



Asia trade needs to get ready for the impact of Brexit and the US undoing of NAFTA

Brexit and a potential US withdrawal from the North American Free Trade Agreement could have large ripple effects on trade in Asia, helping some countries and hurting others, according to prominent trade economist Ben Shepherd. What's more, Asia's tightly integrated supply chains could be disrupted in the aftermath.

Shepherd told a seminar at the Asian Development Bank Institute that although the UK's withdrawal from the European Union and a potential US pullout from NAFTA seem remote from Asia, any effects on trade flows will be keenly felt in the region.

The trading system is a great example of a global, closed, integrated network, meaning if you change something somewhere, you change everything everywhere. These distant trade policy changes are important for Asia, even though we are geographically distant from that going on.

Shepherd said the effect on trade won't be the same across Asia, with both winners and losers emerging from the changes and the effects generally stronger in South Asia than in East Asia.

Positives and negatives, there is this reorientation, some countries lose exports as a result of Brexit and the US pulling out of NAFTA, others gain exports through this dynamic of reorienting demand away from partners towards more distant trading partners.

He said that while both Brexit and the potential US withdrawal from NAFTA will hit Asia, it is Brexit that is likely to hit the hardest. That's because Brexit could disrupt Asian supply chains more than a U.S. pullout from NAFTA.

One, I think slightly counterfactual result, is that even though the UK is a considerably smaller market compared to the U.S. and also a more distant

market than the US, the trade orientation brought about by Brexit is actually larger than what is brought about by the US exiting NAFTA.

Politicians in the UK and in the US would like to see any shift in trade flows benefit their own internal markets, but Shepherd said it is inevitable that some demand will be filled by other trade partners. Cambodia, Bangladesh, and Sri Lanka are examples of countries that would likely benefit from this trade adjustment, he said.

The biggest effect on Asia though, is the potential damage a shift in trade flows could do to tightly integrated global supply chains.

Not only does withdrawal from the EU and NAFTA reorient trade flows all over the world, it potentially does something to break up supply chains, and I think it's actually this second half that's more important and it's probably this second half that's going to catch on in Asia where people care about supply chains and value chains. We find that Brexit tends to prove a bit of disintegration in Asia supply chains, okay? It's not some sort of huge seismic effect, but it's an effect that's definitely there. We see that some of the integration of global value chains that have taken place in Asia and Asian value trades, dies as a result of Brexit, so a bit of integration decreases.

While the effects may be small, Shepherd suggested even such a small disruption could be enough to alter existing business models.

Remember that these are business models running on tiny margins and tiny inventories, it's all very, very precisely calibrated. If that is the case, is this at the tipping point where suddenly these things are disintegrating and we're undoing a lot of the good work we've been doing?

That was Ben Shepherd, principal at Developing Trade Consultants, speaking on the impact of US withdrawal from NAFTA and the UK's exit from the European Union trade blocs, at the Asian Development Bank Institute in Tokyo.

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