STUDY

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Protectionism and international diplomacy

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ABSTRACT

Just three decades after the fall of the Berlin Wall signifying the end of Cold War aggression and the ascendancy of international liberalism, the world faces even greater uncertainty. In every region of the world, geopolitical shifts are taking place that have brought offensive trade agendas to the fore. The US has withdrawn from underwriting the post-World War Two international economic and foreign policy architecture, instead proposing to build a wall between itself and neighbouring Mexico, imposing unilateral tariff increases while refusing to negotiate new international agreements. In Europe, the project of ever greater integration has been attacked by Brexit, as well as other populist sentiment against the perceived power of EU institutions and the forces of globalisation.

The breakdown of the western coalition advocating global governance has left a power vacuum that other key players such as China are forced to respond to. These current tectonic shifts in power and foreign policy positions impact on every country and every individual in the early 21st century. While many governments strive to maintain international cooperation and further integration, it is an unpredictable era. For trade policy has established itself firmly within the arena of high foreign diplomacy and as a result, traditional assumptions and adherence to international norms can no longer be assumed in such a state of political and economic flux. Yet when trade policy becomes a tool of diplomacy and foreign policy, sound economic reasoning can be lost to political decision making.

This report shines a spotlight on the rise of protectionism in the 21st century. It examines the diplomatic dynamics behind economic nationalism and its attack on the established liberal international institutions that were created after the second World War to settle disputes without recourse to war. Before focusing on the US, UK, EU and China, the first chapter centers on the threat to economic integration and cooperation in promoting sustainable development through the multilateral rules-based system established under the World Trade Organization.

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Overview

Trade and international diplomacy have been intertwined throughout history. Traditionally, however, a distinction has often divided 'high foreign policy' concerned with national security from 'low foreign policy' focused on secondary technocratic issues, such as international tariff rates. This report highlights the extent to which this distinction has blurred at the beginning of the 21st century, with the intrusion of trade problems into 'high foreign policy.' No longer confined to the reduction of tariffs in trade, international trade agreements increasingly incorporate non-tariff regulation, services, investment, labour and environmental provisions to support foreign policy. From being an area of relatively low importance and visibility, trade policy in the 21st century has taken centre stage. The media routinely discusses trade wars and tariff increases, while non-governmental organizations actively monitor and demonstrate civil society opinions on trade negotiations as they impact on the environment, human rights and the labour market. Yet when trade issues become a tool of foreign diplomacy, there is a greater potential for sound economic reasoning to be lost to political interests.

This most recent incursion of trade into foreign policy is caused, in part, by various challenges to the established international economic order, constructed under the Bretton Woods Institutions in the aftermath of World War Two. The most visible challenge is the withdrawal of US in leading and underwriting international cooperation to promote peace and economic prosperity in diplomatic communities such as the G20, G7 and the World Trade Organization (WTO). The leadership vacuum caused by the reversal of US diplomatic and trade policy under President Trump has created instability across the world. All institutions, countries and regions have been affected by the recent revitalisation of US 'America First' policies and are responding by seeking to forge new partnerships both diplomatically and through regional trade agreements.

Yet the discourse of protectionism is not unique to US politics. Throughout the EU, populist politicians have mobilised the discontent of disaffected societal groups and individuals under the banner of sovereignty. Isolationism and economic protectionism have proved to be an attractive blend of high and low foreign policy objectives to those who perceive themselves to be 'loser' of globalisation. Despite the demonstrated achievements and benefits of integration, open international trading relations and specifically the project of the Europe, the appeal of sovereignty remains strong. This was vividly demonstrated in the 2016 Brexit vote in the UK to leave the EU and step into the unknown.

This report surveys this fusion of diplomacy and protectionist trade policy in the 21st century. The six chapters indicate that alongside high foreign policy, trade and investment negotiations have become an important diplomatic issue because they increasingly touch upon sovereignty and security issues – topics at the heart of foreign and domestic policy. From being narrowly confined to the reduction of tariffs, trade negotiations have become a new crucible for forging and destroying alliances and coalitions internationally, yet also lightning rods for igniting voter anger domestically. This dilemma is the challenge that politicians and policy makers face everywhere.

The report is set out as follows: it begins with an examination of the implications of the slowdown of international trade negotiations under the World Trade Organization, the main post-World War Two achievement in establishing a rules-based trading system on the principle of non-discrimination. The following four chapters then look more closely at the diplomatic and policy developments taking place in the US, the UK, the EU and China. The report closes by drawing conclusions and lessons from this overview of protectionism and diplomacy in the 21st century.

1. The slowdown of multilateralism in trade

1.1 Overview

In recognition of the mutual benefits to be gained from international trade, the World Trade Organization (WTO) brings together over 164 governments to negotiate the reduction of unnecessary trade barriers based on the principle of non-discrimination. Until the WTO was established in 1994, its predecessor – the General Agreement on Tariffs and Trade (GATT) – had operated quietly under the radar of public scrutiny as a 'low' foreign policy issue confined to tariff negotiations. However, this was to change under the WTO, as the negotiation topics broadened and the recommendations of the dispute settlement mechanism (DSM) became binding upon the growing number of Members. And while many of the benefits of openness in international trade often pass-by unnoticed, encroachments on domestic decision making typically do not.

This chapter begins with a brief overview of the history of the WTO Doha Round to highlight some of the challenges it has faced since its inception. It examines some of the structural features of the WTO that help explain the non-progress of the Doha Development Agenda, most notably the institutional limits to the mandate of the WTO as an inter-governmental organization based on consensus decision making among 164 or more increasingly divergent Member governments.

The second part of the chapter looks at the role of the US in the WTO and its historical stance towards multilateralism through its membership of this rules-based inter-governmental organization. The analysis then broadens to encompass the attitudes of the wider membership of the WTO. It assesses the extent of the recourse to mercantilism among the WTO Members and the use of other international institutions and negotiating fora to pursue their individual goals, such as the G20 as well as bilateral or mega-regional trade agreements. The chapter concludes with the geopolitical implications of these findings and their consequences for regionalism and bilateralism in 21st century diplomacy.

1.2 The Doha Development Agenda - an on-going non-deal

The Doha Ministerial Declaration of November 2001 noted that 'the majority of WTO members are developing countries' and agreed to 'place their needs and interests at the heart of the Work Programme adopted in this Declaration'[1]. However, this has not happened. On the contrary, after over sixteen years of unsuccessful negotiating, US Trade Representative Robert Lighthizer began the 2017 WTO Buenos Aires Ministerial Conference by calling the very role of the WTO into question. And in doing so, he set the stage for another non-deal on the implementation of the work programme of the now 17-year-old WTO Doha Round agenda.

The WTO has now suffered reputational damage whatever the outcome of the Doha Round. Ambassador Lighthizer's statement symptomized the uncertainty of future US leadership role in supporting international cooperation and multilateral trade liberalisation. Prevailing liberal assumptions have been replaced in powerful American constituencies with the mercantilist rhetoric that exports are good, while imports – particularly cheap imports – are bad. Yet the rhetoric is becoming the rule, as the US have imposed tariffs of 25 per cent on steel and 10 per cent on aluminum, while negotiating divisive exemptions with various trading partners - strictly against the law and spirit of the WTO's most favoured nation principle[2]. This sea-change in the US' support of

[1] World Trade Organization, para. 2, WT/MIN(01)/DEC/1, 41 I.L.M. 746 (2002).

[2] The WTO defines the most-favoured-nation (MFN) as treating other people equally under the WTO agreements, countries cannot normally discriminate between their trading partners.

the WTO, as well as the current ill-fated Doha Round, has led to growing widespread uncertainty over the future of multilateralism. For in 21st century geo-politics, when the US raises doubts, the rest of the world has no choice but to be concerned.

Back in 2001, the Doha Ministerial Conference took place in the post trauma of the 9/11 terror attacks. The direct threat of international terrorism called for immediate solidarity. High foreign policy concerns for security in cooperation spilled onto lower diplomacy issues such as trade and development. For developing countries dissatisfied with the results of the 'grand bargain'[3] negotiated during the Uruguay Round, it was a good time to address their concerns. For within the framework of the 'single undertaking', developing countries had conceded to disciplines on intellectual property rights and services, in exchange for developed countries accepting disciplines in agriculture, textiles, and voluntary export restraints. However, the true costs of implementation[4] and the built-in agenda[5], now seemed disproportionate next the low level of agricultural concessions being made by developed countries[6].

The Doha Ministerial Conference Declaration acknowledged these implementation problems calling on the WTO Committee on Trade and Development to identify which existing Special and Differential Treatment (SDT) provisions are mandatory, and consider the implications of making mandatory those that are currently not binding. In the area of agriculture, Member governments committed themselves, without prejudging the outcome, to comprehensive negotiations aimed at substantial reductions in export subsidies. Developing countries also secured a two-stage process that postponed the negotiation of the 'new' Singapore issues until after negotiating modalities were agreed to at the 5th Ministerial Meeting in 2003.

The Doha Conference displayed a post 9/11 internationalist surge in promoting sustainable trade and development that was short lived. The history of the Doha Round negotiations since then indicate that consensus is an elusive commodity in international trade negotiations among over 160 governments. At the 5th Ministerial in 2003, an increasingly assertive G20 group of developing countries failed to obtain principles of progressivity or deeper commitments from developing countries in market access in agriculture. For developed countries, it was apparent that the four Singapore 'New' issues for negotiation of competition, public procurement, investment and trade facilitation, were not going to be accepted as of 'systemic interest' to developing country WTO members. Instead they were going to have to be bargained for with greater concessions in agriculture or other areas of direct trade interest to developing countries. The US reverting to its earlier negotiating position that developing countries, when unilaterally lowering their trade barriers in 1980s, were simply making a late payment for the disproportionately large trade access that developed countries had given them years before. Failure to make such concessions in the Uruguay Round, the US argued, left the situation out of balance and thus justified US trade barriers[7].

[3] Sylvia Ostry, 'The Uruguay Round North-South Grand Bargain', in The Political Economy of International Trade Law: Essays in Honor of Robert E. Hudec by Daniel L.M. Kennedy and James D. Southwick, eds. (Cambridge: Cambridge University Press, 2002) p. 287.
[4] See J. Michael Finger and Philip Schuler. Implementation of Uruguay Round Commitments: The Development Challenge. World Bank Working Paper. WPS2215 October 1999.
[5] Encompassing ongoing negotiations on agriculture and services, traditional GATT/WTO issues and new issues such as investment competition policy and environment, and institutional issues such as dispute settlement reform.
[6] One study suggested that more than 70 % of gains accrued to developed countries, of the remaining 30 % most went to a few middle-income countries while the poorest countries were worse off. The 48 least developed countries as a whole, were worse off. See Joseph E. Stiglitz and Andrew Carlton. The Doha Round of Trade Negotiations. An Agenda to Promote Development and Facilitate Adjustment. Initiative for Policy Dialogue 2004.
[7]See R Hudec. Developing Countries in the GATT/WTO.

This deadlock continued throughout the unsuccessful July 2004 Package of negotiations[8], the Hong Kong Ministerial Conference in 2006, the subsequent July 2008 Package[9] and all bi-annual Ministerial conferences since then including the most recent in December 2017 in Buenos Aires, which the US effectively undercut at its opening ceremony. The WTO has been providing less and less optimistic results from each Ministerial Meeting since the Doha Round began in 2001. As a result, questions have been asked whether the Doha Round should be altogether scrapped, or otherwise be renamed to move on from this impasse. More profound questions have been raised about a fundamental reform of the WTO and indeed the future of concluding successful multilateral trade negotiations among over 164 diverse governments.

1.3 Institutional Challenges of the WTO

A major structural obstacle to concluding successful WTO negotiations is the voting system among the 164 current Members. The WTO negotiations are based on consensus-based decision making, where each Member has one equal vote and can therefore individually veto any decision. This high threshold for agreement among diverse member governments has contributed to this 17-year diplomatic impasse at the negotiating table. Yet agreement has been found in the past; and most trade economists continue to agree that liberalizing trade is one of the most powerful engines of economic growth with which to raise living standards. Research findings suggest that the GATT/WTO has been effective in increasing international trade[10]. Other studies point to the further potential gains from liberalizing trade in services[11]. Most of these gains are accrued from specialization and the fact that trade reallocates resources towards the most-productive firms.

Indeed, despite increasingly protectionist and critical statements from its Members, the WTO 2017 Annual Report indicated a slight decrease in the number of new trade-restrictive measures introduced by WTO members. Between mid-October 2015 and mid-October 2016, an average of 15 such measures were introduced per month compared with the recent peak of 20 measures per month in 2015. Of the 2 978 trade-restrictive measures recorded since 2008 for WTO members, 740 had been removed by mid-October 2016. The WTO 2017 Annual Report further stated that the Doha negotiating groups were continuing work with new proposals covering a wide range of issues including agriculture, fisheries subsidies, services, e-commerce and measures related to SMEs. It noted 'heightened engagement' in the large number of Members who advanced their ratifications of the Trade Facilitation Agreement (TFA), which is forecast to slash WTO members' trade costs by an average of 14.3 per cent, and in amending the WTO's intellectual property agreement to enhance access to essential medicines among the poorest countries. Moreover, disbursements of Aid for Trade reached USD 39.8 billion in 2015, the highest amount for a single year.

The dispute settlement arm of the WTO also faces a mounting workload. The 2017 Annual Report notes that 520 trade disputes have been brought to the WTO since the organization was established

[8] The July 2004 Package on the principles and the framework for future negotiations, including the tiered approach to reducing farm subsidies and tariffs, which required that a member with a higher level of trade distorting agricultural subsidies and agricultural tariffs cut its subsidies and tariffs to a higher degree. Developing countries were to have longer implementation periods and greater flexibility in reducing industrial tariffs.
[9] Under this 2008 Package, a main requirement was for the US to cut the current bound level of farm subsidies (USD 48 billion) to USD 14 billion, and the EU would cut its farm subsidies by 80 percent.
[10] M. Tomz, J.L. Goldstein, D. Rivers, 'Do We Know That The WTO Increases Trade? Comment,' American Economic Review, Vol.97, No5, 2007, pp2005-2018; A.K. Rose, 'Do We Really Know The WTO Increase Trade, American Economics Review, Vol.97, No5, 2007, pp2019-2025. X. Liu, 'GATT/WTO Promotes Trade Strongly: Sample Selection and Model Specification,' Review of International Economics, Vol. 17, No.3, 2009, pp428-446. A. Subramanian and S. Wei, 'The WTO Promotes Trade, Strongly but Unevenly' Journal of International Economics, Vol 72, No.1, 2007, pp.151-175.
[11] Antoine Gervais & J. Bradford Jensen, 2015. 'The Tradability of Services: Geographic Concentration and Trade Costs,' Working Paper Series WP15-12, Peterson Institute for International Economics.

in 1995. Trade complaints are now routinely raised by both developed and developing country Members. Out of the 17 requests for consultations in 2016, three complaints were led by Brazil – against Indonesia, the United States and Thailand. Three complaints were led by the US – all against China on different matters: export duties on raw materials, domestic support provided to agricultural producers and China's administration of its tariff-rate quotas for wheat, rice and corn. The other disputes were brought by China (2), the European Union (2), India (2), Japan (2) and Turkey. So, despite the negotiating deadlock, the dispute settlement body is still tasked regularly by both developed and developing countries to issue interpretations of existing rules as they relate to modern trade disputes. With nearly six hundred disputes raised in its twenty-two years of existence, it has issued over 350 dispute settlement decisions on a wide range of trade disputes. It is now one of the most active international dispute settlement systems in the world.

High-profile litigation has however resulted in a governance challenge as the imbalance grows between the judicial and legislative arms of the institution. The WTO DSB's burgeoning workload and requests for Panel and Appellate Body recommendations on domestic trade measures are increasingly at odds with the painfully slow speed of the Doha Agenda negotiations. This asymmetrical development has led to escalating accusations of judicial activism in expansive interpretations of ambiguous provisions or omissions in the current agreements. The lack of executive and judicial balance has contributed to heightening perceptions of distrust at the extent of power wielded by a remote binding dispute settlement body. The WTO system is unprecedented in public international law; it is the first inter-governmental organization to possess a legal mechanism providing for binding third-party adjudication of disputes between sovereign states.

As such, the WTO's mandate sits in opposition to the US' revitalized America First policy of economic nationalism and protectionism. Since 2016, the US has effectively blocked the appointment of new WTO Appellate Body Members by refusing to agree on a selection process for them. As of January 2018, there are three vacancies to be filled in the seven-member Appellate Body. This slows down the process of dispute settlement, further hindering multilateralism and international trading relations. For if nominations to the Appellate Body are continually blocked, Members that have won dispute settlement panel cases might seek to introduce remedies, while the losers seek to appeal the Panel findings claiming that retaliation is unjustified until an appeal has been decided upon. As the appeal process takes longer and longer, there is greater potential for the delay to trigger tit-for-tat trade retaliations, or a trade war – both of which the WTO was set up to avoid through multilateral cooperation and a binding dispute settlement mechanism.

In effect, in 2018, both the executive and deliberative arms of the WTO framework are facing an impasse. This situation serves current US America First policy's rejection of multilateralism and support of bilateralism and unilateralism. When formal dispute settlement takes so long, Members are more reliant in the short term of the use of trade remedies such as anti-dumping and countervailing measures. These, due to their protectionist effect, are a second-best option in trade. Disrupting international liberal cooperation, US trade policy has been captured by US foreign policy diplomacy, no longer confined to the world of technocrats. The US is a unipolar global power without historical precedent, home to 80 per cent of world military research and development. This position affords the US a huge power advantage to use multilateralism only when it is expedient and disrupt international coalition-building when it threatens US interests. And although various other countries have misgivings over certain institutional aspects of the WTO, no other country is in such a strong position to disrupt its function unilaterally, and go it alone.

1.4 Rising doubts on international trade and benefits of fair competition

The US is not alone in questioning the role and future of the WTO but the concerns of other Members typically revolve less around high foreign policy issues and more around the unequal benefits of international trade and non-discrimination. While this is particularly the case for the newly emergent big economies – Brazil, Russia, India, China and South Africa (BRICS), the populations of many developed economies are also questioning the current spread of the gains from trade.

Trade-induced competitive specialization involves labour churning. This is the adjustment period during which the workers need to re-locate themselves to the more competitive firms and sectors of the economy that are expanding. These immediate losers from trade often do not get to see benefits, particularly during a period of low economic growth. Moreover, the immediate losers from forced redundancies caused by new technologies and new trade relations tend to be both socio-economically and geographically concentrated. These communities are readily mobilised by populist appeals to easy solutions, such as protectionism. The extent to which support for further trade liberalization in high-income nations can be garnered increasingly depends on domestic governments' ability to fix their local labour markets. That is, 'the Achilles' heel of free trade may well be flawed policies at home rather than the foul deeds of our trading partners'[12].

Focusing on the competitive shock created by the surge in imports from China between 1988 and 2007, Colantone and Stanig note that stronger regional exposure to an import shock does determine an increase in support for nationalist parties, a general shift to the right in the electorate, and an increase in support for radical right parties[13]. The policy proposals of these parties tend to bundle support for domestic free market policies with a strong protectionist international trade policy stance. This combination has come to be referred to as 'economic nationalism'. If parties offering this policy mix become increasingly successful, it could further halt multilateralism and globalisation.

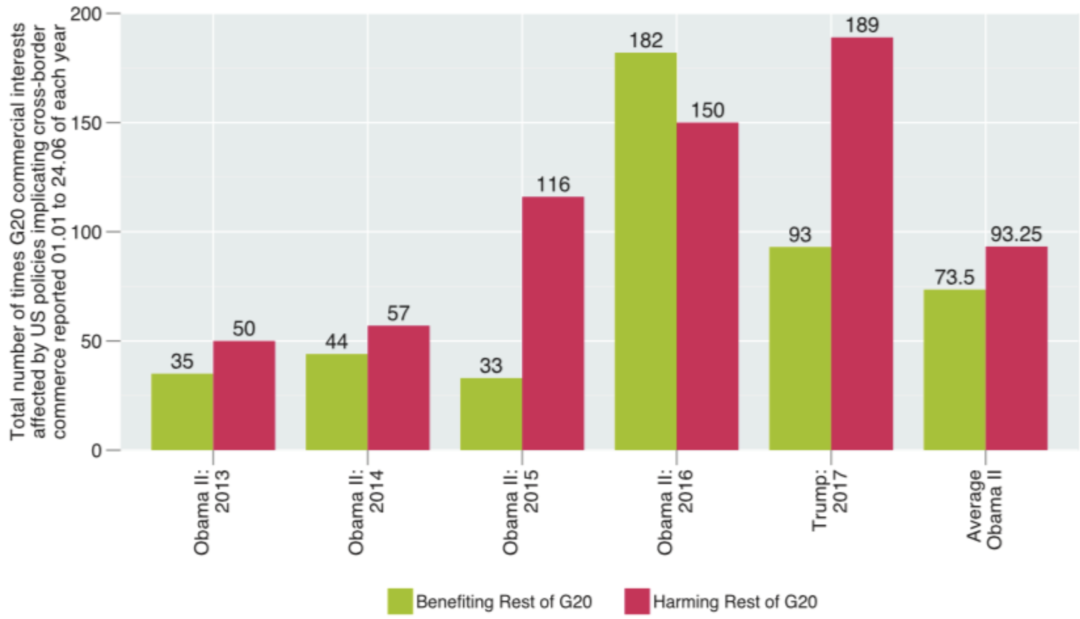
The market does not seem optimistic on the immediate future of trade liberalisation. In 2017, the rating agency Fitch, predicted a decline in international trade as governments focus on pumping investment into their own economies and embracing protectionist policies. Fitch's prediction was driven by 'the surge in populism and anti-establishment sentiment witnessed in the Brexit vote and Donald Trump's victory in the US presidential election. Fitch stated that the populist surge could exacerbate fragmentary tensions within the Eurozone, with non-mainstream anti-EU parties gaining in popularity ahead of a series of key elections. Further, in the event of the US imposing punitive trade restrictions on China, retaliatory actions could see a trade or currency war develop. This would be highly damaging for global market sentiment and would reduce world growth.' The OECD has called economic nationalism a bigger wildcard in its outlook for major economies because it is difficult to know how the language of protectionism translates into policy. The America First policy imposes punitive tariffs on imports from China and Mexico, but nevertheless unsettles all of US major trading partners. Indeed, Global Trade Alert data indicates that in 2017, US policy initiatives hit the commercial interests of G20 partners 26 per cent more often than in 2016. However, this was

[12] Simon J Evenett. Cloth for Wine? The Relevance of Ricardo's Comparative Advantage in the 21st Century. CEPR Press. 2017, p3.

[13] Colantone, Italo and Stanig, Piero, The Trade Origins of Economic Nationalism: Import Competition and Voting Behavior in Western Europe (January 21, 2017). BAFFI CAREFIN Centre Research Paper No. 2017- 49.

not reciprocated because the rest of the G20 resorted to protectionism 29 per cent less often in 2017[14].

More discrimination, less liberalising US policy intervention in 2017 than during Obama II



1.5 The use of both informal and formal fora, ex: the rise of the G20

The US diplomatic shift away from multilateralism is affecting other international cooperation fora, most notably the G7 and G20 Summits. Since President Trump took office in 2016, US foreign policy has prevented these bodies from signing wide-ranging international agreements on issues such as migration, climate change, economic policy and sustainable development. The issues that these international organizations address are typically interlinked and cross referencing. Obstruction in one area of global cooperation can impede agreement in other fora. This knock-on effect was evident when President Trump announced in June 2017, that the US would cease all participation in the 2015 Paris Agreement on climate change mitigation. He stated that 'The Paris accord will undermine (the US) economy,' and 'puts (the US) at a permanent disadvantage.' The Declarations of the G7 and G20 Summits of 2017 subsequently suffered. At the 2017 G7 Summit, the typically unanimous final communique was forced to formally indicate that the US would not join the consensus on climate change and implement the Paris Agreement. The 2017 G20 Summit Declaration was also forced to include a formal carve out exception for US because of its withdrawal from the Paris Climate Accord. This led some critics to rename the forum the G19+1.

The G20 is the most recent post-World War II initiative aimed at furthering international coordination of economic policy. Having acknowledged that in a rapidly globalizing world, the G7, G8, and the Bretton Woods system would be unable to provide financial stability, the G20 is a new, broader, permanent group of major world economies with new responsibilities. The establishment of the G20 was a symbol of internationalism based on a common belief of major nations that they belong to a global community with common interests in maintaining peace, mutual security, prosperity and economic integration. These common international principles are threatened by the

[14] The 189 hits this year exceed totals for comparable periods during the second Obama administration. See: Global Trade Alert. http://www.globaltradealert.org

unilateralism expressed in official statements from the US government that 'The world is not a global community but an arena where nations, non-governmental actors and businesses engage and compete for advantage.[15]. It signifies the desire of the US to end post-World War Two international cooperation through the US-led Bretton Woods institutions. This departure has resulted in a leadership vacuum within the international community, with consequences for all.

Summary conclusions

The WTO Doha Round negotiations have been taking place for over 17 years without gleaning any achievements. The lack of results has undermined the reputation of the WTO as an organization structurally capable of gaining consensus among its diverse organization on future trade liberalisation. Yet the Members of the WTO have also been undermining the potential effectiveness of the Organization. Most notably, after supporting the establishment of the GATT and WTO, the US is withdrawing its leadership role of this rules based international trading system. Populist politics and lack of US leadership on international cooperation efforts have been directly effecting the WTO both legislatively in negotiations and judicially, in appointing new Appellate Body members. As a result, while Members continue to use the WTO dispute settlement system, it is becoming overloaded and effectiveness undermined through lack of capacity. The legislative halt and judicial slowdown in the WTO are preventing governments from collectively addressing harmful protectionist measures.

Geopolitical consequences: regionalism and bilateralism

While both blatant and murky protectionism has been more commonplace since the 2008 fiscal crisis, the strength of the statements against multilateralism and regionalism from the world's greatest superpower are new and their repercussions are felt far beyond its borders. The US' current leadership is vigorously attacking the post-World War Two model of peace through economic cooperation and opening up trade through market liberalisation. US official policy seeks to replace multilateralism and regional trade agreements with bilateral trade agreements by re-negotiating or withdrawing from existing commitments. Under President Trump, US foreign policy has been strident in advocating an inward-looking trade and economic policy. The topic of trade has moved front and centre in the US objective to remain the strongest global power. Trade negotiations are becoming increasingly politicised in an era of populist politics, which has led to protracted negotiations and continual non-deals, both in the WTO and in FTAs.

Other major trading nations have sought to avoid following the US trend towards isolationism and economic protectionism in international relations. While progress cannot be made in the WTO without US involvement, many governments have sought to continue negotiating mega-trade agreements in response to the US withdrawal from TPP, rather than take a similarly protectionist stance. China's official statements continue to support the WTO and multilateral trade liberalisation, while the successor to the Trans-Pacific Partnership – the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) negotiations involving 11 countries in the Pacific region,[16] are actively progressing without the US, despite the gap this leaves in coverage. Two of the CPTPP negotiating countries are Canada and Mexico, forging alternative international trading relations in the face of a confrontational US negotiating stance under the NAFTA, under the EU-Canada CETA and updating the EU-Mexico FTA. While Korea is under pressure from the US demands under its Korea-US FTA

[15] President Trump's Warsaw Speech. May 2017.

[16] The CPTPP negotiating parties currently include: New Zealand, Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, Peru, Singapore, and Vietnam.

negotiations, it is also negotiating the Regional Comprehensive Economic Partnership (RCEP),[17] which accounts for almost half of the world's population; 30 per cent of global GDP and over a quarter of world exports and if successful, it will be the world's largest trading block. This could leave the US increasingly isolated to the detriment of its economy and citizens.

Yet despite the efforts of many other trading parties to integrate regionally without the US, the economics incentives are much reduced without the US. The institutional strength of the post war liberal economic architecture, most notably the WTO and other intergovernmental bodies such as G20, have been undermined by US withdrawal. This diplomatic action necessarily undermines the ability of other governments to reap the potential benefits that this network of international institutions can offer, provoking alternative strategies and solutions.

[17] RCEP is a proposed trade agreement between the ten member states of the Association of Southeast Asian Nations (ASEAN): Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, Vietnam with Australia, China, India, Japan, South Korea and New Zealand.

2. Charting the return to protectionism and isolationism in the US

'From this day forward, a new vision will govern...
it's going to be America first'[18].

2.1 The US's historical attitude towards the WTO and multilateralism

In the early 21st century, many are assessing the loss of US internationalism both diplomatically and economically. Yet for much of its history, while participating in international trade the US government has chosen not to play a sustained leadership role in forging international rules or policy in most areas in need of cooperation. The US's geopolitical location straddling both the Atlantic and Pacific Oceans has allowed it to remain largely detached from Old World conflicts. Throughout most of the nineteenth century, the US followed a foreign policy strategy of isolationism based on President George Washington's advocacy of non-involvement in European wars and politics.

Part of the explanation for this was institutional. At the birth of modern America, the US Constitution explicitly divided foreign policy making into low and high issues, providing the mandate for promoting and regulating trade to Congress, while the executive branch was given the responsibility for foreign security policy. Exceptions to the separation of trade from diplomacy under an isolationist foreign policy strategy emerged at the beginning of the 20th century with President Taft's foreign policy of 'dollar diplomacy' using US military backing to promote US business interests abroad and by signing international arbitration treaties[19]. Self-interest in maintaining a peaceful world order also justified US involvement in World War One, while under President Roosevelt, the Monroe Doctrine was used to actively secure US commercial interests in Latin America through investor protection[20].

The extent of US casualties in conflicts overseas in World War One led to a resurgence of support for isolationism. Congress rejected US membership of a League of Nations to provide stability through international dispute settlement to prevent future war[21]. The US Congress then passed the Smoot-Hawley Tariff Act in 1930, raising tariffs to their highest levels since the 19th century. This further eroded the US' commercial relationships[22]. As history indicates, raising the average tariff by about 20 percent tends to provoke similar 'beggar-thy-neighbour' duties in retaliation from foreign governments. The value of US imports tumbled from USD 4.4 billion in 1929 to USD 1.3 billion 1932; US exports also dropped from USD 5.3 billion to USD 1.7 billion over the same period[23]. Overall global trade declined by two-thirds in the four years that the legislation was in effect. Many commentators have reasoned that by deepening the Great Depression, the Tariff Act contributed to the rise of populism, political extremism and the outbreak of aggressive wars. Internationalist initiatives such as participation in the World Court were opposed by Congress[24], complementing

[18] The US President Trump's Inauguration Speech. 2017.
[19] LaFeber, W. The Cambridge History of American Foreign Relations: Volume 2, The American Search for Opportunity, 1865-1913. 207. Cambridge University Press. 1993.
[20] Between 1919 and 1930, the value of foreign debts owed to American creditors more than doubled, from USD 9.7 to USD 21.5 billion Historical Statistics of the United States [HSUS], Cambridge University Press. Table Ee23–36.
[21] Hadley Cantril and Mildred Strunk, Public Opinion, 1935–1946 (Princeton: Princeton University Press, 1951);
[22] Douglas Irwin, The Battle over Protection: A History of US Trade Policy.
[23] Ibid. HSUS Table Ee1–21.
[24] Including progressive politicians such as Senators Hiram Johnson of California, William Borah of Idaho, and Robert La Follette of Wisconsin.

US economic nationalism with diplomatic isolationism. This has led to similar fears regarding the consequences of any US tariffs increases towards and potential retaliation from its export competitors, such as China, Japan and the EU.

The one outward looking law introduced in the interwar period was little used but had great future significance. Against the prevailing tide of protectionism, the 1934 Reciprocal Trade Agreements Act sought to reduce tariff levels and promote trade liberalization with the aim of expanding domestic employment opportunities by providing the President and executive branch the legal basis to negotiate bilateral trade agreements. While hardly used until after World War Two, the Act has now become a highly visible method for the US President to push foreign policy and reinforce domestic political agendas through negotiating, re-negotiating or walking away from the negotiation of international trade agreements.

2.2 US Post War International Leadership and the GATT/WTO

The US that emerged from the aftermath of World War Two was a superpower alongside the Soviet Union in a geo-politically bi-polar world. This new superpower status led to an era of US liberal internationalism to contain any Soviet communist threat. The Senate approved US participation in the United Nations (UN) in a bipartisan vote and departed from its long-standing policy of no military alliances in peacetime, establishing the North Atlantic Treaty Organization (NATO) alliance in 1949. The 1934 Reciprocal Trade Agreements Act was finally triggered to permit the US government to enter into negotiations on international trade agreements, and initiate the ill-fated International Trade Organization (ITO) in 1948. The ITO was designed to be a set of world trade principles and a formal international institution to support governments playing a positive role in encouraging international economic growth. It included comprehensive chapters on commercial policy, investment, employment and competition policy.

However, from being the driving force behind the ITO initiative, the US Congress u-turned without voting on ITO membership. Despite the other 54 ITO signatory parties, the ITO effectively died without the US. What remained of this multilateral trade effort was the provisional GATT framework for trade liberalization. The GATT's scope and membership grew dramatically from 1948 until 1993 over eight trade liberalizing rounds. As it developed relatively successfully and quietly, away from the glare of high foreign policy and diplomacy, a growing number of nations decided that the GATT could better serve global trade expansion if it became a more formal international organization. Once again, the US played a firm leadership role.

US trade relations during the Cold War period remained outward looking. Under the Marshall Plan, the US injected USD 13 billion into rebuilding war torn Europe. However, the low politics of trade was often used as a tool to further high foreign policy ambitions. US Congress increasingly objected that in trade negotiations, the US foreign policy had subordinated the interests of domestic exporters to the economic rehabilitation of America's allies[25]. Nevertheless, the economic and military power of the US, coupled with its geographic position, still enabled it to use its leadership role become the pivotal actor of the twenty-first century. To maintain this position, the US has merely to act pre-emptively to prevent any effective coalition from forming to challenge US dominance[26]. This gives the US an incentive to undermine rather than reinforce effective international cooperation and the supremacy of international law if the purpose originally designed for them is no longer useful.

[25]http://americanhistory.oxfordre.com/view/10.1093/acrefore/9780199329175.001.0001/acrefore-9780199329175-e-52#ref_acrefore-9780199329175-e-52-note-26 (accessed 04/05/2018).
[26] G. Friedman. The Next 100 Years. A Forecast for the 21st Century. A First Anchor Books Edition. 2010.

2.2.1 Section 301 of the 1974 US Trade Act

Even as willing leader in forging the post-World War Two international architecture, the US encountered difficulties wholeheartedly committing itself to inter-governmentalism and multilateralism. One of these 'sovereignty' challenges to emerge concerned Section 301 of the 1974 Trade Act. This domestic law permits the US executive branch to enforce unilaterally US rights under international trade agreements and respond through retaliatory action to certain foreign 'unfair' practices not covered by trade agreements. From the US perspective, Section 301 had been consistently successful in opening markets to US exporters and investors around the world[27]. However, other trading nations, particularly the EU, have long objected to various aspects of Section 301 that seek to open foreign markets based on the threat of closing domestic markets[28]. This gives the US undue leverage, and more perniciously it facilitates a proliferation of bilateral agreements, undermining multilateral cooperation.

One strategic response to such international challenges to its domestic law enforcement mechanism was for the US Congress to initiate, in 1988, the Uruguay Negotiations to formalize the GATT by establishing the WTO with a strengthened system of settling disputes[29]. Yet the then Clinton Administration still preserved Section 301[30]. When subsequently the EU challenged the legality of Section 301 under the WTO, in 1999,[31] the US still did not amend Section 301, rather formally recommitted itself to pursuing, henceforth, the resolution of trade disputes with other WTO member countries through the WTO dispute settlement mechanism. In August 2017, this historical commitment was withdrawn when the USTR initiated an investigation into China's theft of US intellectual property (IP) using Section 301. This was followed in March 2018 by a Presidential Memorandum directing the USTR to confront China's discriminatory technology licensing practices through 25 per cent ad valorem duties on a subject list including aerospace, information and communication technology, consumer electronics and machinery; additional restrictions on Chinese investment involving sensitive technologies, and a WTO dispute[32].

China has indicated that it will take retaliatory action, targeting certain agricultural products China believes are sold below their value in China and are unfairly subsidized by the US. Yet a trade war between the US and China does not make economic sense. It will negatively affect both Chinese manufacturers and upstream suppliers and downstream distributors including US retailers. Retaliatory measures from Beijing will hurt China-based US businesses, which made USD 517 billion in revenue and USD 36 billion in profit in 2015[33]. From 2001 to 2016, US imports from China increased by a factor of 3.5, while US exports to China increased by nearly a factor of six. China is the largest market for US soybeans (62 per cent in 2016) and airplanes (25 per cent of Boeing passenger planes in 2016). China is also the second-largest market for US cotton (14 per cent in 2016), auto (17 per cent in 2016), and semiconductors (15 per cent in 2016)[34].

[27] One study suggests that between 1974 and 1992, there were 83 cases filed pursuant to Section 301. See Alan 0. Sykes, Constructive Unilateral Threats in International Commercial Relations: The Limited Case for Section 301, 23 L. & POL. INT'L. Bus. 263 (1992).
[28] Statement by the European Communities, GATT Doc. C/M/233; infra note 96, at 105.
[29] Under the Omnibus Trade and Competitiveness Act.
[30] Uruguay Round Agreements Act, H.R. 5110, 103d Cong., 2d Sess. § 102 (1994).
[31] Section 301 Panel Report para 7.58. The Panel went on to say (paragraph 7.86) that 'The threat alone of conduct prohibited by the WTO would enable the Member concerned to exert undue leverage on other Members'.
[32] USTR Section 301 Factsheet.
[33] The Institute of International Finance Report. 2017.
[34] Ibid.

President Trump also exercised his authority to provide safeguard relief to US manufacturers injured by imports of washing machines and solar panels[35]. To curb these imports and protect national security, in March 2018, under Section 201 of the Trade Act of 1974 President Trump ordered new tariffs of 25 per cent on steel and 10 per cent on aluminium imports to the US He disrupted normal 'most favoured nation' trading patterns stating that these penalties could increase or decrease depending on the specific country. In the first instance, exempting six countries including the EU and Australia. Korea is also exempted but subject to a quota. Canada and Mexico's exclusion is dependent on NAFTA re-negotiations. In triggering unilateral trade remedies outside of the WTO while depriving the WTO DSM of sufficient adjudicators, President Trump is not only withdrawing US commitment to the established post war liberal international architecture but undermining its' very viability as a forum for future cooperation between the remaining 163 members.

This US foreign policy strategy is destabilizing not only institutions but regions and countries, involving military, diplomatic and economic dominance, as seen in its interventions in the Middle East, North Korea, Afghanistan, South East Asia and Latin America. There are no clear desired outcomes to these interventions, rather they simply disrupt and set regions and countries against themselves precluding growth. Trump's diplomatic strategy has been described as 'grievance-based' and not amenable to logic or even cold political calculation[36]. But when translated into foreign policy, it means that the current US administration will more likely lash out unilaterally than work through international organisations and legal frameworks. There is a rationale behind this. For it has also been postulated that the US does not need to win wars, it only needs to cause enough disruption to prevent the development of any serious challenge. As a result, international diplomacy in the 21st century will revolve around the need for other governments to strengthen institutions and coalitions both economically and politically to control US behaviour, while the US simultaneously works to attack or undermine them[37].

2.3 The US position towards regionalism

2.3.1 The NAFTA

'President Trump continues to fulfil his promise to renegotiate NAFTA to get a much better deal for all Americans'[38].

Under President Trump, the US has not only disrupted cooperation within the established post war international architecture, but is also loudly reconsidering its relationship with its near neighbours. A key feature of the Trump presidential campaign was the pledge to build a 2 000 mile US – Mexico border wall, alongside re-negotiating the pioneering North American Free Trade Agreement (NAFTA) with both Canada and Mexico. Indeed, echoing his message to the 2017 WTO Ministerial, USTR Ambassador Robert Lighthizer's closed the December 2017 NAFTA negotiating round, in Mexico, by stating that that the US had seen no evidence that Canada or Mexico are willing to seriously engage on provisions that will lead to a rebalanced agreement. The USTR's new NAFTA negotiating objective is budget deficit reduction, a digital economy chapter, strengthening labour

[35] The President's 2018 Trade Policy Agenda. https://ustr.gov/sites/default/files/files/Press/Reports/2018/AR/2018%20Annual%20Report%20I.pdf (accessed 04/05/2018).
[36] A. Beattie. How the EU could outflank Trump and his tariffs. Financial Times 30/04/2018.
[37] G. Friedman. The Next 100 Years. Op cit.
[38] USTR Ambassador Robert Lighthizer. December 2017 NAFTA Negotiating Round.

and environment obligations, while resisting a dedicated energy chapter and investor-state dispute settlement mechanism.

The outcome of the March 2018 seventh negotiating round indicated no progress, stalling the NAFTA talks until after the 2018 Mexican election. Ambassador Lighthizer closed the negotiations by noting that while President Trump hoped for a successful completion of the talks: 'If that proves impossible, we are prepared to move on a bilateral basis.' Indeed, after three years of Trump's campaign platform, support for the NAFTA has fallen among traditionally economically liberal Republican voters to 40 per cent[39]. US threats of withdrawing from NAFTA and disrupting north-American economic and political relations do not seem so far-removed, particularly given the fate of the Trans-Pacific Partnership (TPP).

2.3.2 Withdrawal from TPP

'We do not need to enter into another massive international agreement that ties us up and binds us down'.

One of President Trump's first official acts in Office was to sign an executive order removing the US from the 12 country Trans-Pacific Partnership (TPP) negotiations[40] in January 2017, threatening American business executives that he would place a very major border tax on companies that moved production overseas and export products back into the US. Without the US, the TPP as it stood, could not enter into force. The TPP would have integrated the markets of the US and 11 other Asian-Pacific countries comprising 40 percent of the world's economic output. Moreover, reforming and liberalizing trade in Asia under a rules-based trading agreement would have provided America's competitive industries with new markets to sell to and an avenue for the US to strengthen its leadership in Asia, complementing its existing diplomatic and military power.

Geopolitically, the TPP with the US would have rebalanced Asia. And by strengthening US leadership and US alliances based on internationalism, it would have contributed to broadening and re-energizing the World War Two international economic architecture. Thus, by leaving the original TPP, the US manifested its commitment to the neo-isolationist rhetoric vocalized by President Trump. The US move altered the power balance both in the region and globally. The TPP members represent a market of 800 million people with a combined GDP of USD 27.5 trillion (USD 36.3 trillion). As such, the agreement was part geostrategic pact and part trade deal, in that it brought the US together with its closest Asian allies in an economic bloc that encircled a hitherto isolationist China.

The remaining TPP parties subsequently responded by reaching out both to China and Japan to take up the vacant leadership role. Thus, a different danger has emerged from lack of US leadership role – increasing strategic rivalry between China and Japan. Until the rise of China, Japan was the uncontested modern power of Asia since the 19th century. This changed in the context of great power competition between the US and China. Nonetheless, as discussed further in Chapter five, Japan has demonstrated a resolve to regain its global influence through a 'full court press' strategy that extends strategic competition between Japan and China beyond the Asian courtyard.

[39] Quinnipiac University and Pew, cited in The Financial Times. Trump's Republican critics put aside their qualms. 02/04/2018.
[40] The original TPP negotiating parties were: US, Japan, Mexico, Canada, Australia, New Zealand, Vietnam, Peru, Chile, Malaysia, Singapore and Brunei.

2.3.3 The Comprehensive and Progressive Trans-Pacific Partnership (CPTPP)

The outcome of the US withdrawal from the TPP was for Japan to take a lead role in re-negotiating the TPP without the US or China, under the new title of the Comprehensive and Progressive Trans-Pacific Partnership, signed in March 2018[41]. While the original TPP would have covered 40 per cent of global GDP, the CPTPP will cover about 14 per cent and 500 million people. One estimate puts the net benefit of trade liberalization under the proposed CPTPP to all of its members is about USD 37.3 billion or approximately 0.3 per cent of their combined GDP in the medium term. Under the CPTPP, tariffs schedules are set to remain as negotiated under the TPP, with custom duties on 95 per cent of trade in goods to be removed in the long run. Also maintained are those commitments to liberalize in key areas such as textiles, technical barriers to trade and sanitary and phytosanitary measures, competition, state-owned enterprises and small-and medium-sized enterprises, labour, and dispute settlement. However, the 11 parties agreed to suspend provisions that were included in the TPP at the insistence of the US, such as investment, services, public procurement, IPR, trade facilitation, environment and transparency, and has also endorsed the List of Suspended Provisions from the original TPP text.

The significance of this agreement lies not only in economic gains, but also by the unanimous decision of the other 11 countries to move ahead without the US. This diplomatic development signals their continued commitment to the existing international economic order – with or without the leadership of the US. These geopolitical changes will impact on the NAFTA negotiations because both Canada and Mexico are members of the CPTPP, while the US is not. Canada and Mexico are choosing to diversify their trading partners to reduce their dependence on the US market and uncertain US foreign policy. The EU-Mexico FTA has been updated, while the CPTPP provides Mexican and Canadian farmers and automakers with preferential access into the Japanese market and the rest of Asia. The US could seek through NAFTA to free ride on Canada and Mexico's access to the CPTPP as it does not have an FTA with Japan and is currently renegotiating its FTA with Korea. Nevertheless, despite its economic strength, the US is in danger of becoming more marginalized in the region if more countries turn away from the US as a potentially beneficial and trustworthy bilateral trade partner.

2.3.4 The Regional Comprehensive Economic Partnership (RCEP)

The RCEP is another regional trade initiative that does not involve the US. Originally conceived in 2012, it brings together the ten ASEAN states[42], with China, Japan, India, South Korea, Australia and New Zealand. Once concluded, the free trade agreement will be the largest trade bloc in terms of population. In 2017, prospective RCEP member states accounted for a population of 3.4 billion people with a total USD 49.5 trillion GDP per capita, which contributes approximately 39 percent of the world's GDP[43]. China and India combined will initially contribute to more than half that amount. In the long run, it has been estimated the RCEP's share of the global economy could account for half of the estimated USD 0.5 quadrillion global GDP by 2050, with the combined GDPs of China and India making up more than 75 per cent the amount[44].

[41] Including Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam.
[42] The Association of Southeast Asian Nations (ASEAN) is a regional intergovernmental Organization formed in 1967 and now comprising Thailand, Vietnam, Indonesia, Philippines, Malaysia, Singapore, Myanmar (Burma), Cambodia, Laos and Brunei.
[43] Stefani Ribka/Linda Yulisman. RCEP talks speed up amid TPP failure. The Jakarta Post http://www.thejakartapost.com/news/2016/12/07/rcep-talks-speed-up-amid-tpp-failure.html (accessed 04/05/2018).
[44] GDP projections from PwC: how China, India and Brazil will overtake the West by 2050' – PwC forecasts of GDP (PPP), January, 2011.

Of further significance to the achievement of sustainable development goals and the concerns of many environmental and human rights advocates, unlike most recent FTAs, the RCEP does not include any protections of labour, human rights or the environment. Including provisions enforcing environment and acceptable working conditions could have addressed growing concerns about the negative impacts of globalisation; it would make some existing multilateral environmental agreements enforceable within the member countries that currently are not. The inclusion of effective social and environmental provisions would also have served to level the playing field with partner countries, such as the EU, who do enforce such protections. If the RCEP is concluded as anticipated in November 2018, the liberalization and integration of the world economy will have re-oriented itself in response and in reaction to the US' recent policy of economic and political isolationism and unilateralism. The RCEP is not however comparable or compatible with the comprehensive and progressive trade agreements being negotiated by the EU and Canada, for example. As such the conclusion of the RCEP serves a foreign policy strategy more suited to China's model of diplomacy and economic development, see Chapter 5.

2.4 New US legislation

2.4.1 The Tax Cuts and Jobs Act

In addition to introducing far-reaching foreign and trade policies, President Trump has also introduced new domestic legislation with significant and different repercussions for US businesses and society. This USD 1.5 trillion initiative provides corporations a large permanent tax break, cuts income tax rates for some individuals and repeals ex-President Obama's Affordable Care Act's individual mandate[45].

The Affordable Care Act

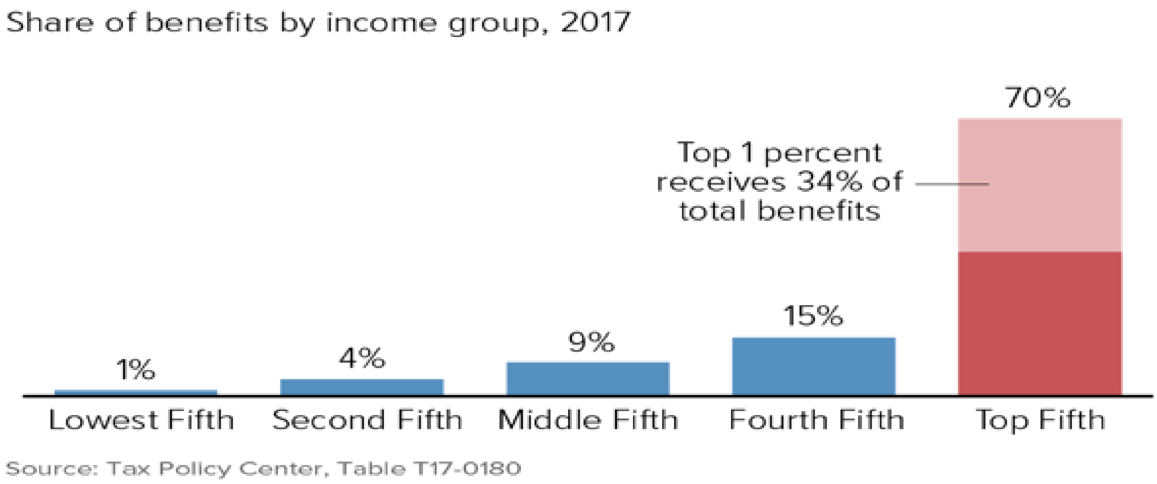
Under the 2017 Tax Act, the individual health insurance mandate was repealed so that from 2019, people will not be fined if they do not have health cover. This new freedom is predicted to result in 13 million fewer individuals with health coverage and increase the cost of individual insurance premiums by 10 per cent[46]. This outcome of these changes to health care suggests that any income tax savings from the Tax Act will be offset by higher health insurance payments. Moreover, given that the poorest unemployed individuals will not benefit from income tax savings, they will be negatively affected financially in the new higher terms of buying medical coverage.

Personal Income Tax Changes

Under the Tax Act, the top marginal personal income tax rate will drop to 37 per cent from 39.6 per cent, while the lowest taxable income will be 10 per cent. Figures 1 and 2 indicate that some will gain more than others from these changes. The Tax Policy Center's analysis shows that the biggest benefits will go to households earning USD 308 000 to USD 733 000, and those who earn more than USD 733 000 can expect a USD 50 000 tax cut. Property tax has also been reformed to double the value threshold necessary to qualify for taxation on property[47]. It has been estimated that President Trump will receive an estimated tax cut of up to USD 15m a year, while amendments to the inheritance estate doubles the exemption to USD 22.4m which could potentially save his heirs

[45] Distributional Analysis of the Conference Agreement for the Tax Cuts and Jobs Act. Tax Policy Centre. December 18, 2017.
[46] How the GOP Tax Bill Affects You | Investopedia https://www.investopedia.com/taxes/how-gop-tax-bill-affects-you/#ixzz56FOG1cPu (accessed 04/05/2018)
[47] Ibid.

USD 4.5m[48]. On the other hand, estimates also suggest that almost half of low-income households will not see their tax liability changed under the tax bill[49].



Corporate Tax Reforms and Foreign-derived intangible income (FDII)

President Trump is also using corporate tax cuts to promote US businesses and provide incentives for US businesses to export. Under the 2017 tax reforms, the corporate tax rate will decrease from the current 35 per cent to a flat 21 per cent[50]. The Act also lowers taxes 'foreign-derived intangible income' (FDII), such as patents and trademarks, to a significantly low rate of approximately 13 percent. US companies operating overseas, such as Walt Disney are predicted to save more than USD 250 million a year[51].

As it stands, the FDII creates an tax incentive that subsidizes exports compared with the domestic consumption,[52] which violates WTO subsidy rules[53]. However, when the European Commission formally raised concerns about the legality of the FDII under the US' WTO obligations, in December 2017,[54] the US House Committee on Ways and Means replied that the tax bill was drafted to be 'consistent with WTO requirements' and, that the FDII 'simply levels the playing field

[48] For example, tax cuts of USD 5m to USD 12m are estimated for Jared Kushner, White House senior adviser and Trump's son-in-law https://www.theguardian.com/us-news/2017/dec/20/trump-tax-bill-savings-analysis. (accessed 04/05/2018).
[49] How the GOP Tax Bill Affects You | Investopedia https://www.investopedia.com/taxes/how-gop-tax-bill-affects-you/#ixzz56FOG1cPu (accessed 04/05/2018).
[50] Ibid.
[51] Reuters examined the annual reports and presentations to analysts of more than 100 US companies, randomly picked, going back 20 years. It found 26 firms noted they benefited from the Foreign Sales Corporation scheme. Of those 26, half were businesses whose exports were mainly of intangible goods. Specifically, Walt Disney Co., said in annual reports between 2002 and 2005 that the regime allowed it to reduce its overall effective tax rate by around 3 per cent annually. Tim Bergin. Reuters. December 21, 2017. https://uk.reuters.com/article/uk-usa-tax-trade-analysis/u-s-tax-bill-provision-likely-to-spark-eu-trade-dispute-legal-experts-idUKKBN1EF25D (accessed 04/05/2018).
[52] This incentive arises because the 21 percent tax rate would apply to the 'normal profit' of 10 percent of a company's tangible assets, such as property. Any FDII more than the normal profit would receive a 37.5 percent deduction, thus making the effective tax rate on FDII about 13 percent.
[53] Linking a lower tax rate to export performance violates Article 3.1a and 3.2 of the WTO Agreement on Subsidies and Countervailing Measures (ASCM). Article 3.1a and 3.2 prohibit 'subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance'.
[54] The EU noted that '... the draft US tax bill as it currently stands contains elements that risk seriously hampering trade and investment flows between our two economies. We believe it is in our joint interest to avoid this'. Tim Bergin. Reuters. December 21, 2017. https://uk.reuters.com/article/uk-usa-tax-trade-analysis/u-s-tax-bill-provision-likely-to-spark-eu-trade-dispute-legal-experts-idUKKBN1EF25D (accessed 04/05/2018).

– so American businesses can compete and win anywhere around the world – including here at home'[55]. Thus, when viewed alongside the other recent US trade policy and diplomatic stances, the 2017 tax reforms are the domestic plank of a highly protectionist and isolationist foreign policy. Promoting domestic producers while penalizing international trading partners is a return to the much-discredited mercantilist rhetoric of 'exports good and imports bad.' Nevertheless, the rest of the world is forced to respond to US actions - both economically and diplomatically.

Summary conclusions

The US, though traditionally prone to isolationism and avoiding global politics, emerged from World War Two as an economic and military superpower, alongside the Soviet Union. It became a leader in rebuilding war torn Europe and establishing the post-World War Two international financial architecture and consensus towards liberal internationalism. Following the end of the Cold War, the US has displayed more reticence towards multilateralism but was nevertheless a major advocate of the strengthened dispute settlement mechanism under the newly established WTO.

Under the Trump Administration, the US has withdrawn from its leadership position within the international community, to become one of its most vocal critics. The US Administration has brought trade policy directly into high level foreign policy and diplomacy, undermining many established international coalitions. He has taken an aggressive stance towards promoting America First interests such as refusing to participate in the 2015 Paris Agreement on climate change mitigation, with subsequent ramifications for the work of the G20 and G7 summits. The US has also withdrawn support for progressing on the Doha Round negotiations and is undermining the work of the WTO dispute settlement body through its veto of new appointments to the Appellate Body. Regionally, the US Administration is actively seeking to build a wall between itself and neighbour Mexico, while renegotiating the NAFTA with Mexico and Canada. The US has also withdrawn from the US-Korea and TPP negotiations. Domestically, the US President is promoting US businesses and the business elite through income tax and export incentives.

Geopolitical consequences

In isolating itself from the international community and returning to unilateralism and bilateral trade agreements, the US has destabilized the existing liberal international architecture. Across the world, US statements and actions withdrawing its support for the multilateral trading frameworks is forcing both individual and collective responses from governments across the world – because all institutions, countries, regions, businesses and consumers are directly affected by US Presidential statements. Established international architecture including bodies such as the G7 and G20 are unable to move forward on commitments to resolving both immediate and long term global problems and challenges, without US support. This geopolitical turbulence is in the interests of the Trump administration. Regional instability, whether in Asia Pacific, Afghanistan, or the Middle East, is beneficial to the US because these wars do not take place on America soil, yet prevent strong coalitions from developing to challenge US economic and military supremacy.

US foreign policy under Trump has led to a crisis of leadership at the international level and a power vacuum in the Asia Pacific region. This presents the possibility that key countries become increasingly frustrated with an unresponsive western-led international order. This may lead to some

[55] The US finally reported that Congress had passed legislation to repeal the 'grandfather' provisions of the American Jobs Creation Act and the ETI Act that were a subject of the recent compliance proceedings. Tim Bergin. Reuters. December 21, 2017. https://uk.reuters.com/article/uk-usa-tax-trade-analysis/u-s-tax-bill-provision-likely-to-spark-eu-trade-dispute-legal-experts-idUKKBN1EF25D (accessed 04/05/2018).

countries seeking to establish alternative institutions, or otherwise pursue more unilateral assertions of power to secure and protect their interests. The withdrawal of the US from the TPP has given China an increased opportunity to expand its economic and diplomatic influence in Asia and beyond. These shifts are of concern to other key regional players such as Japan and India. Japan has led the CPTPP without the US, which will also have consequences for the international power balance in Asia. Canada and Mexico are parties to the CPTPP and this will have repercussions for NAFTA renegotiations. China has responded by advancing its own trade pact, the RCEP which will include India, another emerging economic giant. Yet India and China have often criticized the developed countries use of international norms and values, such as labour, human rights and environmental protection. In a contested international order, countries may still agree on the importance of international laws, rules, and norms, but there will be new disagreement over how to define them. This may make international dispute resolution more challenging and volatile.

In sum, under the Trump Administration, the US has rejected any plans to reinvigorate the international order and has rather destabilized it. The US has turned against its neighbours and trading partners in favour of strengthening military strength and bilateral negotiations to protect America First interests. For while Trump ran on an isolationist platform, he has nevertheless chosen highly interventionist hawks to be his national security advisor and secretary of state. Yet the election of Donald Trump, the Brexit vote and the rise of nationalist parties throughout Europe also reveals the extent of disenchantment with globalisation. Even if US leaders return to the TTIP negotiating table or seek to join the CPTPP, they will still face repeated societal challenges. For while the use of trade agreements can serve other national diplomatic purposes, negotiators of trade agreements still need to make the case for future trade agreements more compellingly to domestic workers by ensuring that they can also prosper under such arrangements through more effective national labour and social policies.

3. The UK free-trade vision outside the EU

3.1 The Context of the Brexit Decision

In January 2013, the UK Prime Minister David Cameron made a pre-election promise that if the Conservative Party were to be re-elected at the May 2015 election, he would renegotiate Britain's membership of the EU with a view to a 'full on treaty change' to fundamentally change Britain's relationship with the EU, and also, crucially, hold a 'yes' or 'no' referendum for the British electorate on the UK's very EU membership. When the Conservative Party subsequently won the election, David Cameron first attended an EU Summit to renegotiate unsuccessfully Britain's membership. He then set June 23, 2016 as the date for holding the referendum question 'Should the United Kingdom remain a member of the European Union, or leave the European Union?'

The June 2016 referendum's turnout was high (71 per cent), and the first UK wide referendum since a 1975 vote on whether the UK should stay in the European Community (Common Market), which garnered 67 per cent in favour of staying in the EU. The outcome of the 2016 referendum indicated that the opinion of the 30 British million voters was much closer but negative - with 52 per cent voting to leave. The results across the regions of the UK differed: England voted for Brexit by 53.4 per cent to 46.6 per cent; Wales voted 52.5 per cent for Brexit, while Scotland and Northern Ireland both voted to remain in the EU, by 62 per cent and 55.8 per cent respectively.

While in early 2015, the general perception was that a Brexit vote to leave the EU was unlikely, David Cameron's strategy towards Eurosceptics and the anti-EU UK Independence Party (UKIP), was to appease both through concessions. But after the February 2016 European summit, when the Prime Minister secured the right to curb in-work benefits for up to four years and scale back child benefit for workers whose children remain abroad, the deal was perceived to be watered down and David Cameron's leadership weakened. In the run up to the Brexit referendum, the two campaigns, 'Britain Stronger in Europe' and 'Vote Leave', formed the two official lobby groups and formed the basis of the referendum on their respective positions on two main issues: sovereignty – to bring power back to the people - and migration – to reduce the number of EU migrants entering the UK.

3.2 Sovereignty and Brexit

A strong element of the leave campaign has been based on the slogan to ''take back control', implying a perceived loss or lack of control for the UK government and its electorate. This has led to renewed debates on the concept of sovereignty in the modern world, where issues of the environment, human rights and trade cross borders and require an inter-governmental approach. Discussions have also focused on the roots of this feeling of powerlessness within the EU. Some commentators have positioned Brexit's origins in the British class system under the British Empire, arguing that the factors leading to the rise of nationalism and populism in the UK hinge on its long-term geopolitical and economic decline, and that 'perhaps the Brexit referendum is the last death throes of Empire working its way out of our systems.'[56]

Others point to a more pervasive EU-wide psychological malaise, which is based on the short memory span of today's European citizens of the rationale for integration and peace through trade after the internecine horrors of World War I and II. For people 'do not turn crazy' all of a sudden:

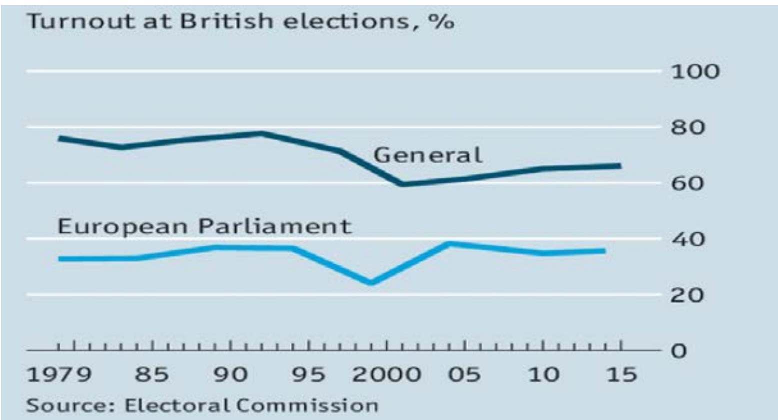
> 'Instead we were merely temporarily rational – as a result of the catastrophe of World War Two. In Europe, we currently live in a historically unusual world: it has been largely

[56] Dorling D, Tomlinson, S. Brexit has its roots in the British Empire – so how do we explain it to the young? The New Statesman. 9 May 2016.

> peaceful for 70 years... And it is exactly this awareness that is disappearing now like 'never again alcohol'-vows on day three after a heavy bender. After 70 years, the hang-over is over, and it all looks like as if Europeans just wanted to have another bender. Can we avoid this?' [57]

Sovereignty is a term developed in 16th century Europe by monarchs of endlessly warring states to proclaim both that no power outside their state had the right to interfere in their state's decisions, and that no internal power could refuse to carry out the decisions of the state[58]. Similarly under Brexit, the sovereignty argument is based partly on the concept of restoring British parliamentary supremacy, because for much of the past two decades the EU's Court of Justice has asserted that EU membership means that in the areas where EU law has supremacy, EU law will trump national law. Yet perhaps this call for sovereignty is no longer helpful in 21st century diplomacy. For example, aside from the EU, the UK is also party to over 600 international treaties and agreements that also influence British parliamentary decision making. The NATO, for example, obligates its members to go to war if another NATO member is attacked. Moreover, while EU laws are proposed by the European Commission, it is up to the elected national governments acting as the Council of Ministers and elected Members of the European Parliament that adopt these laws. This is delegated decision-making rather than usurped power. It has its legitimacy based on elections in national democratic processes.

One problem is that electoral turnout in European elections is low and generally fought on national issues. It is not possible for voters to de-select the EU's collective leadership and a perception persists that the EU's Council of Ministers and European Parliament are both remote and unaccountable. The demise in the 1980s of the Luxembourg compromise that gave EU members a form of veto, coupled by an increase in majority voting, has also resulted in Britain being increasingly outvoted. Yet, lack of leverage is partly due to poor domestic parliamentary oversight. It has been argued that the unelected House of Lords is now more effective than the elected House of Commons on the governments' policies in the EU, simply because many Parliamentarians do not follow EU affairs closely enough[59]. Regardless of the merits of these arguments, the fact remains that the UK was an ambivalent EU member state, already eschewing both the Euro and the Schengen Accord. When asked, 52 per cent of the electorate voted to leave the EU, frequently citing loss of sovereignty and decision making as their motivation; often with a specific reference to the inability of the UK government to control its borders towards EU migration.



[57] Vermes, T., 2016. Quoted in: Bachmann, Sidaway. J.D. Brexit Geopolitics. Geoforum. Volume 77, 2016.
[58] Immanuel Wallerstein, The Myth of Sovereignty. Commentary No. 458, October 1, 2017.
[59] The Economist. Going to Bits: Europeans are splitting their votes among ever more parties. January 12, 2017. https://www.economist.com/news/europe/21714386-means-better-representation-clunkier-governance-europeans-are-splitting-their-votes-among (accessed 04/05/2018).

3.3 Migration

Contrary to many British media statements, net immigration into the UK since 2000 has not been exceptional in an EU context. Behind the rhetoric, the data indicates that between 2000 and 2014 net inflows to Italy and Spain were higher than those to the UK. A higher proportion of immigrants living in the UK come from non-EU countries than in any other EU member-state. Immigrants from EU countries are more likely to be employed than native Britons and are also big net contributors to the UK's public finances[60]. And yet, the issue of EU internal immigration is one of the most virulent strands of the Brexit campaign.

One answer to the cognitive dissonance between rhetoric and reality could be that British workers' real wages fell sharply between 2008 and 2014, with the greatest hit falling on those with lowest wages. So, while there is little data to support the argument that EU immigration has caused this drop in earning, it is an easy link to make both by populist politicians and the general population experiencing this loss of income and lifestyle. Britain has the smallest living space per inhabitant of any EU-15 country and the lowest number of new homes in the EU-28. While it is easy to blame immigrants for this housing crisis, this very tangible problem may instead have been caused by a chronic failure of public policy[61]. Rather than address social policy directly, both politicians and disaffected populations of the UK have found it easier to deflect the blame on the EU, focusing on immigration as the problem rather than a long-term solution to the UK's demographic and skills shortage.

The concern about immigration through the free movement of labour within the EU and its impact on the country was a major driver behind Brexit. Various studies indicate that people who felt anxious about immigration were not only more likely to play down the risk of Brexit; they were more likely to turn out and vote Leave[62]. This surge in populist sentiment against migrants is certainly not limited to the UK. There has been a ground swell in popular support for radical right-wing parties and figures across Europe (see Chapter 4). Yet in the UK this revitalization of populist politics has been exploited and translated into power. Under Brexit, the history of post-war migration has been framed in xenophobic language that sets racist terms for any subsequent discussion on immigration, from the EU and without[63].

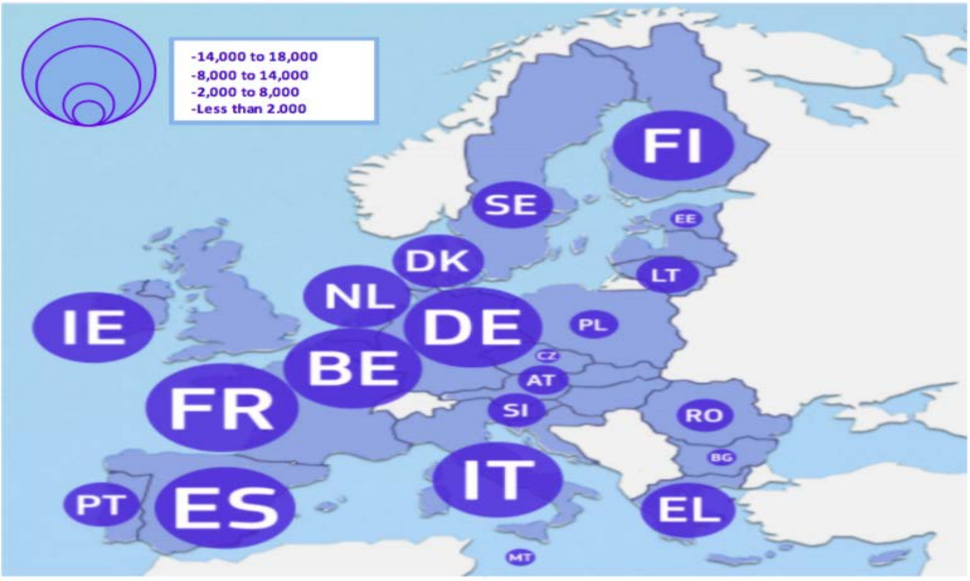
England and Britishness has been conflated and posited against Europe and Europeanness – but this does not adequately represent the different social and political feeling that exist within the UK's devolved nations. Scottishness, Welshness and Northern Irishness challenge Great Britain's sovereign aspirations. Scotland voted to remain with the EU, but not unequivocally within the UK, as did Northern Ireland, which now sits on a geopolitical volcano due to its historical border politics with the Republic of Ireland. Ironically, rather than taking back control, Brexit threatens the geographical integrity of the UK from within, as the regional governments feat that their wide-ranging powers provided by the Devolution Settlement of 1972, will be 'grabbed' back by Westminster after Brexit, when Brussels no longer presides.

Policy instruments exist and can be designed to address the social adjustment costs associated with international trade and globalisation. For example, the European Globalisation Adjustment Fund (EGF) is a funding tool to supports workers who lost their jobs due to globalisation through European and national co-funding. As Chapter 4 further discusses, it is the main EU instrument to

[60] https://www.politico.eu/article/brexit-britain-is-in-denial-over-immigration (accessed 04/05/2018).
[61] Tilford, Simon. Britain Immigration and Brexit. Issue 105. December 2015/January 2016.
[62] https://www.politico.eu/article/brexit-britain-is-in-denial-over-immigration (accessed 04/05/2018).
[63] Tomlinson and Dorling (2016) ibid.

provide financial solidarity towards those severely and personally affected by trade-adjustment redundancies. However, despite the direct relevance of the EGF as trade adjustment mechanism in the UK, the evidence suggests that this fund never been drawn upon by any UK government since it was established in 2006.

Number of people covered by the European Globalisation Fund Assistance 2007-2017[64]



Note: The number of workers under EGF assistance ranges from 17,586 in France to 460 in the Czech Republic.

3.4 The Process

The UK is scheduled to leave the EU on 29 March 2019. The framework for withdrawal is set out under Article 50. This provision frames the four-step withdrawal process, which includes: 1) the decision to withdraw; 2) notification of that decision to the EU; 3) negotiation of a deal; and 4) agreement to the deal's terms. An agreement has been made on a limited duration transition period to help ease Britain out of the EU, which is predicted to operate until the end of 2020. This transition period has become crucial to both businesses and politicians on both sides of the Channel because of the lack of ex-ante strategy from the British government on fundamental questions such as what Brexit entails, or how the Irish Border will operate. No firm blueprint has been put forward by the UK government, leaving the possibilities for the UK's future trading relationship with both the EU and the rest of the world uncertain.

Although the UK government does not have a clear negotiating strategy various models exist, which provide options, most notably i) joining the European Economic Area (EEA) under the so-called Norwegian model; ii) the EFTA Swiss model of negotiating bilateral treaties; iii) a variant on the EU – Turkey Customs Union or iv) the WTO safety net.

3.4.1 The Norwegian model – joining the European Economic Area

The European Economic Area (EEA) was established in 1994 to give European countries that are not part of the EU a way to become members of the Single Market[65]. Members of the EEA are part of the European Single Market and consequently abide by the four freedoms of movement for goods,

[64] Cernat, L; Mustilli F. Trade and Labour Adjustment in Europe: What Role for the European Globalisation Adjustment Fund? Chief Economists Note Issue 2 May 2017.

[65] The EEA comprises all members of the EU together with three non-EU countries: Iceland, Liechtenstein and Norway.

services, capital and crucially people within the EEA region. All EEA members must implement EU rules on the Single Market, which includes legislation regarding employment, consumer protection, environmental and competition policy. Moreover, there is a substantial membership fee to join the EEA and the EU Single Market. Members contribute to both the EU's regional development funds and the costs of the EU programmes in which they participate. Norway's contributed GBP 106 per person in 2011. According to the UK House of Commons, this was only 17 per cent lower than the UK's net contribution of GBP 128 per capita as a full EU member[66].

It could be concluded therefore, that while membership of the EEA would allow the UK to join the single market, it would not prevent the free movement of labour, nor would it provide the freedom for the UK to re-set British regulations and the UK would need to satisfy the EU's rules of origins requirements. Neither would this scenario result in substantial fiscal savings for the UK tax payer. As such, it would presumably not meet the Brexit voter demands for greater sovereignty and less immigration.

3.4.2 The Swiss model – EFTA & bilateral treaties

Switzerland chose not to become a member of either the EU or the EEA. Instead it has sought a more flexible path of negotiating individual bilateral treaties with the EU covering insurance, air traffic, pensions and fraud prevention, for example. Switzerland is also a Member of the EFTA, which allows for free trade with the EU in all non-agricultural goods and as a result has achieved a similar level of goods market integration with the EU as EEA countries. Under the EFTA, Switzerland permits the free movement of people between Switzerland and the EU, and has little decision-making influence over EU programmes in which it chooses to participate in and as with the EEA countries, Switzerland is required also to implement policies and legislation set by the EU. In 2013, the House of Commons estimated Switzerland's average financial contribution to the EU to be approximately GBP 53 per person, which is a significant 60 per cent lower than the UK's net contribution per capita.

If the UK sought a Swiss type trading relationship with the EU it would still have to compromise on sovereignty and the free movement of EU citizens into the UK, it would not be able to influence policy making or set regulations in those EU markets it seeks to integrate with. Moreover, the EU would be under no obligation to offer the UK access to every market that it wants, even to the Swiss-standard. Switzerland has not concluded an agreement on the trade in services, which implies that the UK businesses would not automatically be offered access to EU services markets either.

3.4.3 A Good-only Customs Union - The EU-Turkey Model?

Another proposal being proposed is that the UK Government should seek to retain the EU's common external tariff – or customs union on goods only. This would aim to minimize border inspections and bureaucracy at the EU border while also appeasing the UK business lobby calls for the 'most frictionless arrangement as possible' with the simultaneous freedom to sign its own trade deals across the world[67]. This proposal is similar to the existing trading arrangement between the EU and Turkey, which covers the free movement of goods but not of services or capital, or crucially the free mobility of labour. In addition to tariffs and related issues, the EU-Turkey CU requirements extend to rules and disciplines on various regulatory border and behind-the-border policies, such as customs modernization, eliminating technical barriers to trade (TBTs), competition policies, intellectual property rights, and trade defence instruments. The institutional requirements of the EU-Turkey CU establish equal representation of the parties and requires an association council, an

[66] Gavin Thompson and Daniel Harari. The economic impact of EU membership on the UK. Economic Policy and Statistics. House of Commons, 2013. SN/EP/6730.
[67] UK weighing customs union deal after Brexit. Financial Times. 2/2/2018.

association committee and a parliamentary committee. This means, in practice, that there is no provision for either a competent jurisdiction or a similar institution to the European Commission that could independently monitor implementation or address weaknesses identified by the Parliamentary Committee.

It is a significant sovereignty issue that Turkey is required to adopt the EU's Common External Tariffs (CET) on third-country imports and adopt all the preferential agreements the EU has or will conclude with other countries. This has led to Turkey concluding many FTAs over the past twenty years[68]. However, Turkey can only conclude an FTA with parties that the EU has already signed an FTA with. Turkey suffers from this arrangement because imports entering into Turkey from other countries via the EU are tariff revenue losses for Turkey. This puts Turkish exporters into a disadvantageous late-comer position compared with EU exporters, who can obtain preferential status by penetrating into new markets several years before Turkey can. Moreover, some of EU's FTA partners refrain from concluding FTAs with Turkey due to the lack of tariff incentive caused by transit through the EU-Turkey customs union[69]. It is also of note for the UK's Brexit strategy that Turkey and the EU still do not have a treaty framework that binds market access services commitments, nor those covering the temporary movement of service providers, commercial presence or investment. This scenario would be disadvantageous to the UK. For while a customs deal covering just trade in goods could appeal to the rest of the EU because of its strength in the sector, the UK had a surplus of GBP 14 billion on trade in services in 2016, but it was outweighed by a deficit of GBP 96 billion on trade in goods.

3.4.4 World Trade Organization – the safety net?

If the UK leaves the EU under the Article 50 procedure without first securing an agreement with the EU on its future trading relationship, the UK will have to rely in the first instance on its membership of the WTO as an individual signatory party. The WTO rules govern a country's trading relations with all other 164 members. The most favoured nation (MFN) obligation under WTO rules provides that each member must grant all Members the same treatment that it offers its most favoured trading partners. This means charging all other WTO Members the same tariff rates on the same products. Signing an FTA with even better tariffs rates to specific countries is one of the few exceptions to the MFN commitment, and this exception is subject to rules such as not raising tariffs to other countries that are not a party to the FTA.

As a WTO member, without a special relationship with the EU, the UK's exports to both the EU and other WTO members would be subject to the importing countries' MFN tariffs. This means that tariffs will rise for the UK's exports destined for either the EU or for all the countries that the EU has signed preferential tariff rates with under an FTA. Compared with EU or EFTA membership, this would raise the cost of exporting to the EU for UK firms[70].

The UK's services trade would also be subject to WTO rules, which are far less liberalized than the EU and therefore market access for UK services exports would be significantly reduced. However, the UK's services commitments are currently negotiated under the EU's services schedules of commitments and unless the UK and the EU make an agreement covering services, they will be taken out of the EU's services schedules, and the UK will have to renegotiate its market access

[68] With Israel, Macedonia, Bosnia-Herzegovina, Palestine, Tunisia, Morocco, Syria, Egypt, Albania, Georgia, Montenegro, Serbia, Chile, Jordan, Mauritius, South Korea, and Malaysia.

[69] The Turkey Clause has been included in EU FTAs to signal the intention for EU FTA partners to start negotiating a FTA with Turkey on the basis of the findings of a joint feasibility study, however, it cannot force third countries to conclude a negotiation with Turkey. It was first used in the EU's negotiations with Algeria in 2005.

[70] Ottaviano, G, J Pessoa, T Sampson and J Van Reenen (2014) 'The Costs and Benefits of Leaving the EU', CEP mimeo.

obligations for services with all the other WTO Members, including the EU. As discussed in Chapter 1, the WTO does not contain any social, environmental or human rights commitments. Only limited provisions under Mode 4 of the GATS address the movement of labour. Therefore, under the WTO scenario, the UK would no longer be expected to provide free labour mobility with the EU.

If the UK is free to re-set its own MFN tariffs on imports, it can choose to reduce its import tariffs below EU levels to lower import costs for UK consumers and firms. However, the average tariff charged on imports of goods to the EU is already low[71], which provides limited room for further tariff reductions. Non-tariff barriers such as health and safety standards or technical barriers to trade are already regulated in the WTO. These rules encourage governments to use transparent, international standards where available or to be based on scientific evidence when deviated from. This prevents a race to the bottom in de-regulation and facilitates a level playing field. These minimum standards also limit the scope for the UK to lower non-tariff barriers relating to food and products through unilateral action outside of the EU.

The WTO safety net scenario certainly impinges less on UK sovereign decision-making than the EU. Under the GATS, the UK will not have to provide the free movement of labour to EU citizens. However, the tradeoff is that UK exports will face higher tariffs than it currently does as a member of the EU, which has already negotiated many bilateral and regional trading agreements that are currently benefiting the UK as an EU Member State.

3.5 The slowdown of the British economy

Uncertainty has prevailed since the Brexit referendum. Although the UK economy grew 1.8 per cent in 2016, it was estimated that given the strength of global growth, Britain's would have grown by about 2.5 percent in 2017 were it not for the Brexit vote[72]. A leaked UK Cabinet Report titled EU Exit Analysis - Cross Whitehall Briefing, assessing three scenarios ranging from leaving with no deal to remaining within the EU single market, suggests loss of growth in almost every part of the economy compared with the UK remaining in the EU[73]. Overall, the report suggests UK economic growth would be 8 per cent lower than current 15 year forecasts, if the country left the bloc with no deal and reverted to World Trade Organization rules. Growth would be 5 per cent lower if Britain negotiated a free trade deal and 2 per cent lower even if the UK were to continue to adhere to the rules of the single market, under the Norway model. Financial services, manufacturing and retailing are among the worst hit industries, while every UK region would be negatively affected in all the scenarios, with the north-east of England, the West Midlands and Northern Ireland facing the biggest impacts[74].

It is therefore paradoxical that alongside indicating that British households are each more than GBP 600 a year worse off after the vote to leave the EU, there is rising inflation, low wage growth and political turmoil, the survey revealed that England is now officially happier than ever before a year after the Brexit vote. Key barometers of happiness and wellbeing measured by the Office for National Statistics (ONS) showed small improvements over the year to the end of June – the first 12-month period since the referendum. There was no change in reported personal wellbeing recorded

[71] Hiau Looi Keey, Nicitaz Alessandro. Short-Term Impact of Brexit on the United Kingdom's Export of Goods. World Bank Policy Research Working Paper 8195. Development Research Group. Trade and International Integration Team. September 2017.
[72] Kallum Pickering, Senior Economist UK, Berenberg.
[73] EU Exit Analysis — Cross Whitehall Briefing. Dated January 2018.
[74] William Schomberg; https://uk.reuters.com/article/uk-britain-economy/uk-economy-unexpectedly-picks-up-speed-but-brexit-effect-felt-idUKKBN1FF123 (accessed 04/05/2018).

in Scotland, Wales or Northern Ireland. Yet the ONS also found no change in anxiety levels compared with a year ago[75].

Summary conclusions

On June 23rd 2016, the UK electorate voted in a referendum on the question' 'Should the United Kingdom remain a member of the European Union, or leave the European Union?' Voter turnout was 71 per cent, resulting in 52 per cent in favour of leaving the European Union, although this was not consistent in the four regions of the UK – England, Northern Ireland, Scotland and Wales. A strong appeal of the leave campaign was based on the idea of the loss of sovereignty under the EU and the need for the UK government to ''take back control' particularly towards the movement of labour within the EU and its impact. Various studies indicate that those anxious about immigration were not only more likely to play down the risk of Brexit; they were more likely to turn out and vote — and to choose to Leave[76].

The framework for withdrawal is set out under Article 50. This provision frames the four-step withdrawal process which includes 1) the decision to withdraw; 2) notification of that decision to the EU; 3) negotiation of a deal; and 4) agreement to the deal's terms. As of February 2018, 20 months after the referendum, both the EU and the UK government are still at stage three no firm blueprint has been put forward by the UK government, leaving the possibilities for the UK's future trading relationship with both the EU and the rest of the world uncertain. While various models for future UK-EU trading relations exist, none have been followed to date. Business uncertainty has already emerged. Since the Brexit referendum, the UK economy has slowed down from a predicted 2.5 percent in 2017, to an estimated 1.8 per cent per annum. There has been much business concern both domestically and overseas at the continued uncertainty since the Brexit vote. This has led to both international organizations and firms seeking relocate or leave the UK and set up a commercial presence within the EU 27 countries.

Geo-political Consequences

Brexit manifests the growing divides between political and business elites committed to globalisation, and the masses who believe that their security and prosperity has not been served by a diminution of sovereignty and the lowering of barriers to trade and migrants. It indicates a growing sentiment among voters that domestic communities should take precedence over the international when framing and executing foreign policy and negotiating trade agreements. However, Brexit could easily lead to the UK's further decline in both world affairs and international trade. Many trading nations have viewed the UK as the main gate to European markets, most notably financial services, and any change in this status would affect them economically. The UK after Brexit will lose its value-added position with distant allies and further undermine economic growth in the UK. The UK may seek to ensure foreign trading partners through the Commonwealth. However, many of these countries are already in regional trading arrangements, including NAFTA, or are negotiating the CPTPP and the RCEP. These mega-regionals will provide them with potentially large regulatory and tariff benefits. This detracts from any incentives to rapidly pursue trading relations with the UK once it is no longer a passport into the EU.

The UK has become an individual actor in a world of power politics where former EU partners now have a real and pressing incentive to compete with and to undermine the UK on various fronts.

[75] https://www.theguardian.com/business/2017/nov/28/how-has-the-brexit-vote-affected-the-uk-economy-november-verdict (accessed 04/05/2018).
[76] https://www.politico.eu/article/brexit-britain-is-in-denial-over-immigration (accessed 04/05/2018).

These include the Irish border, the status of Overseas Territories such as Gibraltar, and the presence of financial services companies in London. While Brexit does not entail Britain leaving NATO, it immediately transformed the atmosphere of the July 2016 NATO summit in Warsaw, undermining European solidarity against Russia's actions in Ukraine. Recent diplomatic tensions between the UK and Russia have been successfully transferred to NATO. This was a positive display of solidarity from the US and the EU towards avoiding conflicts and problems collectively on the eastern periphery of the continent.

Yet the UK also faces internal fragmentation, through alienating pro-EU Scotland, and forcing the re-emergence of the political flashpoint of the future of the Irish border between Northern Ireland, which also voted to remain in the EU, and the Republic of Ireland, which will remain in the EU. The UK government's majority is based on a precarious coalition between the Conservative Party and the pro-Brexit and socially conservative Democratic Ulster Party (DUP). Any UK government leading Brexit is faced with the contradiction of seeking to represent the interests of the population voting for Brexit, and implementing trade and foreign policy that many of the population perceive will have a detrimental and uneven effect on the economy and workers of the different regions of the UK. Economic nationalism, protectionism and devolution do not fit easily with an outward looking global Britain, in post-Brexit trade and foreign affairs.

4. The EU 27 vision of harnessing globalisation

4.1 The Challenge of Europe

The EU of today has grown out of just three communities founded after World War II to establish peace and prosperity in Europe[77]. In 1958, the Treaty of Rome[78] established a legal framework to constrain Member States from engaging in behaviour that could adversely affect other European Member States. The EC has evolved dramatically since 1958 in size, scope and name to become the European Union in 1993. What began as a purely economic union is now a mega-regional trade agreement and international organization overseeing policy areas from trade, monetary policy, climate, environment and health to external relations and security, justice and migration throughout 28 diverse European countries. This expanding role of the EU, domestically and throughout the world, has brought not only economic and social benefits, but unavoidable challenges. Nevertheless, to date the Treaty objectives have largely been met. This was reflected in 2012 at the end of the worst global crisis since the 1930s, when the EU was awarded the Nobel Peace Prize 'for over six decades contributed to the advancement of peace and reconciliation, democracy and human rights in Europe'[79].

For instance, since 2000, exports of European goods have almost tripled, increasing by approximately EUR 1.5 trillion, with the EU's share of world goods exports remaining above 15 per cent of the total. Nevertheless, this is a decline of 1 per cent since the turn of the century, which is significant because more than 30 million jobs in the EU are supported by exports outside the EU. This is two thirds more than at the turn of the 21st century, when the EU's share of world exports was marginally higher. Exports directly and indirectly support almost one in seven jobs across the EU and these export-linked jobs are highly skilled and better paid than average[80]. However, emerging economies have been rapidly expanding both relatively and absolutely, competing for a share of lucrative markets. Most notably, China's share of world exports of goods grew from 5 per cent to more than 15 per cent[81]. Forecasts suggest that 90 per cent of global economic growth in the 2030 is expected to be generated outside Europe[82]. Economic growth in the EU will become increasingly dependent on stronger links with the new centers of global growth. As a result, Europeans, across all Member States will benefit from deepening global trading relations at a time when, paradoxically, public reaction to signing new agreements is growing in opposition.

The difficulty for the EU is that although the end of the Cold War, European integration and globalisation have substantially increased interdependencies and broken down traditional borders

[77] The European Coal and Steel Community was set up in 1951, the European Atomic Energy Commission and the European Economic Community were founded in 1957. As of January 2018, there are 28 member states in the European Union: Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Italy, Ireland, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Spain, Slovakia, Slovenia, Sweden and the United Kingdom.

[78] Article 3(g). The Treaty came into force on 1 January 1958. Since the Treaty of Rome, the Merger Treaty in 1967, the Single European Act in 1986, the Treaty on European Union (the Maastricht Treaty) in 1992, the Treaty of Amsterdam in 1997, the Treaty of Nice in 2002 and the Treaty of Lisbon in 2009 have been agreed and ratified by all the Member States.

[79] https://www.nobelprize.org/nobel_prizes/peace/laureates/2012/ (accessed 08/02/18).

[80] For instance, 200 000 jobs in Poland, 140 000 in Italy, and 130 000 in the United Kingdom are linked to German exports outside the EU. French exports outside the EU support 150 000 jobs in Germany, 50 000 in Spain and 30 000 in Belgium. Reflection Paper on Harnessing Globalisation. European Commission COM(2017) 240, 10 May 2017.

[81] The US share of world goods exports declined four times more than Europe's in relative terms, from 16 % in 2000, comparable with the EU, to less than 11 % of total global goods exports. Japan, another post-war economic powerhouse, also saw a fall - from 10 % to 4.5 % of their share of the global goods export market. Reflection Paper on Harnessing Globalisation. European Commission COM(2017) 240, 10 May 2017.

[82] Ibid.

between national and foreign policy - this development has been asymmetrical. The EU has not evolved into a federal state. European integration sits increasingly uneasily at the nexus between internal and external policy; it is simultaneously foreign and domestic[83]. The EU has created both the conditions for the trans-nationalization of politics, through the free movement of goods, services, capital and people, and a space for new disaffection, contestation and disruption[84]. It is an institutional challenge for the EU decision-makers to maintain legitimacy in the eyes of an expanding, diverse European citizenship, as it attempts to make and implement policies on increasingly controversial issues. Traditionally distinct areas of policy making such as trade policy or migration and EU integration are now blurring. There are no longer clear boundaries between local, national, EU, and global levels. Intergovernmental cooperation must take place in cross-cutting policy fields, such as European integration, migration, human rights and international trade, all of which require complex multi-level decision-making. As a result, politics and policy makers now face stakeholder demands on multiple levels when making decisions.

Against the growing complexity of technocratic decision making, there is a temptation to respond to globalisation by demanding simple political answers and solutions. This marginalizes mainstream political discourse as populist leaders offer misguided but appealing responses to confront the status quo and ruling elite. Populist leaders such as Marine Le Pen, Norbert Hoffer, Nigel Farage, and Geert Wilders have altered party politics, gaining votes, seats and entering government coalitions. Their average share of the vote in national and European parliamentary elections has more than doubled since the 1960s, from around 5.1 per cent to 13.2 per cent, at the expense of center parties. During the same era, their share of seats tripled, from 3.8 per cent to 12.8 per cent[85]. Although the rising populist vote has not usually translated into political power, their vocal discourse has put intense pressure on the EU as well as mainstream parties and the political agenda. This was clearly demonstrated by UKIP's success in UK's Brexit referendum vote on leaving the EU.

4.2 The EU and the Trauma of TTIP and CETA Negotiations

Global trade openness has boosted EU economic growth, raising prosperity and competitiveness. Every EUR 1 billion in exports supports 14 000 jobs, and over 80 per cent of European exporters are small and medium-sized enterprises (SMEs)[86]. As a result, Europe is deeply integrated in global markets. Reductions in transportation and communication costs has helped Europe produce, buy and sell goods around the world, providing export opportunities for all types of businesses in Europe. North America, particularly the US, has long been of economic significance to EU markets. Total US investment in the EU is three times higher than in all of Asia, while EU investment in the US is around eight times the amount of EU investment in India and China together. Given the low average tariffs of under 3 per cent, unlocking future growth in EU north-American trade will lie in reducing non-tariff barriers.[87] These consist mainly of customs procedures and behind the border regulatory restrictions. To address these trade issues, the EU sought trade negotiations with both Canada under the CETA, and with the US, under the Transatlantic Trade and Investment Partnership

[83] Balfour, R et al. Europe's Trouble Makers. The populist challenge to foreign policy. European Policy Centre. March 2016. http://www.epc.eu/documents/uploads/pub_6377_europe_s_troublemakers.pdf?doc_id=1714.
[84] Ibid.
[85] Inglehart, R.F., Norris, P. Trump, Brexit, and the rise of Populism: Economic have-nots and cultural backlash. Harvard Kennedy School Faculty Research Paper. RWP16-026 2016.
[86] European Commission, EU exports to the world: effects on employment and income, 2015.
[87] http://ec.europa.eu/trade/policy/countries-and-regions/countries/united-states/ (accessed 04/05/2018).

(TTIP) in 2014. The European Commission predicted that the TTIP would boost the EU's economy by EUR 120 billion, the US economy by EUR 90 billion and the rest of the world by EUR 100 billion[88].

However, while policy makers seek to unlock the potential employment and growth benefits from negotiating free trade agreements, civil society has been less enthusiastic. And this was long before President Trump launched his isolationist Administration halting the TTIP and TPP talks and re-negotiating the NAFTA. Opposition to globalisation and FTAs comes at a time when EU decision makers are already challenged by slow and uneven growth and would welcome the economic benefits they can provide. While inequality in Europe remains much less marked than elsewhere in the world, the richest 1 per cent of the population still own 27 per cent of the total wealth[89]. There are many regions with high unemployment, especially among youth; along with a migrant and refugee crisis and geopolitical instability on its borders. The result of these pressures has been a rise in Euroscepticism, fundamentally questioning the role and future of the EU. Yet these internal pressures conflict with the need for the EU to be a prosperous defender of international community following the loss of US leadership. Again, trade policy has tangibly entered the arena of high foreign policy, as FTA negotiations have the potential to polarize public debate and upturn election results both within the EU and globally.

4.2.1 Stop TTIP - A European Citizens' Initiative against EU FTAs

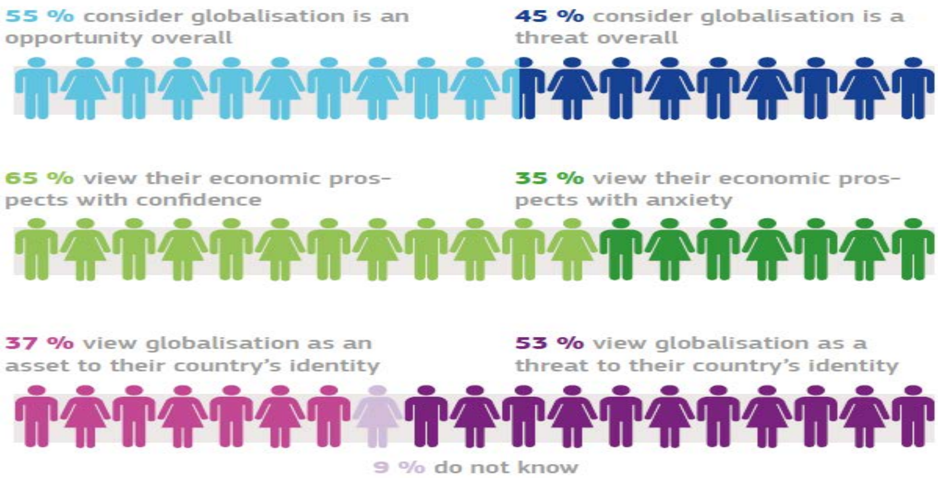
When transatlantic civil society mobilized effectively against TTIP and CETA negotiations in 2016, the issue of sovereignty was frequently raised. The perception was that trade agreements set rules undemocratically, behind closed-doors under the influence of powerful lobbyists, rather than local governments[90]. The view was also that existing standards and communities would be threatened by the interests of big business in food safety law, environmental legislation and banking regulations. A direct democracy mechanism introduced by the 2007 Treaty of Lisbon, the EU's European Citizens' Initiative (ECI) attained over 3.2 million signatures against TTIP and CETA within a year[91].

'Stop TTIP' invited the European Commission to recommend that the Council repeal the negotiating mandate for the TTIP[92] and stop the CETA. This invitation argued that both agreements include several critical issues such as investor-state dispute settlement and rules on regulatory cooperation that pose a threat to democracy, the rule of law, and lower standards and public services in the EU[93]. The Commission responded by rejecting both proposals because they fell outside the framework of the Commission's powers to submit a proposal for a legal act of the Union for the purpose of implementing the Treaties. Following this, the 'Stop TTIP' organizers brought a case contesting the European Commission's decision before the EU General Court.

[88] Ibid.
[89] Julius Baer, Wealth Report: Europe, 2014.
[90] Stuart Jeffries. What is TTIP and why should we be angry about it? The Guardian. 3 August 2015. Leo Cendrowicz. 'Europeans Fight US Trade Deal With Fear of McHospitals, Fracking Under Eiffel Tower'. The Daily Beast. Retrieved Lee Williams What is TTIP? And six reasons why the answer should scare you. The Independent. 6 October 2015. TTIP: 'Völlige Entmachtung der Politik'. 3sat. Published on April 8, 2016.
[91] An ECI is an official invitation to the European Commission to propose legislation on matters where the EU has competence to legislate. A citizens' initiative must be backed by at least one million EU citizens, with a minimum number in at least seven out of the 28 EU Member States, see http://ec.europa.eu/citizens-initiative/public/basic-facts.
[92] Article 218(2) TFEU is the legal rule on the process of the EU negotiating treaties.
[93] http://ec.europa.eu/citizens-initiative/public/initiatives/ongoing/details/2017/000008?lg=en; https://stop-ttip.org (accessed 04/05/2018).

The General Court for *Stop TTIP* concluded that the Commission did in law possess the competence to submit to the Council the two proposals[94], rejecting the Commission's argument that the Initiative could not be registered because the suggested actions did not aim to implement the Treaties but were destructive to the law-making process. The Court concluded that citizens should not be obliged to wait until an agreement is concluded before they can contest the conclusion of the agreement through an ECI[95]. The Commission reassessed the proposed Initiative and decided to register it. In the event, the Initiative not to sign CETA was devoid of purpose because the trade agreement was signed on 30 October 2016, while the TTIP negotiations were halted by President Trump.

Regardless of the outcome, the *Stop TTIP* campaign highlighted how the European Commission is tasked with the necessity of promoting European economic growth through increasing trade and investment relations with the rest of the world, while facing highly mobilized popular resentment towards greater income and wealth inequality. European citizens clearly have mixed opinions about globalisation as well as further integration under the EU, and populist leaders mobilising this feeling among the minority of left-behinds to gain political leverage.



Source: Bertelsmann Stiftung and European Commission (2016)

4.3 The EU and Brexit

As UK follows through implementing the referendum vote to leave the EU, it is already experiencing change. Yet so has the EU. The loss of Britain is directly opposed to the EU's teleological ethos of peace and prosperity through ever-greater integration. Indeed, the remaining EU Member States have not sought to accommodate the UK's demands in negotiations to date as a demonstration of continued collective strength.

Yet post-Brexit, the EU will lose one of its most economically liberal Member States, a leader on climate policy, cross-border organized crime and terrorism control and an important bridge for the EU's transatlantic relations with the US and NATO. On the other hand, the UK has often opposed further centralization, and without the UK, the Eurozone should have more power to drive economic and financial policy. The UK will no longer be present in decision making to push for a bottom-up approach to creating a Capital Markets Union (CMU), this should make stronger the French and Commission requests for a robust common regulator. Greater centralization may also emerge in

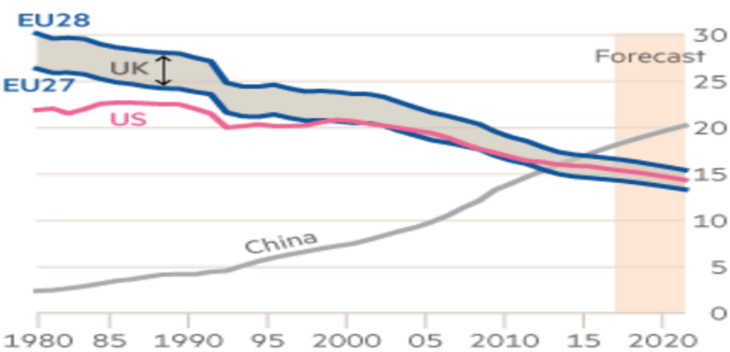
[94] Judgment in Case T-754/14 Press and Information Michael Efler and Others v Commission, paras 30-32.
[95] Ibid. para 44. See also: A. Karatzia 'The European Citizens' Initiative in practice: Legal admissibility concerns' (2015) 40 EL Rev. 509, pp. 516-518.

energy market regulation, without the UK traditional opposition to Commission interventions in national energy policy decisions to improve security of energy supply.

Militarily, the UK has been one of the EU's strongest defense powers, as one of the only two member states possessing 'full-spectrum' military capabilities, including a nuclear deterrent, spending 2 per cent of GDP on defence. The UK, alongside France, also holds a permanent seat on the UN Security Council and has the largest military budget within the EU. Yet despite the UK's military power, it is not the biggest contributor to EU defence missions. UK engagement in Common Security and Defence Policy (CSDP) missions has been relatively modest in comparison to its defence capabilities – ranking just fifth amongst contributors to CSDP military operations and seventh for CSDP civilian missions. Without Britain, CSDP cooperation will remain strong, and there will be less opposition to the establishment of a European defence policy[96]. The UK has traditionally vetoed closer integration and cooperation in EU defence. Since 2011, the UK has resisted increases to the European Defence Agency Budget and has vetoed the creation of a single military headquarters in Brussels. Thus, although the UK's military power currently makes it an important contributor, removing the UK from the CSDP could facilitate greater integration and ambition in EU defence policy[97]. Since Brexit, the UK Government has sought to assure EU partners that the UK will continue to play a 'proactive role' in tackling security threats, including illegal migration. While the European Commission has noted that it is in the EU's interest to continue cooperation in these areas, the UK can no longer host EU military operational headquarters or remain in command of EU operations.

The geopolitical future of the EU is being necessarily influenced by the UK's departure. At the extremes, Eurosceptics hope that Brexit would lead the EU to unravel entirely, while others see this as an opportunity for the EU to reform and improve the way it works. Indeed, evidence suggest that the UK's departure is likely to translate into higher growth figures for the bloc as well as stronger export figures and savings rates. On the other hand, the UK is the second biggest economy in the EU, accounting for 12 per cent of EU GDP, losing the UK means that the EU will also mean losing 13 per cent of its population. In 2017, the UK's estimated net public sector contribution to the EU was GBP 8.9 billion[98]. The EU will therefore have to find new sources of growth.

The EU Share of GDP[99]



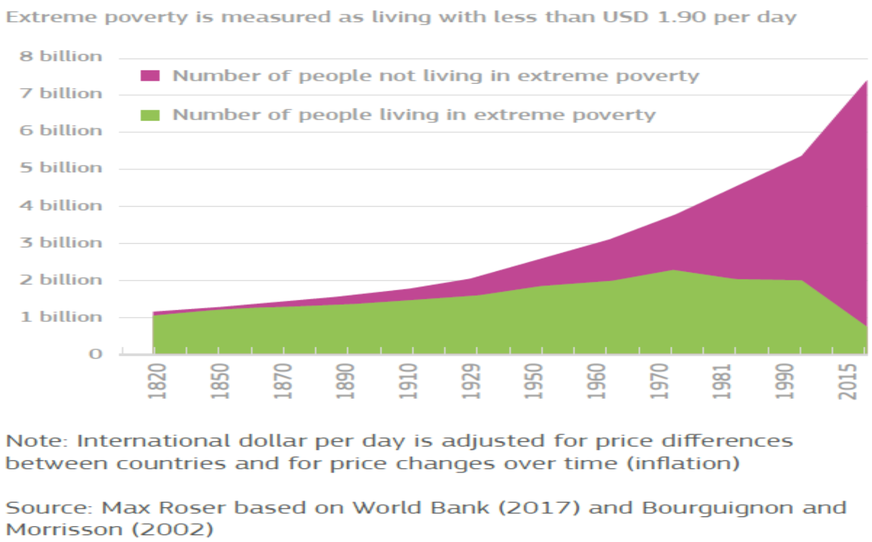
[96] Europe After Brexit: Unleashed or Undone? April 2016. www.cer.org.uk (accessed 04/05/2018).
[97] UK Defence and Security Policy. Institute for Government. www.instituteforgovernment.org.uk/explainers/uk–eu-defence-and-security-cooperation. (accessed 04/05/2018).
[98] Matthew Keep. The UK's contribution to the EU Budget. House of Commons Briefing Paper. Number CBP 7886, 23 March 2018.
[99] Reproduced from Romeii, V, Smith, A. Financial Times Graphic. Source IMF.

4.4 'Harnessing globalisation'

'To better harness globalisation, we need more global governance and global rules. And we need to support that with domestic policies that boost our competitiveness and resilience at home. Europe must now decide how'[100].

International trade in the 21st century represents half of world gross domestic product, up from less than one fifth in the early 1970s, with cross-border trade in services such as data flows growing exponentially[101]. Trade generates economic growth and has served to lift millions of people out of extreme poverty. Trade liberalizing policies are beneficial in offering a wider variety of cheaper goods for consumers and fostering productivity as firms rely on their comparative advantage[102].

People lifted out of extreme poverty in the world 1820-2015



The downside of this is that the gains from trade can be unevenly distributed both among countries and within countries. There are also adjustments costs incurred by shrinking sectors making some people worse-off in absolute terms[103]. Over the last decade, real incomes of middle-class households in the EU and other advanced economies have, for the most part, stagnated even as the economy has grown overall. Yet much of the cause of these labour changes are technology rather than trade agreement induced. OECD estimates suggest that as a result of automation, on average and across countries, 9 per cent of jobs are at high risk of being automated, while for an additional 25 per cent of the workforce, half of the tasks will change significantly. European citizens face economic uncertainty, marginalization, and other societal costs, without knowing where the blame lies. This is fertile ground for populism, radicalization and reaction against further globalisation.

[100] European Commission Reflection Paper on Harnessing Globalisation. Op cit.
[101] Estimates show that with an appropriate framework, the value of the data economy will increase to EUR 739 billion by 2020, representing 4 % of overall EU GDP, more than doubling today's value. Ibid.
[102] A, Hornok and Koren, (2016) summarize the main sources of welfare gains coming from trade liberalization. First, trade liberalization fosters specialization according to comparative advantage of each commercial partner. Second, it allows access to bigger markets, reduce prices due to economy of scale and increase consumers' choice. Finally, resources are reallocated in such way that the most productive firms thrive and the least productive ones lose market share and sometimes, exit the market. Indeed, trade liberalization is beneficial for firms whose comparative advantages increase when bilateral tariffs are removed and this is good for the economy as a whole.
[103] Obstfled, M. (2016) Get on Track with Trade, Finance and Development, December 2016.

The European Commission faces a communications challenge to counter the view that governments are no longer in control or are not willing to shape globalisation and manage its impacts in a way that benefits all[104]. It is understood that trade-induced competitive specialization involves labour churning – the adjustment period during which workers need to relocate and retrain to enter more competitive firms and sectors of the economy that expand because of the trade reforms. The EU 'Trade for All' strategy stresses the role of institutions in safeguarding the interests of those adversely affected by trade-related adjustment costs. It concludes that actively managing change is essential to making sure the benefits of globalisation are fairly distributed and negative impacts are mitigated. The social consequences of market opening must be addressed'[105]. The European Globalisation Fund (EGF) was set up in 2006 by the first Barroso Commission, complemented by the European Social Fund (ESF) to provide financial support for longer more strategic responses to the challenges imposed by the globalisation process. The EGF is rather designed to provide immediate support to workers made redundant as consequences of the globalisation process. The EGF co-funds 60 per cent of a labour market initiative in a Member State that is oriented towards the re-training and re-employment of workers. Despite its relatively small budget and complex procedures, the EGF has delivered tangible results. Yet it has remained underutilized with little political visibility at the Member State level. The current EGF annual budget of EUR 150 million has never been exhausted. And while countries such as Germany and Denmark are effectively utilising this support to the benefit of their labour force, as Chapter Three noted, the UK government has not.

The Commission also produced a reflection paper on the social dimension of Europe, noting that although Europe already has the most equal and inclusive societies in the world, there is a continual need to strengthen and adapt policies for the future and address inequalities through fair and modern tax policies[106]. The Commission calls for the European Pillar of Social Rights to ensure a better distribution of the benefits of globalisation, coupled with effective social protection to help people find a decent job and adapt to change. More broadly, a fair and equitable redistribution of wealth, as well as focused investments fostering social inclusion of more vulnerable categories of people including migrants, will help to strengthen social cohesion. The key to making the EU fit for purpose for digitalization and globalisation is empowerment through lifelong learning. Equal access to high-quality education and training is a powerful way of redistributing wealth in a society. Already 90 per cent of all jobs require at least some level of digital skills[107]. Future jobs created in Europe will be different and the challenge is to innovate in strategic technologies and help workers to gain the right skills to avoid widening the gap in the labour market. Harnessing globalisation therefore has an internal dimension, with Europe acting to more fairly share the benefits of globalisation in line with the principles of solidarity and sustainability.

The renewed Lisbon strategy sets out an agenda for adapting European economies to better harness the new global environment[108]: 'The case for openness is undermined if its benefits are lost along the supply chain. The Commission and Member States have important roles in ensuring that

[104] European Commission Trade Policy webpage: http://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements/ (accessed 10 Dec. 2017); European Commission, Report on Progress Achieved on the Global Europe Strategy, 2006–2010 (Staff working document) SEC(2010) 1268/2 final; European Commission, Trade as a Driver of Prosperity (Staff Working Document) SEC(2010) 1268 final; European Commission, Global Europe: Competing in the World (Communication) SEC(2006) 567 final.

[105] Trade For All Report. http://trade.ec.europa.eu/doclib/docs/2015/october/tradoc_153846.pdf (accessed 04/05/2018).

[106] European Commission Reflection Paper on Harnessing Globalisation. Op cit.

[107] European digital progress report 2017, Staff Working Document, (2017) 160.

[108] 'Promoting decent work for all', adopted by the Commission in May 2006.

the benefits of trade opening and globalisation reach all citizens and are not captured by specific interests' [109]. It also has an external dimension or foreign policy. The EU's global strategy is to uphold and further develop the existing global rules based order in the face of unprecedented challenges, such as the 2008-2012 financial crisis, the rise of protectionism and the loss of US leadership of the post-World War Two international order. In its commitment to international cooperation, the EU governments signed up to a G20 coordinated programme to support the global economy with more robust global rules to regulate financial markets and fight tax avoidance. The EU also supports the UN 2030 agenda for sustainable development, endorsing the UN Sustainable Development Goals in 2015 and has committed itself to the 2015 Paris Climate Change Accord. The EU advocates further international rules and cooperation in areas such as the digital economy, tax evasion, corruption, resources extraction and preventing illicit financial flows. For an important element of EU trade and foreign policy is to promote fairness in free trade[110].

4.5 The fight against protectionism with fair trade more than free trade

In fulfilling its mandate of economic prosperity through ever increasing economic integration, the EU has sought to address citizen concerns while containing populist economic nationalism within its Member States and among the G20 economies. The WTO, OECD and UN Conference on Trade and Development report showed that since 2008 over 1,500 new trade restrictions have been recorded in G20 economies. Yet only a quarter of these had been rolled back by May 2016. This is despite the strong evidence indicating that protectionism disrupts production and increases costs and prices for consumers. It was estimated that an increase in trade restrictions by 10 per cent is estimated to lead to a 4 per cent loss of national income,[111] while consumers and firms are denied access to new products, services and technologies. As prices rise, the poorest are most affected by price increases. A study of 27 European and 13 other large countries concluded that the real income loss from closing off trade would be 63 per cent for the poorest households and 28 per cent for the richest, because the poor spend a higher share of their income on consumption.[112]

The EU has sought to include a sustainable development clause in each FTA to help ensure that a basic level of labour and environmental standards is respected between the parties to the agreements. The rationale behind these clauses is that increased free trade with countries with lower standards of protection creates pressure to lower such standards in the EU to maintain trade flows or investments. Such sustainable development clauses contain references to international labour conventions and environmental treaties as well as some procedures to be used in case one of the parties is not respecting the conventions referred to. However, traditionally, sustainable development clauses remain excluded from the dispute settlement mechanism of the FTAs and do not allow legal actions from affected private parties.

This extension of EU trade agreements into investment and sustainable development also raised concerns over the legal competence of the Commission to negotiate investor state dispute settlement mechanisms (ISDS) and other non-direct foreign investment rules. Seeking an Advisory Opinion[113] in 2016, on many trade related areas covered in the EU – Singapore FTA, the CJEU

[109] Challenge Europe European Policy Centre. Issue 21 Growth, well-being and social policy in Europe: trade-off or synergy? 2011. http://www.epc.eu/documents/uploads/pub_1281_challenge21.pdf (accessed 04/05/2018).
[110] European Commission Reflection Paper on Harnessing Globalisation. Op cit.
[111] OECD, The sources of growth in OECD countries, Paris, 2003.
[112] Measuring the unequal gains from trade', Fajgelbaum, P. D. and Khandelwal, A. K., Quarterly Journal of Economics, 2016).
[113] Pursuant to Article 218 of the Treaty on the Functioning of the European Union (TFEU).

confirmed that that the EU does possess exclusive competence over areas in relation to transport services and related public procurement, foreign direct investment, intellectual property rights, sustainable development and certain institutional, transparency and dispute settlement provisions. On the other hand, the CJEU also confirmed that the EU is not endowed with exclusive competence over non-direct foreign investment, nor the ISDS regime, in that it removes disputes from the jurisdiction of the courts of the Member States, and therefore cannot be established without the Member States' consent. In effect, with respect to investment protection, the EU has exclusive competence to enter international agreements that only cover purely foreign direct investment as long as they do not contain any ISDS provisions. Any broader investment related agreement would involve 'shared competence' between the EU and the Member States. Such a 'mixed' agreement requires approval by the Member States in accordance with their own constitutional requirements.

The findings of the Court are of relevance for the entire EU Common Commercial Policy. As shown by the uncertainty caused by the Walloon governments' delayed ratification of the EU-Canada CETA, any FTAs that include non-direct foreign investment and ISDS provisions will need to be approved by all relevant national and regional parliaments before they can be signed by both the EU and the Member States. This could affect the content of FTAs, incentivizing the EU to avoid 'mixed' areas such as ISDS, because the approval procedures are much more lengthy and uncertain, which could undermine the unity and negotiating strength of the EU in trade negotiations. For its part, the EU has actively sought to promote fair rules for the protection of international investments, while allowing governments to pursue their legitimate policy objectives. The EU has been a vocal advocate of a transparent, permanent multilateral investment court in place of ad hoc arbitration under the existing investor-state dispute settlement, as well initiatives such as a screening mechanism of inward investment into the EU.

4.6 Foreign Direct Investment (FDI) Screening

Investment into the EU also causes concern to the European Commission. An increase in non-EU takeovers of EU firms that employ cutting-edge or dual use technologies and strategic infrastructure assets has led to apprehension about the implications of foreign investment for security and public order. In a destabilised geopolitical context and recent shifts in global power, the emergence of significant new foreign state-backed investments has clear national security implications. The concern is that these new FDI providers may pursue state-led economic development models that on the one hand restrict market access for EU investors, and on the other hand fund foreign investment for strategic industrial goals. Such asymmetrical investment relations are protectionist and in conflict with the EU's trade policy of reciprocity. They also pose challenges to the EU's essential interests.

Although investment is undertaken at a Member State level through domestic mechanisms, there are cross border effects that fragmented and decentralised monitoring cannot adequately respond to. To address this, the European Commission proposed a regulation to establish a framework for screening of FDI into the EU on grounds of security or public order[114]. Current EU law addresses unfair competition, and trade and investment agreements address asymmetric market access between the EU and its trading partners; they do not address inward investment domestic security or public order issues. The 2017 Commission proposal sets out minimum requirements for FDI screening schemes, including good governance mechanisms such as the possibility of judicial

[114] COM(2017) 487 13.9.2017 2017/0224(COD).

redress for decisions adopted under the FDI screening mechanism, non-discrimination between different third countries, deadlines, and transparency.

The Proposal contains a non-exhaustive list of factors that may be considered in the screening process, including 'whether the foreign investor is controlled by the government of a third country, including through significant funding'. As such, this is a direct response to the changes in global power and the growing economic and political influence of new FDI providers such as China, for example through its 16+1 initiative, discussed in Chapter 5. The Proposal also signifies the merging of trade policy with foreign diplomacy concerns. The EU seeks to defend its security and strategic interests through investment policy. It would identify and restore a level playing field if the screening indicated that new FDI providers are restricting market access for EU investors or have policies to subsidize FDI policies for strategic industrial goals. In sum, the screening FDI proposal seeks to ensure that the EU's essential interests are not undermined by openness to trade and globalisation, while maintaining the Member State's individual and diverse FDI mechanisms.

4.7 Enforcing existing EU agreements

One low hanging fruit for the EU to harvest is by ensuring that existing international agreements are implemented and enforced. A 2017 European Commission report on the implementation of EU FTAs highlights the lack of comprehensive monitoring or overview of the implementation of all EU FTAs, such as annual reporting only being conducted for some of them[115]. The report concludes trade in goods has overall increased, and particularly for EU exports, as a result of these agreements, although the actual extent is dependent on the specific agreement. The newer FTAs have exceeded expectations in effecting a considerable increase in EU exports of agricultural products and motor vehicles. The high rates of EU companies using preferential FTA tariffs in these sectors mean that FTAs were essential for these trends. Where EU exports decrease, the causes were mainly external factors affecting the economy of the partner country concerned, rather than because of the functioning of the FTA. The report concludes, however, that a lack of awareness of FTAs was the main reasons preventing companies from using FTAs. There remains untapped potential for further exports in both directions with all partners, particularly with regards to tariff rate quotas[116].

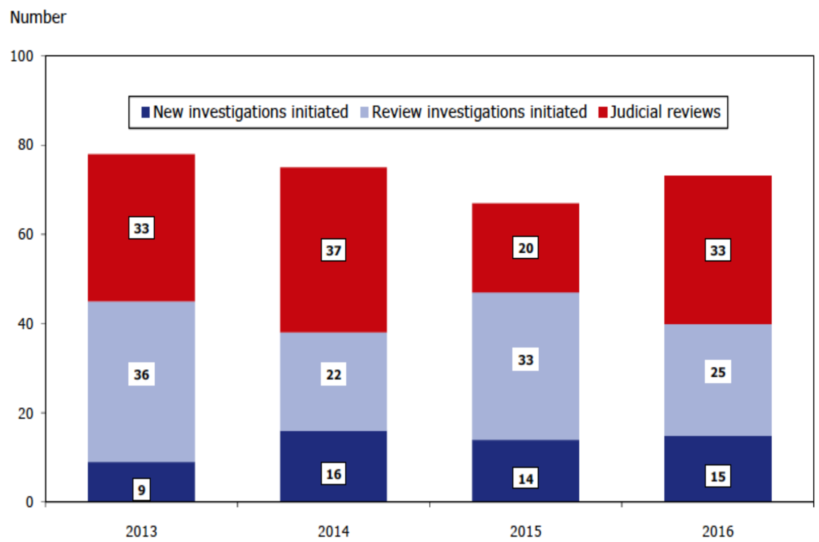
The Commission seeks to further enforce as well as implement rights and commitments agreed to under its FTAs. The new generation CETA agreement replaces the traditional ISDS mechanism for resolving disputes between governments and investors with an Investment Court System (ICS). In 2015, each of the 3304 international investment agreements in operation had its own unique forum for dispute settlement[117]. This presents a lack of transparency and undermines consistency in the interpretation of international law. It has led to allegations that arbitrators under ISDS tend to represent business over public interests when disputing government regulations that impact on investments, such as in the challenges led by Philip Morris against domestic health policy targeting tobacco packaging. Moreover, the average cost of an ISDS case is USD 8 million with an upper range of USD 30 million, not including compensation awards which average USD 10 million.[118]

[115] Report from The Commission to The European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions on Implementation of Free Trade Agreements 1 January 2016 - 31 December 2016 {SWD(2017) 364 final} Brussels, 9.11.2017 COM(2017) 654 final.
[116] Report from The Commission to The European Parliament, The Council, The European Economic and Social Committee and the Committee of the Regions on Implementation of Free Trade Agreements 1 January 2016 - 31 December 2016 {SWD(2017) 364 final} Brussels, 9.11.2017 COM(2017) 654 final.
[117] United Nations Conference on Trade and Development (UNCTAD). World Investment Report 2016: Investor nationality, policy challenges. Geneva: UNCTAD; 2016.
[118] European Commission (EC). Investor-to-State Dispute Settlement (ISDS): Some Facts and Figures. EC; 2015.

This procedural cost is estimated to be five times more than a state-state dispute within the World Trade Organization (WTO) dispute settlement system[119]. The EU-Canada CETA's ICS moves towards the WTO model, establishing a public and transparent permanent tribunal consisting of independent judges to ensure the rights of governments to regulate in the public interest while protecting the interests of investors.

When enforcing FTA commitments, the EU has typically not made use of the specific FTA dispute settlement system, rather finding it more expedient to invoke the WTO DSM to examine the dispute. For example, when seeking to determine whether Colombia's alcoholic spirits regulation was discriminating against EU producers, the EU's mere request for consultations under the WTO led to Colombia revising its law to address the concerns raised by the EU. Forum shopping can be a useful FTA enforcement tool in some economically or politically significant cases. The EU is also a highly competent user of the WTO DSM. Since its creation, it has been involved in more than 180 cases as both a complainant and defendant, and has requested third-party status in over 170 other cases[120]. The EU has also been one of the most active users of trade remedies, particularly towards the Asia region. Indicating that it is able and willing to enforce its rights under trade agreements, or directly remedy any transgression from the rule book that diminish any benefits that accrue from these agreements.

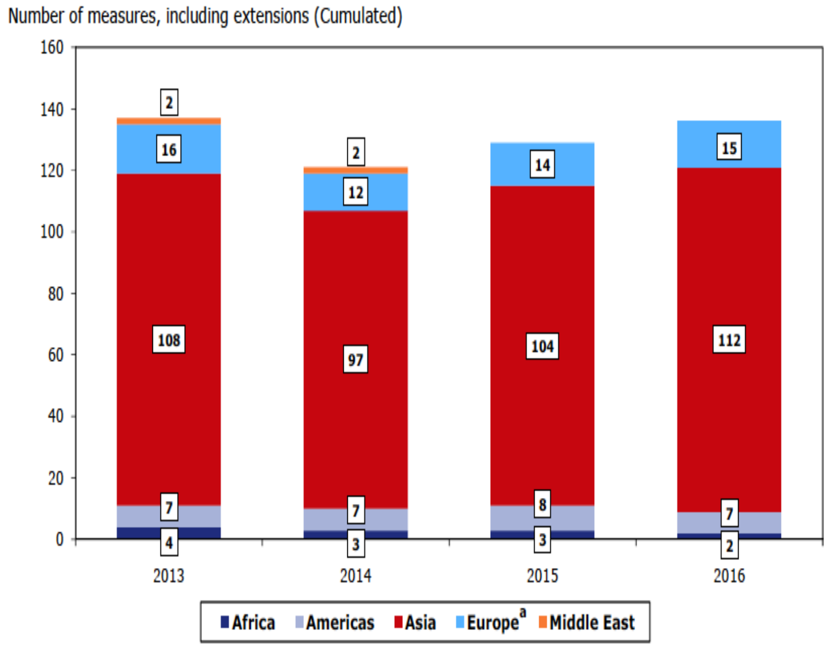
Overview of anti-dumping and anti-subsidy activity, 2013-16



Source: Annual Reports from the Commission to the European Parliament and the Council on the EU's Anti-Dumping, Anti-Subsidy and Safeguard activities (2013-2015); and European Commission Anti-Dumping, Anti-Subsidy, Safeguard – Statistics covering the 12 months of 2016. Viewed at: http://trade.ec.europa.eu/doclib/docs/2017/january/tradoc_155243.pdf [February 2017].

[119] Pelc K. Does the International Investment Regime Induce Frivolous Litigation? May 10, 2016. http://papers.ssrn.com/abstract=2778056.
[120] Report by the Secretariat. The European Union Trade Policy Review. WTO. Trade Policy Review Body WT/TPR/S/357 17 May 2017.

Anti-dumping and anti-subsidy measures in force by region, 2013-2016



a Non-EU European countries include Belarus; Bosnia and Herzegovina; the Russian Federation; Republic of Moldova; Turkey; and Ukraine.

Source: Annual Reports from the Commission to the European Parliament and the Council on the EU's Anti-Dumping, Anti-Subsidy and Safeguard activities (2013-2015); and European Commission Anti-Dumping, Anti-Subsidy, Safeguard - Statistics covering the 12 months of 2016. Viewed at: http://trade.ec.europa.eu/doclib/docs/2017/january/tradoc_155243.pdf [February 2017].

Summary conclusions

Despite the challenges of Brexit, the Stop TTIP campaign and loss of US support for the established international architecture, the EU has remained committed to principles and goals of European integration and liberal internationalism. The EU also continues to support further globalisation to support its export driven growth. It ratified its comprehensive deep integration agreement with Canada, despite popular and legal challenges, as well as updating its agreement with Mexico and successfully forging comprehensive trade negotiations with Vietnam, Japan, Singapore and other important trading partners.

Yet the EU still needs to respond more directly to rising populism and anti-globalisation movements, implementing better policies to ensure the gains from liberal trade are felt by the more marginalized sections of society. As a part of this on-going challenge, the 'Trade for All' strategy and Harnessing Global Trade report, focus on trade and sustainable development to safeguard the interests of those adversely affected by trade-related adjustment costs. In the EU, as elsewhere, policy makers increasingly acknowledge that more needs to be done to ensure social rights and protections are effective in improving the lives of citizens at all income levels. The Commission has also sought to clarify its legal competence to a negotiated comprehensive FTAs, as well as the competence of sovereign EU Member States. For the EU wants to promote a level economic playing field by including trade and sustainable development chapters in comprehensive and progressive FTAs, which protect labour, social and environmental standards in both trade and foreign investment. Yet as the EU pushes ahead promoting fair and free trade within the EU and externally though its international trading and investment relations, it requires more effective redistribution mechanisms and increased communication with European citizens about the potential value of free trade and further integration as compared to protectionism.

Domestic policy makers also need to better regulate their economies to serve the public interest. The EU is too easily scapegoated as the root cause for rising disenchantment with local economic and social conditions. The use of the EU as a deflection tool for domestic politicians does not serve the public interest. For it is the responsibility of Member States to design and implement appropriate labour and social policies at the local level. The underutilization of available funds to address long and short term adjustment costs indicates that the governments of the EU could do more domestically to take advantage of available resources and respond proactively to labour changes and the impact of technology in production. The distinction between domestic and EU responsibility and leadership in protecting the welfare of citizens is mirrored in two competing approaches to the future of Europe. On the one hand, the European Commission advocates further integration on the grounds that the solution to many problems require a stronger role for Europe. On the other hand, the European Council cautions that more centralization simply turns citizens against the EU, obstructing regional solutions to problems. This internal tension will define EU geopolitical strategy and diplomacy through the 21st century.

Geopolitical Consequences

The challenges EU policy-makers face both internally and externally have had geopolitical consequences. The withdrawal of the US from its leadership position in the international community has left a power vacuum that destabilizes the post-World War Two consensus towards many institutions and norms in international cooperation. While the EU has sought to maintain global integration through the Paris Accord, G20, G7 and WTO, these efforts have been undermined by the US's withdrawal from international cooperation and integration. Shifts in power in Asia and the rise of China as a key diplomatic and economic participant in global affairs threaten to destabilize EU economic and political interests in ensuring competitive markets and strong labour and environmental standards. Initiatives such as the 16+1 encouraging investment links between China and Central and Eastern European countries also challenges the loyalties of individual member states.

Internal changes such as Brexit have had important geopolitical effects. After Brexit, the US will lose the UK as a cultural bridge between the US and continental Europe. This loss and consequent instability inhibits the EU from becoming a stronger challenge to the US. The EU's foreign policy stance will be affected by the absence of UK, most notably because the UK, along with France, is a permanent member of the UN Security Council, with powers of veto. Yet the UK has been also been a leader on cross-border organized crime and terrorism control, and an important link in the EU's transatlantic relations with the US and NATO. The UK is one of the EU's strongest defense powers, possessing 'full-spectrum' military capabilities, including a nuclear deterrent, and the largest military budget within the EU. The loss of the UK will weaken the perceived strength of the EU, despite both parties being members of NATO.

Yet the loss of the UK geopolitically should not be overstated. The EU still includes France with its membership of the UN Security Council. Moreover, the UK is not the biggest contributor to EU defence missions, with relatively modest engagement in Common Security and Defence Policy (CSDP) missions when compared to its' defence capabilities. Although the UK's military power currently makes it an important contributor, removing the UK from the CSDP may have little consequence on current cooperation, given that it is already strong - despite the fact that the EU does not possess common armed forces[121]. The UK has also often opposed further centralization, so without Britain, there will likely also be less opposition to the establishment of a European defence policy[122]. The UK has vetoed closer integration and cooperation in EU defence, increases to the European Defence Agency Budget and the creation of a single military headquarters.

However, the delicate balance of power within the EU bloc is upset by Brexit. This is directly connected with the details of the voting procedure in the Council, specifically the blocking minority. This minority has to consist of at least four Member states representing 35 per cent of the population, which can normally only be achieved with the inclusion of one or two of the biggest Member States – such as the UK. This veto is valuable to smaller Member States whose interests are aligned with one of the larger ones and provided them an opportunity to bargain for their own interests. Prior to Brexit, the balance of power between the three key members – Germany, France and the UK, prevented the dominance of any individual country. The departure of the UK makes leverage against the strength of Germany more difficult. Yet, none of this internal geo-politics is likely to make the EU become more protectionist and isolationist in either trade or foreign diplomacy. Indeed, the challenges caused by both the Trump administration and Brexit have also pushed the EU Member States to seek greater internal cohesion and cooperation

[121] UK Defence and Security Policy. Institute for Government. www.instituteforgovernment.org.uk/explainers/uk–eu-defence-and-security-cooperation (accessed 04/05/2018).
[122] Europe After Brexit: Unleashed or Undone? April 2016. www.cer.org.uk.

5. The rise of China and its defence of liberalism

5.1 China's entry into the world economy

China has transformed over the past four decades. In 1982, China accounted for a mere 2.2 percent of global output,[123] yet within thirty years produced 14.6 percent of the world's GDP, a roughly sevenfold increase. China is now the world's largest economy (on a purchasing power parity basis), manufacturer, merchandise trader, and holder of foreign exchange reserves. The OECD predict that China's share of global GDP will reach 28 percent by 2030[124]. China is therefore a modern economic success story: World Bank data suggest that from 1981 to 2010, 679 million people in China were raised out of extreme poverty[125].

Unlike many other rising powers, China has not sought to match its economic advances, militarily. Nevertheless, mapped over time, China's share of global military spending has charted an exponential growth path[126]. US Pentagon data suggests that throughout the 1990s and again in the 2000s, China nearly tripled its share of global military outlays. A 2013 white paper to the US Congress notes that China has the 'fiscal strength and political will to support defence spending growth at comparable levels' in the future. This military growth does not necessary translate easily into military supremacy. For the US to gain economic and military supremacy, it took two world wars, a change in public opinion against isolationism and, significantly, the creation of a new international order backed by a set of military alliances before the US could fully translate its economic size into global dominance[127].

China faces other challenges. Demographically, China's working-age population shrank in 2012, marking the beginning of a trend that will accelerate over the next two decades and have profound implications[128]. While China is rich in gross domestic product, it is poor in resources compared to its needs. China has 18 per cent of the world's population, but 7 per cent of its arable land. Ensuring not just food supply but equally importantly food security is a policy preoccupation in Beijing that is absent in the capitals of the other global powers. There are other acute and persistent problems: widespread environmental degradation[129], endemic corruption[130], civil unrest, as well as the risks associated with increasing income inequality. The Chinese government has acknowledged these problems and has pledged to implement policies to increase the role of the market in the economy, boost innovation, make consumer spending the driving force of the economy, expand social safety net coverage, encourage the development of less-polluting industries (such as services), and crack down on official government corruption. The ability of the Chinese government to implement such

[123] Angus Maddison, Historical, Statistics of the World Economy: 1-2008 AD.
[124] OECD Economic Outlook, Volume 2012/1 http://www.oecd.org/berlin/50405107.pdf (accessed 04/05/2018).
[125] www.worldbank.org/en/country/china/overview (accessed 04/05/2018).
[126] The Soviet share spiked after World War II and then plateaued at around one-third of global military spending. The US share fluctuated around specific events. Germany's share of global military spending expanded and contracted over time, generally remaining between 10 and 15 percent of world spending on arms. Japan increased its share of global military spending throughout, but at a much slower pace than China. Angus Maddison, Historical, Statistics of the World Economy: 1-2008 AD.
[127] Angus Maddison, Historical Statistics for the World Economy: 1–2003 AD; World Bank, World Development Indicators Online; Correlates of War Project Trade Data, Version 2.01; Correlates of War Project, National Material Capabilities Dataset, Version 3.02; Stockholm International Peace Research Institute, Military Expenditure Database, 2013.
[128] www.ft.com/content/ad1e00e6-6149-11e2-957e-00144feab49a (accessed 04/05/2018).
[129] www.nytimes.com/2013/03/30/world/asia/cost-of-environmental-degradation-in-china-is-growing.html?_r=0 (accessed 04/05/2018).
[130] www.nytimes.com/2012/10/26/business/global/family-of-wen-jiabao-holds-a-hidden-fortune-in-china.html?pagewanted=all (accessed 04/05/2018).

demanding reforms will likely determine whether China can maintain relatively rapid economic growth rates and satisfy the needs of its vast population.

5.2 Developments during the 19th Chinese Communist Party Congress

In October 2017, the theme of the five-yearly 19th National Congress of the Communist Party of China was set out in President Xi Jinping's 65-page speech. He stressed that socialism with Chinese characteristics had crossed the threshold into a new historical era: 'Openness brings progress, while self-seclusion leaves one behind.' Xi told the world that China would not close its door to the world; but will only become more and more open:

> 'We will expand foreign trade, develop new models and new forms of trade, and turn China into a trader of quality. We will adopt policies to promote high-standard liberalization and facilitation of trade and investment; we will implement the system of pre-establishment national treatment plus a negative list across the board, significantly ease market access, further open the service sector, and protect the legitimate rights and interests of foreign investors. All businesses registered in China will be treated equally'.

With this two-pronged strategy of openness under a policy of socialism with Chinese characteristics, President Xi Jinping consolidated his control over the machinery of the Chinese government. He successfully altered the composition of the highest authority – the Politburo Standing Committee, the highest authority in the land, by circumventing the party cadre and enlisted an inner circle of six men with extensive connections to him personally to help him implement his agenda. Symbolically, Xi Jinping was also able to include what is called 'Xi Jinping Thought' within the Party Constitution. The highest-level Communist Party decision making has significantly departed from consensus building to a larger individual role for Xi. In this past, this shift has also entailed a cult of personality. Indeed, Xi Jinping has been General Secretary of the Party since 2012, the core leader as President of the People's Republic of China (PRC) he is '*core leader*', as well as being the Chairman of the Central Military Commission. President Xi is now thought to be the most powerful leader in China since Mao Zedong[131].

The foreign and trade policy making consequences of this are unclear. Further centralized decision making could result in more political will to introduce and implement a difficult agenda of economic reform while maintaining the ideology of Chinese socialism. Consolidation of power may also allow President Xi to make positive inroads into curbing corruption, internal factionalism, and not least, addressing the critical challenge of environmental degradation. These developments could alternatively result in continued heavy state involvement in the economy with more control over all institutions and citizens. And to the potential detriment of international trading relations both bilaterally and within the WTO, the 'decisive role of market forces' in the Chinese economy is no longer a priority. This contradicts with China's main foreign policy objective of obtaining Market Economy Status (MES). Beijing has long reasoned that China should be regarded as a 'market economy' from the end of 2016. This is because Article 15 of China's WTO accession agreement states that: 'Once China has established, under the national law of the importing WTO Member, that it is a market economy, the provisions of subparagraph (a) shall be terminated provided that the

[131] Xi Jinping's name and thought 'Socialism with Chinese characteristics for a new era' were enshrined in the Party Constitution, an honour only Mao and Deng Xiaoping have achieved.

importing Member's national law contains market economy criteria as of the date of accession. In any event, the provisions of subparagraph (a)(ii) shall expire 15 years after the date of accession'.

The main implication of Non-Market Economy Status (NME) status is that in anti-dumping proceedings it permits the use of other methodologies to determine the 'normal value' of the good, instead of using domestic prices to compute the dumping margin. In general, NME methodologies to calculate normal value have led to higher anti-dumping duties. China would therefore economically benefit from being recognized as having Market Economy Status (MES). However, the EU and US along with other WTO Members question China's reasoning that Section 15 allowing for NME methodology expired after 11 December 2016, resulting in a legal obligation to grant MES to China after that date. The prevailing position is that China must demonstrate it is a market economy before being recognized as such. Section 15 otherwise provides that China can be treated as a non-market economy (NME) in anti-dumping proceedings if Chinese firms cannot prove that they operate under market economy conditions.

Developments during the 19th Chinese Communist Party Congress therefore exhibited the many internal contradictions that China straddles – between a controlled economy and international trade liberalization; between party control and democracy and the rule of law. While President Xi consolidated CCP power amidst apparent political stability, no party dictatorship has lasted more than 75 years. The USSR survived 74 years, but was ultimately unable to maintain political power without sufficient economic growth. China's trade policies cannot be seen apart from national security issues.

5.3 The Chinese vision: One Belt/One Road

China's growing economic power and policy of openness has led it to become increasingly involved in global economic institutions, taking on economic commitments towards the rest of the world to underpin both its economic reform strategy and its foreign policy. China is projected to spend over USD 1 trillion on international initiatives such as the One-Belt, One Road (OBOR) project and the creation of two investment banks: the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB). President Xi Jinping introduced the term One Belt, One Road in May 2014 to describe a potential trading route. The belt aspires to connect China with Central Asia, South East Asia, South Asia, Russia, and Europe by land, while the maritime road would re-create the shipping routes that made China powerful in the past. Indeed, this 21st century Maritime Silk Road links China's coastal regions with Southeast and South Asia, the South Pacific, the Middle East, Europe and Eastern Africa.

For some the OBOR is a 21st century Chinese variant of the US Marshall Plan to rebuild war-torn Europe and Japan after World War Two and provide a buffer against the Soviet Union through global alliances between prosperous countries that supported the US economically and politically. Indeed, there are similarities. The OBOR initiative consists of infrastructure projects, railways, ports, and oil pipelines, and over 60 countries have expressed an interest in participating. Many of the existing OBOR participating countries are in fragile economies with poor infrastructure and an unskilled labour force. Some have natural geographic challenges such as weather conditions and scattered populations. China nevertheless plans to establish railway and telecom facilities to achieve connectivity. These countries comprise 55 per cent of world GNP, 70 per cent of the world's population, and 75 per cent of known energy reserves. The initiative is funded with USD 100 billion from the Asia Infrastructure Investment Bank (AIIB), which China successfully launched with 57 founding member states, and USD 40 billion from the Silk Road Fund[132].

The result of OBOR is a shift in geopolitics. Developing Eurasian infrastructure across many countries also requires many players. It is estimated that Asia's infrastructure requires over USD 1.7 trillion per year, far outstripping the OBOR project[133]. The OBOR region includes Japan Russia, India, and Turkey – all with their own different visions for the future of the continent. There is geopolitical concern over the deeper reasons for some Chinese investment decisions. These are particularly strong in India, where China's port construction is seen as an effort to encircle India with a 'string of pearls,' woven throughout the Indian Ocean. In Sri Lanka, the government handed over the strategic port of Hambantota to China on a 99-year lease in the face of sovereignty concerns domestically and abroad. Sri Lanka's financial relationship with China has deepened to replace the losses caused by Western sanctions imposed on human rights grounds during the civil war. As a result, Sri Lanka seeks to replay the USD 8 billion it owes to state-controlled Chinese firms through long leasing ports such as Hambantota, which is valued at

[132] Cai, P. Understanding China's Belt and Road Initiative. Lowy Institute. 2017.
[133] Asian Development Bank Newletter. 28/02/2017. www.adb.org/news/asia-infrastructure-needs-exceed-17-trillion-year-double-previous-estimates (accessed 14/05/2018).

USD 1.1 billion[134]. The OBOR draws countries and companies more tightly into China's sphere of influence, dispensing with the established international institutions that are ailing without US leadership.

In 2013, the Philippines invoked the dispute-settlement mechanism of the United Nations Convention on the Law of the Sea (UNCLOS) to use the International Tribunal for the Law of the Sea (ITLOS) to assess the legality of China's claims in the South China Sea including its capture of Scarborough Shoal in 2012. The tribunal has rejected Beijing's claim to historic rights to much of the South China Sea and held that China was in violation of international law by causing ecological damage, including through its island-building spree. Yet, in the absence of a mechanism to enforce this legally binding ruling, Beijing has so far ignored the Tribunal, damaging UNCLOS and increasing insecurities in Asia, particularly India.

China is clearly engaging in global commerce in a strategy that refashions not just the region, but the global economic order. Under the 16+1 project, China is expanding its cooperation with 11 EU Member States and 5 Balkan countries in the fields of investments, transport, finance, science, education and culture[135]. From among these, China has prioritized cooperation in high technologies, green technologies and infrastructure, announcing a EUR 10 billion investment fund for infrastructure projects in 2016. The EU institutions face a further political challenge if Chinese economic support fractures EU-cohesion in sensitive areas such as trade, foreign policy and human rights. The China-Africa relationship is also shifting the commercial and geopolitical axis of continent that has been perceived by many western governments as a source of instability, migration and terrorism. China, without colonial baggage, perceives a big opportunity to source precious metals, minerals and oil. Africa, on the other hand, provides a promising expanding market for Chinese manufacturers and construction companies.

To counter the emergence of a Chinese superpower, Japan has responded with a diplomatic strategy more competitive than cooperative in nature. Japan has already been building Asian infrastructure over the past decades, through financing vehicles like the ADB and the Japan International Cooperation Agency. Since the OBOR, Japan's investment activity has increased dramatically. Japan has launched the Partnership for Quality Infrastructure (PQI) to rival China's 'lend and build' policy, with a USD 110 billion budget. This sum is 10 percent higher than the initial capitalization of the Chinese led AIIB. Japan has also strengthened alliances with India, hosting joint military exercises and promoting an alternative Silk Road in the form of the Asia-Africa Growth Corridor. This serves India's foreign policy interests. India has been increasing its investments in Southeast Asia and Iran, but to compete with China, India needs Japan as much as Japan needs India.

For China, foreign investment presents a promising strategy to increase its geopolitical influence. China has not signed up to the OECD Arrangement maintaining sustainable export credit arrangements. Consequently, China can and does offer much more attractive investment conditions than most Western governments, leading to further concerns that China is not making investment decisions on a commercial basis, rather a broader geopolitical strategy of expanding influence overseas. The IMF has explicitly voice concerns over OBOR financing unneeded and unsustainable projects in countries with already heavy debt burdens, warning that 'ventures can also lead to a problematic increase in debt, potentially limiting other spending as debt service rises, and creating balance of payments challenges'[136].

There are many political challenges to the OBOR project externally and domestically. Changes in government in OBOR beneficiaries could involve unhospitable changes in policy orientation. Southeast Asia is also not immune to the rise of populism. Territorial disputes over the

[134] www.nytimes.com/2017/09/13/magazine/what-the-worlds-emptiest-international-airport-says-about-chinas-influence.html (accessed 14/05/2018).
[135] Plus China, the 16 countries are: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Montenegro, Poland, Romania, Serbia, Slovakia, Slovenia, Macedonia.
[136] Charles Clover. IMF's Lagarde warns China on Belt and Road debt. Financial Times. April 12th 2018.

South China Sea have increased anti-Chinese sentiment in neighbouring countries, including Vietnam, Indonesia and Malaysia, for instance. Many Chinese companies operating abroad are branding themselves as part of OBOR to receive support and preferential access from the Chinese government. Without economic, political and cultural sensitivity, China's efforts to push out the grand OBOR vision based on mutual respect and cooperation could be undermined. Internally, the OBOR project requires the different regions of China to use their comparative advantages to support the initiative and harness the benefits locally. However, OBOR is a top-down policy and there remains a lack of capacity within local governments to mobilise resources effectively, often competing rather than coordinating with other regions. Yet Chinese citizens will need to see the material benefits of supporting the OBOR initiative to sustain their national pride in the project, otherwise resentment will build against China's subsidising development projects in OBOR countries. Social unrest and dissatisfaction will be exacerbated if Chinese people do not themselves benefit, or perceive they are even losing out on foreign OBOR projects.

5.4 China's Contribution to the Davos Discussions

President Xi's contribution to the Davos 2017 championed globalisation with a social face, against the protectionist statements of President Trump's America First policy. In 2018 Mr Liu instead represented China as head of the Chinese Communist Party's top economic affairs steering group[137]. Liu presented a more technocratic version of the Chinese economic vision to Davos, while at home President Xi passed regulation in Beijing relating to the protecting investors, intellectual property and promoting Chinese culture under the OBOR project and China's global strategy. The Chinese state newspaper the People's Daily in January 2018, calling on China to seize the 'historic opportunity' to reshape the world order, as 'the world has never focused on China so much and needed China so much as it does now'[138].

China's increased diplomatic role at Davos in both 2017 and 2018 has strengthened the perception of China as an emerging economic and political force to be addressed. China's foreign policy statements and law reforms are tangible examples of China's expansion across the world both economically, financially and diplomatically. China is increasingly confident and assertive in international diplomacy, appearing as both major defender of the established international architecture and in stark defiance of other less convenient international rulings. Yet, the established world welcomed China's response to the US triggering Section 301 against Chinese alleged theft of US intellectual property, with the counterclaim that it was the US' unilateralist methods that are the unprecedented challenge to the multilateral trade system[139].

[137] https://www.weforum.org/agenda/2018/01/pursue-high-quality-development-work-together-for-global-economic-prosperity-and-stability (accessed 14/05/2018).
[138] http://www.scmp.com/news/china/policies-politics/article/2128711/make-china-great-again-communist-party-seeks-seize (accessed 14/05/2018).
[139] https://www.reuters.com/article/us-usa-trade-steel/u-s-commerce-department-proposes-hefty-import-curbs-on-steel-aluminum-idUSKCN1G01QB (accessed 14/05/2018).

Summary conclusions

Within three decades China has transformed its economy and experienced GDP growth at an average nearly 10 percent a year - the fastest sustained expansion by a major economy in history - and has lifted more than 800 million people out of poverty. China now vocally supports globalisation and multilateralism in various international fora, including the WTO and Davos. Yet China is also more confident in asserting its opposition to international rules, ignoring Maritime Law in pursuit of its foreign policy objectives. These assertions indicate the Chinese leadership believes that the 21st century offers huge opportunity for China to stake out a global leadership role[140].

The 19th Party Congress confirmed the consolidation of President Xi's life-long power over the CCP, along with the continued belief that the CCP is the only body able to lead the country and implement Xi's challenging agenda of economic reform, while still maintaining the ideology of Chinese socialism. Centralizing decision may also allow President Xi to make positive inroads into curbing corruption, internal factionalism, and addressing the critical challenge of environmental degradation. However, President Xi and the CCP can only maintain power and control if they provide stability, economic growth and employment to the citizens of China.

The issue of China's market economy status has not been resolved to China's satisfaction. Meanwhile the imposition of higher US tariffs and China's economic slowdown requires new strategies for ensuring economic growth to address regional and social inequalities. The One Belt One Road project is a significant strategy to both develop and connect China's internal economic and infrastructure, and utilize domestic over-capacity while driving economic growth regionally. However, it is fraught with risk both politically and socially. In the current international context, it has far reaching geopolitical and diplomatic repercussions.

Geopolitical consequences

China's liberalizing dynamic and rapid growth is both welcomed and feared. The proposed RCEP agreement brings together both China and India and addresses the withdrawal of US engagement with Asia Pacific. However, it focuses on economic and foreign policy without addressing the sustainable development concerns of major trading partners, including the EU. Many key countries fear China's policy of regional expansionism, which includes an ambitious regional development strategy in the OBOR initiative, as well as China's ability to establish the AIIB to help to underpin these financial plans, and rapidly rivaling other established financing institutions.

There is a mixed reaction of cooperation and competition towards the OBOR project for Eurasian connectivity, due to suspicion that OBOR is part of China's emergence as the next world power. Japan and India's collaboration is motivated by a desire to resist a future dominated by China. India is concerned by China's acquisition of key ports in the Indian Ocean and its economic involvement in Pakistan. Other big players on the continent - the EU, South Korea, Turkey, and Iran - view the Belt and Road with varying degrees of enthusiasm and caution because they have their own infrastructure initiatives, which cooperate and compete with the Belt and Road to varying degrees.

The 16+1 initiative has brought potential conflicting loyalties and power shifts within the EU Membership, as China extends its economic diplomacy towards individual Balkan and EU enlargement countries. The Central Asian republics are also caught between the competing interests of their Russian and Chinese

[140] http://www.scmp.com/news/china/policies-politics/article/2128711/make-china-great-again-communist-party-seeks-seize (accessed 14/05/2018).

neighbours, while the Association of Southeast Asian Nations (ASEAN) is hindered by the disunity of its members, both reliant and concerned about Chinese financial strength in the region.

China's support of multilateralism, the G20 and the WTO is an important counterweight against the current US withdrawal as leader of the post-World War Two international economic and geopolitical order. China's on-going support and international engagement fills an unstable power-vacuum both globally and regionally, despite the shifting geopolitical dynamics caused by its other foreign policy interactions. Yet on the other hand, China is an unknown quantity, extending its reach rapidly throughout every continent using investment and economic policy to support its foreign policy ambitions, undermining existing loyalties and structures.

6. Conclusions

Just three decades after the euphoric end of the Cold War and belief in the unstoppable spread of democracy and peace through trade and international cooperation, the future of the established post-World War Two liberal internationalist consensus is no longer assured. This report indicates that the prevailing geopolitical climate is unequivocally unstable. Politicians and policy makers would be naïve to ignore the surge in economic nationalism and backlash against globalisation, given the repercussions in the UK with Brexit and the US's strident America First policy. The rhetoric of sovereignty and anti-globalisation is communicated against a backdrop of disenchantment with social living standards and rising inequality throughout the world. This paradoxically eases the pressure on governments to identify effective domestic policies and address deteriorating social standards and labour market changes, yet further hinders the potential for deeper integration to promote future economic growth.

The departure of the US as leader of the established international architecture has weakened these institutions ability to produce effective cooperation among key governments on pressing global issues, such as the environment, financial stability and arms control. The G20 was unable to produce a unanimous declaration due to the US' withdrawal from the 2015 Paris Accord on Climate Change. The US has also refused to recognise the International Criminal Court's ten-year preliminary investigation into members of the US Central Intelligence Agency and US armed forces for torture and other serious crimes committed during its 'war on terror' following the 9/11 terrorist attack on the US. The US' foreign and diplomatic policy under Trump has also destabilised the international trading system, shifting the geopolitical balance of power in an unknown direction.

International trade policy is now firmly established within the toolkit of high foreign policy, as the US Administration seeks to impose unilateral tariff rates, renegotiate long standing trade agreements with neighbours Mexico and Canada, while withdrawing from the negotiation of the mega-regional Asia Pacific TPP and Transatlantic TTIP with the EU. Evidence-based economic policy has been jettisoned, for America First policy is now a blend of protectionism and economic nationalism, complemented by aggressive unilateralism in other areas of foreign policy. Historically, trade and political diplomacy were distinct areas of foreign policy, with the latter commanding more power and media headlines. Today trade and investment policy is no longer left to technocrats but intrinsically linked with foreign political affairs. This has made trade relations more susceptible to the vagaries of domestic and international politics, to the detriment of sound policy making.

China's growth in trade and investment has also been accompanied by a foreign policy strategy of expansionism through commerce. Recent centralisation and consolidation of political power has facilitated China's engagement in unprecedented levels of regional and international economic diplomacy. China is in the process of implementing a highly ambitious infrastructure and interconnectivity project in the One Belt One Road initiative, large scale infrastructure projects in Africa, Central and Eastern Europe, and Latin America, along with increased investment in dual purpose high-tech firms in Western Europe and the US. Although China has not yet developed its military capacity to match its economic might, it has been territorially aggressive in maritime waters and ignored international tribunals' recommendations to resolve such disputes. This has led other regional powers such as India and Japan, to formulate a response to counter rising Chinese presence economically and strategically in the region. Both have sought to compete rather than cooperate with China, increasing their own investment in regional projects and together building stronger military alliances and economic cooperation.

Amid a testing Brexit divorce, the EU is left facing the dual challenge of addressing the concerns of its diverse citizenships' declining living standards, while better communicating the benefits of openness in trade and foreign policy. In the popular perception, these are policies often seen as antithetical and politicians can harness this sentiment in opposition to integration, including the project of the EU itself. Yet the EU has the mandate to work towards deeper integration to harvest the widely-understood benefits of international trade agreements both within the WTO and in FTAs. It needs to identify more effective methods of channelling these benefits to better protect its citizens.

Meanwhile, the international community, but particularly the emerging large countries, have also shown little appetite for concluding the Doha Round in the WTO. To adds to the organization's woes, the US is further undermining the WTO's dispute settlement arm. Until now, most major trading nations have sought to continue to negotiate and conclude trade and investment agreements, ignoring or working around the recalcitrance of the US, in the case of Mexico, Canada and the EU. Yet this is the second-best option. Economic consensus typically advises against raising trade barriers, rather targeting domestic labour and social policy towards improving and safeguarding living standards more directly and effectively. However, 21th century foreign policy has blurred the boundaries between politics and trade to the extent that factual evidence is often lost to crowd pleasing rhetoric and short term political expediency.

International diplomacy at the beginning of the 21st century is conditioned by the prevailing uncertainty. It is no longer possible to take established international norms and guidelines for granted. The withdrawal of the US as underwriter of the post-World War Two architecture leaves the EU more vulnerable to attacks on its principles and achievements in improving environmental, social and labour standards of citizens throughout the world. All countries with trade links to the US are affected by the protectionist policies the current US administration is implementing unilaterally and selectively in disregard of existing agreements and treaties. This hinders the development of agreements and coalitions that can address global problems and peacefully resolve conflicts between and within nations. It may be in the short-term interests of the US to prevent the emergence of stronger rivals to its supremacy. However, the evidence strongly suggests that enlightened leadership can better represent its population's long-term interests through cooperative integration, not protectionist isolationism. In this way, sovereign states use international engagement to strengthen, not weaken, their ability to address people's needs.

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