

The Global Trading System in a Time of Geopolitical Disruption

Prof. Robert Koopman
School of International Service
American University

Trade and Economic prospects for 2023 will slow sharply

- WTO trade forecast revised downward to 1% from 3.4%.
- 2022 will remain strong at 3.5% on the back of COVID recovery policies and early year lockdowns that shifted demand from in-person services to tradeable goods.
- IMF forecasts global GDP growth to slow from 6% in 2021 to 3.2% in 2022, and down to 2.7% in 2023.
- IMF also sees global inflation going from 4.7% in 2021 to 6.5% in 2022, and then dropping to 4.1% in 2023.

In three major players for global trade, the US, EU and China all face different policy challenges.

- In the US the FED has raised interest rates significantly, the recent SVB/banking “crisis” and increased political uncertainty seems to be slowing the US economy, but thus far not a rapid slowing.
- US inflation drivers were strong fiscal and monetary stimulus driving demand during a period of supply chain disruptions and tight labor markets.
- Traded goods prices have come back down, but now other inflation drivers remain stronger than many expected.
- In Europe inflation has been driven much more supply shocks, from COVID19 disruptions but particularly Russia’s invasion of Ukraine disrupting energy and food supplies.
- China faces a more rapidly slowing economy due to debt challenges around property markets, a crackdown on the digitally intensive sectors of the economy, and following a very stringent COVID19 lockdown policy that only recently was lifted. Recent policy developments aim to address these challenges, but not clear how effective they will be.

Outside of these macro economic developments- security, climate and health challenges could disrupt global trade and international cooperation...

- We a significant ramp up in US trade and commercial policy tensions with China over national security drivers in the technology area.
- The longer term trend of the US expressing concerns, and taking policy steps, has been amped up significantly with the Biden Administration's export controls on advanced node semiconductor chips and manufacturing equipment, AI and supercomputing.
- The US did took these actions with little public consultation with allies, and appears only recently to begin public engagement with them on this set of policies.
- Great uncertainty remains on how the policy will be implemented, on how effective it will be – particularly if allies do not join in.
- The policy will likely contribute to continued short term disruptions in semiconductor chip supply chains, but will also likely result in a global realignment of those supply chains over the next 2 to 5 years. A major question remains whether that realignment results in significant re-shoring to the US, a coordinated supply chain among US allies, or a fragmentation of the global supply chain into competing spheres.
- The US has also introduced significant domestic policies around R&D and manufacturing subsidies in the semiconductor sector as Europe contemplates similar actions. This is likely to result in at least some re-shoring of production, but its not clear how substantial that reshoring will be.
- That reshoring will also likely result in a diversion of resources away from other sectors in the US – keeping in mind the US has been operating at or near full employment for a number of years. Most policymakers don't consider the economic constraints that advanced market economies operate under – there are few unemployed resources lying about to be used for such activities and therefore overtime must come from other sectors.
- The US Inflation Reduction Act is also causing tensions with some close allies over subsidies, or lack of them to their EVs due to electric battery component sourcing from China and similar countries. Once again consultation with allies seems to have come after the fact.
- Another area causing potential trade tensions comes from green transition policies in general.

Climate change and global health challenges require global cooperation to solve these global commons challenges.

- With US trade and commercial policies becoming more aggressive around national and economic security, China's dual circulation policy aimed at ensuring its firms capture more of its domestic market growth combined with a challenging domestic economic environment, Europe aiming to support domestic producers in the semiconductor, tech firms and green transition sectors, AT the same time with have a major military conflict in Europe disrupting politics and energy and food supply chains
- This all adds up to a great deal of uncertainty for global trade and cooperation on cross border commercial policies.
- The next year or two will likely be ones of continued disruption in international trade as supply chains try to adjust in an environment of great economic and policy uncertainty.

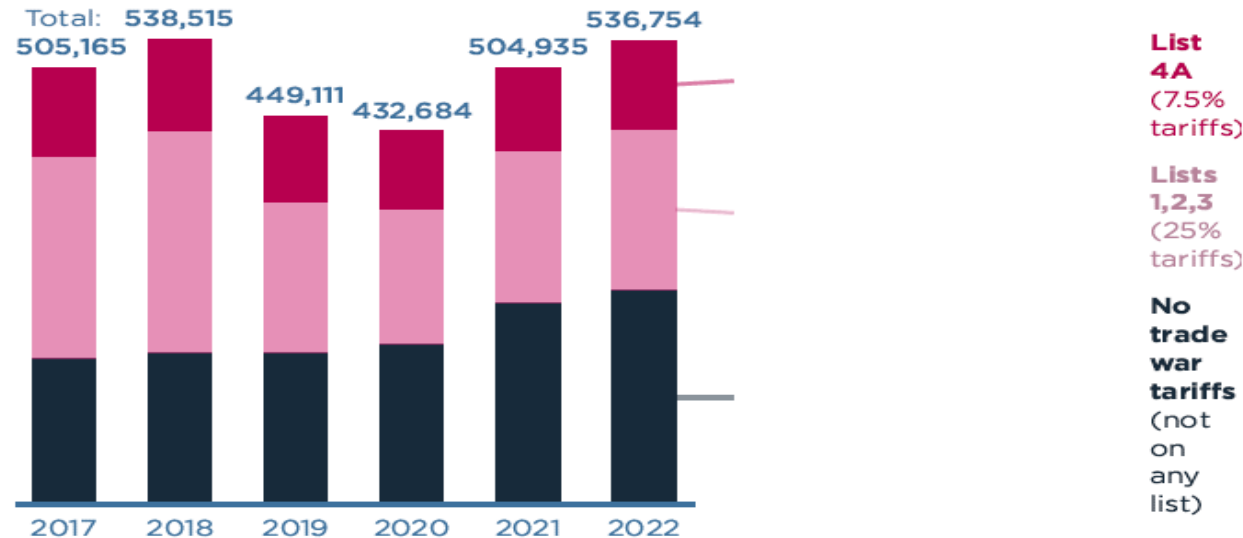
Demise of globalization? No, a reorganization of globalization.

- No evidence of reshoring, more evidence of trade diversion/diversification.
- Global trade share of global GDP slowed but stabilizing (with variation) at around 30%.
- Faster growth in services trade, including harder to measure data flows.
- So composition of trade is definitely shifting...consistent with growing share of services in GDP and decline in manufacturing VA in most advanced economies. More output, but less value. Driver...automation in nearly all economies...ag to mfg to services increasingly looking like ag to services. See Baldwin on Globotics.
- But supply and demand balance in globalization needs more attention...supply more diversified, but demand seems still US (and EU) centric. Need for better macro coordination rather than micro policy applications...
 - Repressed consumption in China? Germany's relative wages and weak demand? See Michael Pettis' work.
 - Something to watch going forward...will fast growing, converging economies encourage consumption or repress it?

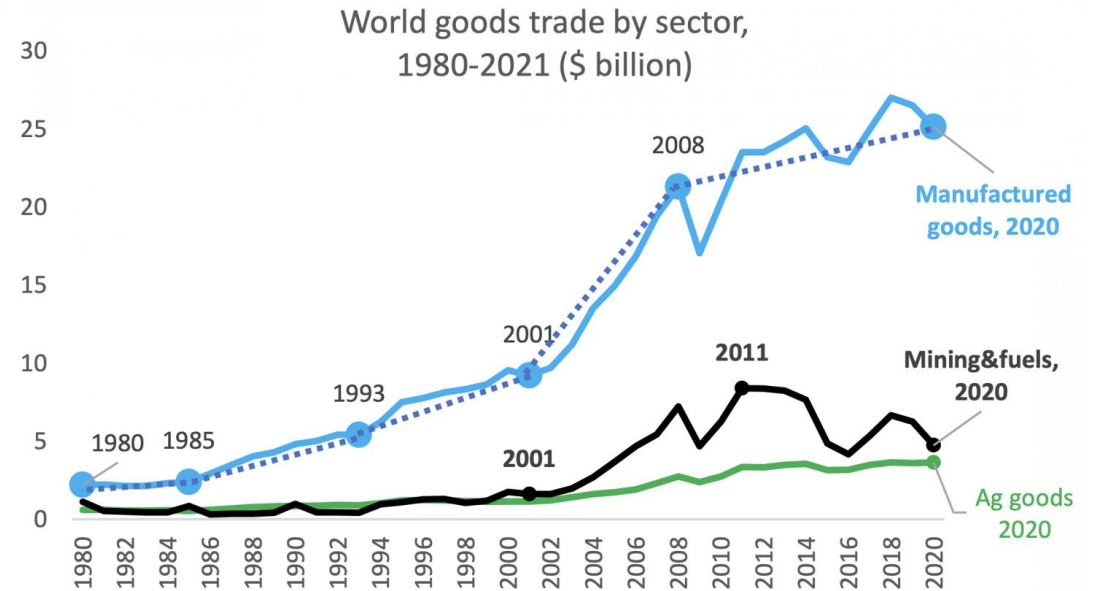
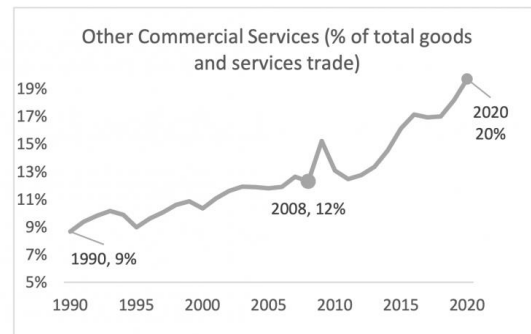
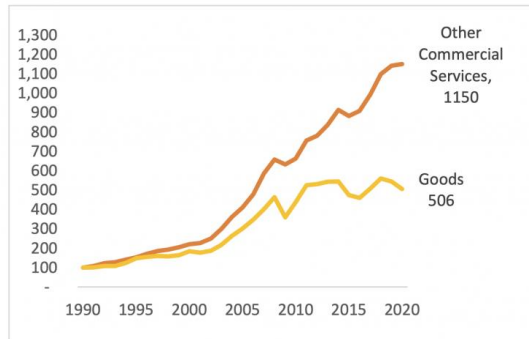
Trump tariff policies haven't worked to "fix" US China trade imbalances....tariffs don't fix macro driven savings/investment imbalances.

US imports from China are both decoupling and reaching new highs. Here's how.

a. US annual goods imports from China by trade war tariff list, millions of US dollars (current), 2017-22



Peak globalization? Services continue to grow fast, and goods trade affected by price changes.



Source: Baldwin, using WTO data, 2023

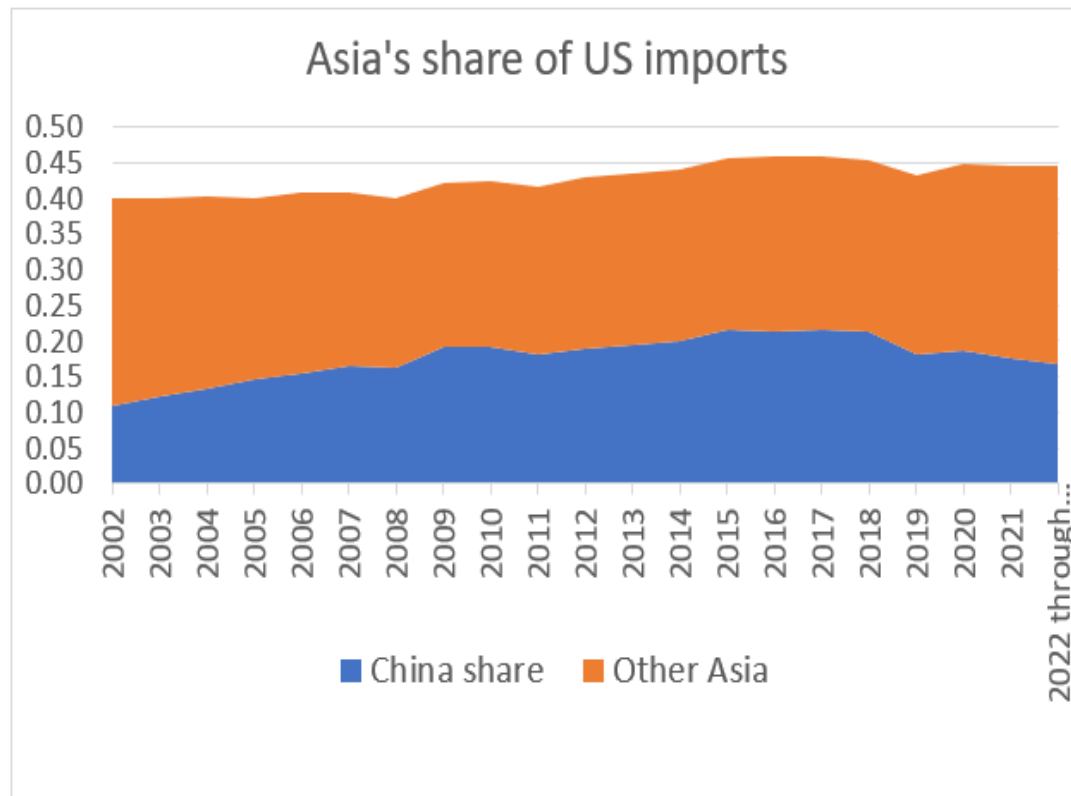
The WTO and Fragmentation?

- Multilateral cooperation on trade has been challenged for many years, and recent developments suggest its getting harder.
- The world currently could be on a path to fragmentation, with like minded bloc integration replacing global integration and this would generate significant economic opportunity costs.
- What are the potential traditional economic costs of this shift? (Metivier, Bekkers, Bacchetta, and Koopman, 2023)
 - There is a lot at stake for global trade cooperation with the difference between cooperation and rivalry being 8.6% of global GDP growth in 2050 - global real GDP increasing by 3.2% compared to the baseline under multilateral cooperation and decreasing by 5.4% under geopolitical rivalry.
 - LDCs would gain the most from multilateralism (real GDP increases by 4.8%)
 - Geopolitical rivalry leads to a 21 percentage points decrease in exports between Western and Eastern blocks from 46% to 25%

Backlash against globalization stressing multilateral cooperation on trade

- In one country in particular, the United States, political developments have emphasized the role of trade, and cooperation around trade, as driving mechanisms of a number of economic and social challenges.
 - Among the challenges identified are: growing income inequality, long term reduction in manufacturing jobs, concentrated geographic income shocks, adverse health and wellbeing outcomes.
 - More recently political arguments have been made regarding both economic and national security concerns and supply chain resilience.
 - While the literature is pretty clear that trade contributes to these challenges it is also pretty clear that trade is not the main cause, and as a result, not the main source for a solution to these challenges.
 - However the Trump and Biden administrations have pursued, perhaps with different intents, trade policies that are characterized as solving these challenges.
- Most other advanced economies have not experienced the same extent of domestic shocks while exposed to the same level of globalization and integration, nor have they taken the extreme policy decisions that the US has with respect to trade.

Some myths in the US...



Source: US Census Bureau

- Similarly to what happened from the 1980's onward Asia's share in US imports remained reasonable constant, while China's share crowded out other Asian countries initially (Japan), and peaking at 22% in 2017, China's share of US goods imports has fallen to 17% No evidence of reshoring: US import value grew 21% from 2017-2021 compared with 4% from 2013-2017 Nor nearshoring: Rest of Asia absorbed the drop, with Asia's share of US imports flat at ~45%

The context for multilateral cooperation

- Slow progress in negotiating multilateral outcomes since the creation of the WTO in 1995.
 - Multilateral agreements on Trade Facilitation Agreement and MC12 outcomes on Fisheries Subsidies.
 - Notable plurilateral outcomes on ITA expansion and domestic regulation.
 - Multilateral work continues on Fisheries, WTO reform.
 - MC12 also resulted in numerous Ministerial Declarations and Decisions such as:
 - a package on WTO response to emergencies, comprising: a Ministerial Declaration on the Emergency Response to Food Insecurity ([WT/MIN\(22\)/28](#)); a Ministerial Decision on World Food Programme (WFP) Food Purchases Exemptions from Export Prohibitions or Restrictions ([WT/MIN\(22\)/29](#)); Ministerial Declaration on the WTO Response to the COVID-19 Pandemic and Preparedness for Future Pandemics ([WT/MIN\(22\)/31](#)); a Ministerial Decision on the Agreement on Trade-related Aspects of Intellectual Property Rights ([WT/MIN\(22\)/30](#)); a Decision on the E-commerce Moratorium and Work Programme ([WT/MIN\(22\)/32](#)); an Agreement on Fisheries Subsidies ([WT/MIN\(22\)/33](#)).

Further challenges are well known... for example around the WTO Appellate Body

- US refusal to allow appointments to the Appellate Body, means the second tier of the two-tiered dispute settlement process is not functioning as negotiated. Note the EU led alternative has made its first determination.
- The vast majority of WTO members support restarting the two tiered system – though most have also accepted that reform and updates should be negotiated...but so far the US has not engaged substantively in negotiations and only making general statements about its interests.
- The US has also invoked national security claims (Article XXI) around its tariffs on steel and aluminum and more recently related to its economic sanctions on semiconductor chips,
- Somewhat ironically a national security claim was first invoked formally at the WTO by Russia on trade with Ukraine.

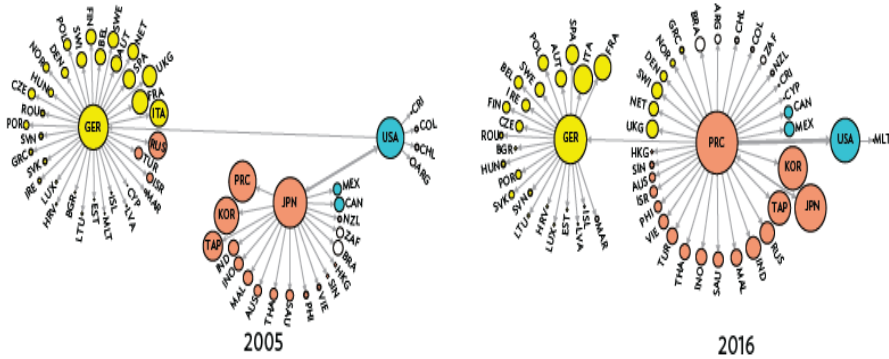
And a broader set of challenges...

- Trade tensions between the US and China, which started in 2018 materialized as an average 17% increase in bilateral tariffs and led to reduced bilateral trade, trade diversion effects, value chains re-organization in Asia and increased uncertainty (Bekkers and Schroeter, 2020).
- The war in Ukraine and the sanctions adopted by a number of countries against Russia have also disrupted longstanding economic relations (OECD, 2022, WTO, 2022a).
- The COVID19 pandemic – supply chain disruptions from related health and trade policy responses.
- In this context, the shortages and dependencies that have become more visible during crises have triggered talk of friend-shoring, re-shoring, fragmentation and de-coupling, often around both broad economic security concerns and national security concerns. (Posen, 2022, Xing et al., 2021).

GVC Development Report 2021 - The evolution of manufacturing production and demand based value chains. US drives demand – so its policies matter – but Europe integrated regionally and globally – yellow circles.

Figure 1.8: Complex Global Value Chain Networks, Supply Perspective, 2005 and 2016

a. Domestic Manufacturing Firms



b. Multinational Manufacturing Firms

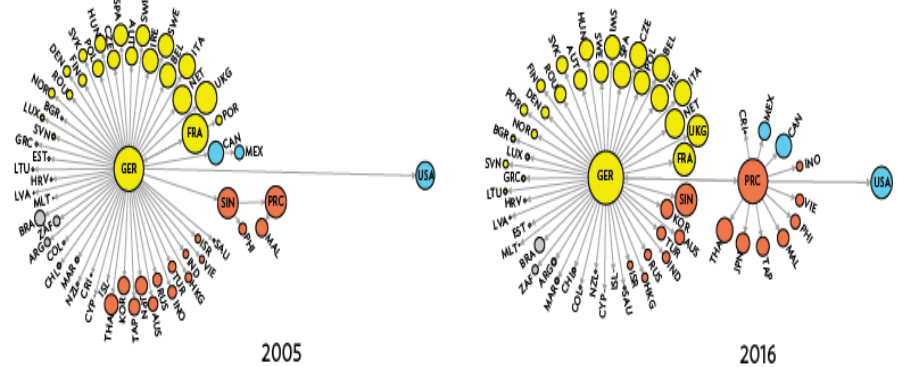
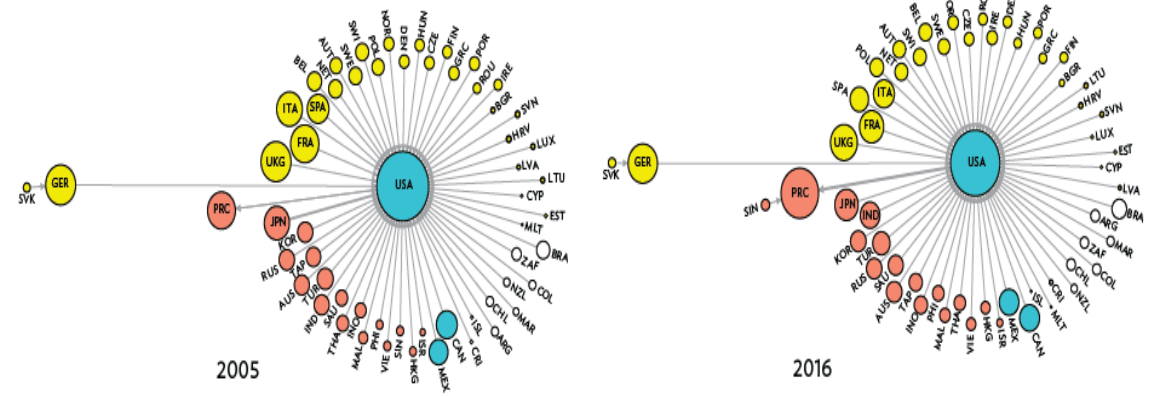
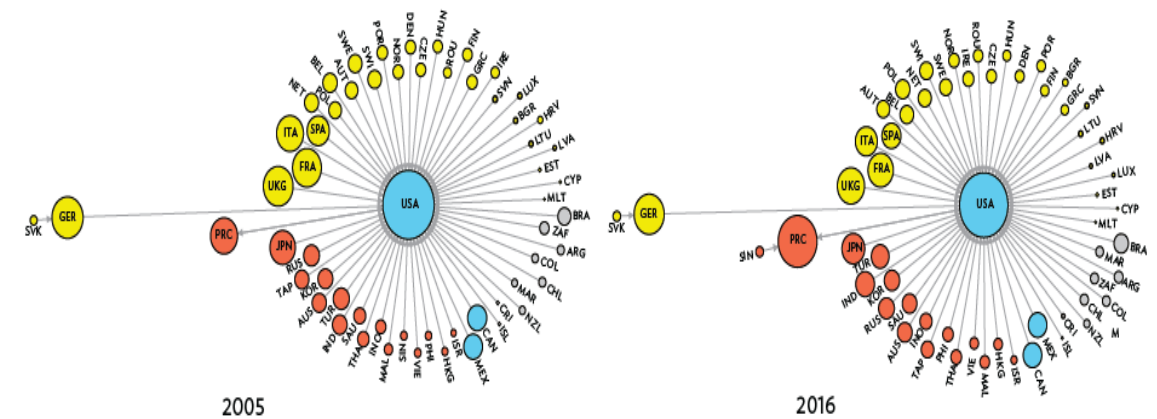


Figure 1.9: Complex Global Value Chain Networks, Demand Perspective, 2005 and 2016

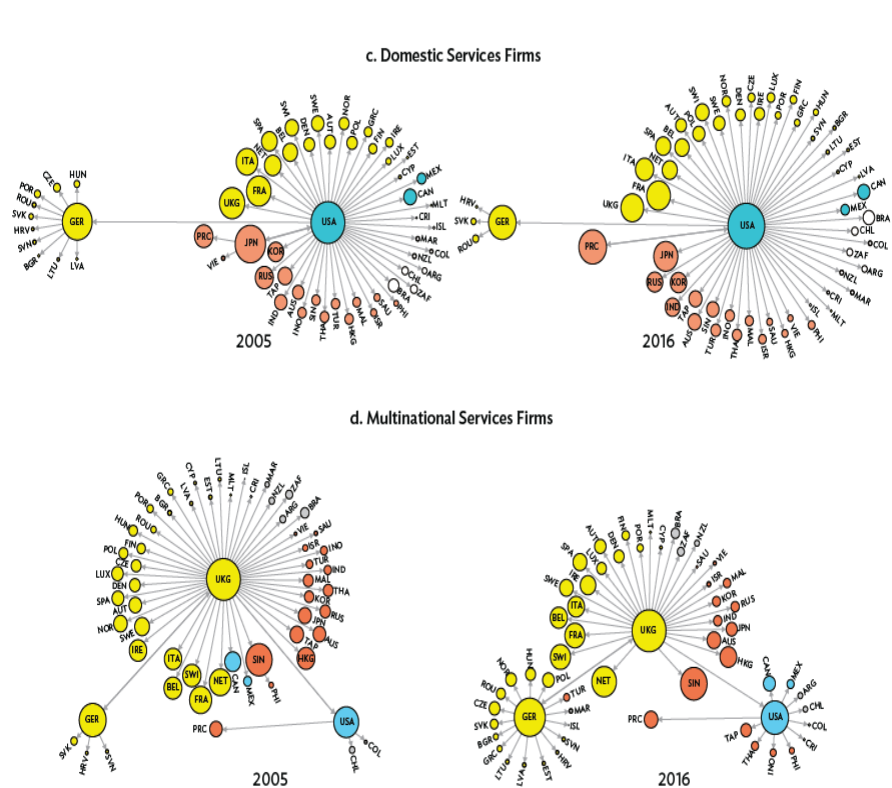
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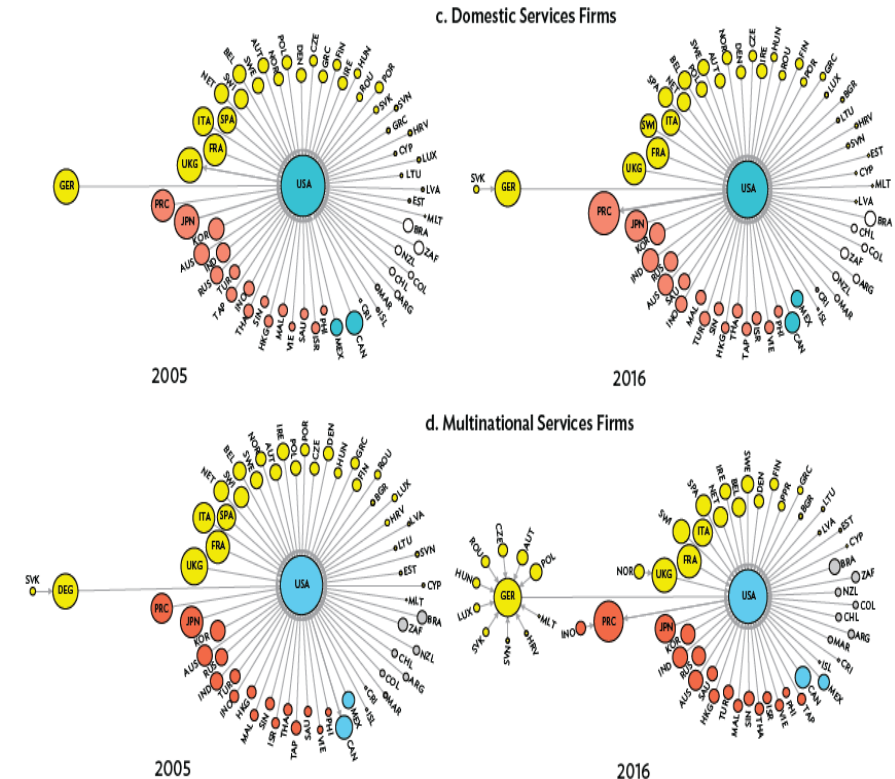
b. Multinational Manufacturing Firms



The evolution of services production and demand based value chains. US drives demand – so its policies matter here also



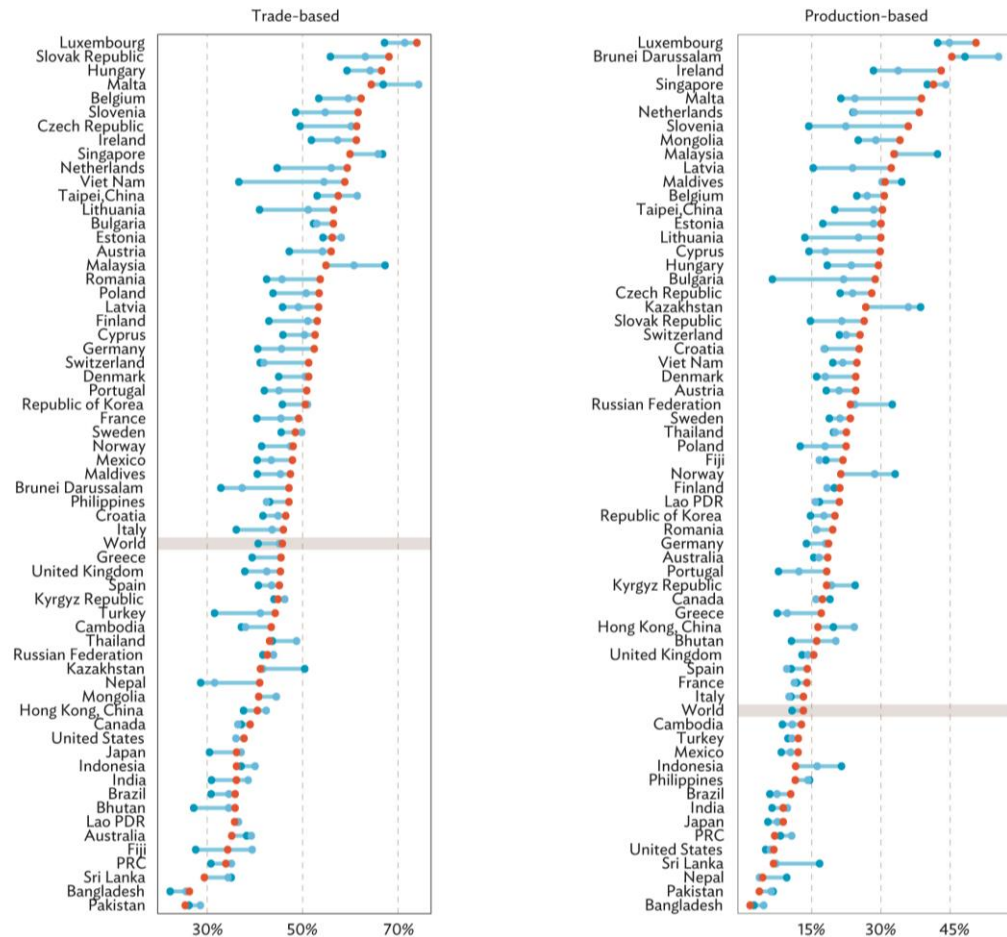
Sources: Y. Gao, B. Meng, G. Suder, and J. Ye. 2021. Who Dominates Global Value Chains? Multinationals vs Domestic Firms. *IDE Discussion Paper*. No. 825. Chiba, Japan: Institute of Developing Economies – Japan External Trade Organization; Organisation for Economic Co-operation and Development. Analytical Activities of Multinational Enterprises Database. <https://www.oecd.org/sti/ind/analytical-amne-database.htm> (accessed 31 July 2021).



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Recent Trends in Global Value Chains – while not growing as fast as historical rates still growing in aggregate. China’s role declining.

Figure 1.2: Measures of Global Value Chain Participation, 2000, 2010, 2019 (%)



➤ Almost all economies had seen participation expanded between 2000 (dark blue dots) and 2019 (red dots).

➤ The participation rate for Germany: 45.6% in 2010 & 52.4% in 2019;

But

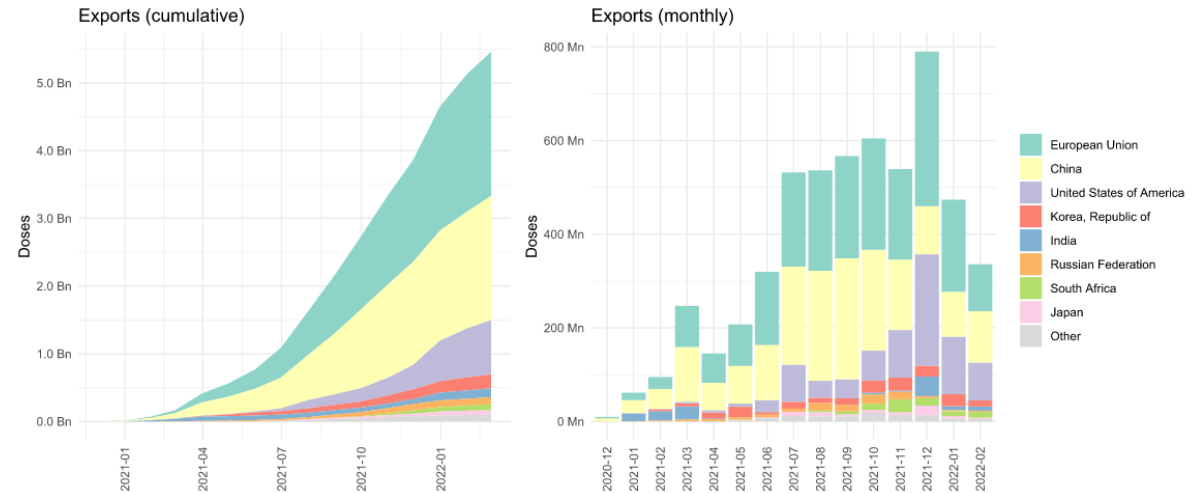
➤ The GVC participation rate of the PRC, the center of global manufacturing assembly: 35.1% in 2010 & 33.9% in 2019;

Some insights on multilateral cooperation on trade from recent COVID crisis

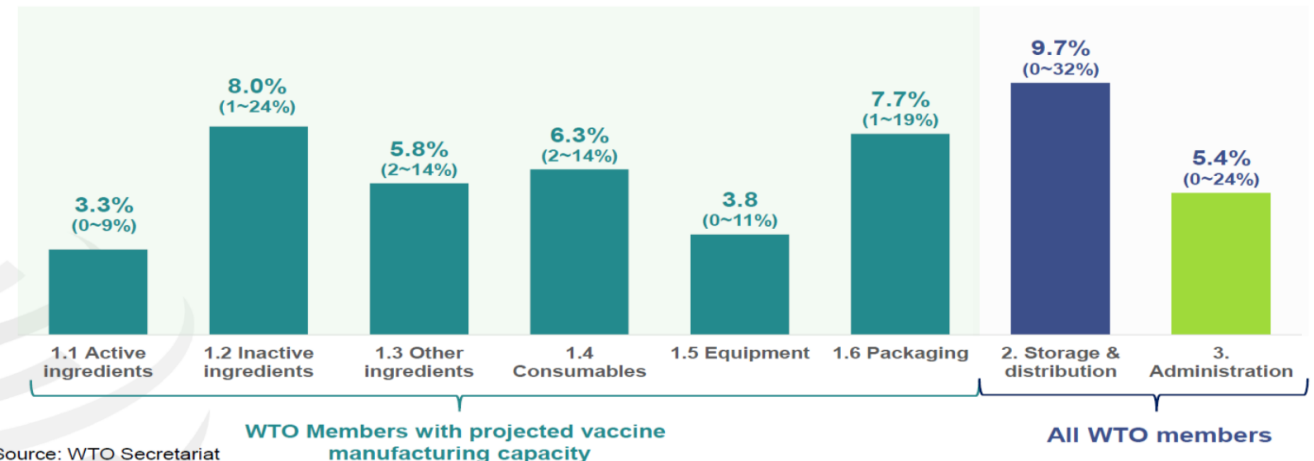
- Total estimated production in mid-2022 >15 billion doses or 25 billion?
 - Manufacturers worried about potential excess supply in the future
 - Production and export of vaccines is concentrated in few countries
- ... and appear to develop in increasingly complex supply chains
- Takes years to build domestic capacity – far from just IP, but complex know how and management skills.
 - Trade barriers include:
 - Tariffs on vaccines inputs range between 3% and 10%
 - Some countries with production capacity have restricted their export

Based on the confirmed information: 32 economies restrict exports on at least 1 input for the production of vaccine, 21 use export bans and 11 export licensing schemes.

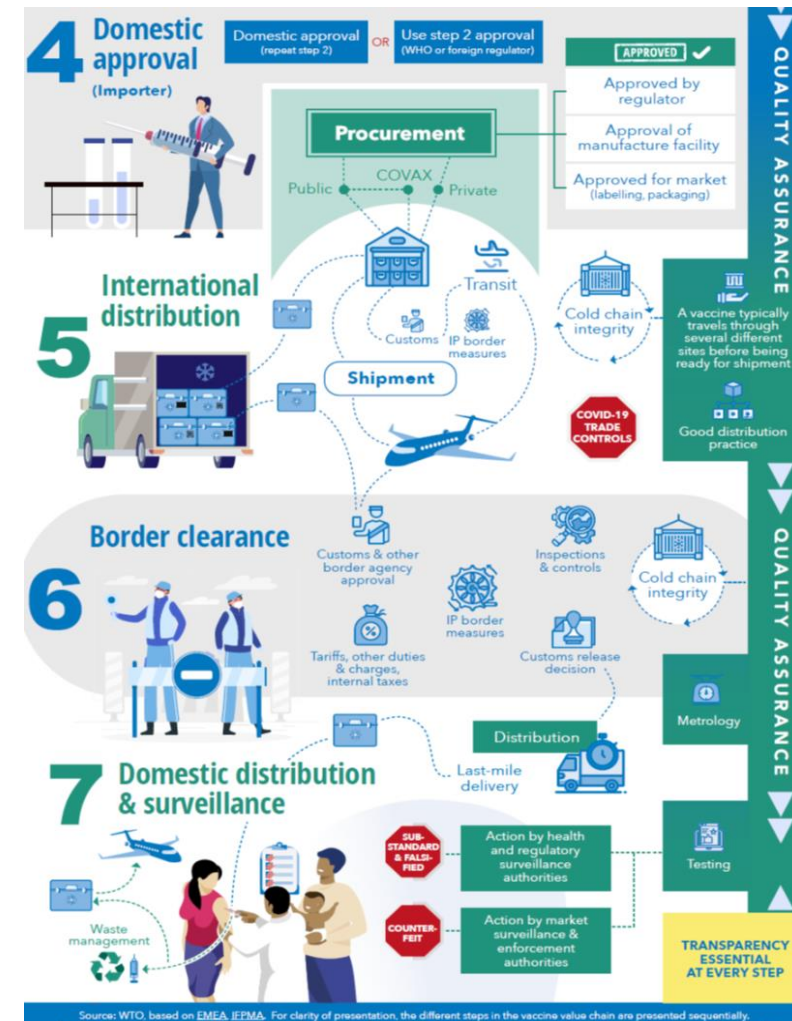
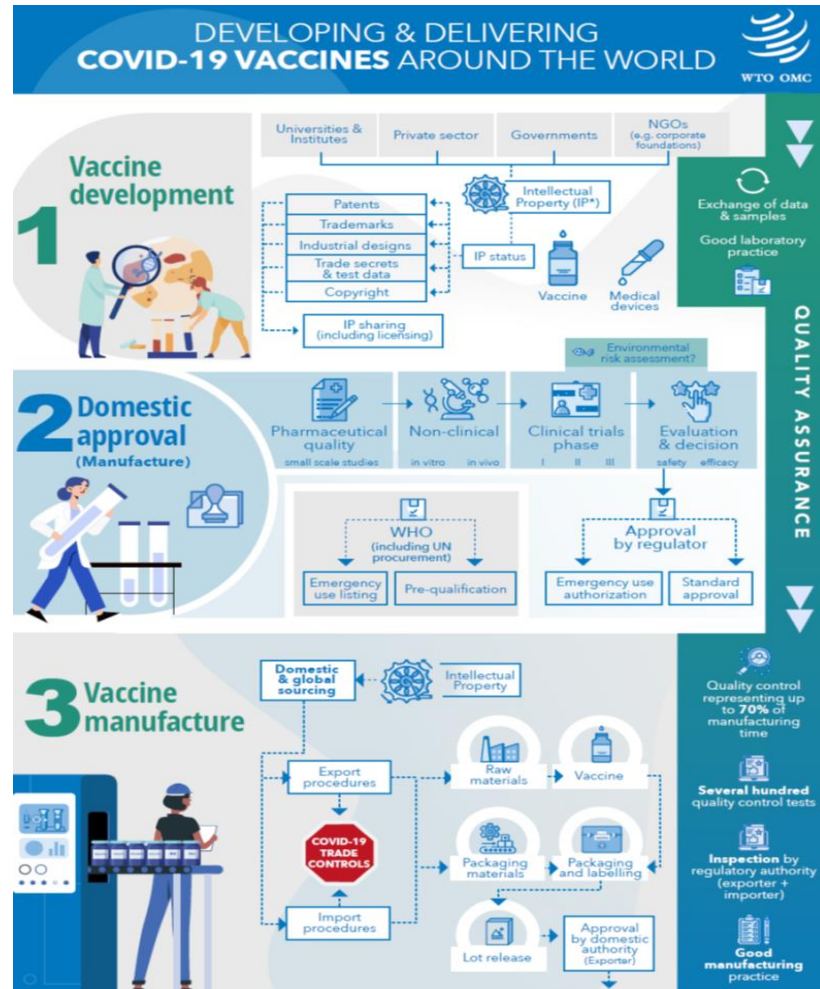
Vaccines Exports by producing economy



What are the average tariffs levied on critical vaccine inputs? Selected WTO Members with COVID-19 vaccine manufacturing capacity

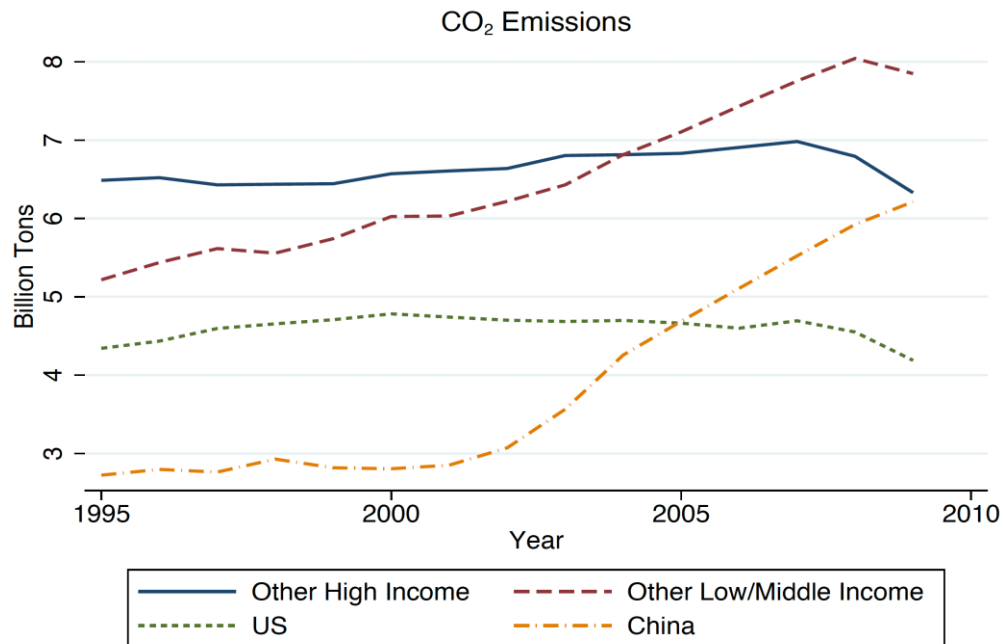


What's needed to get vaccines produced and distributed? Trade plays a critical role...

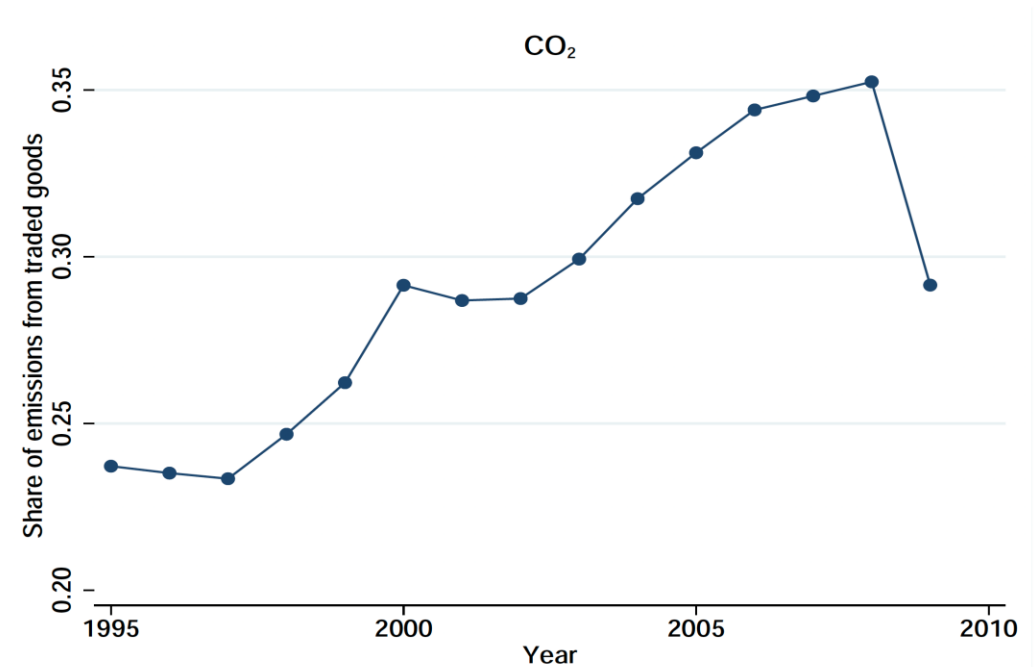


Trade and Climate Change? A global commons challenge...

Trade or growth responsible for increase in carbon emissions?



Carbon emissions embodied in international trade – keep in mind domestic trade also embodies emissions



Source: Copeland, Shapiro and Taylor – Globalization and the Environment.

Shapiro – bias in trade policies toward “grey goods”

- Global trade appears to raise carbon emissions by about 5% - what is the counterfactual?
- The “gains” from trade appear very large compared to relative to “cost” of carbon emissions induced by trade.
- But has environmental degradation been an unintended side effect of trade policy reform?
- Existing structure of trade protection stimulates trade in pollution-intensive goods Shapiro (2021): tariff and non- tariff barriers are lower in carbon intensive industries than in clean industries.
- Upstream industries are more carbon intensive
- Upstream industries face lower trade barriers

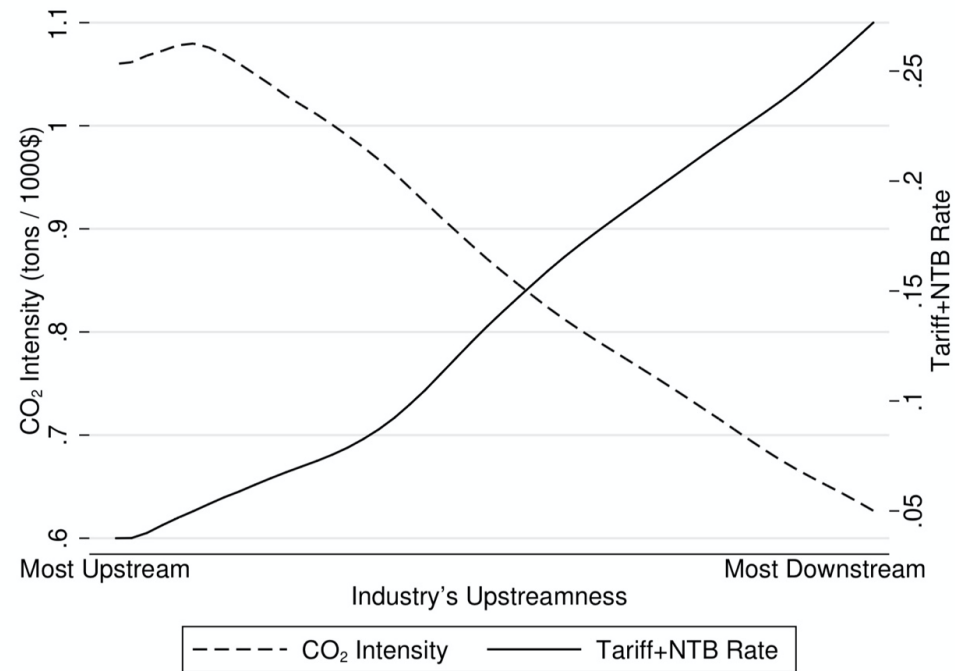


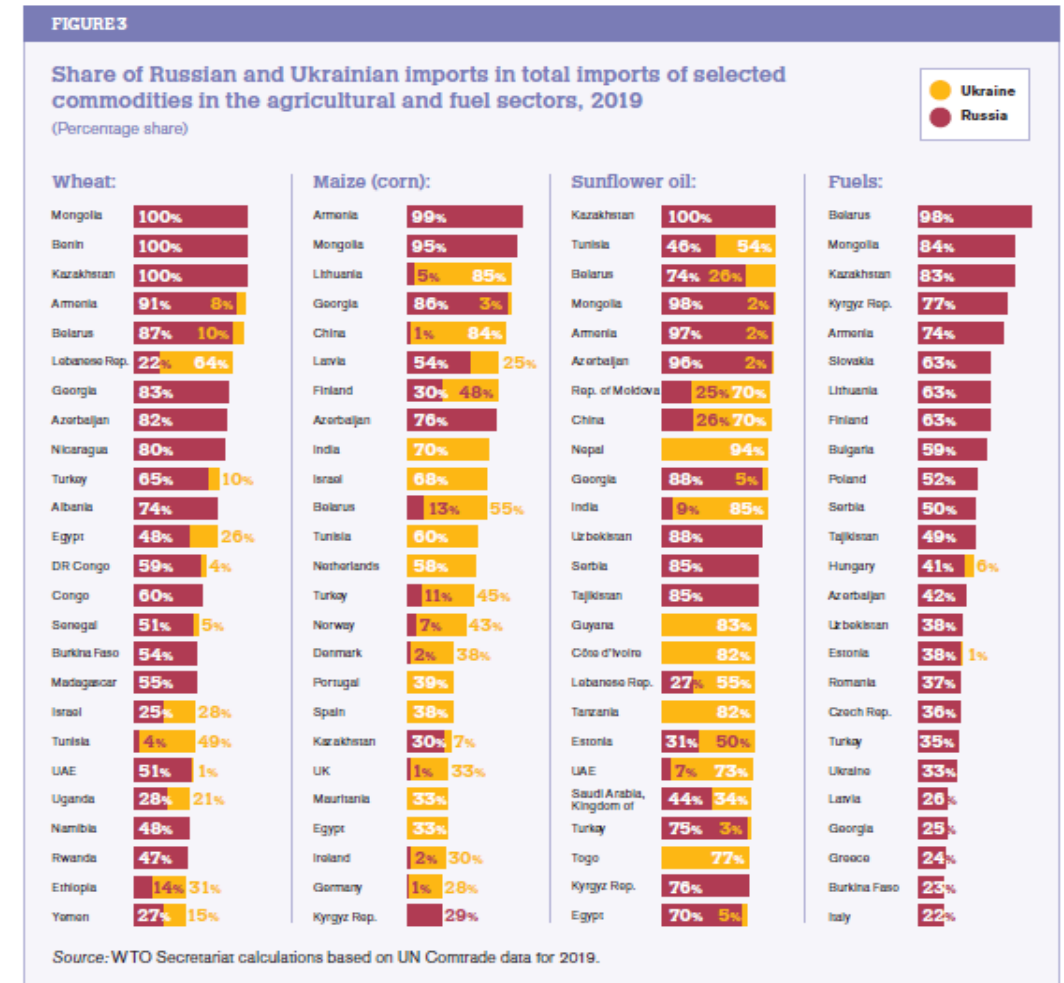
Figure 9: Pollution intensity, upstreamness, and protection.

War in Ukraine...

The world is connected...and onshoring does not solve problems like some think

- The most immediate economic impact of the Russian invasion of Ukraine was a sharp rise in commodity prices. Despite their small shares in world trade and output, Russia and Ukraine are key suppliers of essential goods including food, energy, and fertilizers, supplies of which are now threatened by the war. Grain shipments through Black Sea ports were halted, with initially dire consequences for food security in poor countries. BUT Global Markets responded...and global grain trade (like oil trade) has been reorganized...because of an open global trading system that could adapt. Prices have come down and supplies appear adequate.
- But the war is not the only factor weighing on world trade at the moment. Now we have increasing tensions between the US and China, US and allied trading partners, and increasingly difficult debt challenges in many developing countries.
- Fragmentation is likely to slow growth, particularly for developing countries, and countries further from the global productivity frontier through slower and fewer technological spillovers and rising trade costs.

The immediate issue: Food Security – Solution? Reasonably well functioning global markets.



Conclusions

- We are entering a period of global trade disruption not seen in many decades.
- Global trade growth has slowed but not declined, while services trade growth has remained strong, and global supply chains are realigning as firms look to minimize increased political and natural uncertainty while balancing against search for continued efficiency gains.
- Global economy faces many global commons challenges which require increased cooperation....at a time when global cooperation appears to be declining, while cooperation within spheres of influence may be increasing.