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What Multinational Businesses Need To Know About The Future Of Global Trade

May 19th, 2016

OVERVIEW

While RTAs typically do not create shared political and legal institutions, as in the European Union, the desire to set up new cross-border regulatory agreements affects everything from intellectual and property rights to employment benefits, environmental protection, online commerce and product standards.

There are several major new regional agreements in the works:

- The Trans-Pacific Partnership (TPP) represents an RTA that would link 12 economies in the Asia-Pacific region. It is one of the largest and most controversial of such deals yet to be negotiated.
- The Regional Comprehensive Economic Partnership (RCEP) is considered an alternative to TPP, with negotiations led by China and involving ten members of the Association of Southeast Asian Nations (ASEAN) plus six other countries.
- In Latin America, the Pacific Alliance aims to unite Chile, Colombia, Mexico and Peru.
- The Tripartite Agreement will lift trade barriers between parties to the Common Market for Eastern and Southern Africa, the East African Community and South African Development Community.
- Meanwhile, the Transatlantic Trade and Investment Partnership (TTIP), still in negotiation, aims to promote trade and multilateral economic growth between the EU and the U.S.

Opportunities and Risks

The Organisation for Economic Cooperation and Development (OECD) has said that the benefits of RTAs could help build the case for stronger and more inclusive multilateral trade agreements between countries outside of a particular region. What is more, access to larger regional markets encourages foreign investment – thereby introducing new technology, increasing productivity, and creating new jobs.

Despite the benefits RTAs provide, there are legitimate concerns about the effects these agreements can have on local businesses and consumers. Opening domestic markets up to new sources of competition can endanger local manufacturers and undermine environmental principles. These issues are all too familiar to most residents of countries where cross-border agreements have been implemented. As such, protections for businesses, consumers, laborers, and the environment must be in place if RTAs are to fully succeed.

With so much debate over various trade agreements, it is critical for businesses to understand how new trade rules and regulations could change the way they operate in the global economy.

Kshitij Anand, Head of International Strategy at Aon Benfield, says that the primary benefit of RTAs is that they can foster growth in global trade by reducing cross-border trade friction and bringing greater stability and balance to businesses operating in multiple countries. This can help drive innovation, lower costs and produce more relevant products and services for end-customers. But he warns that implementing RTAs is not without risk.

"There's always a question about how these agreements are structured, and what social-political impacts they can result in," he says. "The fundamental problem is distribution of wealth," he says. "But wealth imbalances are really questions best addressed at the individual country level through fiscal policy."

RTAs can also present material risks to a company's bottom line if they are not managed properly. For multinationals doing business across borders, trade credits and asset-based financing are viewed as essential tools for facilitating international trade. But they can also increase exposure to suppliers, counterparties, and commercial trade debts.

According to Carol Murphy, Managing Director, Aon Risk Solutions, the need for multinational companies to protect themselves against credit and country risks is huge. "As companies enter new markets and extend their supply chains through trade agreements, managing credit and counterparty exposure has quickly become one of the top risks facing manufacturers, distributors, and wholesalers. The reasons for this are clear: accounts receivable is often the largest uninsured asset on a company's balance sheet – even though it is also a source for future revenues."

How can multinationals manage credit and counterparty risks while also supporting growth in new markets? Trade credit insurance can minimize exposure to credit losses. These products can help companies with operations in multiple countries protect themselves against commercial trade debts by insuring accounts receivable for nonpayment, insolvency, and country risk.

A New Focus On Standardizing Regulations

Trade barriers are already at historical lows. The goal of today's new generation of regional trade deals is to further harmonize rules covering employment, intellectual property and data.

"An RTA needs to be understood as more of a roadmap for improving the efficiency of trade," Anand says. "In the end it will improve the allocation of resources, including people — not just supply chains and skills." This is particularly important for supporting economic growth, because trade now accounts for some 30 percent of global GDP, he says.

The European Union is one example of how nations can set common trade and regulatory standards that go beyond specific products and services, according to the Council on Foreign Relations. The implementation of these agreements within the EU, however, has met some resistance. Trade-related concerns are currently among the most hotly debated issues in the lead-up to next month's Brexit referendum. Despite this and other ongoing challenges, the EU's regulatory coordination has made the process of allocating resources within its bounds easier than ever for businesses.

In Africa, the recently launched Tripartite Free Trade Area (TFTA) has opened up merchandise trade in 26 countries that make up 58 percent of the continent's economic activity, and trade in services will be addressed at a later phase. However, according to the Brookings Institution, true growth for Africa lies in creating a Continental Free Trade Area – a single market with shared regulations much like the EU.

Anand says that such intra-African agreements could be vital to fostering growth across the region, where trade currently only accounts for only 15-20 percent of GDP, versus around 50 percent in Asia and North America.

Moving Beyond Trade Regulations

Reduced tariffs, other things being equal, should lead to cheaper products for consumers, which has significant demand-side appeal. On the supply side, companies and certain workers can benefit from these deals, as people travelling across borders to do business are able to get visas faster and new temporary entry rights.

In this respect, the TPP and the TTIP are more advanced in that they aim to eliminate non-tariff barriers to trade. These include, among others, regulations around sanitation, e-commerce, government procurement, intellectual property, labor, the environment, energy, financial services and dispute settlement. In fact, there are so many non-tariff barriers to trade that Pascal Lamy, the former director-general of the WTO, estimates that 80 percent of these negotiations deal with regulatory convergence rather than tariff agreements.

Anand believes that a significant issue that RTAs could address is the challenge of "one billion people wanting to leave their country for economic reasons." If trade agreements lead to a more level playing field for businesses, the growth in employment opportunities they can foster domestically could reduce the pressure on their populations to migrate, he says. Moreover, RTAs can help lower the cost of transferring remittances from migrants working abroad to their families in developing countries, thereby increasing the economic impact of the money they send back. The importance of remittances as a source of income in developing countries is growing globally, but is most significant in East Asia and the Pacific.

TPP and TTIP both face significant opposition over concerns that their implementation could override existing national labor laws, benefit corporate interests at the expense of workers and consumers and increase income inequality. Both are focused on dismantling cross-border barriers in the services industry, which employs a growing number of workers in both developed and developing economies. In the U.S., for example, four out of five people have services-related jobs, while in the EU the services sector accounts for 60 percent of the economy.

Reviving Global Growth?

Increased global trade seems to go hand in hand with global growth. The Peterson Institute calculates that the U.S.-led TPP alone could yield the world $295 billion a year of widely shared benefits, mostly resulting from trade and investment creation over the next decade. The European Commission predicts the TTIP would help the region's economy grow between 0.3 and 0.5 percent, the equivalent of 550 euros per household every year.

But China's slowdown has led to a series of recent downgrades to global GDP growth and trade expectations. During 2015, the world saw the biggest contraction in global trade since the end of the financial crisis. Catherine Mann, Chief Economist for the OECD, recently called the weak outlook for trade growth in coming years "deeply concerning."

Access to new markets also brings increased competition. Unions fear the deals will put many firms out of business. For example, Japanese farmers worry that imports of U.S. and Australian rice will further decrease their share of the market. Likewise, American aviation and maritime workers have asked President Obama in an open letter to exclude transport services from the TTIP negotiations, as they believe liberalizing trade in their sector would lead to job losses and threaten air transport and security.

Adjusting to a changing trade environment is also not without costs to business, both in terms of meeting new regulatory standards and winning market share from new sources of competition. Some critics, like the European Centre for International Political Economy, have also expressed doubts about the benefits of RTAs to local economies. In Europe, small and medium enterprises make up 99 percent of the economy, and only one out of four would consider selling abroad – yet, if an RTA were implemented, they could still face its accompanying regulations.

The Challenges and Opportunities for Business

So should global businesses be pushing for more global rather than regional agreements, or are RTAs a good start towards a universal trading system?

The WTO has warned that the regulations and common standards RTAs aim for may end up overlapping, leading to competing regulations and increased protectionism.

But another approach put forward in a study written for the OECD suggests that reconciling regionalism and multilateralism might be achieved by identifying which sectors and industries are more efficiently organized at the global level, and which are best set at the regional or national level.

The majority of outcomes from RTAs are hard to predict, but further vertical specialization is one of the most likely. Already half of world trade in goods and services takes place in global value chains. Regional trade agreements could enable countries to continue specializing in activities where they have a competitive advantage.

While only time will tell who the winners and losers will be, business of all sizes and sectors should re-evaluate strategies to thrive in a new environment, and keep a close eye on how new regulations may affect them.

TALKING POINTS

"Non-tariff measures, such as burdensome regulatory requirements, bureaucratic hurdles and customs procedures, are... problematic... The service sector – which is playing a large and increasing role in the global economy – faces particularly extensive trade barriers, such as discriminatory regulation and restrictions on foreign investment" – Douglas Lippoldt & Tadeusz Bara-Slupski, HSBC

"The key question is how to make preferential deals more coherent with multilateral efforts. How can we achieve eventual multilateralization – preferably in the context of the World Trade Organization? How can we avoid trade fragmentation – the 'spaghetti bowl' of competing regimes and preferences?" – Christine Lagarde, IMF Managing Director

"The costs of these regional trade barriers fall disproportionately on the poor. Building better regional linkages means more than simply removing tariffs. It is about addressing real world constraints that paralyze the daily operations of ordinary producers and traders." – Jim Yong Kim, World Bank Group President

FURTHER READING

- What's at stake in the EU-US trade deal talks – The Guardian, May 12, 2016
- US and China skirmish as trade clash looms, Financial Times May 10, 2016
- Simmering for Decades, Anger About Trade Boils Over in '16 Election, New York Times, March 29, 2016
- U.S. Trade Ambassador Talks TPP's Impact on Africa, The Wall Street Journal, May 12, 2016
- The New Protectionism Will Hit Emerging Markets Right Where it Hurts, Says HSBC, Bloomberg, May 12, 2016

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