



Global Counsel

# The Politics of Trade

London, 16 January 2020

# Welcome

Thank you for attending The Politics of Trade. 2019 was an extraordinary year for trade and trade policy. 2020 shows no signs of being any different.

Our aim with this conference is to focus not just on the outward effects of trade policy tension but on some of the technological and political changes that are shaping the challenge that both trade policymakers and trade businesses face. It is self-evident that US and Chinese policy choices can and are reshaping global supply chains. But there are technology-driven changes in e-commerce and cross-border trade in services where policy choices will also reshape trading models in the years ahead.

Beyond these areas, the political frameworks governing trade are changing, and under strain. The WTO system established in 1995 is desperately in need of a new consensus if it is to continue to be the key locus of rule-making and governance for global trade. Political expectations of trade policy are also evolving, especially in areas such as climate change, where decarbonisation policies will need flanking strategies for managing trade competition.

None of these challenges have easy answers. But we hope today's conference will be a source of interesting questions and ideas. Enjoy the conference.

Stephen Adams  
**Senior Director**

## About Global Counsel

Global Counsel (GC) is an advisory firm, working with clients to navigate the critical area between business, politics and policymaking. GC works with investors and management teams across a wide range of sectors to anticipate the ways in which politics, regulation and public policymaking drive both risk and opportunity associated with specific assets and broader portfolios - and to develop strategies to meet these challenges.

# Trade in 2020: technology and tension

2019 was a year of policy-driven disruption in the global trading system unprecedented in the post-war period. The largest players in the global economy raised tariffs on their trade with each other in a way that they have not done since the creation of the 1947 GATT regime and its built-in mechanism for restraining taxes on trade. Triggered by a radical evolution of US policy on China and its other large trading partners, the spiral of punitive trade measures, coupled with a newly-assertive US approach to the WTO has brought a new level of uncertainty to international trade.

Technological change ultimately lies behind a large part of this tension. The Trump administration has chosen to pick a range of trade fights for a wide range of reasons, but its challenge to China is the most fundamental. US tensions with China are not new, but they were ultimately brought to a head by the Trump administration in 2017 over the simmering question of US technological primacy in the face of a concerted Chinese push to assert its own technological leadership on the basis of strategic model of state-backed development that the US regards as antithetical to a model of fair and open competition and trade. The resulting tariff war has disrupted supply chains, strained relations and triggered a much wider decoupling of markets for technology.

But technology is also driving trade and trade policy in other less visible and less confrontational ways. The dramatic rise in international e-commerce has opened up big potential

opportunities for both small and large firms to directly reach individual customers almost anywhere in the world. But a model in which every purchase triggers international trade has had a transformative effect on consignment sizes and volumes, with important implications for customs systems and border security.

In services trade, as cross-border communications have become more sophisticated, this has driven significant growth in cross-border services trade in ICT, consultancy and other professional services in which remote provision is increasingly feasible. This has led some observers to speculate that technology is about to unlock a new wave of globalisation and price arbitrage in services trade similar to the restructuring of good supply chains since the 1980s.

This change is both driving policy and being driven by it. US tariffs on Chinese goods are a material cost on trade, but evolving policy frameworks for e-commerce and cross-border trade in regulated services can and will also materially shape the way these markets and models develop in the years ahead. For trade policymakers and trading businesses, understanding the potential opportunities and challenges in technological change is integral to building the trading system of the next decade.

# New models, new actors...new politics?

Fig 1. New tariff protection measures  
Number

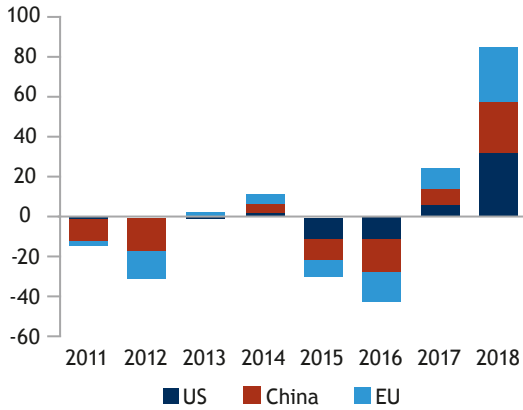


Fig 2. Incoming small consignments, US customs  
Million

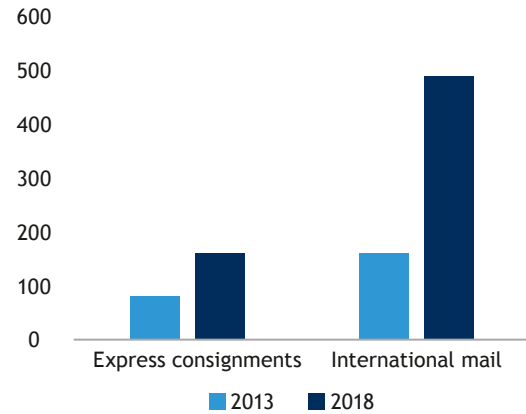


Fig 3. State-invested\* companies in the Fortune 2000  
Number and sector, selected states, 2018

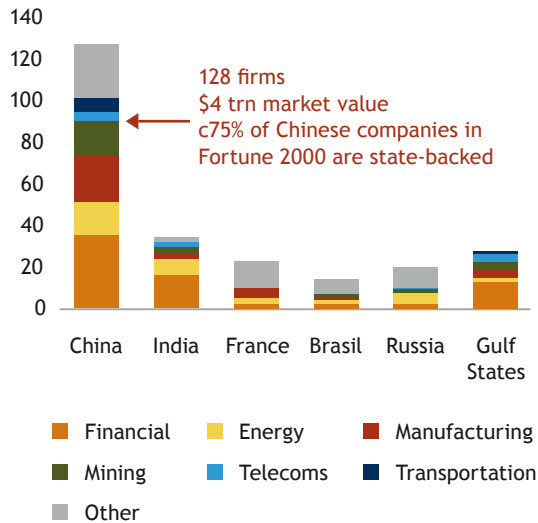
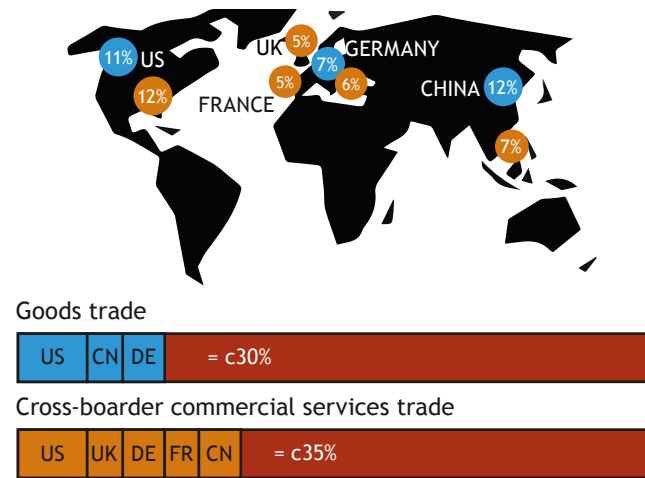


Fig 4. Megatraders 2018  
% share of global imports + exports of goods and services



Global Trade Alert 2019; US CBP Annual report July 2019; Forbes 2019 \* State-invested = at least 10% state ownership; WTO 2019

# Technology and proximity in service trade

Over the last five decades, the globalisation of goods supply chains has radically changed the way goods are produced. Firms have taken advantage of dramatically improving efficiencies in transportation and the cost differentials between countries to build models of production in which trade is as much part of the production process of manufactured goods as it is the mechanism of their final distribution. The revolution in services trade triggered by containerisation and hyper-efficient transport logistics unlocked this huge latent potential for the globalisation of production and distribution of goods.

Unlike goods trade, it is in the nature of selling services that the 'producer' and the consumer have a direct relationship. In many cases, this relationship unavoidably requires that the supplier and consumer are in the same place at the same time - a hotel bed, repaired toilet or haircut cannot be delivered remotely. In others, such co-location may not necessarily be required for the supply of a service, but remote delivery of the service can be constrained by the limitations of communication technology, or the simple preference of the consumer for personal over remote supply.

For these reasons, commercial establishment in the market of sale (Mode 3 in WTO jargon) dominates global trade in services. Cross-border (Mode 1) supply is focused in areas such as international transportation where cross-border activity is integral to the service itself, or services such as insurance and certain banking services,

where limitations of the efficiency of cross-border communications may be less important than access to pools of global expertise or capital (Figs 5 and 6). The share of Mode 1 trade in the UK's export profile reflects the unique conditions of the EU single market, which facilitates cross-border supply via a shared rulebook and legal regime (Fig 8).

Nevertheless, over the last decade there is some evidence that this may be changing. Mode 1 trade has grown faster than Mode 3 trade across all traded services, and growth has been strongest in sectors such as ICT, advertising and consultancy where the potential for remote supply is intuitively strong once supported by sufficiently sophisticated communications (Fig 7). There is little technical difference in a video conference between London and Birmingham or Birmingham and Bangalore.

How this technological potential ultimately impacts trade in services remains uncertain. The potential for remote supply will have to be set against a range of strong factors that pull against such change. The most fundamental is likely to be regulation, especially in areas like financial services where the primary barriers to cross-border supply are often legal rather than technical. Customer preferences will also be key - the preference for a doctor in the room, a teacher in the lecture hall or a supplier in your meeting room may prove harder to erode than consumer preferences for locally-made goods.

# Technological change and cross-border trade

Fig 5. World services trade by Mode 2017  
%

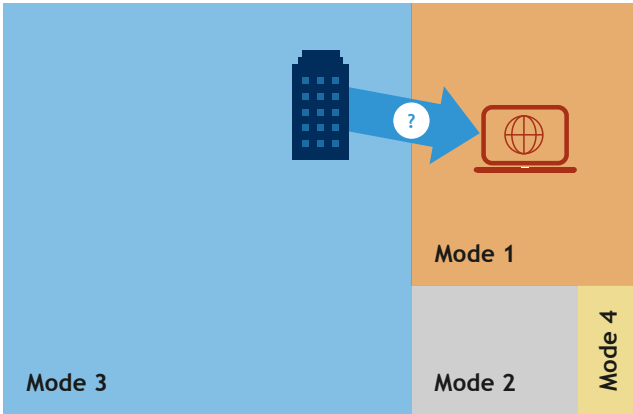


Fig 6. World services exports by Mode 2010-2017  
\$ bn

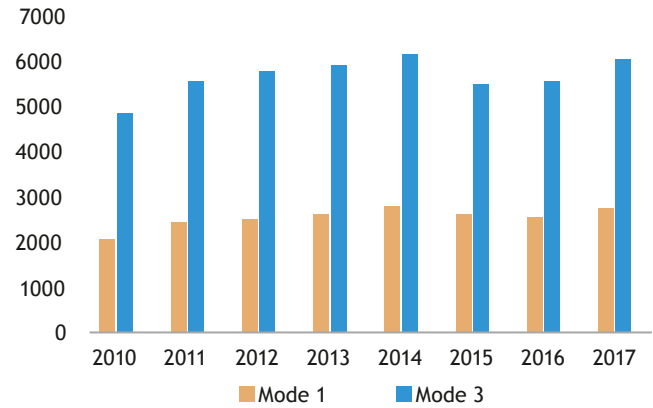


Fig 7. World Mode 1 services exports 2010-2017  
% change 2010-2017, selected sectors

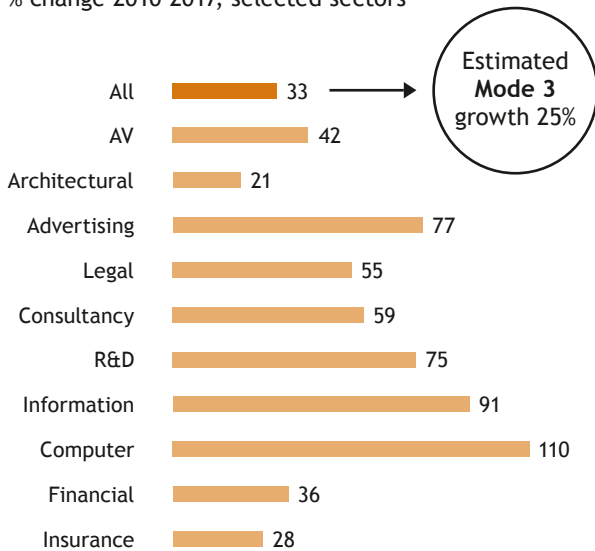
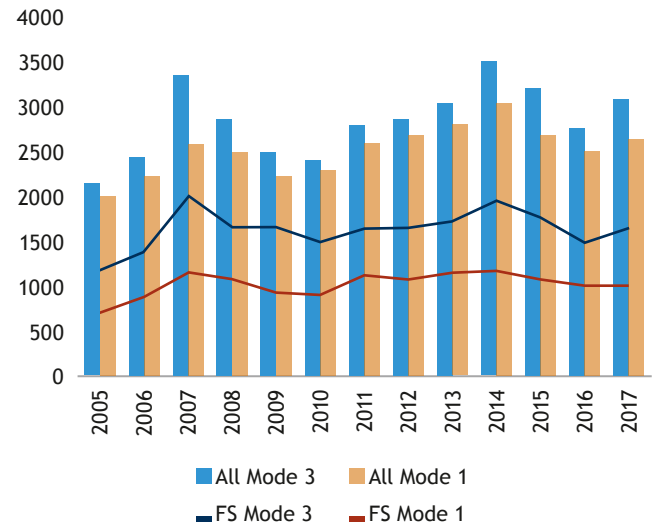


Fig 8. UK services exports by Mode 2005-2017  
\$m



WTO TISMOS database, extracted December 2019

# The challenges of international e-commerce for small traders

E-commerce has transformed commerce. The ability to market and supply goods and services over the internet has had a profound effect on the way businesses sell to each other, and to consumers. It is now possible in principle for a business - including the very smallest businesses - to reach potential customers anywhere in the world via the internet and for customers to search for suppliers in the same way.

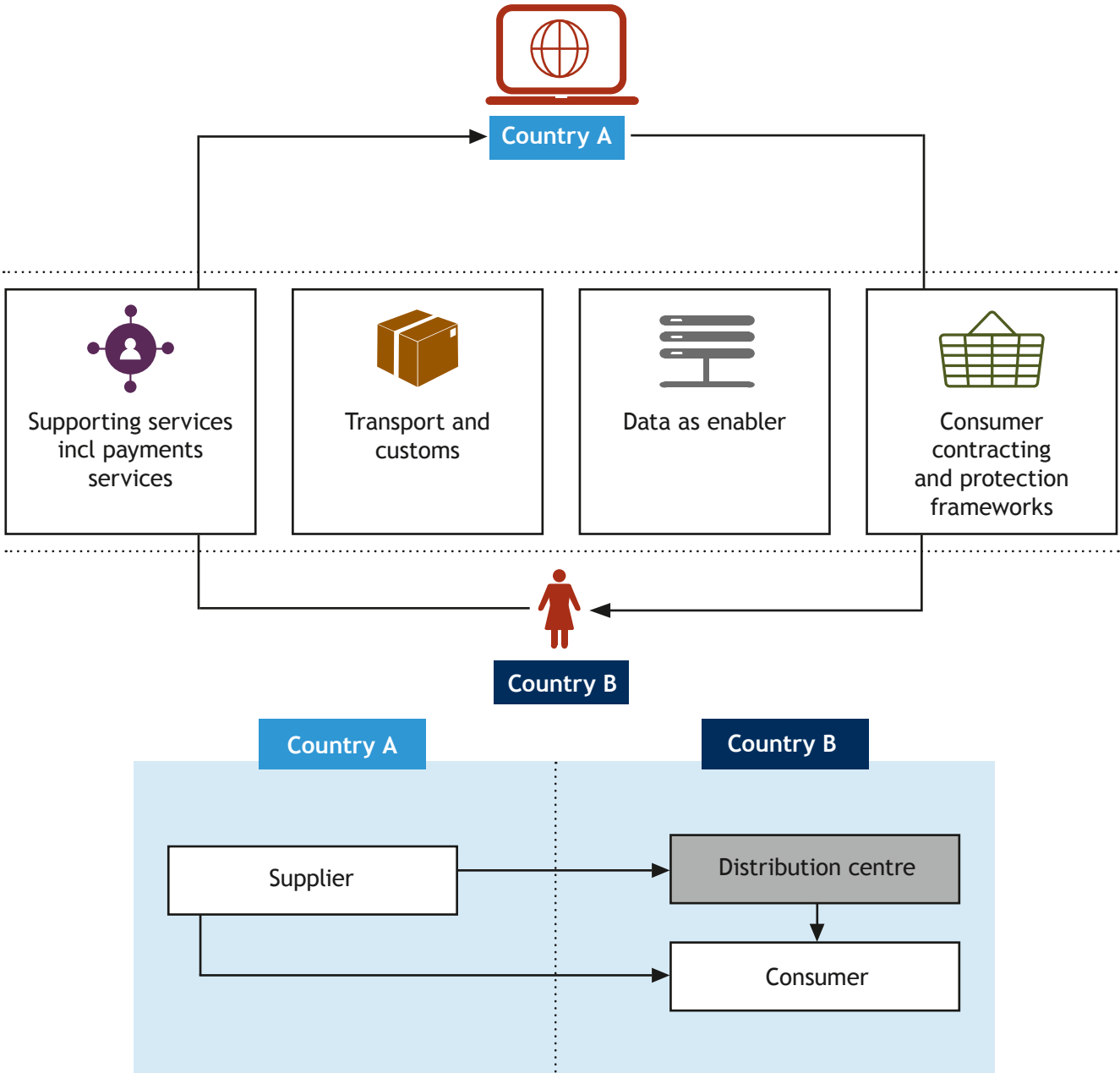
By transforming the way people shop, it has inevitably transformed the way markets for shopping look and work. But the development of the 'online' channel within jurisdictions has not forced policymakers to revisit any basic assumptions about how to regulate commerce. This cannot be said for the international variant of e-commerce, especially its business-to-consumer variant. The modern global framework for trade policy was not conceived for a world in which goods and services could be marketed, sold and supplied via a ubiquitous global digital infrastructure in which a retail consumer and retailer supplier might be in different jurisdictions. Trade in this model is generally part of the production and distribution supply chain, rather than an integral part of the sale to the final consumer.

International e-commerce challenges this model in a range of ways, all of which raise important questions for policymakers and traders. It is shifting the dynamics of global trade by changing the nature of consignment sizes and the role of airfreight in the global trade mix (see right) -

with implications for customs protocols, border security and even environmental sustainability. It is de facto liberalising trade in certain digitisable products such as film and music by replacing physical storage formats with electronically-transmitted ones that can potentially escape the reach of goods tariffs. It depends on the infrastructure of an international payments system and effective frameworks for data standardisation and transfer that for now are constrained by interoperability problems. Conventional consumer protection frameworks are built around a clearly identifiable actor placing a product on a local market - and present in some legal form in that market for the purposes of enforcing consumer protection. But this is not necessarily the case for international e-commerce.

None of these challenges negate the potential value and opportunities of international e-commerce. This must be especially the case for small businesses, for whom it provides dramatic new scope to reach an international customer base - in principle. However, they do emphasise the policy problems that need consideration in designing an effective international e-commerce strategy and framework. Some of these themes have been integrated into the WTO's new proposed workstream on e-commerce. But the wider puzzle of international e-commerce's feasibility for small businesses remains an important one for trade policy.

# The challenges of international e-commerce





# Levelling the playing field?

The GATT and WTO regimes take a very limited approach to the question of substantive standards in the markets of WTO members. Beyond some basic disciplines in areas such as subsidies and the protection of intellectual property rights, WTO members have invoked a general principle of state sovereignty to resist any suggestion that the basic WTO principles of non-discrimination should be coupled to normative standards in areas such as labour rights or environmental protection. Emerging economies in particular have often rebuffed any linkages between trading rights and matching the environmental and labour standards of their more developed trading partners.

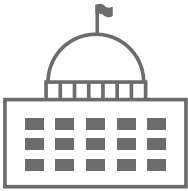
But these demands for a level playing field from developed country stakeholders have played an increasingly important political role in shaping bilateral FTA negotiations, where developed countries can in principle force them back onto the agenda. Starting with the 1994 NAFTA negotiation, developed country legislators have demanded that preferential liberalisation be coupled with substantive commitments in the areas of labour standards and environmental governance.

Over time, these demands have become more specific and more focused on 'hard' binding obligations linked to clear baseline standards over softer commitments to enforce domestic standards consistently (see right). For both the European Parliament and the US Congress, the expectation now is clearly that such provisions should exercise genuine constraint on a trading partner and be

linked to both dispute resolution procedures and to remedies - the potential scope to withdraw trade privileges if minimum standards are not maintained. Although negotiators have generally restricted the reach of such commitments by making them applicable only where the underlying standards affect trade between countries, many activists and legislators argue that such tests reduce their bite in an unnecessary way.

Much of this debate has been driven over the last twenty years by labour interests demanding a more level playing field in baseline labour conditions and clearer contingency between trade privileges and the meeting of developed-country norms. Looking ahead, it seems likely that an increasingly important role is going to be played by the question of environmental and decarbonisation standards. Businesses in jurisdictions adopting strict emissions targets will inevitably argue that those in jurisdictions that do not are benefiting from a regulatory subsidy that distorts competition. Agreements in the UN COP process may help ensure something of a level playing field in this respect. But if they do not, then the pressure to find new ways of using trade policy tools including FTAs and carbon border adjustment tariffs will increase.

## Evolving legislator demands: labour and environmental provisions in FTAs



Commitments  
Monitoring  
Dispute settlement  
Remedies

### EU Parliament mandate resolution EU-Japan FTA 2012

“A robust and ambitious sustainable development chapter with core labour standards, including the four ILO priority conventions for industrialised countries; this chapter should also include the establishment of a civil society forum that monitors and comments on its implementation.”



### EU Parliament mandate resolution EU-Australia FTA 2018

“Binding and enforceable provisions which are subject to suitable and effective dispute settlement mechanisms, and consider, among various enforcement methods, a sanctions-based mechanism.”



### US Congress Trade Promotion Authority 2015

USTR must secure:

- Commitments to adopt and maintain measures implementing ILO core labour standards and obligations under common MEAs
- Provisions that enforceable labour and environment obligations are subject to the same dispute settlement and remedies as other enforceable obligations under the agreement



# Where next for the WTO?

Since 1995, the WTO has been at the centre of multilateral governance of the international trading system. It was conceived at its creation of serving three basic roles. The first was to provide the basic forum for continued rounds of multilateral trade liberalisation similar to those that had been conducted under the GATT since 1947. The second was as a forum for maintaining and continuing to expand the international rulebook represented by the GATT itself and the large expansion of that body of law adopted alongside the WTO's creation, including new rules on services, intellectual property rights, technical standards and sanitary standards. The third, and arguably the most important, was to provide a binding dispute resolution system to oversee and enforce that rulebook.

The first of these roles ran into serious trouble in 2008 with the stalling of the Doha round of multilateral negotiations, although the WTO membership have experimented with narrower formats for tariff elimination in specific classes of goods and binding commitments on trade in services. The second has seen a range of files partially salvaged from the Doha agenda in areas such as farm supports and trade facilitation. More recently, negotiations have been launched on a possible new agreement on e-commerce. Much more speculatively, it is often suggested that the WTO membership should consider an attempt to revise the WTO's disciplines on subsidies - although there is serious resistance to such an agenda.

These are certainly a downgrade of early ambitions for the WTO and they reflect the complex and competing mix of interests in the WTO membership now that it covers every major economy. But neither necessarily represent an existential challenge to the institution or its governance framework. However, the blocking by the US (through a refusal to approve new judges) of the WTO's dispute resolution function is arguably a much more profound challenge. Stripped of its capacity to enforce its rulebook, the WTO is threatened with irrelevance. The US argues that WTO judges have over-reached their authority over the last twenty years, especially in the way they have interpreted WTO rules in a way that erodes the political discretion of members in key areas such as trade defence. Others disagree, but there is a clear recognition that the WTO walks a fine line between exercising genuine judicial prerogative and having to maintain the political support of its members, over which it ultimately has no binding power (Fig 9).

Is there a way out of this impasse? Can the WTO membership agree a way to delimit the reach of the WTO judicial function, or reverse established jurisprudence in a way that wins back US support? Should it? Can the WTO membership continue to add new meaningful disciplines and rules to the WTO rulebook in the years ahead - including in key areas such as subsidies? Will there ever be another multilateral trade round?

## Stalled, downgraded, blocked

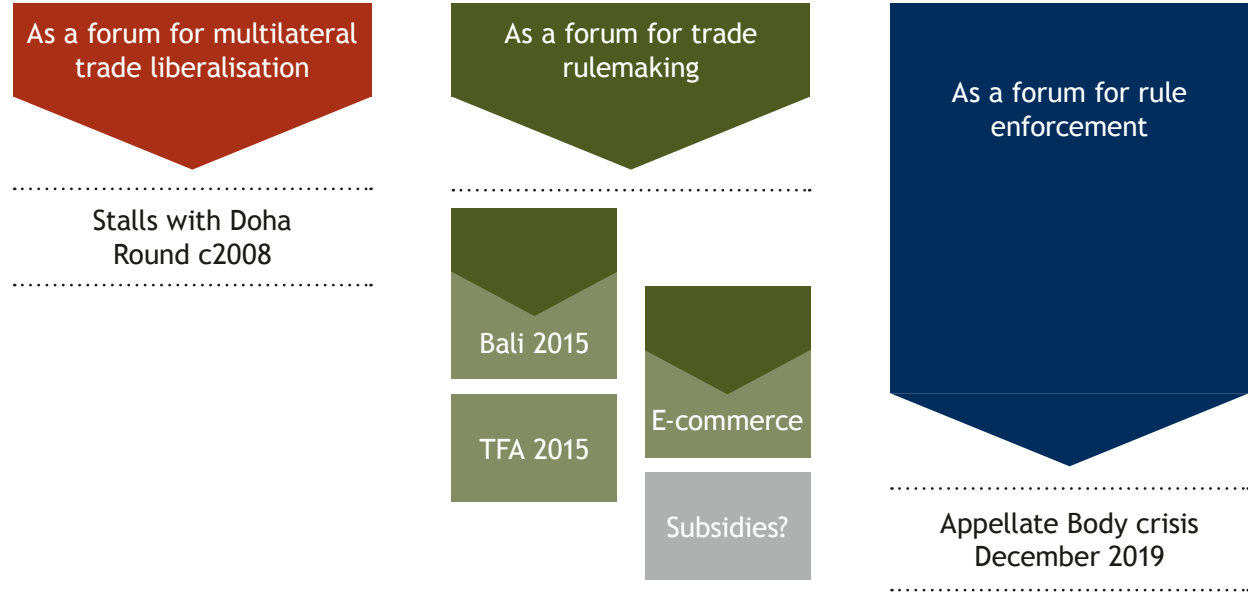
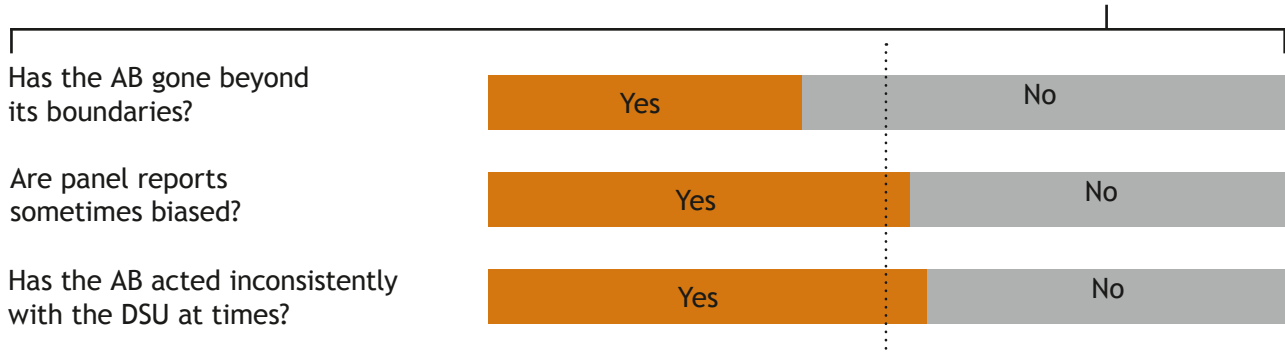


Fig 9. Insider views on the Appellate Body impasse



Bertelsmann Stiftung survey of WTO member state policymakers and trade law professionals, Autumn 2019. Full results: <https://www.bertelsmann-stiftung.de>

# The Global Counsel trade team

Change in trade-related rules and regulation, border protection and openness to foreign supply can have important implications for any company that imports or exports goods and services.

The GC trade team works with companies at each stage of their engagement with trade and inward investment policy. We assist clients in monitoring, anticipating and adapting to trade policy change and engaging constructively with the trade policy agenda. This can cover everything from the debate on domestic policy choices to effective engagement on FTA and WTO negotiations and all aspects of commercial and regulatory diplomacy.

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