# Globalization to withstand protectionist challenges

*By Dr Isabel Yan*

***Dr Isabel Yan**, Associate Professor in the Department of Economics and Finance, discusses the efficacy of President Trump's protectionist policy, the future of UK-EU relations in the wake of Brexit, and how the One Belt One Road project is boosting economic cooperation.*

There is no doubt that the globalization project is set to travel a bumpy road in 2017. A number of unprecedented events are poised to stall its progress. Brexit and Trump's protectionist agenda are significant obstacles, and will challenge the globalization project as we know it. On the other hand, China's One Belt One Road (OBOR) based on open borders and boosting economic cooperation offers an alternative vision. Time will tell which of these countervailing forces will prove more influential. Are we witnessing the end of an era, or will globalization arise anew from the ashes?

## The Trump Presidency

The cozy Clinton-Bush-Obama era Globalization project has already taken some hard knocks, and international policy since January 2017 has turned largely protectionist. The Trump-led administration consistently criticizes pre-Trump trade and immigration policies as insufficient in advancing US interests and in paying too little attention to the interests of US workers. As a result, it advocates policies that put major restrictions on two aspects of globalization: trade and immigration.

## Restrictions on trade

As promised, one of President Trump's first acts was to sign a presidential memorandum to withdraw the US from the Trans-Pacific Partnership (TPP). He also intends to renegotiate the North American Free Trade Agreement (NAFTA), crucial to North American economic integration since 1994. NAFTA abolished tariffs on over one-half of Mexico's exports to the US and over one-third of US exports to Mexico. It also set up the CANAMEX Corridor that strengthens connection among the three member countries via telecommunications, railway and pipeline infrastructure. Nevertheless, Article 2205 of the NAFTA agreement gives a provision for members to withdraw with six months' notice.

Trump's opposition to TPP and NAFTA is largely on the grounds of their effect on US employment. Trade liberalization enables large US corporations to outsource their production, which arguably leads to job losses and lower wages for US workers. Nevertheless, this argument has ignored at least three important stylized facts in economic development.

Firstly, trade liberalization can generally increase the welfare of low-income households by reducing the cost of subsistence manufactured goods like textiles or packaged food. It also broadens the choice of consumer goods available to US customers. Secondly, the comparative advantage of the US is in knowledge-intensive services which are skilled labour-intensive rather than in manufacturing industries which are unskilled labour-intensive. Competing with developing countries in secondary industries will not be a suitable strategy to maintain long-term economic growth for the US. Innovations and technological improvements are well-documented drivers of sustainable long-term growth.

## Product life cycle theory

Thirdly, product life cycle theory shows that any product will generally go through three stages during its production life-time. The first stage is the "new product" stage during which products are invented in advanced countries with abundant capital and skilled labour such as the US, and are marketed there at relatively high prices. Exports are predominately from the invention country. The second stage is the "maturing product" stage in which there is growing consumption demand from other advanced countries and the invention country starts to set up production facilities there. The invention country's exports to these advanced countries thus gradually

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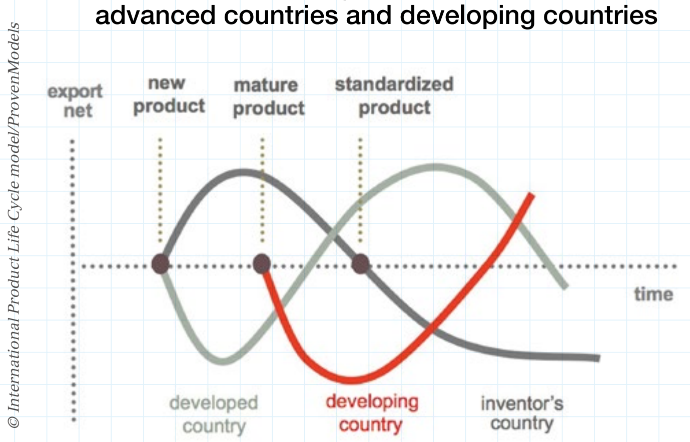
## Product Life Cycle

**Implications on the dynamic of trade balance of advanced countries and developing countries**




reduce. The last stage is the "standardized product" stage during which the production of the product becomes more standardized and the price lowered. The invention country will take advantage of the lower production cost in developing countries (e.g. China, South Asia) and outsource its production there. The invention country becomes an importer at this stage.

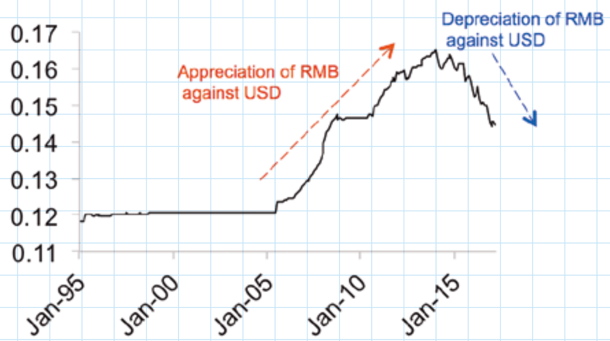
Based on this theory, outsourcing production to developing countries is a natural evolution process in the product life cycle. To maintain its exports, invention countries should focus on continuing to invent new products, rather than restricting the production of mature products to itself which is against its best economic interests. Overall, withdrawing from international free trade agreements will do little to bring factory work back to the US. Instead, it will lead to a reallocation of direct investment to other developing countries and possibly retaliation from countries which are being discriminated against.

### Allegations of currency manipulation

Trump's administration also threatens to take a tough line on countries identified as having "violated global trade rules". In particular, it declares an interest in bringing cases against major exporters who allegedly "compete unfairly", including China. Trump accuses China of manipulating its currency to gain trade advantages, which, if confirmed, would allow other countries to impose trade restrictions against China's exports. However, on 28th February 2017, Trump's currency manipulation claim against China was dismissed by the US Treasury itself. In fact, the plot of China's nominal exchange rate over the last two decades shows that the Renminbi broadly followed a persistent appreciation trend against the US dollar until early 2014. There was no evidence that China actively engaged in one-sided intervention to push down its currency value.

In fact, Trump's radical agenda to restrict trade and immigration is not without potential downside. If the US were to start a trade war, affected countries would be likely to retaliate. And there has been a history of Chinese retaliation. In 2009, China responded to the US imposition of tariffs on its tire exports by taking antidumping measures against US's food exports. Besides, any trade cases against China would require a formal dispute settlement from the World Trade Organisation (WTO), a process based upon the WTO's past decisions.

## Nominal Exchange Rate of RMB against USD




### Restrictions on immigration

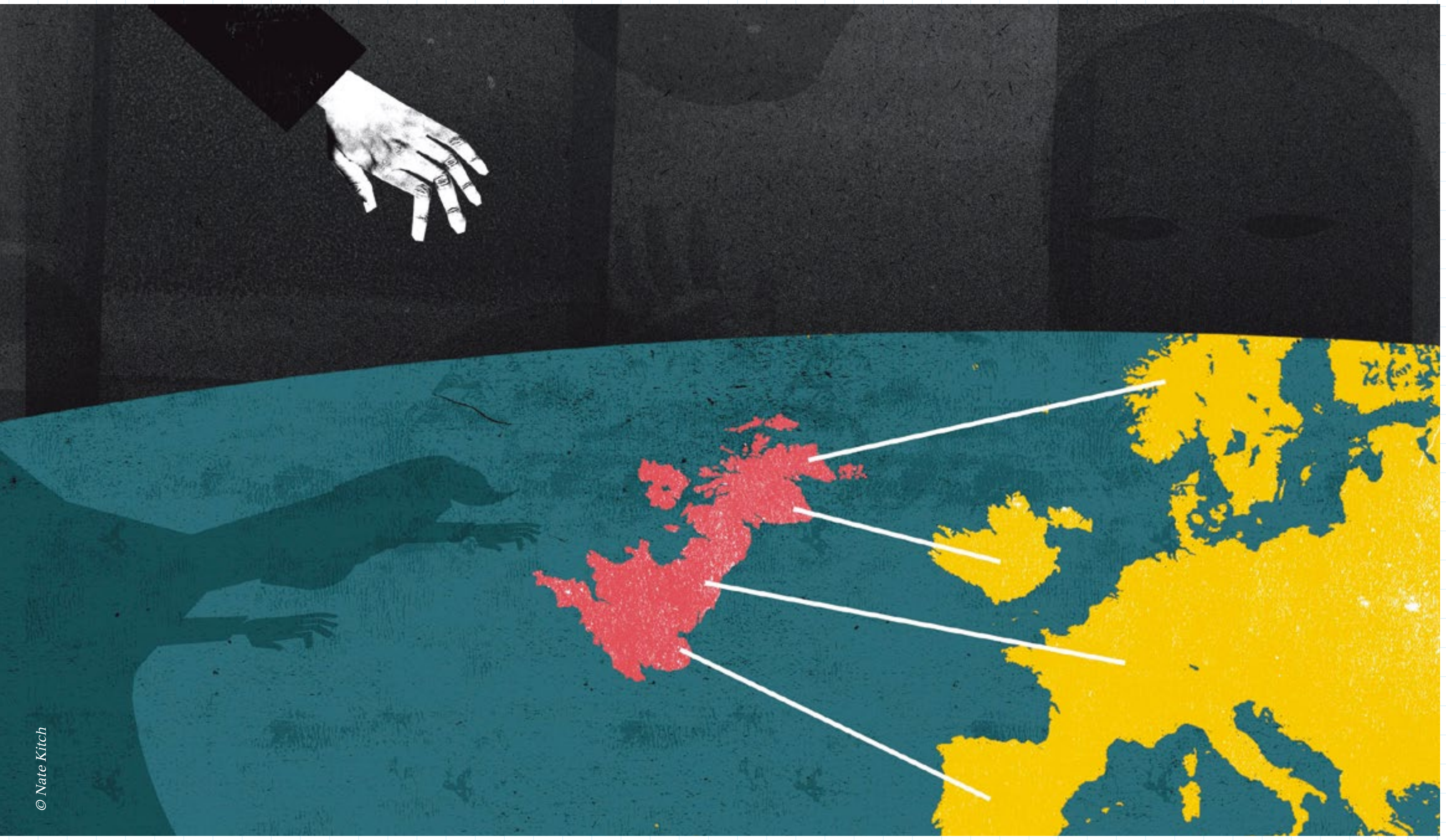
In the first 90 days of his presidency, Trump has signed Executive Orders suspending entry of citizens of seven (later six) Muslim-majority countries for 90 days. Those countries were Iraq, Iran, Libya, Somalia, Sudan, Syria and Yemen. (Iraq later excepted). Trump's future trade and immigration policy is uncertain, but the US's more protectionist policy is expected to result in a redistribution of economic power. Nations whose global trade position is being jeopardized are likely to find ways to lock in their trade position by identifying alternative economic partners. The One Belt One Road Initiative provides just such an opportunity to build new economic connections.

### Brexit

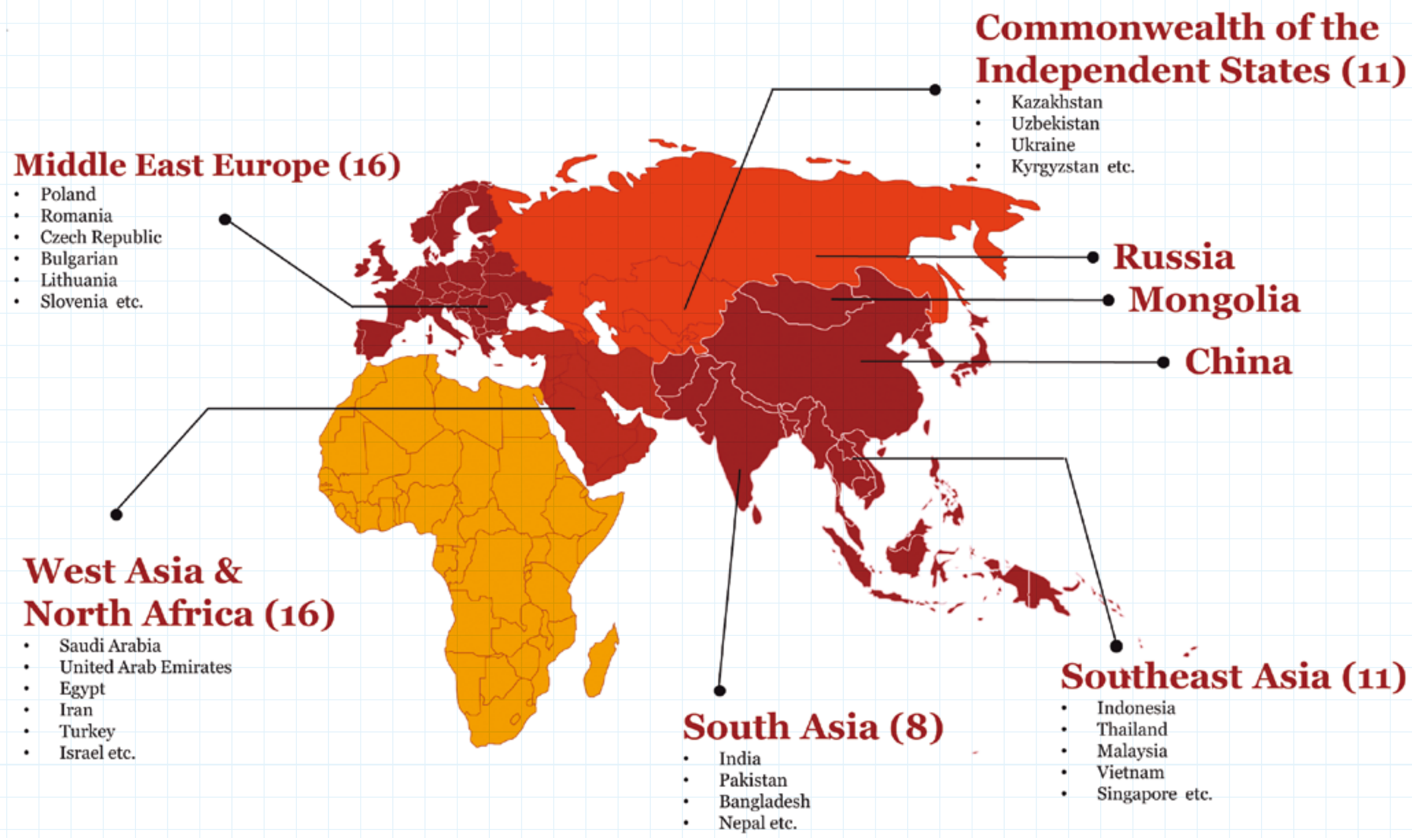
The outcome of the June 2016 British referendum on European Union (EU) membership shocked the world, and set the UK off on the path of departure from the union. The EU currently comprises 28 member countries, of which 19 are in the Euro area. The departure can potentially deprive the UK of four major freedoms with member countries: the free movement of goods, the free movement of services and freedom of establishment, the free movement of persons including workers, and the free movement of capital. These dramatic changes are set to start from the date of the UK's entry into any withdrawal agreement with the European Council, or two years after its notification to the Council of the intention to withdraw.

> *"The future of a new UK-EU free trade agreement is uncertain"*

Until new trade and economic agreements between the UK and other EU members are established, the UK's net exports of goods and services to the European Single Market, especially in its key financial services sector, could decline significantly due to the loss of its passporting rights in the EU. In 2014, the UK's trade surplus in financial services and insurance amounted to around £20 billion. Much of this can be attributed to the UK's passporting rights for UK banks and investment companies to provide services to clients in other European Economic Area (EEA) states by establishing branches or providing services across borders without further authorization requirements. Moreover, the UK's position as the top global euro trading centre (the UK accounted for 45% of total global euro trading in 2016) was challenged by the European Central Bank (ECB) whose "location policy" requires euro-denominated trades to be cleared by Central Counterparty Clearing Houses (CCPs) based in the Eurozone. A PwC report estimates a reduction of 70,000-100,000 jobs in the UK's financial services sector as a result of Brexit. The future of a new UK-EU free trade agreement is still uncertain, and represents a backlash against the current process of globalization.




## 65 countries along One Belt One Road

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### One Belt One Road

Counter to the prevailing protectionist trend, the OBOR plan lays down an economic framework that boosts economic cooperation. First introduced by President Xi Jinping in 2013, it is arguably the largest cross-region infrastructure development project in history. The project aims to connect countries in Africa, Central Asia, Eastern Europe, the Middle East, Russia, South Asia and South-east Asia along the Silk Road Economic Belt and the 21st century Maritime Silk Road. The total population in these countries amounts to about 4.4 billion, relative to 0.3 billion in the US, 0.5 billion in the whole EU and 7.4 billion globally (2016 figures). This multifaceted project includes the construction of port facilities, air transport facilities, IT infrastructure, retail and distribution networks, as well as communications, road, power, and rail networks. The success and widespread acceptance of the OBOR plan serves as a counterforce to Trump's protectionist policy. OBOR is connecting countries in Eurasia interested in reducing poverty, attracting syndicated funding for infrastructure development, and forming ever-closer economic partnerships with China.

The globalization project in 2017 is facing a number of backlashes, but the need for greater cooperation among countries continues to be strong. It is essential that countries work collectively to arrive at win-win situations, not only in boosting mutual economic growth, but also in promoting good governance and environmental protection. For Eurasia and Africa, One Belt One Road is showing the way.