Wither WTO…and EU?

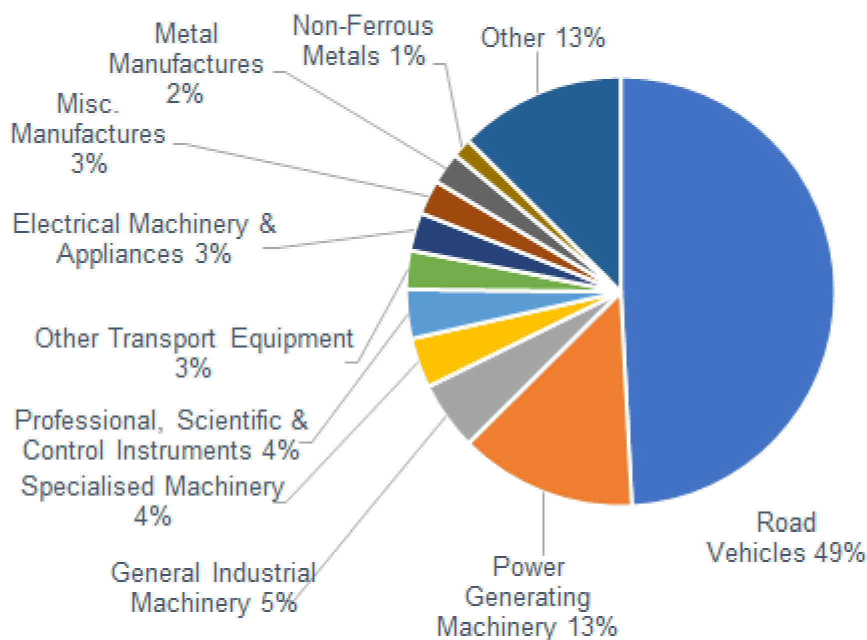
By Professor Paul Forrest, West Midlands Economic Forum

By the time Britain finally exits the EU, or indeed seeks to reverse the process, the architecture of international trade and economy may have changed dramatically. Not only is the framework of the EU coming under acute pressure, but the unilateral action by the US administration to impose sanctions on steel and aluminium imports from Mexico, Canada, and the EU, threatens to jeopardise the long-established integrity of the World Trade Organisation (WTO).

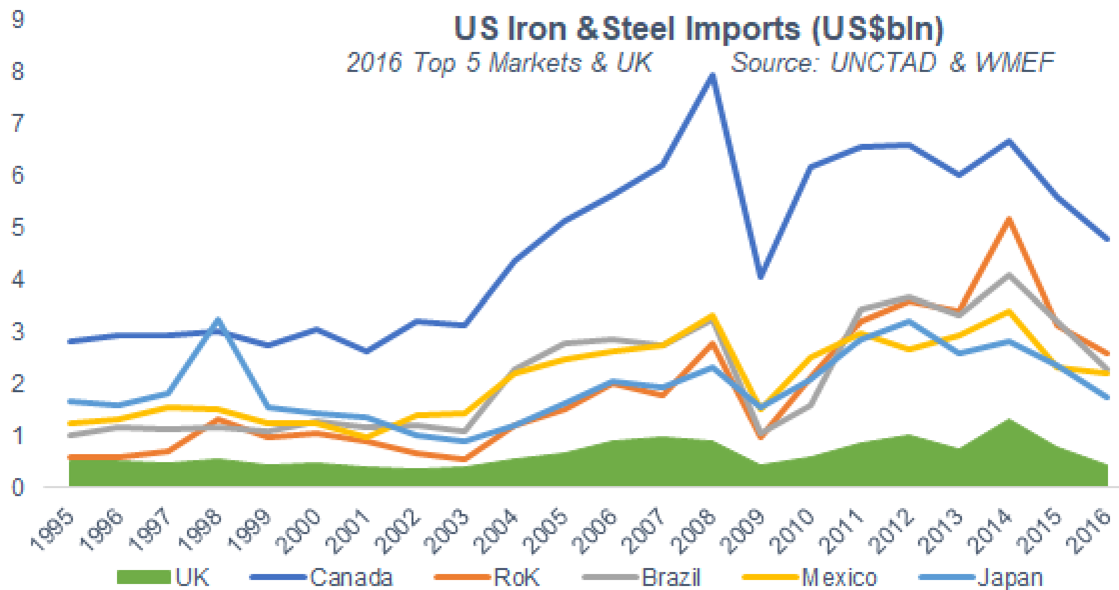
Although the US has stated that the measures are a national security response, this has failed to assuage the concerns of both its NAFTA partners or the EU. Indeed, the response has generally been one of disbelief with many political leaders responding either immediately announcing retaliatory duties, or that they will soon do so. These are likely to be made against export products that the EU, for instance, perceives will have the maximum political impact. Moreover, the increased costs for US manufacturers as a result of the duties of 25% and 10% on steel and aluminium respectively, could have an immediate negative impact on output. Furthermore, given the specialised, high-purity of much of these exports to the US, it may prove difficult to source US-produced equivalent supply in such a short space of time.

Following this first salvo, the expected retaliatory sanctions could descend into a spiral of reciprocal and counter-reciprocal actions of increasing intensity, and one that may prove difficult to stop. The US action would appear to violate accepted WTO practice and precedent for resolving trade disputes. The US administration advocacy of Fair Trade, however that is structured, and rejection of Free Trade (although that is in itself a misnomer) could seriously undermine the preferred international system of trade, fostered under GATT and consolidated under its successor the WTO, developed over the past 70 years. What emerges from this debacle remains to be seen, and the wider ramifications for other international co-operation bodies such as the IMF and World Bank and not least NATO remains to be seen. Next week’s G7 summit in La Malbaie, Quebec could prove particularly interesting.

In 2017, iron and steel made up less than 1% of Midlands' exports to the USA, with the largest export to the USA being road vehicles, making up 49% of all merchandise exports. However, many of the export products to the USA involve steel as an input, including the automotive industry, so disruption in the steel market could have an impact.



In addition, although iron and steel exports to the USA are a relatively small proportion of total Midlands exports, the USA was still the destination for 10% of iron and steel exports in 2017, making it the third largest market for Midlands' iron and steel after Ireland and Germany. Reduction in demand from this market, as well as the likely fall in global prices as the supply of steel increases will impact on Midlands steel producers.



Overall, the UK was the 17th largest exporter of iron and steel into the USA in 2016, exporting US$0.45m worth of iron and steel to America in that year.

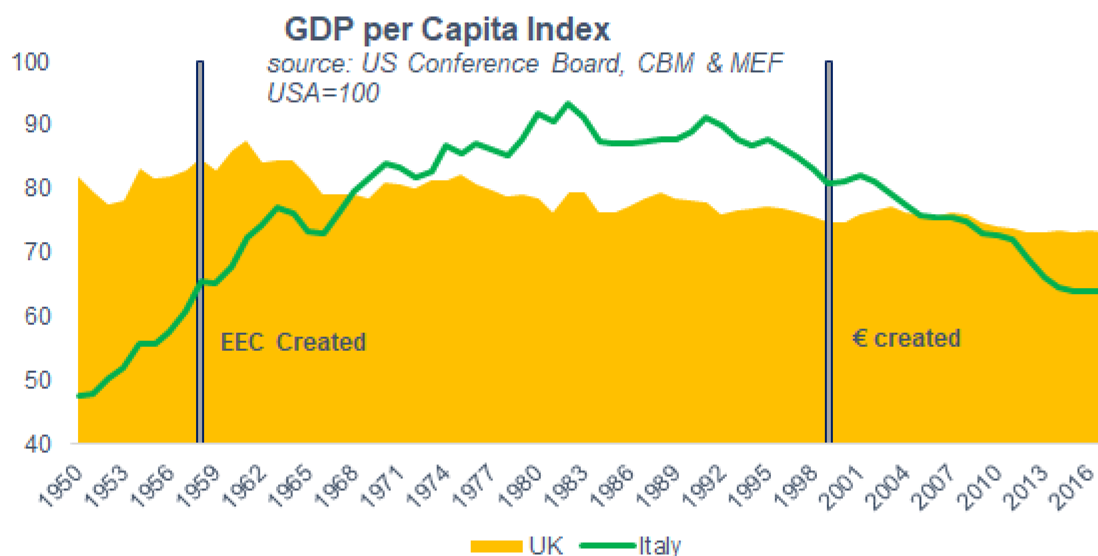
In terms exposure to the steel sector in the Midlands, which is only just recovering from its previous crisis, there are an estimated 216, 925 people employed in the steel supply chain, in around 10, 150 enterprises.

Estimated Midlands Steel Supply Chain		
		Source: Nomis & WMEF
	Employment (2016)	**Enterprises (2017)**
Basic Metals Production	5,660	365
Metal Fabrication	74,685	6,640
Machinery Manufacture	43,175	1,945
Motor Vehicles	62,250	880
Other Transport Equipment	31,155	320
Total Steel Supply Chain	216,925	10,150
Total	4,728,000	390,840

Whether the EU will remain the safe haven it is perceived to be by many on the remain side, is itself a moot question. Widespread continental discontent with the EU has now found voice within the government of what will soon be the third largest EU economy, with the installation of an Italian coalition government comprising the far-

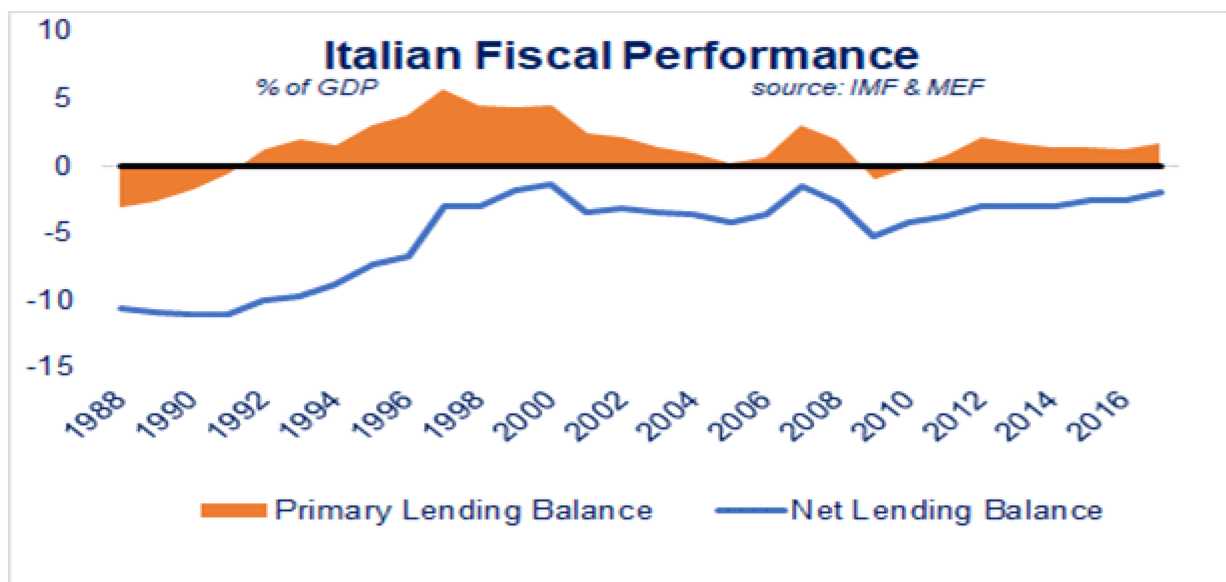
right League and the anti-establishment Five Star Movement. The essentially regional base of each, the League with strongholds in the north, and Five Star in the south, reflects the fractured nature of the Italian economy, with the industrial dynamism of Lombardy contrasting with the agriculturally and tourism orientated Sicily for instance, represented in the distinct political objectives of both. However, what draws them together, despite their kaleidoscope of policy differences, is their rejection of past political practice and increasing antipathy toward the EU. After much wrangling, the hiatus between the election and the government's formation was the longest in post-war history. After the clumsy intervention of the supposedly titular President, the coalition is expected to unveil an accommodative fiscal policy as well as macro-economic strategy designed to stimulated growth – a marked contrast to the austerity programme advocated by the European Council.

Alone among Euro members, over the past 20 years of membership of the currency bloc, Italy's GDP per capita, measured in purchasing power parity has stagnated in real terms. According to IMF data when Italy entered the Euro, GDP per capita was $34,802 in 1999, and by 2017 had eased to $34,741. Whereas in Germany over the same period, and according to the same measure it increased by over a quarter, and in France and the Netherlands by 15% and 20% respectively.

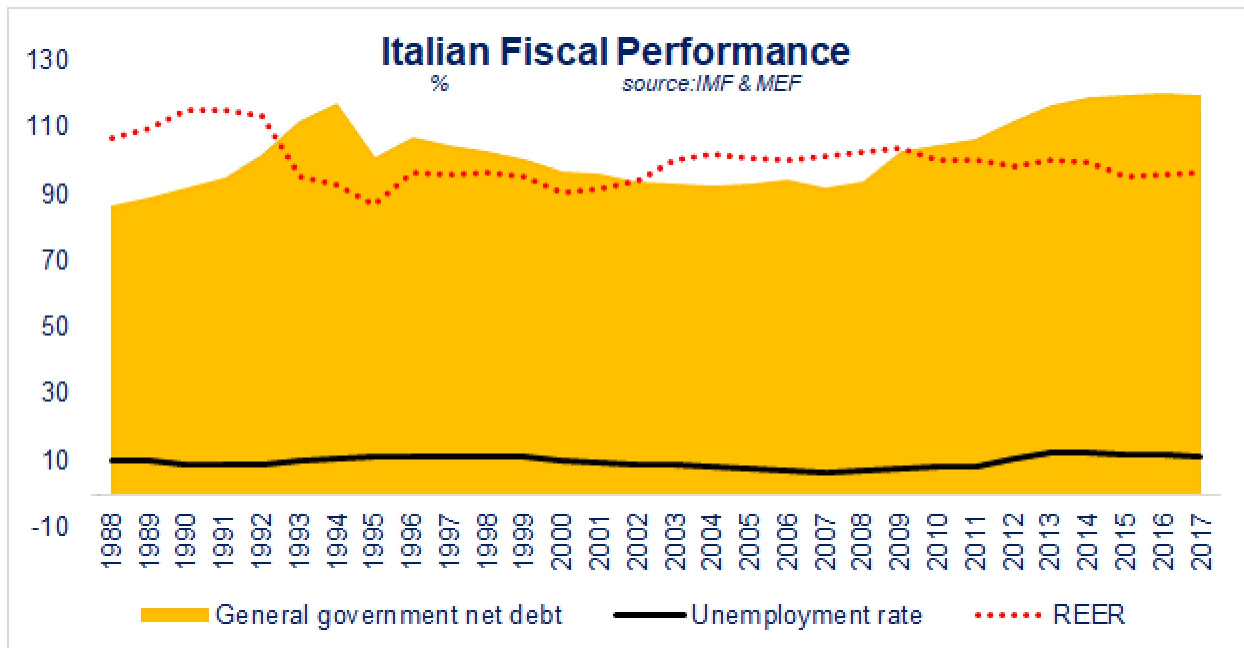


Italy's productivity growth after it joined the EEC was robust, substantially narrowing the differential with the US in GDP per capita

term. However, membership of the Euro, and it seems before that the Exchange Rate Mechanism has had a debilitating impact on performance. By 2017, GDP per capita was some 64% of the US equivalent, peak performance being in 1982 when Italy achieved 94%. Membership is not simply the cause, but by joining the Euro this removed the traditional policy option favoured by Italian monetary authorities, that of successive Lira devaluations to sustain competitiveness. In contrast to a number of other Euro members the Italian polity was not able to improve competitiveness by fiscal adjustment. This despite the fact that the country has been running a primary (excluding interest payments) fiscal surplus for much of the past two decades.



The overall stock of debt, according to Maastricht criteria is however problematic, and perhaps a drag of performance.



What was once described as the Golden Banana, an arc of manufacturing and technological excellence, one of the most productive and innovative globally in the last 50 year, stretching from Valencia up to Barcelona through southern France via Marseille to Turin and Milan appears are have suffered by the imposition of the EU austerity programme. This has been reflected by the strength of support of the League in northern Italy, of the Front National in southern France and of the secessionist movement in Catalonia, apparently largely fuelled by dissatisfaction with the capacity of national governments to deliver economic goods or their failure to assuage regional aspirations or to provide effective access to key EU and Non-EU markets.

In Spain, the support of Catalan and Basque political parties, of varying hues, for the no-confidence vote in the Rajoy's Popular Party government and his replacement the Sanchez-led Socialist Party, is indicative that centrifugal forces at play across the EU. The Catalonia issue is likely to prove a pivotal issue that will determine the longevity of the new Spanish coalition governments, if indeed Sanchez can form one, given the widely differing ideological and policy perspective of the potential component partners. Fresh elections can be anticipated in Italy and Spain by the end of the year.

Whilst one swallow does not make a summer, the decision by Roman Abramovich to cancel the £1 billion development of Chelsea's stadium, following visa issues, may reflect a major shift in Russian

investment attitudes towards Britain and may force a major reappraisal of the government’s current FDI strategy.

1st June 2018

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