RTA Exchange

RTA EXCHANGE NEWS DIGEST
VOL. 12 MARCH 2017

INTRODUCTION

While the landscape of regional trade agreements and negotiations continues to be dominated by the uncertainties associated to the new US administration trade policy, and the possible impact of the Brexit negotiations, other countries are also developing new approaches to regional pacts; that is the case, in particular of some Latin American countries, as reviewed in this issue of the RTAs News Digest.

WHAT IS NEW IN THE "NEW" US TRADE POLICY?

During his campaign, Mr Trump's positions trade policy matters was an alarming mixture of complaints on existing regional agreements such as the North American Free Trade Agreement (NAFTA), and fierce threats of protectionist retaliation. But other than withdrawing from the Trans-Pacific Partnership (TPP) agreement – one of his first decisions after taking office - the world has been in the dark about how much of his approach to trade policy his administration might turn into reality.

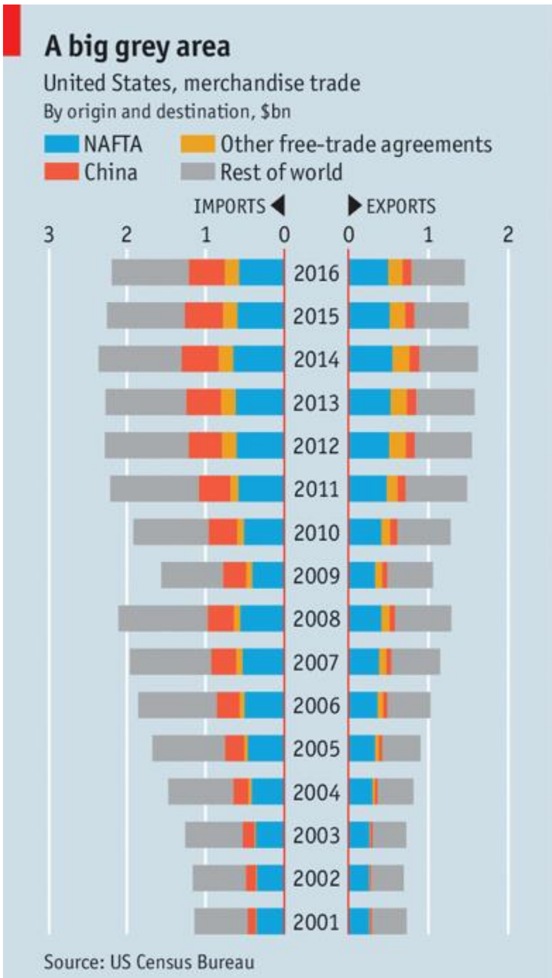
On March 1, the new US administration's trade-strategy document was presented to Congress. Although little is new in the document's promises of "new and better trade deals" or of strict enforcement of American trade remedy laws, a preference for bilateral trade deals over multilateral ones is an important change, and the tone is rather confrontational: "It is time for a more aggressive approach". The document also gives an indication of how the new administration might deal with China: by enforcing more vigorously Sections 201 and 301 of the Trade Act of 1974.[1]

The Trump administration called for the review of 14 bilateral and regional free trade agreements the US participates in. According to it, a model trade agreement has 24 elements with "trade-deficit reduction" being second on the list of priorities, giving a hint as to why the Trump administration may want to review existing agreements.

Reducing trade deficit was a key pledge of Donald Trump's presidential campaign last year, and it continues to be one of the main issues to target in President Trump's trade agenda. According to The Economist, this argument seems of a little sense.

[1] Section 201 permits the President to grant temporary import relief, by raising import duties or imposing nontariff barriers on goods entering the United States that injure or threaten to injure domestic industries producing like goods. Section 301 authorizes the President to take all appropriate action, including retaliation, to obtain the removal of any act, policy, or practice of a foreign government that violates an international trade agreement or is unjustified, unreasonable, or discriminatory, and that burdens or restricts US trade.

While Mr. Trump blames US free trade agreements for the large deficit in trade in goods (about USD 800 billion), these agreements are with countries representing just two-fifths of US two-ways trade in goods, and less than 10% of its goods trade deficit. Most of the US trade deficit (about 77%) stems from trade with China, the EU and Japan, none of which has an FTA with the US. Therefore, it is unclear how poring over trade deals will achieve President Trump's goal of squashing the trade deficit.



Source - The Economist

Another important component that Mr Trump did not take into account while criticizing trade deficit is trade is services. The US excels in many service industries, including education, finance, legal services and intellectual property, and those provide growth and wealth to Americans just as exporting corn or widgets does.

A focus on trade deficits means that NAFTA and the US – Korea Free Trade Agreement (KORUS), a trade agreement with South Korea, will face more scrutiny because of the US trade deficits with these countries. Also, the US administration is exploring alternatives to taking trade disputes to the WTO. The US Trade Representative's office has been asked to draft a list of the legal mechanisms that Washington could use to level trade sanctions unilaterally against China and other countries. According to The Financial Times, the goal is to find ways that allow the new administration to circumvent the WTO's dispute settlement system.

At the same time, there is an increase in tensions between the US and its traditional allies on trade issues, as evidenced at a meeting of finance ministers and central bankers from the Group of 20 industrialized and emerging nations and the European Union.

The US Treasury Secretary, Steven Mnuchin, attending his first major international gathering, signalled that American policy would follow the campaign promises made by President Trump to put "America first" and review existing trade agreements to seek better deals for the United States. We believe in free trade but want to re-examine certain agreements, he said.

The divisions between the US and world's major powers over trade were further on display when Mr. Trump hosted German Chancellor Angela Merkel at the White House. While Mr Trump said he expected the US to do "fantastically well" in trade with Germany, he was rather vague in his response to a comment from Mrs Merkel regarding the fate of the Transatlantic Trade and Investment Partnership (TTIP) negotiations, which Mrs Merkel said she expected the US and the EU to resume soon the TTIP agreement. Trump said he did not believe in isolationism but reiterated his view that trade policy should be "fair".

A focus of Mr Trump criticism of trade deals has been NAFTA, which he´s said needs to be modify significantly, something that the Mexicans may not be against, as reported by the New York Times.

Source - Reuters

For more than two decades, free trade has been at the heart of Mexico's relationship with the US. To the nation's leaders, it was central, vital, and non-negotiable. At least until President Trump came along, promising to upend nearly $500 billion in annual trade between the two countries if it could not be re-engineered more in US favour.

Now, the Mexico's leaders have a new priority: urging their American counterparts to hurry up and get on with it. While free trade has long been an article of faith in Mexico, uncertainty over the fate of the NAFTA is hitting the country hard.

There has been an abrupt slowdown in foreign investment. Last year, it fell by 6 percent, a prelude to what analysts have predicted will be a 21 per cent drop in 2017. Add to that a fluttering peso, lowered growth expectations, rising interest rates and looming political headwinds, and the urgency becomes clear.

Mexico, and its investors, need certainty, but the US does not seem in a rush to do so. This month, Commerce Secretary Wilbur L. Ross said it would be later in the year before real talks even started — after a mandatory 90-day consultation period with Congress, which has yet to start. Thus, there seems to be a growing awareness that dealing with NAFTA a campaign priority for Mr. Trump, has suddenly taken a back seat to more pressing battles. And Mexicans are taking note.

The posture of the US vis-à-vis the WTO are two other areas where uncertainty about US plans are also a source of concern. In the report sent to the US Congress the administration demonstrated its scepticism towards the World Trade Organization (WTO), established in 1995. It pointed out that a president who wanted to fight unfair trade practices need not engage in protracted legal battles at the WTO but had tools to levy punitive tariffs unilaterally.

To some this approach smacks of the creeping protectionism and tit-for-tat unilateral trade battles of the 1980s. "It's not like it's a new scenario. What they are saying they want to do has been tried before," said an international trade official. "If you look back at the 1980s and early 1990s when Japan was really booming the same paranoia was in the air." It was also a time of bitter trade fights between countries over everything from cars and rice to sugar and semiconductors. "What was the result of that?" asked the official. "The WTO. Because [the

US and other countries] realised that they needed something to put the house in order, that just taking unilateral action and retaliating against each other was a never-ending escalation.”

BREXIT: LES JEUX SONT FAITS!

On March 24, EU leaders gathered in Rome to mark the 60th anniversary of the European Union. As reflected in a Financial Times piece, they have good cause to celebrate. This experiment of shared sovereignty would underpin the longest period of peace and prosperity in the continent’s history. However, the trouble that the European process currently faces cannot be minimized or hidden. The Rome celebrations come days before Britain triggers the first departure from the EU, and the Brexit negotiations formally started.

Source – The Financial Times

Indeed, on 29 March, Prime Minister Theresa May signed the letter that set in motion the negotiations for the withdrawal of the United Kingdom from the European Union. In doing so, the British government and its European counterparts would have a period of two years to define the terms on which their separation would materialize as well as the conditions on which their mutual, future relationship would be established.

This is a historical moment from which there can be no turning back, said Mrs. May after invoking the EU´s Article 50 exit clause. Also, in her letter, Mrs. May reiterated several times that she wanted a deep and special relationship with the EU.

The six-page letter was handled by Sir Tim Barrow, the UK´s ambassador to the EU, to Donald Tusk, the European Council president, who in response indicated that he would publish draft guidelines for the negotiations shortly, and announced that on 29 April the European Council would meet to decide on these guidelines and approve a negotiating mandate for the European Commission.

Thus, the stage is set for the beginning of a process that would be complex no matter how you look at it. The stakes could not be higher, as they touch upon the future of a historic relationship that has for decades influenced the political and economic landscape of key partners.

As pointed out by Anand Menon of the King's College in London, who directs the *UK in a changing Europe*, an academic network, the Brexit negotiations would be the most difficult and complicated any post-war government has faced.

The Brexit negotiations would start in earnest by mid-year, with the next couple of months devoted to deal with some preliminary, key matters. Among them a very prominent one is the rights of the about 1 million British citizens now established in European countries, and of the more than 3 million European citizens living in the United Kingdom.

Another key, preliminary issue is what has come to be known as the "exit bill" that the EU would claim Britain should pay. As stressed by The Economist, rows over money have always been the bitterest of all in the EU. Thus, as in any divorce there is a serious risk that differences on the "exit bill" will blow up the negotiations before they start, but at the end a settlement has to be worked out for the whole Brexit process to succeed.

Beyond these key preliminary issues, the core of the Brexit negotiations would be the conditions under which Britain leave the EU´s single market and customs union, as well as the nature of future EU-Britain relations.

But here the negotiations would enter into a better known ground, involving tariff and non-tariff barriers, custom duties, special treatment for items and economic sectors, i.e., agriculture, as well as the status of the dozens of trade agreements the European Union has concluded with both developed and developing countries, often at the initiative of the UK.
All these tasks or at least most of them should be completed in less than two years, so that by March 2019 the Brexit negotiations are completed.

The Brexit process and the content of Article 50 of the EU treaty, which set the conditions for Member countries to "divorce" from the EU, are summarized in Tables 1 and 2, below:

Table 1: Brexit: everything you need to know about Article 50
What is Article 50?
Introduced in 2009, Article 50 of the Treaty on European Union provides the formal exit mechanism for a country wishing to leave the EU. Its key provision is that, in the absence of a unanimous agreement to extend negotiations, a country activating the clause will leave the bloc two years after notification. That means Britain will be out of the EU by April 2019. The text of the article says the EU will "negotiate and conclude an agreement with [an exiting member] state, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union". So while the negotiations are specifically about divorce — dealing with issues such as financial obligations and expatriate rights — future ties between the EU and the UK also play a part.
How will a deal be ratified and is Article 50 revocable?
A comprehensive (future) trade deal between Britain and the EU would be separate from an Article 50 agreement and would require unanimity among member states. That is a higher hurdle than the requirements for the exit agreement itself, which needs to be backed by the UK, a "super qualified majority" of the other EU countries (at least 72 per cent of the states representing 65 per cent of the population) and the European Parliament.
What happens when Article 50 is triggered?

A formal response to Britain will require the endorsement of leaders of the EU's other 27 countries at a summit on April 29. At issue will be the content and structure of the talks with the UK. Britain puts a high priority on striking a trade deal, and not just a divorce agreement, within the two years set out by Article 50.
<u>When will the real negotiations start?</u>
Formal talks cannot take place until the Member States give the European Commission a more detailed, and confidential, negotiating mandate. So, the first face-to-face encounter is unlikely before late May.
<u>What is the British government looking for?</u>
Essentially, Mrs. May's government has indicated that Britain wants to control the number of people who come to Britain from Europe and end the European Court of Justice's sway over British law. This means the country will leave the EU's single market and customs union. Still Mrs May wants Britain to have a "new, comprehensive, bold and ambitious free-trade agreement" with the EU. Also, on one of the most sensitive issues facing both sides, Mrs May has indicated that "we want to guarantee the rights of EU citizens who are already living in Britain, and the rights of British nationals in other member states, as early as we can". Also, Mrs. May has reiterated that Britain seeks "a new and equal partnership — between an independent, self-governing, global Britain and our friends and allies in the EU. Not partial membership of the EU, associate membership of the EU, or anything that leaves us half-in, half-out".

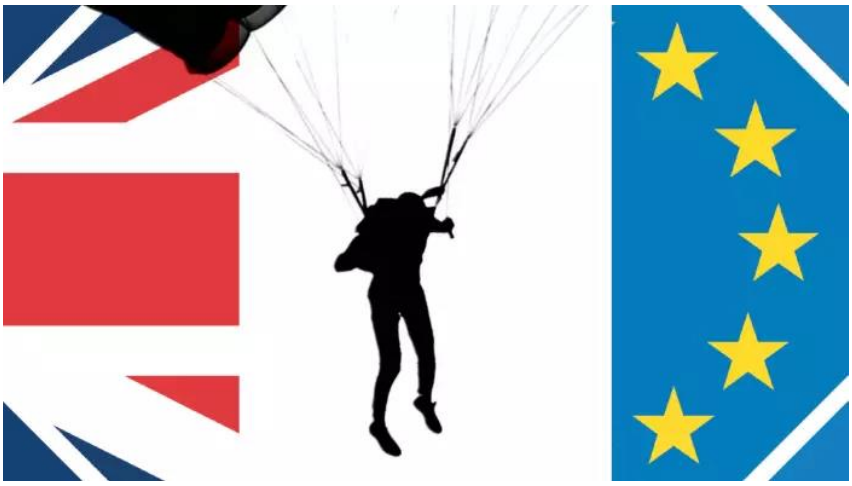
Table 2:
<u>The full text of Article 50:</u>
1. Any Member State may decide to withdraw from the Union in accordance with its own constitutional requirements. 2. A Member State which decides to withdraw shall notify the European Council of its intention. In the light of the guidelines provided by the European Council, the Union shall negotiate and conclude an agreement with that State, setting out the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union. That agreement shall be negotiated in accordance with Article 218(3) of the Treaty on the Functioning of the European Union. It shall be concluded on behalf of the Union by the Council, acting by a qualified majority, after obtaining the consent of the European Parliament. 3. The Treaties shall cease to apply to the State in question from the date of entry into force of the withdrawal agreement or, failing that, two years after the notification referred to in paragraph 2, unless the European Council, in agreement with the Member State concerned, unanimously decides to extend this period. 4. For the purposes of paragraphs 2 and 3, the member of the European Council or of the Council representing the withdrawing Member State shall not participate in the discussions of the European Council or Council or in decisions concerning it. A qualified majority shall be defined in accordance with Article 238(3) (b) of the Treaty on the Functioning of the European Union. 5. If a State which has withdrawn from the Union asks to re-join, its request shall be subject to the procedure referred to in Article 49.

Thus, once the British and EU negotiators start the Brexit talks, they will be eyeing something any serious negotiation needs to be successful: a landing zone. Both sides know what they want, i.e., they have their own vision and know their objectives in the negotiations, the question is whether their respective visions overlap or are irreconcilable.

As reflected in a piece in the Financial Times, a full Brexit deal will require at least three documents: one covering the terms of disentanglement of the UK from the EU; an annex explaining transition provisions; and a political agreement on a framework for future relations.

Britain and the EU must untangle the past, settling outstanding financial liabilities and the rights of EU citizens in Britain and UK nationals in the continent as well as a political deal to clarify the role of the European Court of Justice (ECJ); also, an outline for a future relationship is essential, framing future trade ties and underpinning any transition arrangements.

The completion, content and timing for these three documents are subject to different views. Michel Barnier, the EU's lead negotiator, wants "divorce-first" negotiations, delaying talks on trade issues, both present and future until Britain has agreed in principle on an "exit bill" of up to €60bn.



Source - The Financial Times Montage

The rights of EU citizens living in Britain and UK migrants in the EU is another huge issue Mr Barnier wants resolved before trade talks begin; here, even if both sides want a reciprocal deal, the issue is a rather complex one.

Also, Britain wants to avoid a "cliff edge" - a sudden break with the EU - but the bloc seems to insist that a transition period would require accepting the free movement of people and continued compliance with the rulings of the European Court of Justice; these are two critical issues for the Brexiteers, and Mrs May has vowed the UK will establish immigration controls and end the sway of the ECJ as soon as Brexit takes place.

And then there is the politics of Brexit. Shortly before the formal initiation of the Brexit negotiations, tens of thousands of anti-Brexit demonstrators marched through the London streets, as if to underline that the UK government does not go to the negotiating table with the full support of the British people.

Also, there is Scotland and Northern Ireland, both of which voted in the June 2016 referendum in favour of staying in the EU; recently the Scottish Parliament supported the demand of Scotland first minister, Nicola Sturgeon, for a second independence referendum, and Sinn Fein is calling for a referendum on whether Northern Ireland should join the Irish Republic.

Finally, there is the issue of the little time available to complete the Brexit process. Trade analysts and negotiators have a tendency to exaggerate the complexity of trade negotiations, so they are quick to underline the complexity of the issues and the negative consequences of failure. Pascal Lamy, a former EU trade commissioner who lead the WTO from 2005 to 2013, said recently at an event hosted by the Institute for Government in London that any Brexit deal is going to be costly, as in trade, there is no way switching from an internal market to any other regime, including the best, that will not be costly".

Source - Andy Rain Efe, El País

Still, things could unexpectedly be done faster and efficiently, and some people recall the dire predictions of analysts when evaluating in the complexities associated to the German reunification process. The task at hand was daunting, we were reminded recently. Many people at the time argued that such a momentous endeavour — the abolition of one state, its merger with another, the ending of decades of continental conflict — would take many years.

Yet, in October 1990, less than 12 months after the breaching of the Berlin wall, the two Germanys united. As well as ending the division of Germany, the act of unification also formally ended the Second World War — hardly a bagatelle.

Also, it may well be that the EU takes this opportunity to update itself and make its unique integration experiment more attuned to current times. To this end, it seems that Brussels intends to make more use of multi-speed decision-making in the EU as part of its response to the UK exit from the bloc.

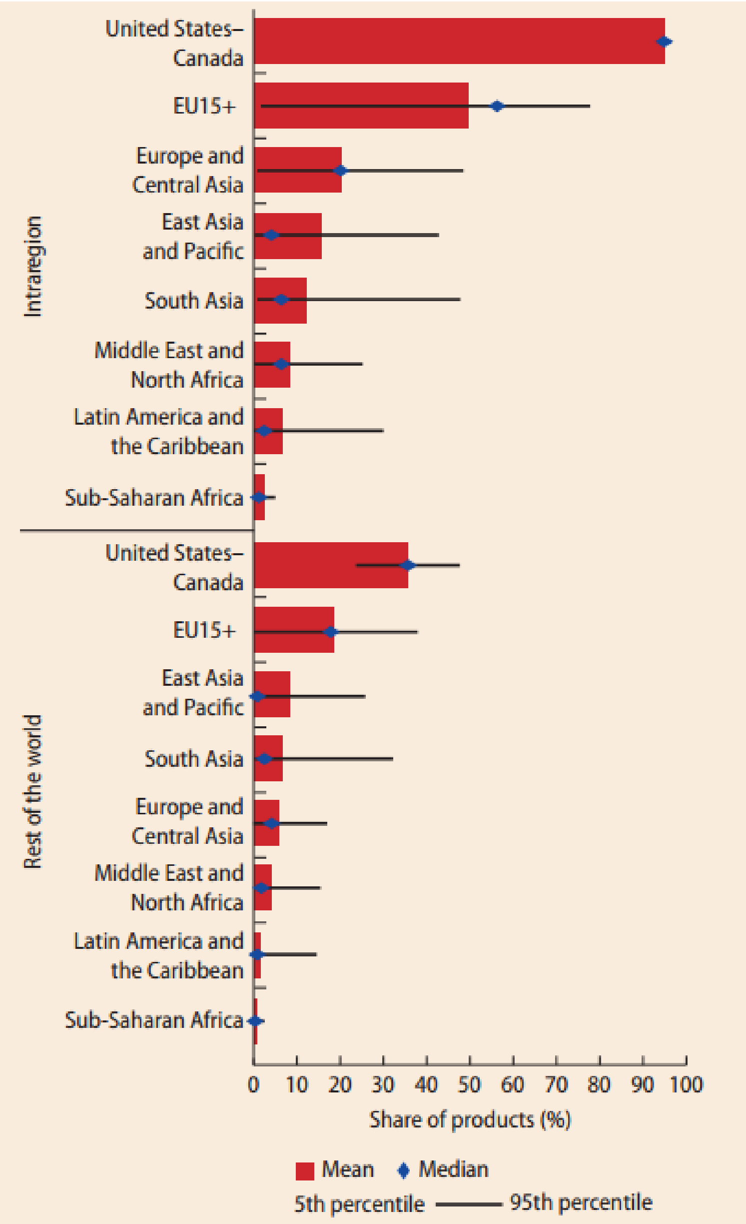
In a paper on the EU's future, Jean-Claude Juncker, the European Commission's president, identify five long-term options for the EU, among them that member states move towards further integration at different times — an approach that he favours and that has the support of some key EU partners, such as Angela Merkel, Germany's chancellor.

The EU already encompasses varied degrees of integration, with the euro used by only 19 of the 28 Member States, but greater reliance on policies that have not been agreed unanimously remains contentious, particularly among poorer eastern member states that fear a loss of financial support from Brussels. Still the jury is still out as to whether this is the preferred route for the EU.

A REVIVAL OF LATIN AMERICAN INTEGRATION EFFORTS?

Source - The Economist

For the past half-century, Latin American politicians have talked incessantly about regional integration, but have found it difficult to make it happen. The number of trade agreements among Latin American countries have increased, but the share of intra-regional exports have struggled to move beyond 20%, according to a new report from the World Bank. That is low compared



Source - The World Bank, Share of total exports to regional partners and to the rest of the world, by region, 2010-2014

with Canada and the United States (35%), East Asia (50%) and 18 core members of the European single market (60%).
The political landscape may now be moving in a more trade-friendly direction. There is now talk in South America of "convergence" between Mercosur, which include Argentina, Brazil, Paraguay and Uruguay, and the Pacific Alliance, a free-trading group comprising Chile, Colombia, Mexico and Peru, and next month, foreign ministers from both groups will meet for the first time.

It may be too early to talk about the merging of these two groups, as they have different rules and philosophies, but it is a possibility that is worth exploring. One option would be to use ALADI, a 1980 integration treaty, to harmonise and improve existing preferential agreements, says Enrique Iglesias, a former head of the Inter-American Development Bank (IADB).

The World Bank report argues that regional and global integration go hand in hand. Mr Trump has killed the Trans-Pacific Partnership; the Pacific Alliance hopes to resurrect it without the United States, linking its members to Asia. Mercosur retains fairly high external tariffs and has few trade deals with others. It is making a fresh effort to conclude long-stalled talks with the EU.

The rhetoric of integration should be translated into action. The challenge, says Roberto Bouzas, a trade specialist at San Andrés University in Buenos Aires, is how to translate the abstract demand for integration into a concrete political agenda backed by organized interests, and find leaders willing to carry this out.

In the same vein, the Financial Times refers to efforts under way to inject momentum into a long-stalled free trade pact between Europe and the Mercosur countries. On-off discussions have rumbled on since 1999 without a breakthrough, but diplomats in the two camps believe an opportunity may be opening up to strike a deal this year.

Negotiators gathered recently in Buenos Aires to advance talks between the two blocs. Significant hurdles remain to be overcome. Agriculture is massively sensitive in the context of Mercosur, and there are deep anxieties in Europe's farming sector that a deal would prompt a big rise in cheap beef, sugar and poultry imports from South America.

At the same time, the Mercosur countries have long resisted demands from Brussels for an open public procurement markets to European companies and to adopt international standards on labour, environmental protection and climate change.
There are similar views within Mercosur. Aloysio Nunes, Brazil's new foreign minister, told Reuters recently that Mr Trump's withdrawal from trans-Pacific trade deal has opened new opportunities. "There is an intensification of our talks with the EU and we are moving into a decision-making phase," Mr Nunes said.

As emphasized by the World Bank paper regional integration could foster deeper ties to global trade and investment flows, especially if Latin American governments were to lower their "most-favoured nation" tariffs with the rest of the world, and integrate their labour and capital markets. It would mean moving from free trade agreements to more solid economic and social integration partnerships.

Also, the World Bank report refers to the importance of regional integration for Latin America's economies: it clearly identifies the efficiency gains associated with deeper integration between the southern and northern parts of the region. According to the study, the average efficiency gains that countries like Argentina and Mexico could obtain from regional partners outside their sub-region are comparable to those that could be attained by trading with countries elsewhere in the world.