Briefing Paper

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Global trade in 2023

What’s driving reglobalization?

Summary

- Global trade will continue to face multiple challenges in 2023 as inflation and high interest rates, debt distress and geopolitical frictions weigh on many economies. The downside risks to the global economy and international trade are significant, ranging from an escalation of Russia’s war on Ukraine to deepening tensions between the US and China.
- ‘Reglobalization’ – rather than deglobalization – best describes the current pattern of economic integration and fracturing across different economies and sectors. Globalization is far from finished, but will increasingly emphasize greater regional links and the formation of economic blocs for sensitive and strategically important sectors. Comprehensive decoupling from China is neither achievable nor desirable for the G7 and like-minded partners.
- The supply-chain disruptions of 2020–22 will continue to ease. Given that extreme weather events are the biggest threat to global production networks, supply-chain resilience and diversification efforts will persist, with added impetus to act on ‘greening’ trade.
- The future of trade is closely linked to the transition to green and digital economies. As climate ambitions and technological leadership are intertwined with industrial policy objectives, concerns about unfair trade practices and protectionism are coming to a head not just as regards China, but also among the US, the EU and like-minded partners.
- With major breakthroughs at the World Trade Organization unlikely in 2023, limited progress can be expected in some bilateral, regional and sectoral agreements. Meanwhile, efforts to avoid further trade fragmentation will progress more readily under Japan’s G7 presidency than under India’s G20 presidency.

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Introduction

This briefing paper analyses the outlook for global trade in 2023, and examines the structural forces shaping global trade and globalization more broadly.

It argues that 'reglobalization' – rather than deglobalization – best describes the current and likely future pattern of economic integration and fracturing across different economies and sectors. Trade policy has an important role to play in underpinning the positive aspects of a reglobalized world and in balancing geopolitical competition and cooperation, not just through coordinated efforts to strengthen supply-chain resilience, but also in harnessing the twin transitions to green and digital economies.

The paper draws on insights from expert roundtable discussions and a high-level speaker series under the umbrella of the Chatham House Global Trade Policy Forum. It is the first of a new annual series that will highlight some of the major global trade trends and prospects for the year(s) ahead.

What to expect in 2023

With the global economy slowing, and several economies already in or heading into recession in 2023, there is a risk that economic stagnation will be prolonged and have lasting implications for global trade. At the same time, recent positive data from major economies suggests that prospects for global growth may improve.

Notwithstanding the recent fall in gas prices, the high costs of energy stemming from Russia's war on Ukraine will continue to subdue spending by households and raise costs for businesses – especially those based in Europe – thus dampening demand for imports. Higher interest rates – and particularly the effects of tighter monetary policy in the US – will impact global trade via two channels. First, higher interest rates reduce domestic borrowing and spending and thus import demand. Second, with the US Federal Reserve expected to continue monetary tightening (albeit raising interest rates at a slower pace than in 2022) and with the dollar remaining a 'safe haven' amid economic and geopolitical uncertainty, the dollar will likely remain strong in 2023 but will edge back from its 2022 high. Given that 40 per cent of global merchandise exports are invoiced in US dollars (a figure much larger than the share of exports, at around 10 per cent, that are destined for the US), the presence of a strong dollar in effect 'exports' inflation to the rest of the global economy.[1] The implications of this will be particularly challenging for low- and middle-income countries, which will incur even higher costs for imports of food and fertilizers and face growing risks of debt distress.

At the same time, how China pursues the easing of COVID-19 restrictions and tackles recurring outbreaks will have ripple effects for production networks internationally. Weaker global demand will likely stifle the outlook for Chinese

1 Boz, E. et al. (2022), 'Patterns of invoicing currency in global trade: New evidence', *Journal of International Economics*, 136, https://doi.org/10.1016/j.jinteco.2022.103604; Gopinath, G. and Gourinchas, P.-O. (2022), 'How Countries Should Respond to the Strong Dollar', IMF Blog, 14 October 2022, https://www.imf.org/en/Blogs/Articles/2022/10/14/how-countries-should-respond-to-the-strong-dollar.

exports and accelerate China's efforts towards reducing the role of foreign trade in the economy. But if domestic consumption is boosted following the end of China's 'zero-COVID' policy, growth in the world's second largest economy could rebound in 2023.

Deepening tensions between the US and China, as well as an escalation of the Russia–Ukraine war, pose downside risks to the global economy and trade. The former include intensified US controls on exports to China and investment screening – particularly as regards sensitive technologies – and geopolitical risks related to Taiwan.

Transatlantic ties have come under pressure concerning how best to deal with China, and more recently also over the US's green energy and industrial policy. The US's Inflation Reduction Act – which provides for investment of an unprecedented $369 billion in American climate and clean energy efforts – has sparked concerns in Europe about industrial competitiveness. Nonetheless, as discussed later in this paper, closer US–EU cooperation will likely prevail over any friction in 2023.

Despite the generally gloomy outlook, there is potentially one more positive shift: the supply-chain disruptions of 2020–22 will likely ease this year. Port congestions in the US and China have mostly been resolved, and shipping costs have come down to pre-pandemic levels.[2] However, supply chains – particularly for critical goods – are still subject to numerous risks, including trends towards 'decoupling' as well as potential disruptions stemming from natural and human-caused disasters. Extreme weather events are perhaps the biggest threat for supply chains in 2023 and the coming years.[3]

Deepening tensions between the US and China, as well as an escalation of the Russia–Ukraine war, pose downside risks to the global economy and trade.

The World Trade Organization (WTO) anticipates that global merchandise trade volumes will grow by 1 per cent in 2023.[4] This is significantly below the volume of merchandise trade growth during 2022, estimated at 3.5 per cent. There will be regional differences. Both the Middle East and Africa will likely see small declines in merchandise exports in 2023 (following record export growth in 2022), but these regions' demand for merchandise imports is expected to remain strong, with import volumes projected to grow by 5.7 per cent in each.[5]

2 DHL (2022), 'Ocean Freight Market Update – November 2022', 31 October 2022, https://www.dhl.com/content/dam/dhl/global/dhl-global-forwarding/documents/pdf/glo-dgf-ocean-market-update.pdf; Milne, R. and Wembridge, M. (2022), 'Maersk warns global trade indicators at 'dark red' on looming recession', *Financial Times*, 2 November 2022, https://www.ft.com/content/08767ba5-ec3e-49f3-a710-64a5ff753b90.
3 Luman, R. and Fechner, I. (2022), 'Trade outlook 2023: slow steaming in rough waters', ING THINK, 14 October 2022, https://think.ing.com/articles/trade-outlook-slow-steaming-in-rough-waters-what-to-expect-in-2023.
4 World Trade Organization (2022), 'Trade growth to slow sharply in 2023 as global economy faces strong headwinds', press release, 5 October 2022, https://www.wto.org/english/news_e/pres22_e/pr909_e.pdf.
5 Ibid.

Russia's overall trade in goods and services fell sharply in 2022. While exports by Russia are expected to continue to decline in 2023, the country's imports could be higher than in 2022.[6] As Western countries have worked to isolate the Russian economy, Russia is increasingly trading with India and China.[7] Meanwhile, Europe is replacing Russian energy with liquefied natural gas (LNG) from the US – although at a higher cost and in volumes that do not offset the entire shortfall. The current upheavals in global energy trade will have lasting implications, potentially hastening the transition to a more sustainable energy system.[8]

The WTO does not forecast trade in services. But given the multiple pressures on the global economy, the uptick in trade for services that was seen during 2022 – particularly the rebound in travel and transport services following the easing of pandemic-related restrictions in many countries – is unlikely to continue in 2023. However, the long-term future of trade is likely to be in services and not goods. The advance of digital technologies and the digitalization of trade processes have profound implications for the 'scale, scope and speed of trade'.[9] New technologies also increasingly blur the distinction between goods and services.

The structural forces shaping global trade and globalization in 2023 and beyond are examined in the remainder of this paper.

The new era of reglobalization

While 'deglobalization', 'decoupling' and 'economic fragmentation' dominate the current public discourse on trade, globalization is far from finished.

According to one common narrative, globalization peaked in 2008 and was then dealt a fatal blow by the global financial crisis. The trade environment deteriorated further with the rise of populism – exemplified in 2016 by the UK's Brexit vote and the election of Donald Trump as US president. Disruptions to supply chains then followed as a result of the US–China trade war, the COVID-19 pandemic and Russia's invasion of Ukraine. But while there are many truths within this narrative, it also contains several misconceptions and oversimplifications.

First, 2008 was not the year of 'peak globalization'. The merchandise trade ratio for the world's largest trading nations either peaked before 2008 (in the case of China) or after (the US and Japan), or has stagnated rather than peaked (the EU).[10]

6 European Council and Council of the European Union (2022), 'Infographic - Impact of sanctions on the Russian economy', 23 November 2022, https://www.consilium.europa.eu/en/infographics/impact-sanctions-russian-economy.
7 Adnett, P. (2022), 'Russia pivots to trade with China and India as western sanctions hit economy', Institute of Export and International Trade, 9 November 2022, https://www.export.org.uk/news/622614/Russia-pivots-to-trade-with-China-and-India-as-western-sanctions-hit-economy.htm.
8 International Energy Agency (2022), 'World Energy Outlook 2022 shows the global energy crisis can be a historic turning point towards a cleaner and more secure future', 27 October 2022, https://www.iea.org/news/world-energy-outlook-2022-shows-the-global-energy-crisis-can-be-a-historic-turning-point-towards-a-cleaner-and-more-secure-future.
9 Organisation for Economic Co-operation and Development (undated), 'The impact of digitalisation on trade', https://www.oecd.org/trade/topics/digital-trade.
10 Baldwin, R. (2022), 'The peak globalisation myth: Part 1', VoxEU column, Centre for Economic Policy Research, 31 August 2022, https://cepr.org/voxeu/columns/peak-globalisation-myth-part-1.

A second misconception stems from a fixation on trade in goods that largely ignores trade in services. Although trade in goods clearly outweighs trade in services in terms of value, the ratio of trade in services to world output has – in contrast to that for merchandise trade – continued to rise. And third, notwithstanding supply-chain volatility, global production networks and trade have been resilient, even through the pandemic.[11]

Multiple measures of globalization – from global trade in goods and services to the flow of investment, people and data across borders – indicate that globalization has not been dealt a mortal blow. However, the forces that have driven the current wave of globalization, which started in the 1990s, are wearing out. Notably, for example, China's approach to integration within the global economy has shifted: the country that focused on strong trade growth is now emphasizing domestic growth and economic self-sufficiency under its 'dual circulation' strategy.[12]

The likely trajectory for trade and investment ties with China is perhaps the most critical factor determining the future of globalization.

Moreover, the rapid pace of technological developments helped lower transportation and communications costs, and thus facilitated the growth of trade in the 1990s and 2000s. But this effect has diminished over time. And the way governments think about technology has also become conflated with national security concerns and competition between the West and China.

So the reality is more complex than the narrative around 'deglobalization' suggests: 'reglobalization' – a term that has been used by WTO director-general Ngozi Okonjo-Iweala[13] – better describes the current and likely future trends of greater economic integration that is taking place in some areas alongside the fracturing of the global economy in others. The likely trajectory for trade and investment ties with China is perhaps the most critical factor determining the future of globalization.

Managing competition and cooperation with China

One of the most striking features of international trade and investment over the last 20 years has been China's continued economic rise and integration in the global economy, which has gone hand in hand with it becoming one of the world's leading trading nations. Before 2001 (the year China joined the WTO), 80 per cent

11 Schneider-Petsinger, M. (2021), *US and European strategies for resilient supply chains*, Research Paper, London: Royal Institute of International Affairs, https://www.chathamhouse.org/2021/09/us-and-european-strategies-resilient-supply-chains.
12 The concept of 'dual circulation' was first introduced by the Chinese government in 2020. It emphasizes a greater focus on China's domestic market and self-dependence ('internal circulation') along with a reduced reliance on the country's export-oriented development strategy ('external circulation').
13 World Trade Organization (2022), 'DG Okonjo-Iweala: "We need multilateral cooperation and solidarity more than ever"', speech, 22 November 2022, https://www.wto.org/english/news_e/spno_e/spno32_e.htm.

of countries had a larger volume of merchandise trade with the US than with China.[14] By 2018, only 30 per cent of countries traded more with the US than they did with China.[15] China overtook the US as the EU's most important trading partner for goods in 2020, although when services are taken into account the US remains the EU's largest trading partner by far.[16]

A debate that figures prominently at the moment concerns whether the world economy is fracturing into two major economic blocs: one made up of the advanced democracies (i.e. the US-dominated G7 plus other like-minded democracies); and the other being a China-aligned bloc that includes Russia.[17] There are signs that geopolitical considerations and national security concerns are playing a greater role in economic policy decisions, for example in the form of export controls and investment screening.[18] But a division of the world into two economic blocs is not as straightforward as commonly suggested. Several developments call into question how solid such blocs would be. For example, despite Brussels' broad political alignment with the US, the EU's trade with China has continued to rise. And (especially with ties with Russia now cut) Germany is determined to keep trading with China, even though it has adopted a tougher and less commercially-driven approach to relations with Beijing in recent years.

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Furthermore, there is no strong evidence of decoupling in aggregate trade and investment data.[19] According to survey findings published by the American Chamber of Commerce in Shanghai in October 2022, just 17 per cent of firms said they were considering moving operations or footprint out of China in the next one to three years.[20] While this is up from 10 per cent in 2021, the majority of businesses surveyed intend keeping their footprint and 30 per cent of companies

14 Rajah, R. and Leng, A. (undated), 'The US-China Trade War: Who Dominates Global Trade?', Lowy Institute, https://interactives.lowyinstitute.org/charts/china-us-trade-dominance/us-china-competition.
15 Ibid.
16 Total EU trade in goods and services with the US reached €1.2 trillion in 2021. In the same year, the combined value of EU imports from and exports to China stood at €800 billion. See European Commission (undated), 'EU trade relations with the United States. Facts, figures and latest developments', https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/united-states_en; European Commission (undated), 'EU trade relations with China. Facts, figures and latest developments', https://policy.trade.ec.europa.eu/eu-trade-relationships-country-and-region/countries-and-regions/china_en.
17 See, for example, Capital Economics (2022), *Spotlight 2022: The Fracturing of the Global Economy*, https://www.capitaleconomics.com/key-issues/spotlight-2022. Beattie, A. (2022), 'No, the global economy is not breaking into geopolitical blocs', *Financial Times*, 13 July 2022, https://www.ft.com/content/d50ebceb-3179-4410-84ab-e8285cbcb644.
18 In recent years, lawmakers in the US and Europe have tightened their respective policies and processes for export controls and for screening inbound foreign direct investment. This shift in approach was largely prompted by concerns over China's activities to acquire sensitive technologies and regarding the country's broader industrial policies, and reinforced more recently by Russia's invasion of Ukraine. See, for example, European Commission (2022), 'EU investment screening and export control rules effectively safeguard EU security', press release, 2 September 2022, https://ec.europa.eu/commission/presscorner/detail/en/ip_22_5286.
19 Bown, C. P. (2022), 'Four years into the trade war, are the US and China decoupling?', Peterson Institute for International Economics, 20 October 2022, https://www.piie.com/blogs/realtime-economics/four-years-trade-war-are-us-and-china-decoupling. Cheng, E. (2022), 'American companies increasingly look outside of China after Covid', CNBC, 27 October 2022, https://www.cnbc.com/2022/10/28/american-companies-increasingly-look-outside-of-china-after-covid.html.
20 American Chamber of Commerce in Shanghai (2022), 'AmCham Shanghai Releases 2022 China Business Report', 28 October 2022, https://www.amcham-shanghai.org/en/article/amcham-shanghai-releases-2022-china-business-report.

are increasing investment. The principal reasons given for reducing investment in China in the short term were the country's (then) zero-COVID policy and related shutdowns as well as travel restrictions. The primary reason cited for increasing investment is the growth potential of the Chinese market.[21] But amid ongoing tensions in US–China relations, and broader concerns over China's use of coercive economic tactics (as seen against countries such as Australia and Lithuania),[22] the overall long-term business outlook is very challenging.

The G7 will likely put greater emphasis on efforts to strengthen supply-chain resilience and reduce economic dependence on China. But full decoupling from China is unlikely.

Many countries – particularly those in the Asia-Pacific – do not want to 'choose sides' between a US-dominated G7 bloc and a China-aligned bloc.[23] Given the sheer size of the Chinese economy, and existing economic links, many Asia-Pacific countries need and want to trade with China despite concerns around Beijing's military and economic coercion tactics.

What all of this means for the future of global trade is less than clear. In theory, reduced trade between the G7- and China-aligned blocs could make way for increased trade *within* these blocs. But given the current lack of appetite (especially in the US) to strike new free-trade agreements (FTAs), it is unlikely that members of the G7-centred bloc will aim for an ambitious and deep integration of their markets in the near future. Instead, the G7-aligned bloc will likely focus on joint concerns regarding China's non-market economy policies and practices (such as subsidies, operation of state-owned enterprises, and forced technology transfer) as well as human rights issues such as forced labour in supply chains.

Moreover, the G7 will likely put greater emphasis on efforts to strengthen supply-chain resilience and reduce economic dependence on China. The EU's embrace of 'open strategic autonomy'[24] resembles the 'friendshoring'[25] aspirations of the US. Given Japan's emphasis on economic security,[26] this will likely be an

21 Ibid.
22 China has taken punitive measures to restrict imports from Australia and Lithuania after the former called for an independent international inquiry into the origins of the COVID-19 pandemic and the latter allowed Taiwan to open a de facto embassy in the country. See Milne, R. and Hille, K. (2022), 'Lithuania tests the EU's resolve on Chinese economic coercion', *Financial Times*, 13 February 2022, https://www.ft.com/content/77adb343-6196-4d66-af84-995c05db7b6c; Herscovitch, B. (2021), 'Australia's Answer to China's Coercive Challenge', London: Royal United Services Institute for Defence and Security Studies (RUSI), 18 August 2021, https://rusi.org/explore-our-research/publications/commentary/australias-answer-chinas-coercive-challenge.
23 Schneider-Petsinger, M. et al. (2022), *Transatlantic cooperation on the Indo-Pacific: European and US priorities, partners and platforms*, Briefing Paper, London: Royal Institute of International Affairs, https://doi.org/10.55317/9781784135423.
24 While not fully defined, the EU describes 'open strategic autonomy' as meaning an open, sustainable and assertive trade policy. See European Commission (2021), 'An Open, Sustainable and Assertive Trade Policy – Open Strategic Autonomy', https://trade.ec.europa.eu/doclib/docs/2021/february/tradoc_159434.pdf.
25 Tan, S.-L. (2022), 'Yellen says the U.S. and its allies should use 'friend-shoring' to give supply chains a boost', CNBC, 19 July 2022, https://www.cnbc.com/2022/07/19/us-treasury-secretary-on-supply-chain-resilience-use-friend-shoring.html.
26 Smith, S. A. (2022), 'Japan Turns Its Attention to Economic Security', Council on Foreign Relations, Asia Unbound blog, 16 May 2022, https://www.cfr.org/blog/japan-turns-its-attention-economic-security.

area for cooperation under the Japanese presidency of the G7 in 2023. The G7 members will almost certainly focus on greater diversification of critical supply chains, underpinned by open and predictable trade rules. Complete decoupling and reshoring from China would not produce the desired results in terms of increased supply-chain resilience. Instead, the concentration of production at home would replace international vulnerabilities with more local ones, including those linked to natural disasters or outbreaks of diseases.

In short, full decoupling from China is unlikely. A more likely scenario involves different categories of trade and investment with varying degrees of (dis-)integration.[27] The first category concerns strategic sectors that are vital to national security (such as arms and advanced technologies), for which trade and investment will continue to be off limits. The second involves sensitive sectors (such as critical raw materials and technologies, as well as pharmaceuticals), for which supply chains will increasingly be shifted away from China. For most other economic sectors, trade and investment ties will likely continue to operate as before – i.e. without many restrictions and in accordance with existing WTO law and other bilateral/regional agreements in place. But even trade and investment flows concerning non-critical or non-sensitive sectors (such as furniture, appliances, electronics and toys) are likely to come under increased scrutiny in light of concerns about China's human rights violations (for example, US legislation banning cotton from China's Xinjiang region) and/or concerns that Beijing could exploit economic links through coercive tactics (such as punitive trade measures against Australian meat, wine and timber). In other words, supply-chain diversification will likely be seen as beneficial for all sectors.

Meanwhile, the transatlantic partners will need to continue to manage frictions in their own bilateral relationship and differences over how best to deal with China. For example, the EU and the US have the ambition to conclude negotiations on global steel and aluminium arrangements by the end of October 2023.[28] This is part of an agreement, reached in October 2021, to replace the US Section 232 tariffs that were introduced by the Trump administration in the name of national security. The aim for global arrangements also reflects the desire of both the US and the EU to confront the threats of climate change (by addressing the high carbon intensity of steel and aluminium manufacturing) and tackle global market distortions (which imply China's overcapacity in the sectors, without naming the country directly).

One important question for the US and the EU, as well as like-minded partners, remains how best to engage with China in the WTO. Considering the difference in economic systems between market economies and China's model, as well as clear geopolitical fault lines, the future of the world trade system is not about convergence but coexistence.

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27 This section draws on work published in Jain, A. and Kroenig, M., with Schneider-Petsinger, M. (2022), *A Democratic Trade Partnership: Ally Shoring to Counter Coercion and Secure Supply Chains*, Atlantic Council, https://www.atlanticcouncil.org/wp-content/uploads/2022/07/A-Democratic-Trade-Partnership-Ally-Shoring-to-Counter-Coercion-and-Secure-Supply-Chains.pdf.
28 European Commission (2021), 'Steel and Aluminium: EU-US Joint Statement', 31 October 2021, https://trade.ec.europa.eu/doclib/docs/2021/october/tradoc_159890.pdf.

Shifting from multilateral towards regional/sectoral frameworks

Ahead of the WTO's 13th ministerial conference, scheduled for February 2024, the organization's 164 members will focus on the need to deliver tangible outcomes concerning food and energy security, climate change and development challenges.[29]

At the 12th ministerial conference, in June 2022, WTO members also agreed to work on reforming the organization – including addressing long-standing issues related to 'special and differential treatment' for developing countries, and improving transparency of trade measures introduced by members. Perhaps most importantly – and ambitiously – they expressed their intention to address concerns regarding the WTO's dispute settlement system and work towards securing a fully functioning system by 2024.[30] The US's ongoing block on appointments to the WTO Appellate Body has meant that the body has been in paralysis since December 2019. With the next US presidential election scheduled for November 2024, it is highly unlikely that this issue will be resolved anytime soon.[31]

The WTO's function as a negotiation forum has also faced multiple challenges, and negotiations of multilateral agreements involving all members have stalled. Meanwhile, most action has been among like-minded subgroups of WTO members in plurilateral initiatives,[32] such as the e-commerce negotiations discussed in greater detail later in this paper. In the absence of any breakthrough in multilateral talks, bilateral and regional FTAs have also proliferated over the last two decades.

But more recently, the US in particular seems to have abandoned the route of bilateral and regional FTAs, and is now focusing on non-traditional and flexible cooperation mechanisms such as the Indo-Pacific Economic Framework for Prosperity (IPEF) or the US–EU Trade and Technology Council (TTC).[33]

This US turn away from decades of trade policy reflects the view that FTAs in many developed countries have reached the point of diminishing economic returns. FTAs are primarily designed to reduce tariffs, which have mostly been eliminated or reduced over the years, and thus the scope for further tariff reductions is limited. Trade liberalization has increasingly focused on tackling non-tariff measures (such as rules, regulations and standards), and has therefore come under greater public scrutiny. Combined with concerns around distributional effects and job

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29 World Trade Organization (2022), 'DG Okonjo-Iweala: During these difficult times, the WTO "cannot afford to stand aside"', 20 December 2022, https://www.wto.org/english/news_e/news22_e/dgno_20dec22_e.htm.
30 World Trade Organization (2022), 'MC12 Outcome Document', Ministerial Conference Twelfth Session, 22 June 2022, https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/MIN22/24.pdf&Open=True.
31 For more detail on the US block on appointments to the Appellate Body, see Schneider-Petsinger, M. (2020), *Reforming the World Trade Organization: Prospects for Transatlantic Cooperation and the Global Trade System*, Research Paper, London: Royal Institute of International Affairs, https://www.chathamhouse.org/2020/09/reforming-world-trade-organization.
32 In the terminology of trade policy, 'multilateral' refers to all members of the WTO, while 'plurilateral' indicates that only some members are involved.
33 In contrast to the traditional model of FTAs, which focuses on negotiations (of at times sensitive issues) and an agreed text as the outcome, recently established forums like the TTC prioritize the process of cooperation and coordination. See Schneider-Petsinger, M. (2022), *Strengthening US–EU cooperation on trade and technology*, Briefing Paper, London: Royal Institute of International Affairs, https://doi.org/10.55317/9781784135546.

losses, FTAs have become domestically unpopular in the US and in Europe.[34] At the same time, specific issues with regard to supply-chain disruptions and the growing importance of regulatory aspects concerning digital economies are not readily covered in the negotiation forums that FTAs represent. Rather, these issues can be more easily addressed in cooperation forums, including the new cluster of platforms like the IPEF or the TTC.

But while the US has seemingly turned its back on new bilateral and regional FTAs, the UK and the EU are still keen to advance this agenda. The UK is in the process of acceding to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). Talks have advanced more slowly than anticipated because of issues related to market access, and also because the UK is the first country to accede. Since this accession process will set the precedent for future negotiations with countries wanting to join the agreement, it is being pursued with extreme care – and even more so since China and Taiwan have also expressed an interest in joining the CPTPP.

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The move to deepen regional cooperation across Asia and the Pacific via the CPTPP and the Regional Comprehensive Economic Partnership (RCEP) in recent years[35] can support inclusive and sustainable growth. However, it also entails complexity in navigating overlapping (and sometimes contradictory) provisions within these mega-regional and other existing bilateral arrangements. Countries outside the region are interested in strengthening trade and investment ties with the Asia-Pacific because it is the world's fastest-growing economic region and is projected to be home to two-thirds of the global middle class by 2030.[36]

Meanwhile, the stalled trade deal between the EU and Mercosur states – Argentina, Brazil, Paraguay and Uruguay – stands a good chance of moving forward in 2023. While both sides reached a political agreement in 2019, trade protection and environmental issues have prevented ratification. The return to office of Luiz Inácio Lula da Silva as Brazil's president may now accelerate the ratification process on the EU side. Moreover, Sweden and Spain each hold the EU presidency in 2023 (Sweden in January–June, and Spain in July–December); the former's traditionally pro-free-trade stance and the latter's close ties with Latin America add a favourable dynamic to the EU–Mercosur deal.

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34 Notably, however, despite negative views towards specific FTAs, Americans are more likely to see foreign trade as an opportunity rather than a threat to the economy. See, for example, Jones, J. M. (2022), 'U.S. Views of Foreign Trade Nearly Back to Pre-Trump Levels', Gallup, 10 March 2022, https://news.gallup.com/poll/390614/views-foreign-trade-nearly-back-pre-trump-levels.aspx.
35 RCEP entered into force in 2022 and has 15 member countries, including China. The CPTPP is a trade agreement between 11 countries following the US withdrawal from the more ambitious Trans-Pacific Partnership (TPP). Seven countries are members of both RCEP and the CPTPP.
36 Tanzi, A. (2021), 'More Than 1 Billion Asians Will Join Global Middle Class by 2030', Bloomberg, 2 September 2021, https://www.bloomberg.com/news/articles/2021-09-02/more-than-1-billion-asians-will-join-global-middle-class-by-2030?leadSource=uverify%20wall.

Regional integration in Africa has received a boost via the entry into force of the African Continental Free Trade Area (AfCFTA) in 2019.[37] With Africa's population expected to double by 2050, the continent will play an increasing role in global trade – beyond the current focus on its large quantity of natural resources. The EU and the US want to increase trade and investment with Africa, with a focus on green energy and digital technologies; part of current engagement efforts is to provide a counterweight to China's engagement in Africa.

Trade and the transition to green and digital economies

The future of trade is both green and digital. A number of trade policy tools and models for managing cooperation and competition are emerging, a trend that will likely accelerate during 2023.

Transatlantic tensions have flared over the US's Inflation Reduction Act, signed into law by President Joe Biden in August 2022. These centre on the EU's concerns – also shared by countries including the UK, Japan and South Korea – over US tax credits that favour North American-made electric vehicles and subsidies for renewables that the US's trade partners see as unfair and discriminatory. While the EU has welcomed the act's potential contribution to tackling climate change, the legislation has led to an outcry in the bloc over fears that the incentives offered could redirect investment from the EU to the US – especially at a time when lower energy prices in the US also lure European investors. The European Commission has threatened to bring the dispute to the WTO (although this is increasingly unlikely) and announced a Green Deal Industrial Plan, which includes temporarily adapting EU state aid rules in response to the US subsidies.[38] The two sides are trying to resolve the issues via the US–EU Task Force on the Inflation Reduction Act.[39] But while some compromises are likely that could widen the scope for EU firms to benefit from the act's provisions, its overall thrust will not change. Avoiding a transatlantic trade war over climate is desirable for both sides in order to accelerate the low carbon transition and to reduce dependence on China-heavy supply chains for critical minerals and batteries used in electric vehicles.

Under a provisional deal reached by European co-legislators in December 2022,[40] the EU's Carbon Border Adjustment Mechanism (CBAM) will enter into force on 1 October 2023. Initially, the mechanism will only cover products, from a limited

37 In 2018, 44 members of the African Union (AU) signed the agreement that established the AfCFTA. Trading under the AfCFTA started in 2021. As at December 2022, 54 members of the AU had signed the AfCFTA agreement. For more information, see https://au-afcfta.org/about.
38 European Commission (2022), 'Special Address by President von der Leyen at the World Economic Forum', speech, 17 January 2023, https://ec.europa.eu/commission/presscorner/detail/en/speech_23_232.
39 European Commission (2022), 'Launch of the US-EU Task Force on the Inflation Reduction Act', 26 October 2022, https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_22_6402.
40 On 13 December 2022, the Council and the European Parliament reached a provisional political agreement on CBAM, which builds on a proposal from the European Commission. The agreement is subject to approval by the Council and the Parliament. See European Parliament (2022), 'Deal reached on new carbon leakage instrument to raise global climate ambition', press release, 13 December 2022, https://www.europarl.europa.eu/news/en/press-room/20221212IPR64509/deal-reached-on-new-carbon-leakage-instrument-to-raise-global-climate-ambition.

number of carbon-intensive sectors, that are deemed to be at higher risk of carbon leakage (such as iron and steel, cement, fertilizers, aluminium, electricity and hydrogen, as well as some precursors and a limited number of downstream products). After a three-year transition phase during which only reporting obligations apply, CBAM will start in 2026 and become fully operational by 2034, requiring EU importers to purchase certificates equivalent to the EU carbon price.[41] While CBAM is stated to be designed in full compliance with WTO rules, the question of compatibility remains and will also come down to how the mechanism is implemented. Moreover, political sensitivities persist, including concerns about the impact on developing countries.[42] Beyond CBAM, other parts of the EU's Green Deal (for example its new regulation on deforestation-free supply chains[43]) have the potential to reshape global trade.

Climate action is still not very high on Japan's political agenda, but a focus on energy security could stand a better chance of success under its G7 presidency in 2023.

The idea of a 'Climate Club' gained traction in 2022, when Germany used its G7 presidency to propose the creation of an alliance of countries committed to stronger action on climate change. In December, G7 members endorsed the terms of reference and agreed 'to support further development of the Climate Club towards a full launch in 2023, ideally by COP28'.[44] With Japan holding the G7 presidency in 2023, however, the Climate Club is unlikely to remain a focal point for the grouping. Climate action is still not very high on Tokyo's political agenda, but a focus on energy security could stand a better chance of success under Japan's G7 presidency. Meanwhile, the Climate Club discussions will be shifted to an interim secretariat (to be hosted by the Organisation for Economic Co-operation and Development, in tandem with the International Energy Agency) and a Climate Club Task Force (chaired by Germany and a yet-to-be-determined Climate Club member from beyond the G7).[45]

As already noted, the WTO is a key forum for advancing discussions at the nexus of trade and sustainability. Three separate environmental initiatives were launched in 2021 to make progress on plastics pollution, reform of fossil fuel subsidies, and

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41 Also in December 2022, European co-legislators reached an agreement on the reform of the EU Emissions Trading System (ETS). CBAM will be phased in at the same rate as free allowances in the ETS will be phased out. See European Parliament (2022), 'Climate change: Deal on a more ambitious Emissions Trading System (ETS)', press release, 18 December 2022, https://www.europarl.europa.eu/news/en/press-room/20221212IPR64527/climate-change-deal-on-a-more-ambitious-emissions-trading-system-ets.
42 See, for example, Weko, S. (2022), 'The future for global trade in a changing climate', Chatham House Expert Comment, 5 December 2022, https://www.chathamhouse.org/2022/12/future-global-trade-changing-climate.
43 European Commission (2022), 'Green Deal: EU agrees law to fight global deforestation and forest degradation driven by EU production and consumption', press release, 6 December 2022, https://ec.europa.eu/commission/presscorner/detail/en/ip_22_7444.
44 G7 Germany (2022), 'Terms of Reference for the Climate Club', 12 December 2022, https://www.bundesregierung.de/resource/blob/974430/2153140/a04dde2adecf0ddd38cb9829a99c322d/2022-12-12-g7-erklaerung-data.pdf?download=1.
45 Ibid.

environmental sustainability. Technical discussions over the course of 2023 are intended to lead to concrete outcomes by the time of the 13th WTO ministerial conference, although political will is ultimately going to be the deciding factor for how much progress can be achieved.

Semiconductors play an important role in the transition to green and digital economies. The US CHIPS and Science Act, signed into law by President Biden in August 2022, provides $52.7 billion for American semiconductor research, development, manufacturing and workforce development.[46] Similarly, the proposed EU Chips Act (which is expected to be adopted in 2023) seeks to mobilize €43 billion in investment for the EU's semiconductor sector by 2030.[47] There is a risk of a subsidy race between the US and the EU, despite both sides vowing to avoid this and to instead cooperate on creating secure semiconductor supply chains. Another risk concerns friction over the Biden administration's efforts to get European governments, among others, to fall in line with US controls on semiconductor technology exports to China.[48]

Many of the US's recent legislative initiatives – including the CHIPS and Science Act, the Inflation Reduction Act and the Infrastructure Investment and Jobs Act – indicate a shift away from a more market-oriented framework towards embracing industrial policy. This more interventionist approach will have a fundamental impact on trade flows as well as on the US's relations with major trading partners, not least in the form of tensions with the EU over subsidies.

The US's more interventionist approach will have a fundamental impact on trade flows as well as on its relations with major trading partners.

The evolving landscape of digital regulation in the EU – exemplified by the entry into force of the Digital Services Act and the Digital Markets Act in November 2022, as well as the pending proposals for the Artificial Intelligence Act – is aimed at strengthening European digital sovereignty and competitiveness. But the full effect of these rules governing the internet and the digital economy remains to be seen. 2023 will be a critical year, as the Digital Markets Act starts to apply and as progress on the Artificial Intelligence Act could bring about its adoption before the year ends.

46 The White House (2022), 'FACT SHEET: CHIPS and Science Act Will Lower Costs, Create Jobs, Strengthen Supply Chains, and Counter China', 9 August 2022, https://www.whitehouse.gov/briefing-room/statements-releases/2022/08/09/fact-sheet-chips-and-science-act-will-lower-costs-create-jobs-strengthen-supply-chains-and-counter-china.
47 European Parliament (2022), 'European Chips Act (semi-conductors) in "A Europe Fit for the Digital Age"', https://www.europarl.europa.eu/legislative-train/theme-a-europe-fit-for-the-digital-age/file-european-chips-act-(semiconductors).
48 In October 2022, the US introduced unprecedented export restrictions on semiconductor components and related technology to China. The Netherlands, which is home to one of the world's most important companies in the chip supply chain, has become entangled in the US–China chips fight. Haeck, P. (2022), 'The Dutch get ensnared in US-China chips fight', Politico Pro, 5 January 2023, https://www.politico.eu/article/the-netherlands-united-states-china-chips-machines-fight.

New governance models concerning digital trade are emerging. For example, the Digital Economy Partnership Agreement (DEPA) between Singapore, New Zealand and Chile entered into effect in 2021. This has been hailed as a landmark agreement on digital trade – not only in terms of its provisions, but also in its approach to allowing parties to make continual updates and other countries to adopt DEPA modules into their own trade agreements.[49] DEPA is designed to be open to all WTO members – and Canada, China and South Korea have already applied to join.

The UK is also at the forefront of initiatives on digital trade, as evidenced by its constructive role in the WTO and G7 as well as its approach to trade and digital economy agreements. For example, the UK-Singapore Digital Economy Agreement entered into force in June 2022, and is the first such agreement between a European and an Asian country.

Important developments on digital trade in 2023 will likely focus on promoting inclusive and sustainable growth of the digital economy, while preventing further digital policy fragmentation. Hopes remain that the negotiations on e-commerce that are currently taking place among 87 WTO members can be finalized before the end of 2023.[50] While such progress would represent a significant accomplishment, it should also be noted that major digital economies – among them India – are not participating in the plurilateral discussions because of both substantive issues (e.g. the contested issue of free flow of data across borders) and procedural matters (e.g. general concerns that the plurilateral process erodes the integrity of the multilateral WTO framework).[51]

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In 2023–24, WTO members will once again debate whether to maintain the current practice of not imposing customs duties on electronic transmissions. The so-called e-commerce moratorium has been renewed at every ministerial conference since its adoption in 1998, and will remain in effect until the next. However, there is a high chance that it will not be renewed at the 13th ministerial conference (India's ongoing concerns regarding tariff revenue losses being just one likely obstacle to renewal). Letting the moratorium expire would not only hurt digital trade, but would also represent a significant setback for the WTO's relevance and credibility.

Thus, in 2023 and beyond, most progress on updating trade rules to address technological change will happen outside the traditional WTO structures. Japan's G7 presidency in 2023 could seek to advance cooperation on 'data free flow with trust' –

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49 Bergsen, P. et al. (2022), *Digital trade and digital technical standards: Opportunities for strengthening US, EU and UK cooperation on digital technology governance*, Synthesis Paper, London: Royal Institute of International Affairs, https://www.chathamhouse.org/2022/01/digital-trade-and-digital-technical-standards.
50 World Trade Organization (2022), 'E-commerce talks resume following summer break, Mauritius joins the initiative', 15 September 2022, https://www.wto.org/english/news_e/news22_e/ecom_16sep22_e.htm.
51 World Trade Organization (2021), 'The legal status of 'Joint Statement Initiatives' and their negotiated outcomes', 19 February 2021, https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/GC/W819.pdf&Open=True.

a concept that Japan proposed under its G20 presidency in 2019.[52] But India's G20 presidency in 2023 is not likely to give great impetus to cooperation on digital trade given the country's stance on data regulation and cross-border data flows.[53]

Conclusion

Greater cooperation to build a more inclusive, sustainable and resilient trade system can help drive economic growth at a time when many countries are already in or entering an economic downturn.

How successfully China navigates the reversal of its zero-COVID policy and the country's economic reopening may be the most consequential determinant – and source of uncertainty – for the global economy and trade in 2023. Interconnected global crises – the scarring economic impacts of the pandemic and uneven recovery, compounded by high inflation, debt distress as well as energy and food insecurity following Russia's invasion of Ukraine – are likely to cast a long shadow over international trade. There is a significant risk that the Russia–Ukraine war could escalate, and that US–China strategic competition will increase.

How successfully China navigates the reversal of its zero-COVID policy and the country's economic reopening may be the most consequential determinant – and source of uncertainty – for the global economy and trade in 2023.

But even if these risks do not materialize, 2023 will likely see a continuation of three major shifts in global trade:

First, an increasing confluence of national security and economics will intensify the geopolitical aspects of trade. Second, efforts to reconfigure supply chains will continue to prioritize (at least in rhetoric) shifts from dependence to diversification. And third, while globalization will not go into reverse, it will continue to change in nature through the emphasis on greater regional links amid the formation of blocs for critical and sensitive sectors of the economy. However, full-scale decoupling from China is neither achievable nor desirable for the G7 and like-minded countries.

52 'Data free flow with trust' seeks to enable cross-border free flow of data while addressing challenges related to privacy, data protection, intellectual property rights and security. See, for example, Sekine, H. (2021), 'Collective action can spark innovation for data flows', Chatham House Expert Comment, 28 June 2021, https://www.chathamhouse.org/2021/06/collective-action-can-spark-innovation-data-flows.
53 India's approach is based on the notion of 'data sovereignty' (which posits that the government has sovereignty over the data generated by its citizens within its borders). Existing and potential new measures include provisions on data localization, although much is in flux as discussions regarding India's proposed data protection law continue. India notably stands apart from other G20 members in that it did not sign the 2019 'Osaka Track' framework to promote cross-border data flows.

For the G7, under Japan's presidency, responding to economic coercion that Beijing has applied to some trading partners and addressing concerns regarding China's non-market economy policies and practices will be a major focus in 2023.

Global trade cooperation at the WTO will remain highly challenging, and is unlikely to deliver any breakthrough achievements ahead of the 13th ministerial conference in February 2024. Plurilateral negotiations among a sub-group of WTO members – most importantly talks on e-commerce – stand a better chance of success by the end of this year.

In this new era of reglobalization – the term that best applies to the current context – the transitions to digital and green economies are major drivers of international trade policy. The threat to supply chains from extreme weather events provides particular impetus to act on greening trade policy. While climate change is usually seen as an area for international cooperation, it is also emerging as a source of international competition, with countries offering incentives to boost domestic clean energy industries. Unfair trade practices and discriminatory provisions are usually raised as issues as regards China, but the recent tensions over the US's Inflation Reduction Act and mixed international reactions to the EU's CBAM plans have highlighted that protectionism is also a concern among like-minded partners. There is a risk that 'greening' trade will become another geopolitical flashpoint.

Not all aspects of reglobalization will be desirable, but a reglobalized world is certainly preferable to a deglobalized one. Reglobalization offers the opportunity to build resilient supply chains and harness the twin transitions to green and digital economies. Giving up on global trade is not the answer.

To shape the future of global trade and reglobalization – and encourage its benefits while mitigating risks – a new model is needed. Such an approach should continue efforts to find multilateral solutions – but where that is not possible, plurilateral, sectoral and bilateral agreements can offer a path to agreeing new rules in areas such as digital trade. Strengthening regional economic integration can help build greater resilience. With growing geopolitical friction augmenting the downside risks for global trade, international cooperation is imperative – but ever more challenging to achieve. Newer platforms – such as the TTC and IPEF – as well as established forums – such as the G7 and G20 – provide opportunities to cooperate on shared ambitions and to defuse tensions. And better linking up different policy areas – trade and climate or trade and health, for example – is essential to addressing some of the most important global challenges without serving as protectionism in disguise.

At a time of major economic headwinds and increased geopolitical rivalry, a trade agenda for a reglobalized world that balances cooperation and competition is crucial for economic prosperity, security and sustainability in 2023 and beyond.

About the author

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Cover image: Dispatch administrators coordinate cargo ships in Huai'an, Jiangsu province, 4 January 2023.
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