Global Trade headwinds

By Lord Waverley **08 Dec 2024**

Global connectivity and engagement through trade and investment is fundamental, however should policy change in Washington and tariffs, among other trade impediments, be imposed then the global trade community will have to adjust. This does not augur well. With Western economies becoming increasingly protectionist, among countries most affected will inevitably be China, which together with India shifting the balance of power, will have global consequences.

Conclusion

Whilst tariffs may benefit certain sectors of the economy in the short term by protecting them from foreign competition, they have broader negative effects. Higher prices for consumers, inefficiency in the market, retaliation from trading partners, and the potential to harm global economic growth with tariffs being counterproductive in the long term as they disrupt international trade.

Ultimately it should be about consumers being offered the best available competitive product combining affordability and service.

Recommendations

- **Coexistence and mutual respect**
  Global economic and cultural interactions should be prioritizing coexistence and mutual respect, leveraging shared values and joint interests to foster sustainable relationships.
- **Global Supply Chains**
  Connectivity through trade and investment is vital for pivotal hubs of global supply chains.
- **Connectivity**. Stable and pragmatic international engagement is essential to support economic growth and cross-border trade.
- **Economic integration**
  Free Trade Agreements (FTAs) enable cross-border investments and opening of marketplaces, deepening bilateral ties and fostering regional economic integration.
- **Emerging Opportunities in Cross-Border Investments**
  Expanding advanced manufacturing sectors, underscore the opportunities for cross-border investments that can bridge economic networks, strengthen bilateral and regional relations that shape future trade dynamics.
- **Adapt to challenges**
  Protectionist policies underline the need for strategic diversification of trade and investment channels, leveraging favourable trade environments to navigate geopolitical shifts effectively.
- **Manufacturing diversification**. Countries should develop sustainable manufacturing workforces with cutting-edge new technologies.

A rising force on the international stage

The current world finds itself beset by geopolitical tensions that threaten the fabric of the international order, which hitherto has been dominated by the US and the West. BRICS, as demonstrated at their recent summit in Kazan, Russia and as a result of the fragmentation of the global order, has taken on new urgency, especially among countries of the Global South. With its new members admitted in 2024, membership currently comprises Brazil, China, Egypt, Ethiopia, India, Iran, Russian Federation, South Africa, United Arab Emirates. and four Southeast Asian countries, Malaysia, Indonesia, Vietnam and Thailand, with nine other states: Algeria, Belarus, Bolivia, Cuba, Kazakhstan, Nigeria, Turkey, Uganda and Uzbekistan becoming "partner countries" as aspirant members, will together stand alongside G20.

Whilst certain of its companies have been on the receiving end of secondary sanctions among others, one of its leading members, China, has been involved in negotiations between Ukraine and Russia, with the government also assuming the role of a mediator in the Middle East, facilitating ceasefire talks between the Israelis and Hamas and brokering rapprochement between Saudi Arabia and Iran. Conflicts however in Ukraine and the Middle East, potential flashpoints on the Korean peninsula, in the South China Sea, and with regard to Taiwan's future, with two considered amongst China's "core interests."

BRICS stands for a new multipolar world order, not dominated by any one group of states, is not intrinsically anti-Western, but nonetheless seeks more equitable global governance. Its countries, by and large, are supportive of the United Nations and its agencies, however many of the developing world have been alarmed by the US and European prevalence of the use of financial sanctions, and as they see it, weaponizing the international financial system for political purposes.

As a result, BRICS has embraced a de-dollarization movement, which could over time lead to the de-throning of the US dollar as the world's reserve currency. A primary beneficiary of this trend is China and its internationalization of the renminbi strategy as well as the roll-out of its digital yuan (e-CNY) and BRICS Pay for electronic payment settlements. There are also moves to replace the US-dominated SWIFT system for electronic funds transfers (EFT).

In addition, it should be noted that the BRICS New Development Bank, headquartered in Shanghai, has approved over US$35 billion earmarked for 105 development projects. In Kazan, BRICS Members also endorsed the bank's plan to fund more projects in local currencies, ostensibly to avoid exchange-rate fluctuations. The incoming US Administration is aware of such disruptive measures and has vowed to reduce its use of economic and financial sanctions in the future, which would be a major break from practices of President Biden's administration.

The Future: China, the West & the Global South

China believes it is being squeezed and contained by the West, principally the US, in a concerted effort to hinder its rise to become the world's largest economy. Counterproductive Western salvos are likely to be overtaken by larger forces coalescing around the world today. Non-Western regional integration and cooperation is a defining feature of our current era: for example, ASEAN, the Regional Comprehensive Economic Partnership (RCEP), the Shanghai Cooperation Organization (SCO), the Eurasian Economic Union (EAEU), the Belt & Road Initiative (BRI), the Gulf Cooperation Council (GCC), the Organization of Islamic Cooperation (OIC), the African Continental Free Trade Area (AfCFTA) and BRICS Plus are examples.

Together these herald the rise of the Global South with China central to many of these alignments. China's associations and burgeoning economic cooperation with such regional blocs will help to soften the protectionist blows of the West, added to which appears increasing evidence of a pivot by the Middle East to China.

Indicative of emerging divergent geopolitical views in the West however, the United Kingdom, unlike the US and EU, has recently signaled its willingness to work more closely with China to strengthen the "economic relationship" between the two countries, especially on trade and investment matters, as expressed by Prime Minister Starmer to President Xi Jinping at the recently concluded G20 Summit in Brazil. This opening provides a window of opportunity for the two countries to move forward with more globalist, less protectionist agendas, which also can be inclusive of many countries of the Global South.

A large majority of the Commonwealth are categorized as developing nations and actively participate in many of the above-mentioned regional organizations. The UK has also recently joined the CPTPP – the gold standard of Asia-Pacific RTAs – the only European country to do so. Going forward, it may well be that the United Kingdom is as readily identified as associated with Asian or African countries as it is with European. That would certainly meet a core objective of Brexit.

Current Situation as it pertains to China

The West has sought to contain China over the last two decades, however, it has advanced to being the world's largest trading nation in goods, notwithstanding Trump 1.0 and tariffs on a wide range of Chinese products. The use of tariffs and FDI controls then were justified on national economic security grounds with the Biden Administration further seeking to constrain China with export controls and the export of state-of-the-art semiconductor chips and other advanced technologies. These have slowed, but not halted China's advance.

Traveling along its eastern seaboard and into its modern cities, one is struck by the economic and manufacturing powerhouse that is modern-day China. Despite economic, financial, and trade headwinds, it continues at a 5% annualized economic growth rate. Committed to globalization, benefiting from relatively open markets in the developed West, and increasingly in the developing Global South, China has become a manufacturing hub of global supply chains, wishing to maintain an even keel thereby protecting progress achieved since 1978.

Biden's further tightening of investment controls encompassed not only in-bound Chinese FDI to the US, but also outbound US FDI to China. His administration began making increasingly liberal use of economic and financial sanctions, with the application of secondary sanctions in China's trade with Russia. China in retaliation issued its own anti-sanctions rules and imposed rigorous controls on exports of rare metals and critical minerals to the West. The ongoing process of Western business and supply chain "de-coupling" from China were designed to reduce or eliminate Chinese companies involved in international supply chains and shrink and weaken the Chinese economy.

Whilst such containment has impacted Chinese production processes and export performance, their effects have been mitigated as China relies increasingly on its own diversified domestic economy through the "dual circulation" strategy, its own consumer markets including online via e-commerce, and with the Middle Kingdom now having other international markets available as a result of its Belt and Road Initiative (BRI) and the rise of BRICS Plus and the Global South.

Implications for Trade and Investment

Post-COVID, China's economy has been still managing a nearly 5% growth rate. The effects of China "de-risking" by foreign companies and "re-shoring" of production to countries such as Vietnam, the Philippines, and India has taken a toll. However, there is a body of evidence that Chinese companies have been mirroring such trends as China deepens its trade ties with "friend-shore" and "near shore" nations like Vietnam, South Korea, Turkey, and Mexico allowing such Chinese companies to continue to play an important role in Western supply chains.

Anticipated protectionist policies from the incoming Trump Administration, particularly in the form of increased tariffs on Chinese goods, underline the need for strategic diversification of trade and investment channels, leveraging favorable trade environments in order to navigate geopolitical shifts effectively. This will increasingly entail the relocation of Chinese production offshore to take advantage of better terms of trade that will often take the form of an existing FTA with developed countries. Trump has also announced that his administration will immediately impose 25% tariffs on Canadian and Mexican products. This proposed move seems designed, at least in part, to deter Chinese trade diversion efforts whereby Chinese goods are further processed abroad, especially in Mexico, for onward sales to the US market and at preferential rates pursuant to the USMCA FTA.

Should Trump 2.0 employ tariffs and other NTMs to inhibit imports of Chinese goods, this could create renewed potential for Chinese companies to invest in the US via M&A "tariff jumping" activities, particularly as the US pursues a path of domestic "reindustrialization." President-elect Trump has announced that the US, "on Day One," will impose an additional 10% ad valorem tariff on Chinese goods. However, it is not anticipated that China will, in the near term, effect a devaluation of the renminbi to make its exports cheaper in order to compensate for US tariff-generated price hikes on Chinese products.

President Xi and the PBOC have signaled China's intention to maintain the renminbi as a strong, resilient currency. This approach is sensible given the immense volumes of trade and other international settlements conducted using renminbi – linked to China's internationalization of the renminbi strategy which has been successful to date. Moreover, were China to devalue the renminbi significantly, this would open up the country to US charges of currency manipulation. The US has legal and trade weapons available to address this prospect, including, among others, the assessment of additional duties on

Chinese goods, in effect, a supplemental tariff. Trump 1.0 threatened to do that, but ultimately backed off.

Relevance of Free Trade Agreements

A strategy ensuring access to critical markets amidst global supply chain disruptions will have to be considered by investing in localized manufacturing in order to enhance resilience in target markets, cultivate goodwill and strengthen ties with trading partners. Internationally distributed manufacturing capacity is not merely a major economic strategy but a policy instrument for fostering robust trade relationships. This will become a testing environment for China therefore as it is a critically important hub in global supply chains.

This puts Free Trade Agreements (FTAs) centre stage as channels to markets and investment opportunities. As the incoming United States administration reportedly prepares to impose protectionist measures on foreign goods and services via tariffs and other means, especially on China, it is with interest that Chinese investors are setting up companies in South Korea, with South Korean companies entering the US market not likely to be subject to US discriminatory trade and investment barriers, indeed could benefit from a range of preferential treatments. The China - Korea Free Trade Agreement of 2015 is a model therefore that demands close examination.

The current Phase 2 negotiations, and their linkage to the Korea-US FTA, have made substantial progress with China and Korea proactively working to further open their sectors to foreign investments. Both countries recognize the potential economic benefits of deepening their investment ties with President Xi making the point at the recent APEC Summit in Peru of explicitly encouraging South Korean investments in China. Such cross-border investments would contribute significantly to preferential treatment of each country's investments and deepen bilateral economic integration. It is also appropriate to recognize the example of the warm cooperation relationship that exists with various provinces; Guangxi and ASEAN being an example.

Case study in cooperation: UK & Advanced manufacturing

China frequently views the United Kingdom through the optic of the contest between the United States and China, however, during a recent visit to China by the British Foreign Secretary Lammy during which he underlined that the UK government would prioritize national security in economic ties, but that 95% of business with China was not in an area where that was major concern.

There are no plans, unlike the US and the EU, for the UK to impose tariffs. China's manufacturing sectors are already open to FDI, allowing for increased overseas capital in multiple sectors. The United Kingdom remains an excellent brand globally with government working to build bridges with the relationship with China. Caught between a rock and a hard place between the United States and the European Union, it becomes an increased necessity that the United Kingdom government promotes a stable and pragmatic engagement with China, adopting as it has a pragmatic real politique approach.

Integrating local research and development (R&D) capabilities can bring further dividends, creating cross-border collaboration on emerging technologies. The UK has a strong innovation base and can host manufacturing sites ready to implement and refine novel advancements. The UK’s High Value Manufacturing Catapult exemplifies this potential, with over £860 million in innovation assets and deep connections to industry and academia. It serves as a gateway to the UK’s extensive supply base and innovation ecosystem, providing international companies with a springboard to establish both manufacturing and R&D footprints, strengthening partnerships and driving mutual economic growth.