

Nationalism: The Rise of a Protectionist World

Slow economic growth and weak job creation have spurred a wave of nationalism and protectionism that has thrown up new challenges to business

Even three years ago, it would have been impossible to predict the rapid rise of nationalism and protectionism that has taken place across the globe. Country after country is working to frame regulation and policy that encourages the domestic production of goods and services, and which somehow stems the natural flow of trade and talent across borders. Driving this trend is a decade of low growth following the GFC, slowing job-creation, and a shifting economic centre of gravity from West to East. In both Europe and America, it is now plainly visible that not everyone has equally enjoyed the benefits of free trade. Coupled with the lingering effect of the GFC, and, especially, the disruptive influence of technology – wiping out jobs, and contributing to longer-term wage stagnation – it has fuelled disenchantment on a massive scale. Politicians like Donald Trump in America, and the anti-EU parties on the Continent, have seized on this raw nerve, and for them, trade is an easy target that resonate well with the electorate. Just as seriously, there are now moves underway to link foreign investment with national security. America's CFIUS review system is the best known – and appears to be directed mainly at China – but even the UK and the European Commission are starting to get into the act. Going forward, they are expected to put up a lot of red tape that will, at the very least, make inbound investment more cumbersome. On a slightly cheerier note, while protectionism itself is gaining currency, Europe's economic prospects have brightened in the last year, and some of the hysteria around populism

has receded.

Geopolitics will remain a serious challenge. Russia's relations with the West are at multi-decade lows, and after some initial enthusiasm from Donald Trump, it is now amply clear, including from Russian actions in Syria and the UK, that repairing these ties will be extremely difficult. China's continuing rise is also a destabilising factor, but recent peace overtures on the Korean peninsula are an additional source of uncertainty. While this effort could succeed, it could also end very badly. Meanwhile, the Middle East remains in deep turmoil, with a resurgent Iran at the heart of a deep schism that is developing there. Closer home, India's near-abroad is expected, at least for the next 12-18 months, to be relatively quiet, particularly with China occupied with multiple issues of its own.

AMERICA: SEPARATING SIGNAL FROM NOISE...

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policies have found resonance within his political base, and his approval ratings have been inching up. However, it may be a mistake to see him as either a protectionist or an isolationist. Rather, he may be just be a businessman who is slowly learning how to govern. His worldview is probably more practical than ideological – and his primary focus is on 'getting the deal done' while considering a wide range of options. Moreover, he has been consistently pro-business, and his tax reforms, for example, will be a shot in the arm for the small businesses that truly drive the US economy. Deregulation has received very little press coverage, but it has proceeded relentlessly.

Viewed from this perspective, the President's approach to many issues, including trade, may be more tactical than strategic. Plainly, Mr Trump believes that there are serious imbalances in the bilateral trade relationship with China, and also that there are issues with its IPR regime. Very likely, however, his posturing is

a way of extracting concessions from China. Similarly, while playing up issues that appeal to his supporters, like immigration, or the wall with Mexico, he has made a big commitment to increased defence spending. Nor has he been particularly 'isolationist' in his response to the situation in Syria or North Korea. For foreign governments, including India's, there may even be opportunities to be seized in his very personalised approach to foreign policy. For example, his strong connection to Mr Modi, and what he sees as important commonalities between the two leaders – as well as the two countries – could serve to further Indian interests.

Short-term pain

Regardless of any longer-term realignments that may be taking place in the global system (see box below), in the short term, there are significant risks of a widespread trade war. When the US announced across-the-board, 25% tariff on steel and aluminium (though exempting 'friendly' nations at the last minute), China retaliated, targeting certain auto components as well as a variety of US agricultural products – including berries, fruit, grain, wine and pork – that are produced in regions that voted for Mr Trump. Worryingly, the US administration has recently dusted off provisions in US trade law that have not been used since the WTO's dispute-settlement mechanism came into force. These include a national security



Undermining the WTO – or reviving it?

An institution like the WTO is rules-based, but it is also members-driven. The present overreliance on domestic law and other ‘alternative channels’ may reflect a lack of confidence in the institution itself – and could end up irreparably damaging its foundations. On the other hand, it may end up mobilising more conversations around the advantages of free trade, while also acknowledging the shortcomings of the current system. Eventually, this might yield better outcomes, making the global trading system more sustainable for everyone.

Today, countries like China are bringing cases before the WTO’s dispute resolution system. If these get resolved successfully, it would bolster confidence in the WTO’s effectiveness. The current situation will also drive ‘middle powers’ like

India, Brazil and Germany to work more closely, stitching together solutions that not only hold the system together, but also take it forward. (In the interim, regional FTAs, based around strong mutual interests, will continue to gather steam as an alternative.) Finally, there is a good possibility that the world’s current hegemon – America – will not entirely abandon the rules-based order. It may have problems with specific countries, but so far, it has not done anything ‘system-breaking’. Moreover, domestic political realignments might occur, with the Democrats, for instance, possibly replacing the Republicans as America’s ‘free trade party’ as the working class defects to the ‘other side’ while free-traders remain. This would help balance out some of today’s protectionist pressures.

provision; safeguard provisions that have been applied to items like solar panels and large washing machines; and Section 301, which allows the government to direct tariffs against imports from countries deemed to have discriminatory IP practices. Together, these will potentially impact USD 50 billion worth of Chinese imports – so China promptly announced retaliatory tariffs on American goods of an equal value. The US measures are subject to a 60-day period of public notice and comment, which means they can only take effect – if at all – this June. It remains to be seen whether America follows through on these provisions, or instead simply uses them to bring China to the table.

A trade war would be expensive and painful, impacting consumers through higher prices, rendering manufacturers less competitive, and disrupting the entire ecosystem around manufacturing – not just in America and China, but any country that supplies intermediary components to either country. Looking beyond tariffs, there is a serious issue around rising, often selective, enforcement at the border. Increasingly, shipments – particularly from certain countries – are subject

to detailed audits and investigations, imposing huge costs on business, and making it more challenging to get their products to market.

The fallout on India

Mr Trump may ‘like’ India, but this will not prevent him from imposing tariffs and other measures on the country. Going back to the Clinton years, previous US administrations have been willing to overlook trade disputes in the interests of the broader strategic relationship. Under Mr Trump, this has changed, and the new President sees little contradiction

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India will work hard to ensure that trade-related issues do not impact the strategic Indo-US relationship



in having the trade relationship move in an entirely different direction from the strategic one. At the moment, the worry is that India will suffer 'collateral damage' from a US-China face-off, particularly given that America is unhappy with some of India's trade practices. The hope, though, is that the 'battle' with China will distract attention away from India.

India runs a trade surplus of USD 20-30 billion with the US, which is large, but not unduly so. The bigger issue is what the US regards as India's very high tariffs on industrial goods. Mr Trump has taken particular issue with the duties imposed on Harley Davidson motorcycles (which to his mind is a proxy for industrial tariffs as a whole), but new price controls on stents are also an irritant. India has done a fair amount of damage control, but it may not be enough. India has since cut motorcycle tariffs by 50%, and also changed the head of the National Pharmaceutical Pricing Authority. Further, it is taking a second look at healthcare pricing structures, particularly for stents and other medical devices. Certain US imports, including chicken parts, have been freed up, and GAIL has settled, a pricing dispute with two US companies. However, the Office of the US Trade Representative has its own agenda, and multiple parties are lobbying it to tack their own issues onto the discussion with India. Export subsidies – an area where India's WTO-compliance has been questioned – could be a big sticking point. There is also disagreement around a gamut of regulatory matters, including

the recent data localisation policy (which companies like Visa and MasterCard have opposed); new standards on electronics imports (aimed largely at China, but affecting some US firms as well); and a recent High Court ruling that prevents bio-tech products like Bt Cotton from being patented in India.

All considered, India's short-term aim would be to try and prevent trade disputes from impacting the strategic relationship with the US. In parallel, it may start to work more closely with China, which has been seeking to make common cause over trade issues, including through the RCEP framework. A number of FTAs are also being revived: discussions about the India-EU one have started, as have those related to Israel and Australia; the existing FTAs with Japan and South Korea might be reworked; and one with the UK established, though possibly only after Brexit takes place*. Internally, the Indian government will need to work to evolve a common, trade-friendly mindset across various ministries, particularly given how India's export-GDP ratios have fallen in the last few years.

SINO-INDIAN TIES: IN A HOLDING PATTERN?

The next 12-18 months will be period of consolidation for India. Having driven through a number of critical structural reforms, including GST, the government will be keen to allow things to settle at home, and to avoid any major surprises on the foreign-policy front. As a share of GDP, defence spending is now down to 1962 levels, and Mr Modi is plainly hoping that his diplomats will act as India's 'guardians of the border.' (As a fiscal hawk, he is holding the deficit in check by easing off on military spending, purchasing only those items that are urgently required.) So far, this strategy seems to be working. The issues around India's smaller neighbours remain manageable, and Pakistan is too consumed by its internal problems to pose a serious challenge. Most importantly, China feels compelled to mend fences – or at least to maintain a temporary truce – with India. This explains the recent, very unusual summit between Xi Jinping and Mr Modi in Wuhan.

**At the moment, the only certainty around Brexit is that the UK will formally leave the EU on March 29, 2019, from when it will have a year's breathing space to work out the details of its exit. Currently, the government is divided between leaving both the customs union and the single market, and staying on in the customs union. (The latter would better suit third parties like India in terms of the rules-of-origin processes.) A major sticking point is Ireland: leaving the customs union would mean either having a border within the island (which would imperil the peace Good Friday peace settlement), or creating one at sea, dividing the island from Britain. Both options are politically fraught.*

The world's most dangerous region

Effectively, much of the Middle East is already at war, and the key battle unfolding there pits Iran against Israel. Right from Lebanon to the border with Afghanistan, Iran is now the region's dominant power. Iraq has collapsed, the IS has largely been destroyed, and the two other possible 'contenders' for dominance – Turkey and Saudi Arabia – are internally weak. Iran's strategy is to 'Lebanonise' as many countries as possible, splitting them along tribal and religious lines, setting up militia, and capturing for outsized influence for their large Shia minorities. However, the only way a Persian-Shia 'Caliphate' operating out of Tehran can hope to dominate Sunni Arabs is by rallying everyone around a common enemy: Israel.

Realising this, Saudi Arabia and the Emirates have been working hard to normalise relations with Israel, thereby neutralising the 'Israel card'. They are also arming themselves heavily. Meanwhile, the Saudis have unleashed a spate of reforms that could – if they go wrong – cause this deeply conservative country to implode in the next decade. Meanwhile, Israel, which remains the region's strongest military power, is preparing to fight a three-front war against the Hezbollah, Hamas, and Syria-based militia, all backed by Iran. For its part, Iran will continue to instigate the Israelis with continuous missile strikes and low-intensity ground attacks. Whether this triggers a full-scale war remains to be seen.

Over the last two years, India and China have repeatedly clashed, over everything from the Dalai Lama's succession, to the Belt and Road Initiative, or BRI. (Angering the Chinese no end, India's campaign against the BRI has found unexpected support, including from Japan, the US, and the EU.) These tensions culminated a few months ago in the Doklam stand-off, but the situation has changed dramatically since then.

Lately, China has had a number of setbacks, including its trade problems with America, a fast-evolving situation in North Korea, and internal security issues, including the radicalisation of Uyghurs in Xinjiang province – which is itself tied to conditions in Afghanistan, where Russia and Iran are now backing Pakistan's support of the Taliban. Additionally, having got himself appointed as China's 'leader for life', Mr Xi is in the process not only of consolidating his hold on power – internal repression is at levels unseen in decades – but also of driving through major structural reforms. In the broader context of a difficult and unstable geopolitical environment, the issues with India will need to be put on the back-burner. Both sides seem to have agreed, therefore, to maintain a temporary truce,

China and India have repeatedly clashed in the last few years, but today, for various reasons, China feels compelled to mend fences – or at least to maintain a temporary truce – with India



while not necessarily moving forward on their fundamental, long-standing problems. At Doklam itself, there has been a massive arms build-up, but this is unlikely to flare up into something bigger. On the contrary, as with other 'middle powers' India and China may even end up supporting each other, including to maintain a rules-based global trading system. ■

This article is based on discussions between Pramit Pal Chaudhuri, Foreign Editor, HT, and Radha Ahluwalia, Managing Director of IMA India, in the lead-up to the Doing Business Globally conclaves hosted by IMA India and Baker McKenzie in Mumbai and Bangalore in April 2018