Key new factors likely to shape the EU’s trade agenda in the next five-year term

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BRIEFING

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ABSTRACT

The landscape in which European Union trade policy operates has changed drastically in recent years. In addition to, and partly in competition with, its traditional objective of economic wellbeing, EU trade policy has become increasingly shaped by two other considerations: geopolitics and concerns over the resilience of supply chains, and climate change.

This briefing note examines the emergence of this new landscape, how it has already affected EU trade policy with measures to increase European economic security and complement the European Green Deal, how it might affect EU trade policy in the next five years, and how the new landscape has already impacted and might affect in future the multilateral trading system. EU policymakers should be cautious about the economic and climate costs associated with geopolitical-driven policies, particularly in trade.

The note ends with recommendations for EU trade policy, calling for a comprehensive assessment of costs in economic terms and climate objectives to safeguard living standards and maintain opportunities for international cooperation in the current context of heightened economic security concerns. Despite evident internal divisions over the EU’s approach to multilateralism, finding a strategic balance between its traditional stance and fostering key trade partnerships is imperative.
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1 Introduction

The landscape in which European Union trade policy operates has changed drastically in recent years. In addition to, and partly in competition with, its traditional objective of economic wellbeing, EU trade policy has become increasingly shaped by two other considerations: geopolitics and concerns over the resilience of supply chains, and climate change.

This briefing note examines the emergence of this new landscape (section 2), how it has already affected EU trade policy with measures to increase European economic security and complement the European Green Deal (section 3), what challenges it poses to EU trade policy in the next five years (section 4), and how the new landscape has already impacted and might affect in the future the multilateral trading system (section 5). The note ends with recommendations for EU trade policy (section 6).

2 Geopolitics and trade

During the Cold War, the world was divided into two politically and militarily rival spheres, with little or no economic integration between the two. Only one sphere – market-economy countries – belonged to the General Agreement on Tariffs and Trade (GATT) and the International Monetary Fund (IMF). The other sphere – socialist countries (China, the Soviet Union and their close allies) – stayed outside these two institutions and the process of trade and investment integration (‘globalisation’) that they facilitated.

With the end of the Cold War, nearly all socialist countries became market economies (although some, like China and Vietnam, have remained socialist, qualifying therefore as ‘socialist market economies’) and joined the successor to the GATT – the World Trade Organization – and the IMF. By doing so, they ushered in a period of truly global trade and investment integration – often referred to as ‘hyper-globalisation’ – dominated by purely economic motivations and global value chains (GVCs), with little or no geopolitical considerations (see, for instance, Antras, 2020). This development reflected the widely shared belief expressed by Fukuyama (1992) that history had ended.

The grace period was short lived. The world is once again beset by geopolitical tensions and rivalries that have led to policies of de-risking or even outright de-coupling, resulting in trade and investment fragmentation. De-globalisation has perhaps not yet happened, but certainly hyper-globalisation is over as companies reconfigure their supply chains in response to the new geopolitical environment.

Geopolitical tensions have greatly weakened the governance of the multilateral trading system, the WTO, thereby further fragmenting the global economy as its members have increasingly adopted protectionist measures that violate WTO rules. The inability of the WTO membership to conclude the Doha Round of trade negotiations was a first setback. But then the situation got worse. Trade took a hit from three shocks: the 2008 global financial crisis (GFC), the 2019 COVID-19 pandemic and Russia’s invasion of Ukraine and subsequent war that started in 2022. The result has been a slowdown in world trade (Figure 1).

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1 A small number of socialist countries in Eastern Europe belonged to GATT and the IMF during the Cold War, but this was insignificant.
Distrust among the WTO membership regarding future conduct is the root cause of the recent proliferation of market-segmenting measures (see Evenett et al, 2024). One might also legitimately suspect heavy doses of classic industrial policy. Indeed, market-segmenting measures could be the result of either legitimate concerns (distrust regarding the conduct of some members) or pure industrial policy or both (self-sufficiency in key sectors to safeguard security). There is no perfect way of knowing. The problem is not mere trade disputes because fault lines run deeper. Distrust is expressed in measures that various WTO members adopted in order to promote national security, in the unwillingness of the membership to reach cooperative solutions at WTO level, and in the continued disregard for the sorry predicament of the WTO dispute settlement, with the Appellate Body in abeyance.

The assault on the WTO started with the Trump administration’s decisions to disregard the multilateral context by (sequentially) reducing the Appellate Body to non-functionality, agreeing a deal with China that violated the letter and spirit of WTO, and unilaterally imposing tariffs on Chinese goods when China did not implement this deal. On assuming power, President Biden did not rescind the unilateral tariffs, and the wider China-US crisis has continued unabated. The rest of the WTO membership has not managed to redress the situation.

The problem is that the crisis is not self-contained. At a moment when the world faces an unprecedented environmental crisis (climate change) which requires global action, the gradual demise of the WTO has gone hand-in-hand with the broader evisceration of multilateral cooperation. More on this, later.

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2 Fajgelbaum et al (2020) discussed this issue extensively.
3 See https://ustr.gov/phase-one
2.1 The weaponisation of trade

The US has adopted various initiatives reminiscent of George Kennan’s ‘containment’ strategy, formulated in the 1940s, aiming to isolate China by denying it access to critical markets. Semiconductors offer a very appropriate illustration. On 7 October 2022, President Biden issued a decree banning any company, wherever they are based, from exporting US high-end technology to China. The extraterritorial effect of the measure is undeniable. But more importantly, its effectiveness relies on the degree of cooperation shown by third countries. To promote cooperation, the US has been building alliances while continuing to act in a unilateral manner. The result is the adoption of market-segmenting initiatives with varied participation and differentiated effectiveness.

2.2 The impact on trade

Data shows a proliferation of import and export restrictions, as well as subsidies. While the latter are consistently unilateral measures, alliances are formed around import and especially export restrictions. We refer to some typical examples only, as there are literally hundreds of measures of the sort.

Unilateral initiatives include the US Infrastructure Investment and Jobs Act, the Inflation Reduction Act (IRA) and the CHIPS and Science Act, as well as the 7 October 2022 measures we have mentioned above. The European Commission subsequently proposed and adopted an EU Chips Act, a Net Zero Industry Act, an Anti-Coercion Instrument and a Foreign Subsidies Regulation. China has put together a $143 billion package to further its dream of technological supremacy in the semiconductor sector. Japan, and Korea have enacted their own subsidy schemes to help critical national industries (such as semiconductors) (OECD, 2022). Meanwhile, national lists of items not to be traded with non-friendly economies are mushrooming and becoming longer and longer.

Bilateral initiatives include the US-EU Trade and Technology Council, or the Trade and Investment Framework Agreements the US has signed. The EU and the US partners have entered into sector-specific initiatives, including the Global Arrangement on Sustainable Steel and Aluminium, to address challenges in the steel and aluminium sector, and the critical mineral buyers’ club to enhance resilience in the supply of critical minerals such as cobalt and rare earths. These initiatives are not per-se trade restricting but are likely to be trade distorting unless they eventually result in new multilateral trade rules.

China’s Belt and Road Initiative (BRI) is the landmark unilateral instrument. To finance the BRI China created the Asian Infrastructure Development Bank. Eichengreen (2023) argued that China has also been frantically attempting to enhance the international use of the renminbi. China markets itself as the apolitical champion of development for the Global South. The US has responded through the Indo-Pacific Economic Forum and the Americas Partnership for Economic Prosperity, which aim to connect members through digital trade, beef up GVC resilience and promote a clean environment. The EU meanwhile promotes its Global Gateway to bolster EU investment in the developing world. All these investment initiatives contain rules that favour the donor’s companies when supplying and constructing the relevant infrastructure projects.

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5 See https://www.fdiintelligence.com/content/data-trends/protectionism-trade-restrictions-reach-an-alltime-high-82637
6 See https://eastasiaforum.org/2024/02/08/the-twilight-of-us-trade-leadership/
3 Recent developments in EU trade policy

Geopolitical considerations have led firms and governments to adopt measures aimed at reducing dependency on global suppliers for critical products.

A global survey conducted by The Economist Impact (2023) of 3,500 senior executives from a wide range of industries and global economic regions, designed to capture their trade and supply chain practices, showed that nearly all those surveyed are reconfiguring their global supply-chain organisations, shifting their focus from efficiency gains to strategic resilience and adaptability. Interestingly, the main reconfiguration strategy in 2023 was diversification of suppliers (for 44% of those surveyed), followed by reduction in the number of suppliers of their most critical inputs (26%). Others chose nearshoring, switching to regional suppliers to shorten supply chains (18%), or reshoring, shifting manufacturing and suppliers from foreign locations to the firm’s home market (8%).

Although the economics literature does not yet permit a comprehensive evaluation of the impact on trade (and investment) of measures adopted by governments to encourage firms to reconfigure their supply chains, some useful evidence exists. Alfaro and Chor (2023) found evidence of a looming “great reallocation” of US supply-chain activity. In particular, the authors documented a decrease in direct US sourcing from China, and a corresponding rise in imports from low-wage Asian locations (mainly Vietnam) and from Mexico. The study also found evidence of the reshoring of some production stages, though it cautioned that “there is some unevenness across sectors in the precise causes and timing of this apparent turnaround, and much remains to be seen as to how strong and sustainable these recent trends are moving forward” (Alfaro and Chor, 2023).

In addition to geopolitical considerations, the fight against climate change has also led to trade and industrial policies that already impact trade and the effects of which are likely to increase in the years ahead.

The EU has taken the lead in the fight against climate change with the European Green Deal, which contains many important provisions aimed at reaching net-zero emissions by 2050. One of the central provisions of the European Green Deal is to increase the effective carbon price paid by EU producers of manufactured products covered by the emissions trading system (ETS) (including cement, chemicals or iron and steel), which was essentially zero, since they received free allocations of emission permits.

The gradual phase out of free ETS allowances will be accompanied by the gradual phase in of Carbon Border Adjustment Mechanism (CBAM) measures meant to equalise the price of carbon between domestic products and imports into the European single market. The system will be fully operational starting in 2026, when EU importers will start paying a financial adjustment by surrendering CBAM certificates corresponding to the emissions embedded in their imports. Since October 2023, relevant operators are already subject to reporting obligations on the emissions embedded in their imports.

The actual trade impact of CBAM will only be known after it becomes fully operational. However, there are already numerous estimates of its potential impact, which vary a great deal across studies depending on their assumptions (see, for instance, European Commission, 2021b, and Park et al, 2023). There are also heated discussions about whether CBAM is compatible with WTO rules. The answer is probably that the principle of CBAM is WTO-compatible, and in particular with national treatment (GATT Article III), but that some of its provisions (including modalities of implementation which have yet to be announced) may not be and, if so, should be revised. In our view, good arguments could be advanced to justify CBAM under WTO rules (as all it has to observe is non-discrimination, which prima facie it does, as CBAM is the external extension of the ETS to which EU domestic producers are subject, the final judgment on its consistency will depend on the scope of the CBAM as well as the modalities for calculating the price. If identical to the ETS, then CBAM should be WTO-consistent). There are equally heated discussions about the ‘fairness’ of the system for developing countries, which we discuss in the next section.
An even more controversial part of the European Green Deal is the EU Deforestation-free Regulation, which entered into force in June 2023 to prevent the importation of commodities linked to deforestation with the goal of curbing forest loss, land degradation and biodiversity loss. This regulation, which will apply from December 2024, could have wide-ranging implications for global supply chains. A different but related piece of EU legislation, the Corporate Sustainability Due Diligence Directive, also grounded in the European Green Deal and proposed by the European Commission in 2022 (but not at time of writing adopted by the co-legislators) could also have a profound impact on global supply chains. We will also discuss these measures in the next section.

In 2022, the US Congress adopted the Inflation Reduction Act (IRA), a major climate law designed to significantly reduce US carbon emissions. Although welcomed by Europeans and others from a climate perspective, the IRA has been criticised because it includes local-content requirements and other trade-distorting measures. In response to the IRA, the European Commission proposed the Net Zero Industry Act, which, like the IRA, spells out a comprehensive green industrial policy, but without some of the more trade-distorting measures of its US counterpart. It is, however, not without consequences for global supply chains, in particular those involving China (Kleimann et al., 2023).

Regardless of whether it is caused by geopolitics, the fight against climate change or, increasingly, both together, the “great reallocation” or “great fragmentation” (Javorcik, 2023) is likely to be expensive. European Central Bank economists Attinasi et al. (2023) found that, from a purely economic perspective, further trade fragmentation scenarios (for instance if global supply chains decouple into a China-led East bloc and a US-led West bloc, with no more trade in intermediate goods between the two blocs) would result in “sizeable costs in terms of substantially distorted trade, decreased welfare and higher prices” for all countries (Attinasi et al., 2023). They also found that, despite its large size, the euro area stands to be more affected than either China or the US because of its greater trade openness and less-integrated internal market, compared to those two countries. The same reasoning applies to the European Union.

Attinasi et al. (2023) also warned that, beyond the economic costs, trade decoupling can have detrimental effects on the fight against climate change if it affects sectors that are critical for the green transition. Similar conclusions were reached by IMF economists (Aiyar, Ilyina et al., 2023; Aiyar, Gourinchas et al., 2023).

### 4 Challenges for EU trade policy

Until recently, the objective of EU trade policy was fairly straightforward. It was, in tandem with the EU internal market, to create an economic environment favourable to the economic wellbeing of EU firms and consumers. The task assigned to EU trade policy was essentially to maintain open markets at home and in the world by promoting adherence to the WTO’s multilateral rules-based trading system, which includes the possibility of bilateral or regional free trade agreements (FTAs) that go deeper (WTO plus) and wider (WTO extra) than multilateral commitments.

Today, the landscape for EU trade policy has changed drastically. In addition to, and partly in competition with, its traditional objective of economic wellbeing, it has also become a tool for other objectives, including European economic security (also known as open strategic autonomy) and the European Green Deal. Another way to frame this, however, is to argue that the meaning of economic wellbeing has been expanded from a narrow interpretation that focused on efficiency, to a broader one that now also includes security (or resilience) and climate sustainability, even though each one of these objectives might be the response to distinct concerns. EU trade policy must grapple increasingly with the potential conflict (or trade-off) between efficiency and security and climate.

EU trade policy is also increasingly subject to the conflict between multilateralism (which has been a key value promoted by the European Union in the pursuit of its own interest and that of the international community to which it belongs), bilateralism (which may or may not be compatible with, or contribute to, multilateralism) and unilateralism. We argue in section 5 that multilateralism should remain central in the
formulation of EU trade policy and why. Here, instead, we focus on bilateralism and unilateralism, which are two features of current EU trade policy.

4.1 The EU’s bilateral and regional free trade agreements

The EU has long maintained a vast network of bilateral and regional FTAs, by far the largest in the world in terms of the number and economic size of the countries they encompass.

During the current European parliamentary term (2019-2024), the EU has further expanded (and deepened) its large FTA network. New FTAs have entered into force with Japan, Singapore, the United Kingdom and Vietnam. The EU is also negotiating new FTAs with Australia, India and Indonesia, on which progress has been slow. An agreement with New Zealand was reached and then ratified by the European Parliament but has not yet been implemented. In addition, the EU has concluded (with Mexico) and ratified (with Chile and Kenya) or is still negotiating (with South Korea and Singapore) agreements to modernise old FTAs. Finally, the EU has tried, without success so far, to amend a previously signed but never ratified old FTA agreement with the Mercosur countries (Argentina, Brazil, Paraguay and Uruguay).

China and the United States have far fewer FTAs and have been far less active than the EU in recent years. China was the driving force behind the Regional Comprehensive Economic Partnership (RCEP) agreement (signed in 2020 and implemented in 2022), which counts 15 members: China, the ten ASEAN countries, Australia, New Zealand, Japan and South Korea. By contrast, the United States has not implemented, concluded or even negotiated new FTA agreements – with the exception of the US-Mexico-Canada (USMCA) agreement, which replaced the NAFTA agreement.

The motivation behind the proliferation of EU FTAs is two-fold. First, there is traditional economics: market access for EU exporters. Second, there is also the geopolitical situation, which requires security of foreign-market access for EU exporters at a time of uncertainty about the fate of the WTO multilateral trading system, and security of access to critical raw materials for EU buyers, especially in the context of the green transition. Uncertainty about the WTO relates perhaps more to the situation in the United States with the potential re-election in 2024 of Donald Trump to the presidency, while uncertainty about access to critical raw materials relates more to China, which has continued to limit exports of certain materials, despite some of its earlier WTO commitments.

It is striking that, in recent years, the EU has managed to secure relatively easily deals with like-minded OECD countries (including Japan, New Zealand and South Korea), but has encountered great difficulty in reaching agreements with large countries from the Global South (including India, Indonesia and Mercosur). An important issue for the future of EU FTAs is whether this contrast in the ability of the EU to reach trade agreements with Global North and Global South partners is linked to purely mercantilist factors or to a geopolitical fracture between the North and the South, with some EU specificity.

Our feeling is that although mercantilist factors and the political economy of exchange of concessions on market access naturally play an important role in all trade negotiations, regardless of whether they are North-North, North-South or even South-South, there is an added and increasingly problematic dimension in the case of North-South, and in particular EU trade negotiations with large countries of the Global South.

As the 2024 Global Risks Report noted:

“Dissatisfaction with the continued political, military and economic dominance of the Global North is growing, particularly as states in the Global South bear the brunt of a changing climate, the aftereffects of pandemic-era crises and geo-economic rifts between major powers. Historical grievances of colonialism, combined with more recent ones regarding the costs of food and fuel, geopolitical alliances, the United Nations and Bretton Woods systems, and the loss and damage agenda, could accelerate anti-Western sentiment over the next two years” (World Economic Forum, 2024, p. 26).
In this context, as Borchert et al. (2021) implicitly remarked, the Lisbon Treaty (which comprises the Treaty of the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU)) poses a problem to trade deals with some countries, in particular those in the Global South, the values of which are not always the same as the EU’s. The reason for this is that the Lisbon Treaty requires that EU trade policy “be guided” by EU values. To be precise, Art. 21(1) of the TEU states that:

“The Union’s action on the international scene shall be guided by the principles which have inspired its own creation, development and enlargement, and which it seeks to advance in the wider world: democracy, the rule of law, the universality and indivisibility of human rights and fundamental freedoms, respect for human dignity, the principles of equality and solidarity, and respect for the principles of the United Nations Charter and international law.”

During the next European Parliament term, the EU will have to resolve this clash one way or the other in its negotiations with India, Indonesia and the Mercosur. There is a trade-off, and the question for the EU will be what kind of transitions it will accept from its FTA partners before they can meet its standards (and of course, whether the EU will be willing to help finance their climate transitions).

4.2 The EU’s unilateral/autonomous instruments

The Global South is also an important part of the difficulty the EU will face during the next European Parliament term as it seeks to implement the myriad of autonomous instruments it has put in place since 2019, and more particularly since the publication by the European Commission (2021a) of the EU Trade Policy Review, which put forward the contours of an EU “trade policy that supports the EU’s open strategic autonomy”.

Having defined open strategic autonomy as “the EU’s ability to make its own choices and shape the world around it through leadership and engagement, reflecting its strategic interests and values”, the 2021 EU Trade Policy Review indicated that it encompasses not only resilience and competitiveness, sustainability and fairness, but also “assertiveness and rules-based cooperation to showcase the EU’s preference for international cooperation and dialogue, but also its readiness to combat unfair practices and use autonomous tools to pursue its interests where needed” (European Commission, 2021a, pp. 4-5, emphasis added).

The autonomous tools introduced since 2019 are clearly designed mainly to defend the EU against unfair practices and aggressive unilateral actions on the part of China and the United States. These EU tools include the Foreign Investment Screening Mechanism, the Enforcement Regulation, the International Procurement Instrument, the Foreign Subsidies Regulation and the Anti-Coercion Instruments. It remains to be seen whether China or the United States (or any other country) will bring a case against the EU at the WTO if they are affected by these autonomous instruments (to the extent that they come under WTO competence), and, if so, how the EU would react to an unfavourable WTO ruling.

Not all autonomous tools are intended to combat unfair practices. Three autonomous instruments (CBAM, the Deforestation-free Regulation, and the not-yet adopted Corporate Sustainability Due Diligence Directive) are intended to reduce EU and global carbon emissions. These three instruments are strongly opposed by the Global South (see, for instance, Lamy et al., 2023), which considers them as unfair because the instruments do not make any allowance for these countries’ relatively low levels of development, nor their past and present per-capita carbon emissions, which are extremely low compared to the EU’s (except China, where per-capita CO2 emissions are now higher than in the EU).

The opposition of the Global South to CBAM, the Deforestation-free Regulation and the Corporate Sustainability Due Diligence Directive risks not only creating a legal problem (with some of these countries bringing cases to the WTO’s Dispute Settlement Body), but even more importantly, it risks creating a political problem between the EU and much of the Global South. The EU would do well to avoid this for several reasons. First, the Global South is where economic growth is the most dynamic in the world. Second, and a corollary of the first, the Global South is now responsible for two thirds of global carbon
emissions. Without cooperation between the Global North (including the EU) and the Global South, hopes that the world will meet the 2050 Paris Agreement targets would be completely misplaced. What would be the point of the EU meeting the high ambition it has set for itself in the European Green Deal and bringing its net carbon emissions to zero by 2050, if Global South countries decided that the Green Deal’s autonomous measures are proof that the EU does not respect the Paris Agreement’s principle of Common but Differentiated Responsibilities and Respective Capabilities and, therefore, reduced their own carbon-reduction efforts? Third, the EU needs access to critical raw materials, which it generally lacks, and which are often located in the Global South.

5 Challenges for the multilateral trading system

In our view, ensuring that the WTO remains in place and relevant is the best buffer against potentially very costly economic conflicts that could arise from geopolitical tensions.

The economic dangers and losses resulting from the collapse of the WTO cannot be overstated. Production would no longer necessarily take place in the most efficient places when trade is regionalised. We have provided evidence above about the costliness of near-shoring and friend-shoring, and the uncertainty surrounding the viability of such endeavours. Competition would decrease and prices increase if international trade barriers increase. Innovation could also suffer if domestic competition and access to foreign markets decrease.

Regionalism is no substitute for multilateralism, but it can be a useful complement. Regional trade agreements operate against the background of multilateral trade liberalisation. Jagdish Bhagwati, a well-known trade economist, once quipped that MFN (most-favoured-nation) has become de-facto LFN (least-favoured-nation) treatment since participants in regional trade agreements – free trade areas (FTAs) or customs unions (CUs) – enjoy access at lower-than-MFN rates, and the number of such agreements has mushroomed. Still, this is better than a world without the WTO and with no MFN treatment, in which countries outside regional trade agreements would have little protection against all kinds of restrictions by FTA or CU participants.

And, alas, there is more. The most-optimistic scenario is that the WTO crisis will be self-contained. But this might prove to be wishful thinking. Lack of cooperation risks having negative spillovers elsewhere as well. How can nations expect cooperation in facing global challenges such as climate change when they cannot deliver on trade? Undoing the multilateral fibre will unavoidably strengthen economic nationalism. Then there is a feedback loop because one of the risks consistently associated with economic nationalism is the ensuing waning of global cooperation.

National security looms large in this discussion, and national security is of course non-negotiable. National security is a perennial commitment of nations and governments. It was not much of an issue for the multilateral trading system during the Cold War, since ‘our enemies’ were outside GATT, and trade sanctions could be imposed on them without questioning GATT disciplines. Now, the targets of invocations of national security (mainly China and Russia) are WTO members. The manner in which national security is understood, therefore, matters.

Most national security invocations originate in the advanced world. The US is the champion of national security measures challenged before a WTO panel. There have been 14 cases adjudicated so far, and the US has been the respondent in 12 of them, the direct outcome of President Trump’s haphazard invocation of national security to justify restrictions in the steel market.

Some might blame the sorry state of WTO adjudication for the current predicament of the WTO. It is true that, with the Appellate Body in abeyance, ‘appeals into the void’ have proliferated. The EU’s sponsored Multi-Party Interim Agreement (MPIA) has not managed to become the “ersatz Appellate Body” (in the words of US WTO Ambassador Dennis Shea) its sponsors intended it to be.
The WTO has three functions: legislative, adjudicative and monitoring of compliance. The first worked well during the GATT years and the initial WTO years, which saw the signing of various services sectoral agreements in the realm of trade in services (financial, telecoms), and the Information Technology Agreement. Since then, the WTO has managed to add only two agreements to its regime, and they are not the most impactful: trade facilitation and fisheries subsidies. At the same time, preferential regional trade agreements with increasingly divergent content have mushroomed. Adjudication has taken a serious hit too: only five cases have been adjudicated on average per year since 2019, compared to 25 between 1995-2019. Monitoring continues as before, but monitoring of what? It makes little sense to monitor outdated legal instruments and the lack of implementation of panel reports (because of the possibility to appeal into the void). But even if the crisis of the adjudicative function of the WTO were resolved, could the issues described above be solved through adjudication? We doubt it.

To start with, the US would never agree to implement adverse reports that involve national security, since in its eyes national security is not justiciable. Non-implementation could lead to a spiral of counter-measures. But there is more. The two measures most frequently used to erect trade fences currently are subsidies and export restrictions. The WTO Subsidies and Countervailing Measures (SCM) Agreement is economically un-informed and outdated. It considers all subsidies ‘bad’ and hence countervailable. Furthermore, the working hypothesis of the SCM is that national and corporate frontiers coincide. This is why transnational subsidies cannot be counteracted. But in today’s world, GVCs are ubiquitous, thus putting into question one of the foundations of the SCM Agreement.

Moreover, there is no agreement on export licensing, even though there is an agreement on import licensing. All export licensing, even when legitimate, is in principle considered an export restriction that must be justified by the respondent. Think of it this way. An import licensing scheme must observe the WTO Import Licensing Agreement. A complainant will carry the burden of proof to show that a WTO member adopting an import licensing scheme has violated the requirements of the Import Licensing Agreement. The existence of an import licensing scheme is not equated to an impermissible import restriction outlawed by virtue of Article XI of GATT. The opposite is true when it comes to export licensing as there is no export licensing agreement. All the complainant has to do is show the existence of an export restriction in a piece of legislation. This suffices to show that Article XI of GATT has been violated, as panels do not request demonstration of trade effects or intent to restrict. It will be for the respondent to show that its measures can be justified through recourse to Articles XX (General Exceptions) or XXI (Security Exceptions) of GATT. It is high time the membership returned to the old idea of enacting an export licensing agreement.

The US has attempted to resolve its large bilateral trade deficit with China outside the multilateral context (though without success). China is resilient and can withstand pressure. In Mavroidis and Sapir (2021), we argued that the WTO offers the most promising pathway towards addressing this issue. Granted, the WTO has suffered several blows (in particular the demise of the Appellate Body), but it is still around and continues to be the global forum to negotiate trade agreements, address trade concerns and litigate trade disputes.

So, what to do under the circumstances? How can the WTO membership be persuaded to go back to business as usual? Proliferation of national security invocations suggests that the trading community needs to rebuild trust. How to do that? In our view, WTO members must first resolve the crisis of the WTO adjudicative function. The realistic option might be to take one step back from the situation in 1995 when compulsory third-party adjudication was unanimously agreed. Emulating the example of the International Court of Justice (ICJ) could be workable: those that want to continue with compulsory third-party adjudication should do so on reciprocal basis. Those that do not could always do so on an ad-hoc basis. The problem with this approach, however, is that the US and other big players (including probably India) are likely to stay outside of compulsory third-party adjudication, so the system would remain divided into two groups of countries, each with important players, as is currently the case with the MPIA. In addition, it
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might be worth contemplating whether a class of sensitive cases (such as national security cases) should continue to be entrusted to part-time non-professional ‘judges’, or whether it would be wiser to provide for a procedure before a National Security Committee or a body akin to that. The current WTO’s adjudicative system seems to be not well-equipped to deal with such issues, both because of its lack of legitimacy (as opposed to the WTO membership) and (very often) because of insufficient expertise.

Legislative initiatives need to be undertaken in a few areas. The renegotiation of SCM and state-trading top the list. The EU could play a leading role here, precisely because of its own experience. The EU possesses a very workable state-aid regime that, with adjustments, could inspire a WTO negotiation. Ditto for the manner in which it has dealt with state-owned enterprises in the single market.

The WTO discipline on state-trading enterprises (Article XVII of the GATT) should be brought back to its original drafting intent: the overarching obligation must be that state-trading companies act in accordance with commercial considerations. A legislative amendment is warranted since it is case law that deviated from the spirit of the drafters. In addition, the scope of Article XVII should be expanded to cover all state-owned enterprises.

The SCM Agreement also needs to change. Two priorities stand out. First, the countervailing of cross-national subsidies (as trade in increasingly conducted through GVCs) should be allowed. Second, the old idea of ‘good’ subsidies (embedded in Article 8 of SCM) must be reinstated. It makes no sense to presume that all subsidies have nefarious effects that outweigh whatever good they produce. This is an important point especially because of what comes next.

In a recent submission to the WTO, the EU sided decisively with those calling for exemptions to the current SCM Agreement:

"Under certain conditions, well-designed subsidies make an important contribution to achieve the climate transition and other environmental goals."

The EU submission also noted that some subsidies can harm both trade and the protection of the environment, arguing that:

"The rules of the WTO are not sufficiently effective in tackling the negative external spillovers of state intervention in the economy. Lack of transparency of some interventions aggravates the problem."

The EU submission focused the attention of the membership on the seriousness of the problem which, if left unaddressed, risks undermining the relevance of the WTO. The EU staunchly supports increased transparency in this context and argues for action along the lines of a joint publication by the IMF, OECD, World Bank and the WTO (IMF et al, 2022).

The WTO membership should also start a discussion about coherence in international economic relations. The achievement of the Paris Agreement, for example, could prove to have been in vain unless the WTO SCM Agreement is revisited: nations might need to have recourse to subsidies to achieve the objectives embedded in the Paris Agreement and similar agreements. There are various ways to do this through legislative means. But a key condition is to include the development dimension in the discussion. Reinstating Article 8 SCM (or a provision along these lines) is necessary but not sufficient. Many developing countries simply lack sufficient resources to subsidise their way to achievement of the targets set in the Paris Agreement. Allowing for the countervailing of cross-national subsidies is tantamount to allowing the countervailing of foreign aid (as well). An exception should be introduced that would allow developed nations to help finance the efforts of developing countries to meet their Paris commitments in terms of carbon emissions.

The contribution of the WTO has been essential for the world trading community. Pause for a moment and think of the counterfactual: how would international trade look like without the WTO? The relative demise of the WTO’s relevance has entailed the emergence of increasing lawlessness, with the membership
appealing into the void all disputes on which they had lost their arguments, and thus making a mockery of the multilateral rules. European Commission President Ursula von der Leyen put it aptly when she stated, in the midst of the COVID-19 pandemic, that:

“Yes, we want change. But change by design – not by destruction of the international system. And this is why I want the EU to lead reforms of the WTO and WHO so they are fit for today’s world. But we know that multilateral reforms take time and in the meantime the world will not stop. Without any doubt, there is a clear need for Europe to take clear positions and quick actions on global affairs”.

6 Conclusions and recommendations

Over the next five-year European Parliament term, the factors likely to shape EU trade policy will again be, like during the current five-year term, geopolitics and the climate transition.

Our first recommendation is that, in implementing EU trade policy instruments, policymakers should take into account not just their potential benefits but also their potential costs.

It is no doubt important to ensure economic security and to achieve a certain degree of strategic autonomy in order to ensure that our societies can continue to enjoy the values they have set for themselves. But it is also important to continue to maintain a high standard of living for citizens that can be best achieved by maintaining an open trade and investment regime. The EU recognised as much when it endorsed the concept of ‘open strategic autonomy’, which suggests that openness and autonomy can go together, although many see them as mutually exclusive.

Likewise, although the EU needs to continue to pursue the goal of meeting the targets of the Paris Agreement, it should also better take into account the potential costs of some of its instruments with a trade dimension for the ability and willingness of other players to do their part. In particular, EU policymakers need to be reminded that the Global South, namely China and the other developing and emerging countries, already account today for two-thirds of global carbon emissions, and that without cooperation between these countries and the Global North (which includes obviously the EU), the fight against climate change cannot be won.

Our second recommendation, therefore, is to continue seeking international cooperation at both multilateral and bilateral levels.

The best way to ensure that openness and economic security go together is for the EU to encourage international cooperation (involving crucially China and the United States) and to negotiate new WTO rules. As Bown (2024) rightly warned, in “a non-cooperative policy environment, much of what comes next for the European Union … rests outside its control, determined by the policy decisions by [China and the US]” (Bown, 2024, p. 37).

Similarly, the best way to ensure that the EU’s and the Global South’s climate objectives work in the same direction is to recognise that development has been the missing side of the trade-environment-development triangle, and that unless the development dimension is taken into account, the EU’s trade and climate policies will not work because of the backlash from developing and emerging countries (Lamy et al., 2023). This requires development assistance tied to climate measures, which should be pursued through both multilateral and bilateral channels. But there is also a need to engage with the Global South on the trade agenda. Rather than increasingly deploying unilateral trade measures that anger the Global South, the EU should seek cooperation with these countries to revise WTO rules on trade and climate.

Our third recommendation is about EU leadership on the WTO and multilateralism.

The EU is clearly divided between the proponents of the two approaches: those who favour the traditional EU stance in favour of multilateralism, and those who view multilateralism as passé and a sign of weakness or even naivety. An additional layer of complexity comes from the possibility that Donald Trump will return
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to the White House in January 2025 and will further weaken multilateralism in all its aspects, including trade. How should EU trade policy react to this possibility if it materialises and President Trump erects new trade barriers, including against EU exports, without even paying lip service to WTO rules?

Can and should an EU in search of strategic autonomy also remain wedded to multilateralism when the great powers of China and the US appear to be either flouting multilateral rules (China) or simply disregarding them (the US)? The situation of China and the US is very different in this respect.

China appears to be committed to multilateralism as its active engagement at the WTO’s 13th Ministerial Conference (MC13, 26 February to 2 March 2024) demonstrated. At the same time, its economic system (‘state capitalism’) is difficult to reconcile with existing WTO rules. Hence, continuing to engage China to reform some WTO rules, in particular on subsidies, is crucial.

The situation in the US is more complicated. Although during his first term in office President Biden has not devoted any political capital to strengthen the WTO, he might change his position if he were re-elected for a second term. On the other hand, a second Trump presidency would further reduce the US involvement at the WTO. This does not mean, however, that the EU should also give up on the WTO. On the contrary, all the other WTO members would surely expect leadership on the part of the EU to ensure that multilateralism remains alive during this difficult period, as it has during the past five years despite the strains on the system.

To this end, the EU should propose a comprehensive blueprint for WTO reform, in order to provoke discussion among WTO members on major issues including governance (the consensus rule), dispute settlement and subsidies (including in relationship to the climate transition).

The next years will be crucial not just for EU trade policy but even more so for the fate of the multilateral trade and investment system and the capacity of the international community to cooperate in fighting climate change. It is precisely because geopolitical tensions have increased so much that multilateralism in general and the WTO in particular need to be preserved to avoid grave economic and climate consequences.

Our fourth and last recommendation is about pragmatism. Being pragmatic as far as trade is concerned means reinforcing the EU's network of FTAs as an insurance policy to preserve the goal of open strategic autonomy. In recent years, the EU has vastly expanded its network of FTAs (the biggest in the world) and has modernised it by adding new clauses (for instance on crucial raw materials) in existing or new agreements. During the next five-year political cycle, the EU will have to decide whether to conclude and ratify free-trade agreements with large partners from the Global South, in particular India, Indonesia and the Mercosur. Our view is that it should and that by doing so, despite some difficulties in reconciling the need to take into account the values mandated by the Lisbon Treaty, on the one hand, and EU economic interests, on the other. There are trade-offs here, but these can overcome if the EU accepts transitions in meeting its standards and is willing to help finance the climate transitions in the Global South.

The EU should also work with its FTA partners from the Global South (including Brazil and India, probably the two least-constructive WTO members at the recent MC13) to foster multilateralism, even (and especially) if a Trump-led US were to decide to withdraw from multilateralism.
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