unlikely to withdraw the U.S. from the WTO, the administration's continued public criticism of the organization and its increasing reliance on unilateral protectionist measures is having a corrosive effect on the legitimacy of the WTO rules. Furthermore, the Trump administration could cause the WTO dispute settlement system to cease to function by the end of 2019 through its blocking of appellate judges. These recent U.S. actions have strengthened the forces of entropy that were already weakening the WTO before Trump, as discussed above.

The deterioration of the WTO is likely to continue, with the potential collapse of the dispute settlement system in 2019 as a watershed moment that could accelerate this decline. Even prior to the Trump administration, the failure of the Doha Round had exposed the WTO's inability to mobilize broad support among members for continued trade liberalization. In addition, many policymakers in emerging economies, which had little influence during the founding of the General Agreement on Tariffs and Trade (GATT), have continued to view the WTO system as one that does not fully reflect the interests of the developing world.

Following the collapse of the Doha Round, the WTO opted to focus on more modest sectoral initiatives such as the enhancement of an earlier plurilateral agreement on information technology products and functional agreements on trade facilitation. The WTO's dispute resolution forum was also under pressure before the Trump administration.

There continues to be a lack of consensus among WTO members about how to revitalize either the trade liberalization agenda or reform its rule-making and enforcement function. While the EU has prepared a set of reform proposals, it is unclear whether these are likely to win sufficient support to move past the current impasse, particularly in the face of the continued hostility of the Trump administration toward the organization.

Faced with the WTO crisis, economies will continue to pursue bilateral and regional trade arrangements. This will lead to the further balkanization of trade through a flourishing of inconsistent market access provisions and regulatory approaches. When compared with multilateral trade agreements, regional arrangements are a decidedly second-best solution given the global nature of supply chains. This is of particular concern in new areas such as digital trade where the multilateral trading system has not yet agreed on international rules and best practices. Economies such as the U.S., EU, China, and India have very different policies on cross-border data flows and digital trade. For these reasons, before the Trump administration, the U.S. viewed the TPP as critical for establishing the rules of the road for cross-border data flows and digital trade in the Asia-Pacific and hoped that it would serve as a platform for broader agreements [e.g. the Free Trade Area of the Asia-Pacific (FTAAP) and the WTO].

With little hope of the WTO effectively establishing global rules in this area, and the U.S. spurning the TPP and other regional and multilateral economic cooperation efforts, global harmonization of rules and standards with respect to cross-border data flows and digital trade is highly unlikely. This means that global companies will likely continue to face a myriad of inconsistent policies and regulations, even within the same region. Balkanization is likely to continue, with cross-border data flows and e-commerce governed by one set of policies and regulatory approaches in the U.S., another in the EU, and another in China and other parts of Asia where Chinese regulatory pull is particularly strong.

Greater Scrutiny of Inbound Investment

Concerns about the negative impact of globalization have spurred efforts to tighten oversight of foreign investment, particularly from China, and we anticipate that this trend will continue. For example, both the U.S. and Europe are strengthening their systems for conducting national security reviews of inbound investment, spurred in large part by concerns regarding Chinese investment in high technology or other strategic sectors. In the U.S., Congress has passed significant reforms to expand the scope of the Committee on Foreign Investment in the United States (CFIUS) to allow it to review a wider array of investment transactions, including minority investments, as well as to include threats to cybersecurity as a key potential risk.

In Europe, the EU is close to adopting its first framework for investment screening, which is clearly intended to strengthen protections for EU technology assets from acquisition by state-backed investors, primarily from China. Several EU member states have also tightened their own investment review regimes, with many prioritizing oversight of investments targeting sensitive technologies.

How much these efforts will, in practice, change the process of acquiring assets in Europe and the U.S. is hard to project with certainty. But they should be seen as a signal of rising political and public concern and, as such, a warning against complacency from investors. Whether these tools are ultimately used or not, the political and media scrutiny of sensitive investments is likely to rise in a way that could impact both costs and reputations.

Navigating the Crisis

The global trade and investment environment will be less certain and more difficult to navigate over the near to medium-term. Governments, companies, and investors will need to enhance their capabilities to navigate and see through this situation.

For Governments

Governments with an interest in an open, rules-based international trading system need to prioritize efforts to prevent its collapse, and investment in WTO reforms must be a key component of these efforts. As discussed above, it is uncertain whether there is a critical mass of WTO members capable of banding together to arrest the organization's decline. However, this is not a foregone conclusion.

We call on key WTO members, such as Japan, China, the EU, and ASEAN members, to invest more in identifying areas where reforms are both needed and feasible and in building support for this agenda. The EU's recent efforts to build a consensus around a set of WTO reform proposals is a step in the right direction. The reforms being discussed, such as new rules on subsidies, will be very challenging, but are necessary to take the system forward.

Developed and developing countries need to participate in these critical discussions. Southeast Asian countries are especially well-positioned to contribute to this dialogue given their experience with consensus-building within ASEAN and their increasing importance in global supply chains.

The alternative is a greater sense of chaos and a heightened risk of large-scale trade conflict becoming a permanent feature of the global trading system.

For Firms

Firms need to develop and execute their own foreign policies to enhance their ability to mitigate against risks (and capture opportunities).

What does it mean to have a corporate foreign policy?

- A foreign policy starts with a sophisticated understanding of the international environment that allows a firm to assess the impact of geopolitical developments on its business. Firms will need to integrate these assessments into their business plans and continually update and evaluate their conclusions in an increasingly volatile economic policy environment.
- Firms will then need to develop and deploy strategies tailored to achieve their objectives in each market in which they operate. These strategies must be grounded in a firm understanding of local private and social sector stakeholders and government decision-makers perspectives and interests and how these intersect with the company's business operations and contributions.
- In the current global environment, where forces of protectionism and nationalism are on the rise, companies must continually articulate their contributions to local societies and national economies to cultivate ongoing support for their operations abroad. This is equally true in the U.S. as it is in India or Indonesia.

- Companies also need to engage more actively with their home governments, to build support for their interests. For example, in the current environment, global firms cannot assume that their home governments understand the value of an open, rules-based global trading system. Companies should also invest in increasing coordination and coalition activities across sectors and nationalities to build out constituencies that support maintaining an open, rules-based global trading system.

About the authors

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Carlos Gutierrez is Chair of Albright Stonebridge Group, a global strategic advisory and commercial diplomacy firm with offices in Beijing, Dubai, New York City, Shanghai, and Washington DC.

As U.S. Secretary of Commerce between 2005 and 2009 under President George W. Bush, Secretary Gutierrez worked with foreign and business leaders to advance economic relationships, enhance trade, and promote U.S. exports. He also played a key role in the passage of landmark free trade agreements that remove trade barriers, expand export opportunities, and boost global investment.

Previously, Secretary Gutierrez spent nearly thirty years with Kellogg Company, a global manufacturer and marketer of well-known food brands. He became President and Chief Executive Officer of Kellogg in 1999, the youngest CEO in the company's hundred-year history. In 2000, he was named Chairman of the Board of Kellogg Company.

He currently serves as Chair of the National Foreign Trade Council and Founding Chair of the U.S. Chamber of Commerce's U.S.-Cuba Business Council, and is on the boards of the Chamber's U.S.-India Business Council and the Boao Forum of Asia. He is also Chairman of the Board of Trustees of the Meridian International Center, and serves on the boards of Occidental Petroleum Corporation, MetLife, PricewaterhouseCoopers (PwC), among other organizations.

Peter Mandelson
Chairman, Global Counsel

Peter Mandelson is Co-founder and Chairman of Global Counsel, a regulatory, political risk and public policy advisory business with offices in London, Brussels and Singapore.

During his time as the EU's Commissioner for Trade between 2004 and 2008, he encouraged a new phase in the European Commission's approach to trade agreements, effectively pushing the EU's policy to embrace free trade agreements to facilitate trade globally and oversaw the EU's pivot toward Asia by launching trade talks with Japan, South Korea, ASEAN and India. He also led the European negotiations in the WTO Doha World Trade Round.

In the UK, he held a number of Cabinet posts under Tony Blair and Gordon Brown including British First Secretary of State, Secretary of State for Trade and Industry, Northern Ireland Secretary and Secretary of State for Business, Innovation and Skills. He was Member of Parliament for Hartlepool in the UK from 1992 until 2004 and Director of Campaigns and Communications for the Labour party between 1985-1990.

As well as Chairman of Global Counsel, Lord Mandelson is a Senior Adviser to Lazard and a member of the International Advisory Group of BlueVoyant, a cyber security company. He is President of the German-British Forum, the UK's primary bilateral forum for promoting dialogue on German-British business, social and political issues and President of the Great Britain China Centre. He is Chairman of the Design Museum in London and Chancellor of Manchester Metropolitan University. He is also President of Policy Network.