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The Future of Trade – Challenges, Uncertainties, Opportunities

International trade is changing. Digital trade is increasing rapidly, global supply chains are becoming ever more complex, the geopolitical landscape is evolving, trade is being impacted by new developments such as the introduction of digital currencies, and public support for trade as a common good can no longer be assumed. In the shorter term, the Covid-19 pandemic has led the EU and other major powers to reassess the extent to which they are dependent on trade for critical supplies. Together these trends are having a major impact on the way we trade. This means that trade policy needs to be constantly reassessed. This goes for the EU as much as for anyone else.

Trade is essential for the EU if it is to remain prosperous and maintain its global influence. This will be even more the case in the future since the EU's share of global GDP is bound to decline (if only for demographic reasons) and its trade-to-GDP ratio - already the highest among major powers - is set to increase. The future context of international trade, however, is likely to be very different from that of today, and this will present both challenges and opportunities for EU trade policy.

This paper aims to provide a concise analysis of three major trends which can already be observed today and which are likely to have a profound influence on international trade over the longer term:

- **The generation of economic value through international trade depends increasingly on intangible factors and activities, rather than 'physical' ones;**
- **International trade increasingly serves as a response to geopolitical concerns, rather than solely to economic considerations;**
- **Globalisation and trade liberalisation face growing domestic opposition, not least in response to the 'servicification' of trade and 'deep' trade agreements, and as a function of identity politics.**

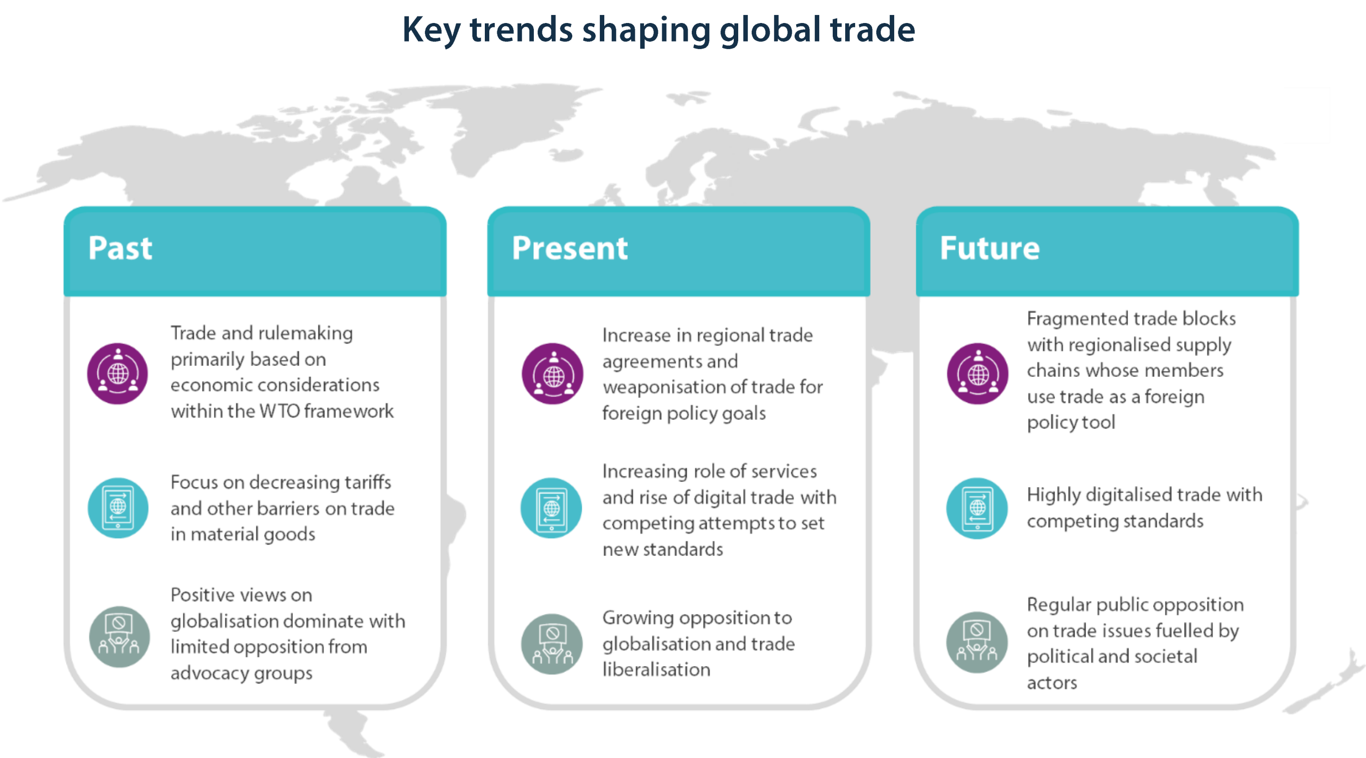

Figure 1: ART infographic

DEMATERIALISATION OF ECONOMIC VALUE

The importance of 'physical' trade (especially in strategic supply chains, such as critical raw materials) should not be understated. However, the generation of added value through trade is increasingly dependent on intangible activities: the share of services in global trade is rapidly growing, and at the same time, trade operations are becoming ever more dependent on digital technology. The de-materialisation of economic value presents both opportunities and challenges.

Services play an increasing role in trade: over the past decade trade in services has grown more than 60 % faster than trade in goods[1]. Nevertheless, difficulties in defining and measuring services trade cloud the full extent of the 'servicification' of trade. The existing WTO classification of services, by mode of supply, does not reflect the reality of today's services trade. Products are increasingly sold as a service ('servitisation') – for example Netflix subscriptions or car leasing. Moreover, many products integrate service components, and ancillary services such as R&D, sales and marketing, and HR are crucial to bringing products to the market. A single car, for example, contains around 30,000 components. These cover both physical goods (such as tyres), but also services (the navigation system), and a car may well come with additional service elements such as leasing and insurance[2]. In general, this means that services are creating much more value compared to what appears in national accounts[3]. In spite of this, the trade narratives of governments are often dominated by a focus on goods[4], and fail to do justice to the rapidly growing role of trade in services and its benefits to economies and consumers.

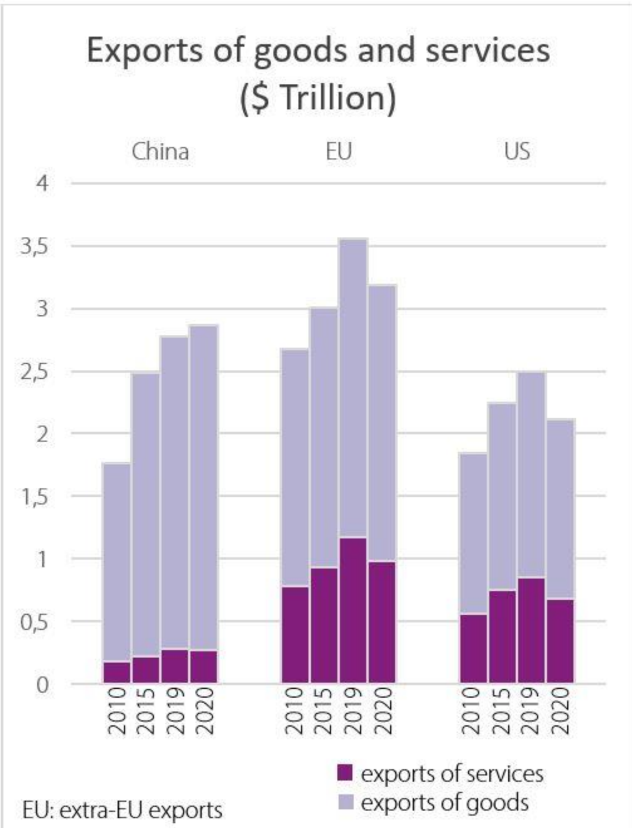

Figure 2: Services constitute an increasing share of total exports for advanced economies; while China is the world's largest exporter of goods, the EU is the largest exporter of services and the largest exporter overall (Data: WTO Merchandised Trade Dataset and WTO-OECD Balanced Trade in Services (BaTIS) dataset).

The digital economy is having a significant impact on the evolution of trade in several ways.

Firstly, digital trade (both e-commerce and digitally delivered services) is taking an increasingly large share of overall services trade. The global e-commerce market is dominated by the US and China. Together they account for all of the ten biggest digital trade firms in the world, with US companies being pure digital firms and Chinese companies more focused on traditional trade in goods enabled by the internet (or pure digital firms serving the domestic market)[5]. In the Digital Silk Road framework, China uses e-commerce and digital infrastructure to expand its exports, establish its own trade standards and rules, and embed its own technology and cyber standards in developing and emerging market settings in particular[6]. It does so through digital free trade zones (such as the China-Malaysia Digital Free Trade Zone, an official Belt and Road project), new digital platforms and mobile payment systems.

With the rise of digital trade, data has become 'the new oil'. Its crucial role in today's trade in both services and goods raises questions about its regulation, which to date is fragmented: 'in contrast to the slow progress in the WTO, many regional trade agreements have been able to include new rules on data regulations'[7]. The three main players – the US, the EU and China – have each developed their own models, which reflect their different market positions in digital trade as well their different domestic regulatory approaches. While the US largely relies on self-regulation, China imposes heavy government regulations of the internet, whereas the EU champions privacy as a fundamental human right[8]. The EU's privacy rules are sometimes seen as a form of digital protectionism[9].

The increasing role played by intangible activities in trade is matched by the growing importance of innovation and intellectual property (IP) protection. The digital economy poses several challenges for IP, including: protecting and exploiting the value of data; the need to move to large and strategically driven portfolio-based IP covering multiple relevant, emerging and converging technologies; the setting-up of 'in-licensing' and 'out-licensing' services for IP (imposed by the complex and fragmented patent landscape); and the protection of trade secrets[10].

A second important impact of the digital economy on trade is through trade-facilitating digital technology. Just as containerisation lowered the costs of the transportation of goods in the 1970s, new technologies – in particular the Internet – are making a vital contribution to the emergence of global value chains, which are now responsible for 70% of global trade[11]. The WTO Global Trade Model estimates that between now and 2030, global trade growth would be on average 2% higher annually as a result of the adoption of digital technologies (with the model predicting a 2.5% higher annual growth rate for developing countries)[12].

A potential game-changer in the influence of digital technology on trade over the next decade is blockchain technology. Possible applications of blockchain include finance, customs and certification processes, transportation and logistics, insurance, distribution, IP and government procurement, all of which would contribute to increased trade efficiency[13]. Provided that technical and regulatory issues are addressed, blockchain could become the backbone of future trade infrastructure, and potentially 'the biggest disruptor to the shipping industry and to international trade since the invention of the container'[14]. At the same time, it is expected to 'give rise to a new generation of services'[15].

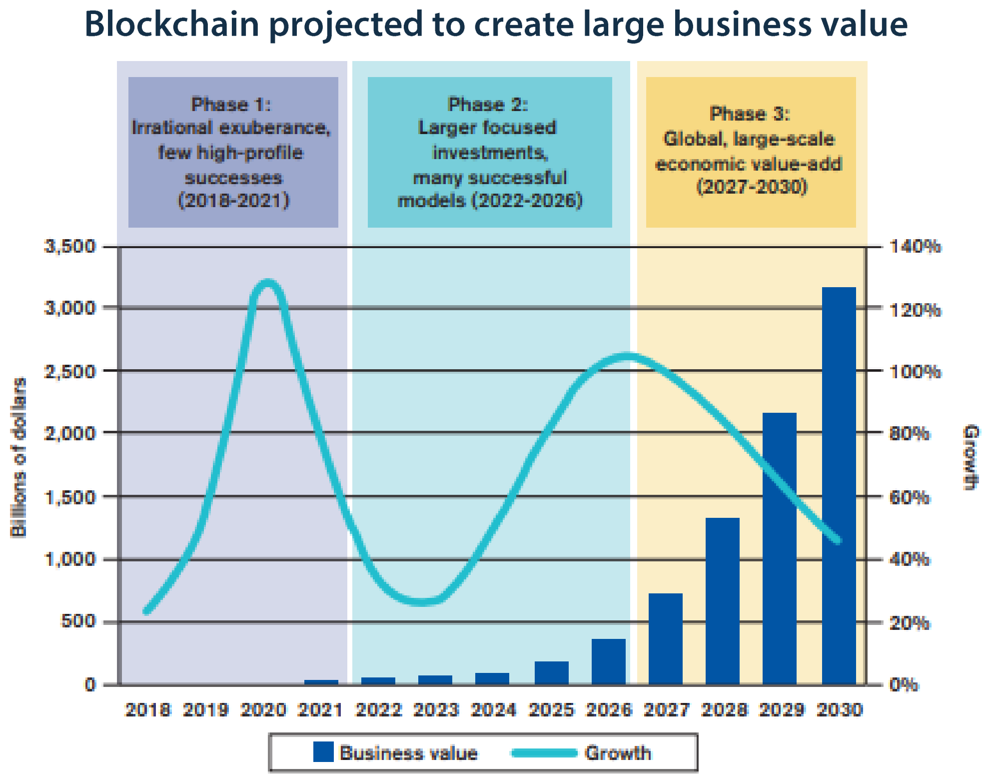

Figure 3: While not immediately evident at the current state of development, Blockchain is predicted to create large business value over the next decade (Source: WTO[16]).

A third impact of digital technology on trade is the emergence of digital currencies (both public and private), which have the potential to boost trade by making transactions faster and cheaper. Digital currencies are likely to challenge existing trade rules, and could well contribute to a shift in the choice of currencies used for trade (where the US dollar still dominates). For example, when fully operational, the digital renminbi – one of the world's most advanced Central Bank Digital Currency projects - could help China bypass existing multilateral governance systems and financial architecture (including the SWIFT system and as a result secondary sanctions). It also puts it in a strong position to influence global standards for emerging financial technology. China sees the push for the digital renminbi as part of a comprehensive strategy that includes trade. For example the introduction of the digital renminbi to the Belt and Road Initiative (BRI) through digital invoicing would pave the way for it to replace the dollar for BRI transactions, encourage participating countries to incorporate it into their national bank reserves, and push these countries to use Chinese financial technology.

At the same time, private cryptocurrencies are gaining traction in emerging and frontier economies. They offer an alternative to weak and volatile national currencies which are hindered by financial restrictions and capital controls: the US is the only advanced economy in a 2021 ranking of the top twenty countries for crypto adoption[17]. According to Paul Domjan, a blockchain specialist, the rise in the use of cryptocurrencies to invest, trade and transact provides them with an element of legitimacy, changes the position of bitcoin in the global financial system, and accelerates the digital currencies debate[18].

GEOPOLITICISATION OF TRADE

Trade has always been intertwined with politics. The EU has used trade policy as a way of achieving political objectives in non-trade areas such as the promotion of human rights and democratic principles through political conditionality[19]. This is the result of conscious decision by the EU to deploy trade instruments to assert its values. The choice of trade as the means to do this is a result of its historical ability to leverage influence in this area.

But the increasing *geo*politicisation of trade is a rather different and more recent phenomenon whereby ´trade policies have become embedded in power rivalries' and are 'both a product and a tool of security policies': an instrument to be used 'to win over allies, overcome foes and restructure the global balance of power'[20]. Several trends seem to be pushing international trade in this direction. These include the crisis and fragmentation of the multilateral trade system, the increasing willingness of states to 'weaponise' trade policy, and the global race by major powers to secure the resilience of their own supply chains.

At the beginning of the century, the triumph of the US-led liberal multilateral trade system seemed to be epitomised in 2001 by China's accession to the World Trade Organisation (WTO). Since then, the emergence of a multipolar world as a result in particular of the rise of China, and the challenge to US global leadership - especially after the 2008 financial crisis - has been accompanied by a crisis in the multilateral trade system which appears to support the much debated theory of hegemonic stability[21]. The paralysis of the Doha Round in 2008 highlighted the inadequacy of the multilateral trade system in being able to reconcile the different interests of developed economies, emerging markets, and developing countries. Multilateral rules were no longer effective in policing global trade. The Trump administration further undermined the system by blocking appointments to the WTO Appellate Body, and even threatening to withdraw the US from the organisation on several occasions[22].

Partially in response to these developments, the international trade landscape has experienced considerable fragmentation. The number of regional trade agreements has grown rapidly, with the share of global trade covered by such agreements reaching over 50 % in 2019[23]. Value chains are also becoming more integrated and focussed at the regional level, reversing the earlier trend towards globalisation[24]. These trends reflect economic imperatives (such as the need for deeper trade agreements among developed economies, and the time-sensitive sequencing of production processes in some of the more innovative industrial sectors), but at the same time they have clear geopolitical motivations and implications.

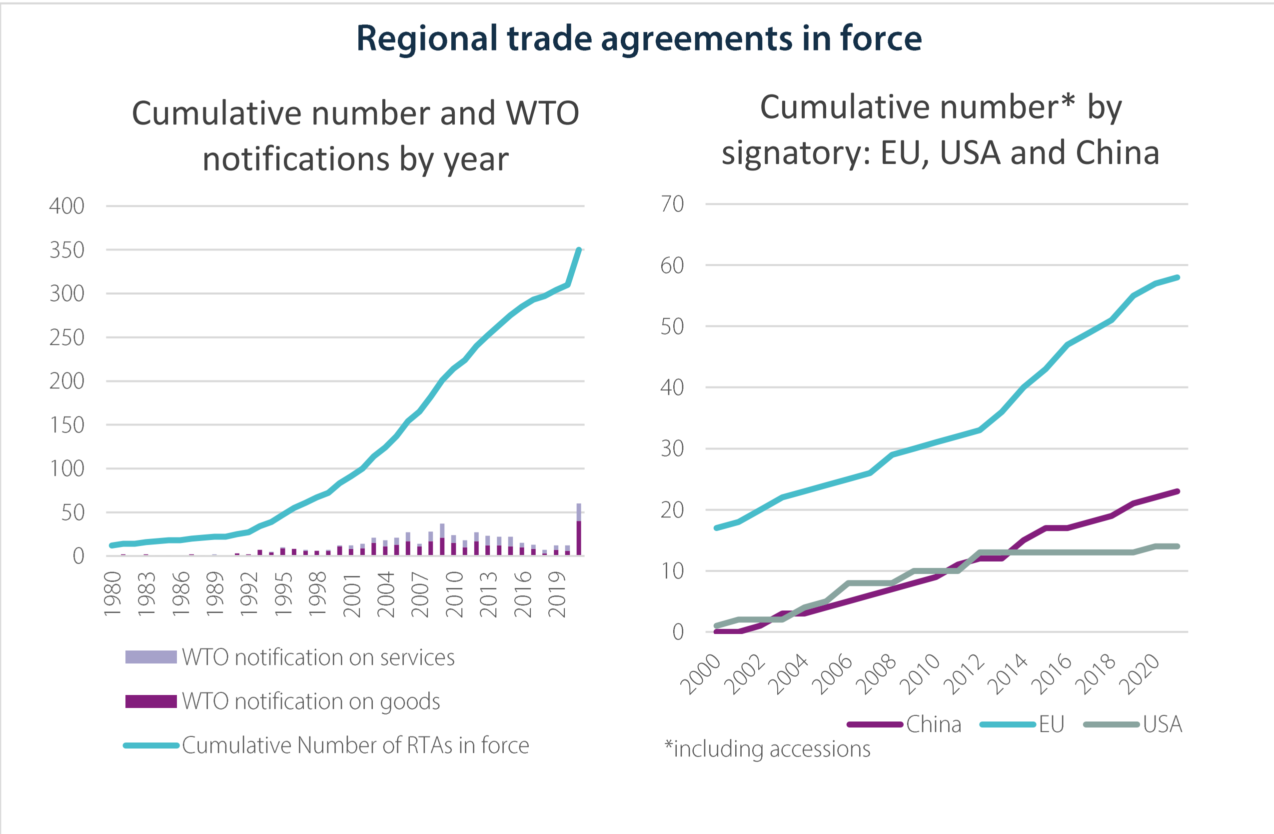

Figure 4: The number of regional trade agreements has grown rapidly over the years, and the EU has been an undisputed leader in this trend (Data: WTO Regional Trade Agreement Database).

The Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP) are a case-study in these developments. The negotations on these two partnerships resulted in trade agreements which were both comprehensive and innovative. By deliberately excluding China and seeking preferential relations with Beijing's main trade partners in both the East and the West[25], they were used as tools in the balancing strategy pursued by the Obama administration with its pivot to Asia. Above all they aimed at securing 'relative gains vis-à-vis Beijing, the sine qua non for maintaining American primacy in a competitive international system'[26].

But this policy led China to pursue 'its own trade architectures in Asia'[27] and Eurasia through the Belt and Road Initiative (BRI)[28] and the Regional Comprehensive Economic Partnership (RCEP). At the same time China sought closer ties with the EU through the negotiation of an investment deal which at the time was seen as a test of China's commitment to opening up its economy with the perspective of possible future trade negotiations[29]. The subsequent withdrawal of the US from the TPP and TTIP negotiations under the Trump administration helped serve as a catalyst for the conclusion of the EU-Japan Economic Partnership Agreement[30]. These examples illustrate that relative gains and the fear of being 'left behind' play a major role in great powers' calculations with respect to trade agreements.

In parallel with this trend, the world is witnessing an **increasing 'weaponisation' of trade policy**. While economic statecraft[31] has always been a part of the foreign policy toolbox of major powers, it has become more prominent and aggressive in recent years. The **US** under the Trump administration presented one of the clearest examples of this in action: it regarded trade as a zero-sum game, pursuing an aggressive and unilateral trade policy, and invoking 'national security' to justify its departures from rules-based trade[32]. At the same time, it took advantage of the privileged position of the dollar to threaten European companies with secondary sanctions, and force them to align their commercial activities with US interests[33]. While the Biden administration has clearly departed from Trump's aggressive rhetoric and erratic behaviour, many see a significant level of continuity in the conduct and content of US trade policy[34].

China's use of economic statecraft has similarly increased, in particular after its relative strength and confidence were bolstered following the 2008 financial crisis. Beijing's tactics often involve a mix of positive inducements and coercive actions. The former may take the form of 'subversive carrots'[35] undermining the political institutions and processes of its targets, as exemplified by the emergence of corruption scandals involving Chinese-funded investment projects in countries such as the Philippines or Malaysia. Coercive measures, on the other hand, may range 'from restricting imports or informally boycotting goods to halting strategic exports (such as rare earth minerals)'[36]. Beijing has not shied away from employing punitive tactics in response to perceived political slights, most recently against Lithuania. But China is not alone in deploying such methods: Japan, for example, famously restricted exports of hydrogen fluoride - a critical raw material for South Korea's semiconductor industry - over a dispute between Tokyo and Seoul about compensation for wartime forced labour[37].

The increasing trend to use trade in this way has resulted in a 'quiet war'[38] to secure control of supply chains as a key geostrategic resource. The COVID-19 pandemic has encouraged this trend by highlighting the fragility of global supply chains of medical equipment. This led the Biden administration to push to 'reshore supply chains so that we are never again dependent on China in a crisis'[39]. In Europe, the need to ensure the resilience and diversification of critical supply chains has been recognised as a key element of the concept of 'strategic autonomy'. While the US and European approaches appear purely defensive, China appears to have taken a more offensive stance. A recent report by Verisk Maplecroft argues that China is seeking to reduce its dependence on foreign natural resources by diversifying its supply chains in order to find itself 'in a better position to weaponise trade with geopolitical rivals, while at the same time increasing the economic dependence of new and existing partners'[40]. This assessment seems supported by recent developments such as the push by China to increase its domestic coal production, after imports from Australia were banned last year as part of a package of punitive measures against Canberra's calls for an international inquiry into the origins of the pandemic[41].

Main sources of Critical Raw Materials (CRM)

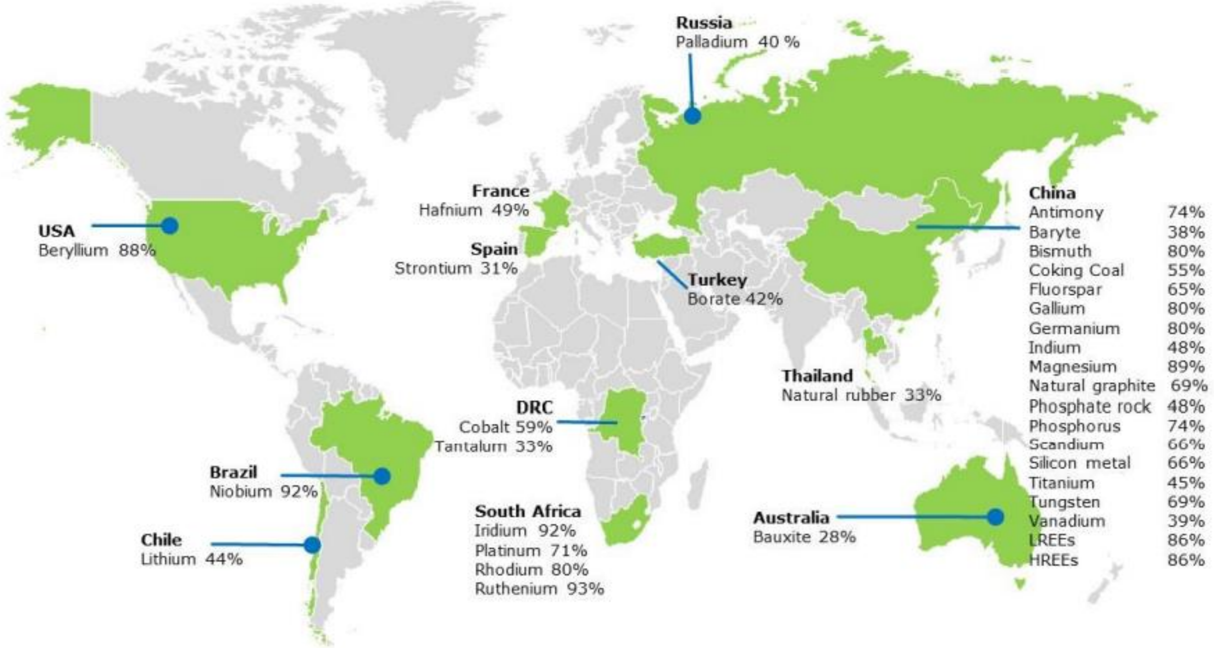

Figure 5: China is the largest global supplier of many Critical Raw Materials (CRM). This over-reliance is pushing other major powers, in particular the US and the EU, to look for alternatives to secure their supplies (Source: European Commission[42]).

GROWING OPPOSITION TO GLOBALISATION AND TRADE LIBERALISATION

Even though trade contributes to global prosperity, this does not automatically generate public support. The perception that trade deals can have a negative impact on a specific sector or a particular group in society can lead to generalised opposition to trade liberalisation. Popular dissatisfaction with the perceived economic and political consequences of globalisation (in particular inequality and sectoral unemployment) has grown in recent years and shows no sign of abating.

This trend is encouraged by more vocal opposition from key influencers[43]. An increasing number of political parties across Europe are not only ready to criticise globalisation but also in some cases construct their manifesto around their opposition. The positive assessment of globalisation by the political class dating from the 1980s is no longer a given: since the 1990s there has been a marked increase in a more critical approach, not least in some EU member states[44].

Overall popular support for parties promoting internationalist policies in the West has almost halved during this period, whilst overt anti-globalists have consistently increased their share of the vote - with the election of Donald Trump being the most striking example. In a recent article on 'the retreat of the West', Peter Turbovitz and Brian Burgoon show that even though economic globalisation, international cooperation, and multilateralism have remained part of the mainstream agenda, political parties which campaigned for this agenda lost ground to parties on the radical left and, increasingly, to the anti-globalist radical right[45].

This trend has is being driven by several factors. Firstly, digitalisation has vastly expanded access to information (as well as disinformation), which makes it much easier for vocal opponents of trade policy to muster public support for their views. Secondly, the gradual widening of scope of trade deals over recent years has increased the possibility of one of more aspect of an agreement being criticised by concerned individuals or interest groups.

This has led (at least in the West) to increasing difficulties in securing popular support for trade deals, and has begun to create real problems for the process of ratification. If negotiated agreements consistently run into difficulties over ratification and are effectively shelved, the credibility of new generation trade agreements is called into question. In general, debates about globalisation are increasingly driven by political polarisation, fuelled by social media and in some cases rendered even more divisive by politicians for electoral purposes. A new generation of "agenda setters", whether young climate protesters or human rights activists, are taking a lead in questioning the value of trade agreements that have sometimes taken a number of years to negotiate.

These developments have contributed to more protectionist and nationalist policies, even in countries that have historically been at the forefront of the global liberal order. Given its position at the centre of world trade flows, the EU has traditionally been the driving force behind an approach based on openness and reciprocity, combined where necessary with measures to protect fair trade. But the free trade agenda is increasingly being challenged in the European Parliament, national Parliaments[46] or organised citizens' groups that have managed to block or reduce the scope of negotiated agreements such as the Comprehensive Economic and Trade Agreement (CETA) with Canada.[47]

In today's more polarised environment, it is more difficult for those pushing a more open approach to trade to be heard. Political leaders who are opposed to free trade claim they are serving the best interests of their citizens and voters. That has led - in the case of the Trump administration – to policies which undermine key international institutions such as the WTO and which challenge instruments such as investment agreements. It also includes an increasing recourse to defensive tools in trade policy as a way of showing that demands for greater reciprocity and fairness in international trade are being taken seriously.

The increase in trade defence instruments, together with measures aimed at undermining fair competition such as sanctions and the unilateral imposition of tariffs, encourages the politicisation of trade in public debate. Such behaviour reinforces a negative view of trade in public opinion. Yet the public view remains fickle: data from the International Social Survey Project[48] shows that, even those respondents who were generally sceptical about the benefits of free trade were reluctant to countenance a limit on imports.

Opposition to globalisation and trade liberalisation feeds off the negative impact of economic decline, particularly in those regions most affected by structural change. In areas that face deindustrialisation or increased trade competition with China and other low-wage economies, radical parties (both left and right) are more successful[49] in tapping into local opposition, and legislators tend to support more protectionist trade measures[50]. Experience shows that international financial shocks and crises also lead to increased opposition to free trade.

In the medium to longer term, an increased use of **automation and the effects of the digital revolution could lead to a an increased sense of vulnerability and a further erosion in public confidence in trade, with job losses amongst the middle class likely to have a particular strong impact.** Although jobs and wages for high-skilled jobs have been on the rise, low-skilled labour takes an increasingly large share in overall employment, with often little or no wage increase. The IMF[51] in its world economic outlook expects the effects of technology on local labour markets to be much more pervasive and long lasting than trade shocks, with the attendant political risks. Recourse to protectionist pressures linked to job losses is expected to increase as a result of the growth of trade in services, as white-collar jobs are no longer shielded from international competition.

Figure 6: Job creation is the main priority for citizens in the majority of member states, a goal that stands in potential contrast to expected effects of the digital revolution (Source: ART elaboration on Eurobarometer[52]).

These trends are not unique to Europe. President Xi Jinping has called on China to achieve 'common prosperity', as he attempts to narrow a significant and growing wealth gap that threatens to undermine the country's economic ascendancy and perhaps even put at risk (ultimately) the legitimacy of Communist Party rule[53]. In the US there has been a shift towards protecting the interests of working people. President Biden has been clear that policies, not least those addressing the changes in the digital economy, must prioritise the interests and protect the jobs of the middle and working class[54]. **The protection and safeguarding of jobs for the middle class has moved to the heart of the US trade agenda and is an internal security issue for China**. While the latter has spent the last two decades creating global interdependencies, its dual circulation strategy[55] aims at refocussing growth on domestic consumption, coupled with a desire for fairer wealth distribution.

Trade is a key to future prosperity as the world emerges from post-COVID economic recovery. It will have a major role in the emergence of a climate-resilient society and in adapting to the technological revolution[56]. Yet Western democracies have to come to terms with the reality that public support for a positive trade agenda is no longer a given (if it ever was). The arguments for trade as a driver of prosperity and innovation need to be restated and underlined, not just in public discourse, but also by showing in very practical ways that trade can bring material benefits to society as a whole.

CONCLUSION

Taken together, the three major trends discussed in this paper present **both challenges and opportunities** for EU trade policy. The EU is well-positioned to remain a major trade power in the years to come. However, long-term thinking and strategic decisions at the leaders' level are essential if the EU is to be ready to meet future challenges, but also help shape the trade landscape of tomorrow so that it reflects its own interests. This is the only way for the EU to maintain its position of leadership.

Trade to GDP Ratio

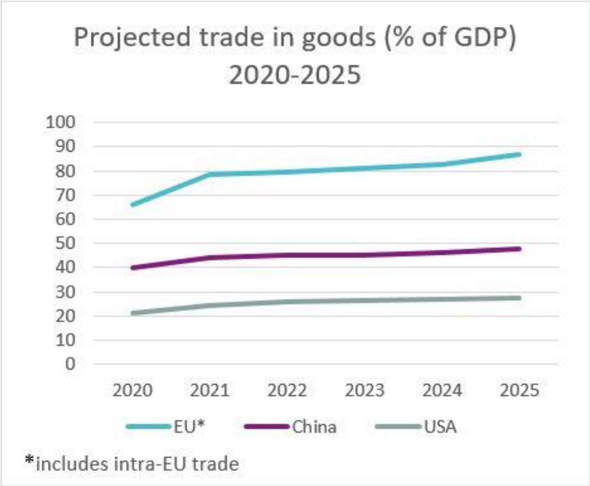

Figure 7: The EU's trade-to-GDP ratio is the highest among major economic powers and it is projected to continue to increase (Data: Economist Intelligence Unit).

Although trade and politics have always been linked, the growing geopoliticisation of trade presents particular challenges. The EU has already taken steps to react to this changing global context: for example by expanding its own network of regional trade agreements, by upgrading its trade defence instruments, and by introducing a new mechanism to screen potentially hostile foreign direct investments. But **simply reacting to a changing geopolitical environment will not be sufficient** to guarantee Europe's interests in the long term: firstly, because Europe's institutional reaction times are often too slow to prevent actual damage before it occurs; and secondly, because this would only reinforce the current trend of geopoliticisation without bringing new momentum to a weakened multilateral system. In this respect, the real dilemma for EU trade policy will be **how to determine the practical extent to which 'strategic autonomy' Is open**, while protecting Europe's security and prosperity in the face of growing geopolitical pressures. Could the EU, for example, take a leadership role in articulating a multilateral response to these pressures?

As the world's leading exporter and importer of services, the EU is well-positioned with respect to current trends towards the de-materialisation of economic value. Nevertheless, the EU will not be able to take full advantage of these trends if it lags behind other major powers in terms of digital technology. Both the US and China have been investing heavily in this strategic field, with the clear aim of gaining first-mover advantage and establishing their dominance. Without a more assertive policy, the EU risks losing the benefits of the so-called 'Brussels effect', and may have to accept de facto standards set by others. Additionally, more rapid and agile institutional processes may be needed to keep up with the pace of evolution in fields such as digital technology. The EU remains the hub of the world's largest network of trade agreements, but this is unlikely to be enough **to maintain its competitive edge in the future**: a successful trade policy will increasingly need to consider other structural elements as well, such as the role of digital infrastructure, technology standards, and digital currencies.

Any debates of trade policy would be moot, in any case, if the EU is unable to secure sufficient public support for its action in this crucial policy area. Perhaps **the greatest challenges for EU trade policy lie not abroad, but domestically**. While pressures to include non-trade interests into trade deals may increase, a necessary precondition for winning the battle of public opinion will be to ensure that the benefits of trade are well distributed and that **they bring the European middle class back on board**. Even the best trade agreement is useless if its ratification is blocked by political and public opposition.

The EU is often described as an economic giant and a political dwarf, in the famous words of former Belgian Foreign Minister Mark Eyskens. But already today, and increasingly tomorrow, this dichotomy is untenable: **the EU cannot preserve its economic status as a trade power, without addressing the political and security challenges of an evolving global context.** By its very nature, the EU has an interest in a liberal multilateral order, governed by strong regulatory standards and underpinned by widespread popular support. But if it does not have the political will at the same time to be more pro-active in defending and promoting its wider interests, it will lose out, and the three key trends discussed in this paper could take the world in a very different and more challenging direction.

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