Teneo

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Teneo Insights:
Global Trade Outlook

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With populist parties and geostrategic rivalries making trade an increasingly salient political issue, it is more important than ever that companies understand the factors driving the range of trade policies currently being considered by governments around the world. The private sector will continue to be looked to as a partner to governments on trade, helping to identify negotiating priorities, articulating the case for open trade flows, and serving as informal advisors and go-betweens. ***Teneo's Global Government & Public Affairs team*** *is well positioned to help our clients monitor global trade developments, advise on engagement strategies, and develop campaigns to help companies achieve their trade goals.*

US-China trade talks hinge on progress on structural issues

The two rounds of recent trade talks between US and Chinese officials focused on structural issues in the bilateral trading relationship yet yielded little in terms of concrete outcomes outside of Chinese commitments to boost imports from the US. American negotiators in Beijing **this week** will press their Chinese counterparts to address structural issues through concessions such as opening Chinese markets to US companies in industries including financial services and manufacturing, improving protections for American intellectual property rights, and reducing pressure on US companies to transfer their technology.

While Chinese officials and business executives have been cautiously optimistic on the chances for a deal ahead of the expiration of the current trade truce, US negotiators are skeptical of Chinese willingness to make the requested changes and have said that "much work remains to be done." **US President Donald Trump indicated on February 12 that he could let the March 1 deadline "slide for a little while" – a move that seems increasingly likely. However this appears to depend on the two sides getting "close to a deal" on these structural issues.**

Both Trump and Chinese President Xi Jinping have strong incentives to reach a deal. For Xi, the Chinese economy is slowing, and the slowdown is being exacerbated by the trade war. For Trump, increasing tariffs on March 2 (from 10% to 25% on $200 billion worth of Chinese goods) would have a major effect on equity markets and increase the economic impact of the trade war at a time when Trump also faces a number of domestic challenges.

Moving the deadline would also create space for Trump and Xi to meet in person – a prerequisite for

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a resolution to the current trade conflict. Trump has said that he is unlikely to meet with Xi ahead of March 2, and **alternatives being floated currently include a meeting on the sidelines of the Boao Forum, which takes place on March 26-29 in China, or a second Trump-Xi summit at Mar-a-Lago in mid-March.** Any deal reached between Trump and Xi would likely include commitments on:

- **Opening markets:** China could take steps to open markets to US companies in the banking, energy, and finance industries.
- **Eliminating JV requirements:** Steps could be taken to eliminate joint-venture requirements, thereby removing leverage that China has in coercing US companies to hand over technology.
- **Revising Made in China 2025:** The Chinese side says it has already taken steps to scale back and tone down "Made in China 2025," and some senior Chinese officials contend it is not productive policy. China will not abandon these goals altogether but might reframe its plan for developing advanced technologies in order to address US concerns.

Resolving these structural issues will take time, making it likely that any deal includes a bilateral agreement to engage in ongoing negotiations to work towards achieving verifiable progress on key issues. Business groups and Democratic lawmakers in the US will push for strong enforcement and verification mechanisms, likely requiring the inclusion of snapback provisions or a gradual easing of tariffs as Beijing meets certain milestones. However, it is unclear whether China would be willing to implement reforms that are sufficiently comprehensive and fast enough to meet both the needs of the Chinese economy and the demands of US negotiators.

UK and EU headed towards last-minute face-saving measure

The attention of UK politicians has been focused entirely on the short-term withdrawal process from the EU. Recent parliamentary votes and comments have seen parliamentary opinion coalesce around two pillars:

1. A no deal Brexit is impossible/unviable.
2. An open-ended backstop arrangement to prevent a hard border on the island of Ireland which does not permit the UK to exit it unilaterally is unacceptable.

The advantage of this shift in opinion is that it enables the governing Conservative Party to remain broadly united. The disadvantage is that there is no sign that the various proposals to amend the backstop to the UK government's satisfaction will secure traction in Brussels. However, recent signals on both sides hint at the potential for a face-saving last-minute deal at the end of long and bruising negotiations.

The base case is still that some opaque but legal-sounding form of comfort, without reopening the Withdrawal Agreement, might be constructed to enable UK Prime Minister Theresa May to claim a little more progress; and with enough apparent substance to carry a coalition of most of the Conservative Party, the increasing open number of leave-supporting Labour MPs, and the DUP over the line.

The options of a second referendum or a much softer Brexit (including a permanent Customs Union) seem to have failed as neither can succeed without a major split within the Conservative Party, which the Prime Minister wants to avoid. Nor does the leadership of the Labour party want to impede a Brexit.

Future UK-EU trade agreement

Following the March 29 separation date, attention will swing immediately to the negotiation of a long-term trade agreement foreshadowed in the Political Declaration. The Declaration is a deliberately upbeat document, whose tone is set by its early reference to the need for "an ambitious, broad, deep and flexible partnership across trade and economic cooperation."

Subsequent sections apply this philosophy to data sharing, trade in goods, tariffs, customs, trade in services, and regulatory convergence.

Brexiteers are already concerned that the ultimate result of this might be to advantage the EU in trade in goods versus the UK's interests in export of services, where the barriers are likely to be more complicated.

Post-Brexit trade outlook

The UK government is working to roll over approximately 40 free trade agreements in which it currently participates in through its EU membership. These govern approximately 11% of all UK trade, of which 70% is with four countries: Norway, Switzerland, South Korea, and Turkey. An outline bilateral deal was signed with Switzerland in December 2018.

Progress has however been relatively slow, with about 21 agreements now signed and a further 13 or so imminent. Despite this, **the official UK position is that all roll-overs will be completed by March 29, the current withdrawal date, although internal leaks have indicated that this is not accurate.** Officials within the trade department have confirmed off-the-record that none of the major FTAs will be ready by the deadline.

In a recent speech, Trade Secretary Liam Fox placed greater emphasis on working to liberalize global trade in services, an obvious priority given the balance of the UK economy. He aims for Commonwealth countries to act as a group of trade champions within the WTO.

EU and US taking steps to set stage for talks

In July, President Trump and EU Commission President Jean-Claude Juncker agreed to pursue a new bilateral trade agreement that would build on the less controversial parts of the Trans-Atlantic Trade and Investment Agreement (TTIP) started under President Obama. The two sides intentionally avoided sensitive areas such as agriculture – a non-starter for the EU – and public procurement policies in the US. Since July, multiple rounds of informal talks have occurred.

On **January 11**, the US Trade Representative (USTR) released its negotiating objectives with the EU, **starting a 30-day timer** before formal negotiations can begin. The objectives focused on trade in industrial goods, textiles, pharmaceuticals and medical devices, financial services, chemicals, and digital trade, as well as strengthening rules of origin. The US objectives also included increasing market access for US agricultural goods, a topic the EU has firmly rejected, as well as other controversial provisions related to EU trade with Israel and China. The EU has released two negotiating mandates, one focused on creating a free trade area for industrial goods, and another on "conformity assessment agreements" to remove non-tariff barriers. **EU trade ministers will discuss the objectives at an informal meeting on February 21-22 in Bucharest, and the mandates are likely to be formally approved by March 1.**

Both sides have expressed a desire to quickly conclude talks, particularly with US steel and aluminum tariffs against the EU, as well as EU's retaliatory tariffs, still in effect. Success hinges on both sides' willingness remain within the contours of the July agreement. However, the US side faces domestic pressure to address agriculture, most notably from Senate Finance Committee Chair Chuck Grassley (R-IA) who oversees congressional approval of trade deals in the Senate. Seemingly in acknowledgement of this challenge, the USTR's objectives noted the potential of pursuing a deal in stages. The EU, eager to avoid the imposition of auto tariffs by the US (more below), has been quick to show progress by increasing imports of US soybeans, certifying US soybeans for use in EU biofuels, facilitating the import of more US liquefied natural gas (LNG), and showing a willingness to accept US hormone-free beef. However, the EU has also made clear that it views the removal of the steel and aluminum tariffs as a prerequisite to concluding any deal and that the imposition of auto tariffs would bring an end to the talks.

The EU trade agenda beyond the US

The EU has been conducting an ambitious free-trade policy over the past year, resulting in comprehensive free trade agreements with, among others, South Korea, Canada, Japan, Vietnam, and Singapore. Negotiations are underway with New Zealand, Australia, and Indonesia. The deal with New Zealand is likely to be concluded first. Australia, a bigger and more diversified economy, is more complicated, but reaching an agreement is still a short-term objective, while a deal with Indonesia will take much longer. Last year, the EU and the Mercosur countries lost an opportunity to finalize a free trade agreement, and the deal is on hold pending clarity on the strategic relationship between Brazil and Argentina following the election of President Jair Bolsonaro in Brazil. Additionally, general elections in Nigeria this month could pave the way for the Economic Partnership Agreement (EPA) between the EU and West Africa to enter into force.

However, with the next few years focused on the EU-UK trading arrangement and new natural trading partners becoming more difficult to find, the EU's push to open trade is likely to slow down. The trade agenda also faces challenges from domestic constituencies, who have shown a growing wariness of the EU's trade activism.

US-Japan talks awaiting start date

In September 2018, Japan and the US agreed to negotiate a bilateral trade agreement, despite Japanese Prime Minister Shinzo Abe previously asking that the US re-enter the 11-country Trans-Pacific Partnership (TPP) and pledging to resist US requests for bilateral trade negotiations. Trump and Abe announced that the framework for the agreement would be limited in scope and would be focused on areas in which quick agreements could be reached, amounting to less than a bilateral free trade agreement.

On December 21, 2018, the USTR submitted its objectives for trade talks with Japan to Congress, setting off a 30-day timer after which formal negotiations could begin. However, since then, neither government has announced the first round of talks. Though negotiations could commence at any time, they have been delayed largely due to the US focus on trade talks with China. **It is possible that the US-Japan talks could be put off until at least April.** The Japanese government has also considered delaying the talks until **after their upper house elections in July.**

The exact agenda of either government at these talks is still rather uncertain; however, if the US attempts to incorporate the USMCA's provisions on exchange rates, automobiles, and trade agreements with "non-market countries" as precedents in the US-Japan talks, Japan is likely to reject such an agreement. Another question is whether the Trump administration will abide by an understanding included in the September 2018 agreement that the US would respect Japan's inability to offer concessions on agricultural market access that go beyond what it offered in TPP, Japan's FTA with the EU, and other trade agreements.

Additionally, recent comments from the two sides have shown disagreement over whether the talks will seek a comprehensive agreement, as referenced by US Ambassador to Japan William Hagerty, or the “trade agreement in goods” (TAG) that Japanese officials have emphasized.

Auto tariffs risk derailing US talks with Japan, EU

Hanging over US talks with both the EU and Japan is the threat of potential US tariffs on vehicles and auto parts. **The Commerce Department’s report to the White House on the national security impacts of current auto imports is due to the White House on February 18, though it is unclear if the five-week shutdown impacted the timeline for delivery. After receiving the report, the President has 90 days to determine a course of action. The White House previously gave a period of about two weeks between announcing steel and aluminum tariffs under Section 232 and them taking effect.**

While the imposition of auto tariffs would likely bring a halt to any talks in progress with Japan and the EU (the latter of which has already promoted its plans to retaliate), President Trump may face more pushback domestically. Fearing the threat of auto tariffs, GOP Sens. Rob Portman (OH) and Pat Toomey (PA) have introduced separate, bipartisan proposals to curtail the President’s Section 232 authorities. Chairman Grassley, who would be a key player in advancing such legislation, has previously said that he is opposed to imposing “tariffs disguised as national security protections” on US allies, particularly “when it comes to trade in automobiles and auto parts.” However, he has more recently endorsed the idea of auto tariffs as “an effective tool” to “bring Europe to the table in a reasonable way” on US agricultural demands.

Grassley’s shift, despite the harm that auto tariffs would likely bring to his state’s farmers, reflects what is likely the White House’s strategy in moving forward with the auto tariffs – one driven by negotiating tactics rather than actual plans for action. Facing stagnant trade talks on a number of fronts – China, the EU, Japan – President Trump will be looking for new ways to demonstrate his willingness to be bold on trade, with the goal of accelerating the pace of deal making. However, given the strong opposition from the business community and Trump’s own party, it is likely that the auto tariffs remain a negotiating chit and do not enter into force in the near term.

Steel and aluminum tariffs hang over USMCA ratification

In November 2018, leaders from Mexico, Canada, and the US signed the United States-Mexico-Canada Agreement (USMCA) to replace the North American Free Trade Agreement (NAFTA). In the US, the USTR met a 60-day deadline to submit a list of changes to US law to implement the agreement, doing so on **January 29**. Concurrently, the US International Trade Commission (ITC) has 105 days to review the deal and detail its economic impact. However, this process was delayed by the government shutdown in December and January, and the ITC now says the report is **unlikely to be released until April 19. Congress is not likely to formally begin moving towards ratification until after the report is released.**

In Mexico, there is still no date to ratify the USMCA, but the majority of the governing coalition, as well as the leading opposition parties, are supportive of ratification, so any serious hurdles are unlikely. The current government’s lead USMCA negotiator, Jesús Seade, has said he **expects ratification to occur in the second half of the year.**

The Canadian government has yet to table the agreement in the House of Commons, which, when it happens, will **begin a period of debate for 21 sitting days.** After this, the government can introduce the implementing legislation. The ratification process is expected to go smoothly and will likely be **completed before the House of Commons adjourns on June 21** ahead of the election in October.

The main hurdle to USMCA ratification will be the lifting of US tariffs on steel and aluminum imports from Mexico and Canada. Justin Trudeau's government is facing calls to get the tariffs lifted before the agreement is ratified. Similar calls have come from Republican lawmakers in the US, particularly from states with large agricultural regions. Sen. Grassley and others see the lifting of the tariffs as a way to provide relief to US farmers targeted by a range of retaliatory tariffs. Additionally, Democrats, who control the House, have pushed for stronger environmental and labor protections and enforcement mechanisms. Though these demands are unlikely to derail the agreement, especially given the strong support for the deal from the business community, they may require the negotiation of side letters and the securing of other commitments from the Trump administration.

Regional integration in Asia

Asian regional economic integration took a significant step forward on December 30, 2018, when the Comprehensive and Progressive Agreement for the Trans-Pacific Partnership (CPTPP) came into force after being ratified by six of eleven signatories. While the bloc's members are already thinking about adding new members, it could take time for the remaining four signatories to ratify – Vietnam ratified in January – and domestic politics in potential applicants, including Thailand, Colombia, and possibly the United Kingdom, may make it difficult for them to launch accession talks in 2019. The best hope for Asian regional integration in 2019 would therefore be a final agreement on the Regional Comprehensive Economic Partnership (RCEP), a 16-country pact that has repeatedly missed targets for completion. However, RCEP too will be vulnerable to domestic constraints in key members – a springtime general election in India being the biggest challenge – that could frustrate efforts to conclude negotiations this year. Even if RCEP is concluded, it will be broader but shallower than the CPTPP, including all of ASEAN plus China, Japan, South Korea, Australia, New Zealand, and India, but advancing significantly less ambitious rules to govern investment and trade in goods and services.

Regional integration in Africa

The African Continental Free Trade Area (AfCFTA) is likely to enter into force later this year. 49 of the African Union's 55 member states have signed the agreement since its official launch in March 2018. Nigeria, the continent's largest economy, would be more likely to sign up if the opposition wins the February 16 general elections. Since 2018, 17 states have ratified the agreement, while ratification is imminent in another eight, including South Africa, Senegal, and Mali, **suggesting the threshold of 22 ratifications will be reached in 2019.** The first continent-wide FTA would represent a huge symbolic success but is merely a first step in making the free trade zone operable. Issues including tariff schedules and rules of origin still need to be worked out to enable trade in goods and services under the agreement. Topics such as competition policy, intellectual property, and investment will be relegated to future negotiation rounds.

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