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### **PSSG 2. REINVENT GLOBALIZATION: CAN AN EXPORTS LED MODEL STILL SUSTAIN EUROPE'S PROSPERITY INTO AN INCREASINGLY FRAGMENTED WORLD?**

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The world is in deep turmoil and international trade facing the biggest challenges probably in a century. Trade tensions, if not outright trade wars, are on the rise. While globalization has generated economic welfare benefits, it hasn't benefited all alike and thus led to a huge setback. Nationalistic policies aimed at protecting domestic markets, national welfare and jobs flourish based on national security considerations. Protectionist measures and policies are spinning out of control and are applied with a disregard to the rules of the WTO. Multilateralism and the world trade order are under threat and so is the very existence of the WTO, which risks becoming increasingly irrelevant, if it cannot restore order. Economic growth is on the decline. The world has entered a period of chaos and uncertainty, which in turn affect productive investment and global value chains. The validity of the old trade paradigms need to be reconsidered in light of the new economic realities and there is an urgent need for appropriate policy responses.

Rising tariffs, export limitations and controls, as well as investment restrictions lead to growing trade policy uncertainty for the global economy and, according to the WTO, a sharp deterioration in the prospects for world trade. Following a strong performance in 2024, the world merchandise trade is projected to decline, thus marking a reversal from earlier forecasts, with an anticipated

continued trade expansion, supported by improving macroeconomic conditions. According to the WTO, the reciprocal tariffs would reduce global merchandise trade growth by an additional 0.6 percentage points, thus leading to a 1.5 per cent decline in world merchandise trade volume in 2025.

The escalation of trade conflicts, a rise of tariffs to peak levels never seen before, followed by tit for tat policies, worsen the economic prospects. The ongoing tariff war and the proliferation of unilateral economic security policies have eroded trust in global trade and significantly undermined the rules-based framework established under the WTO. A process of de-coupling, de-globalization has led to economic fragmentation, a re-orientation of trade, the forming of new alliances along geographic lines, a significant decline in FDI and a trend towards (forced) re-shoring, near-shoring, friend-shoring. While trade integration and specialization increase economic efficiency, so does the risk factor inherent to a high interdependency between nations. As ‘a chain is as strong as the weakest link’, the longer the chain, the higher the vulnerability. Both the risks and vulnerability were further exposed during Covid and increased following the geopolitical trade wars.

Nationalistic policies are increasingly paired with pro-active industrial policies in support of potential winners. Governments’ industrial policies specifically target high technology sectors to generate value addition and create a competitive edge. Government support programs include R&D funding and subsidies which significantly distort markets. At the same time, limitations in access to critical minerals through import and/or export bans affect the supply lines and the very existence of industries that depend on these inputs.

This leads to the question how efficiency can be secured in an increasingly fragmented and polarized trading environment and taking into account both national security and global economic interests? What trade policies offer the most appropriate response to the new economic realities and what WTO reforms can fix the system and make it relevant again? How can a framework be designed that preserves openness while minimizing vulnerabilities? Last but not least, what role is there for the EU to play?

It is time for bold actions, taking into account the new economic realities. Several lines of action are proposed to put the trading system back on track:

1. Rebuild trust in trade and strengthen global cooperation: Given the critical role that trade and investment play as key drivers of economic welfare and development, a first action consists of rebuilding trust in trade. This includes ensuring stability, predictability, security, transparency and

sustainability. This requires a credible multilateral trading system, relevant rules and a commitment to resist protectionism and unilateral trade measures.

2. Reforming the WTO: The WTO needs fundamental reforms to regain relevancy and credibility. The rules need to be flexible and adaptive to the new economic realities and challenges of today. This includes inter alia a review of the process of decision making, which has paralysed the WTO, revisiting its rules, making new rules where required, taking into account the role of investment, services and digitalization in GVCs, adopt plurilateral agreements (e.g. IFDA, e-commerce) and fixing the dispute settlement system, including through a plurilateral approach such as the Multi-Party Interim Appeals Arbitration Arrangement (MPIA).
3. Coherence in policies: Achieving more inclusive, resilient, and sustainable outcomes requires intensified global cooperation and coherence in economic policies at the global level. This includes coherent and sustainable industrial policies, avoiding subsidy wars and creating new economic opportunities for developing countries in support of their fuller integration into the trading system.
4. Diversification: revisit global value chains, diversifying suppliers, making them inclusive, sustainable and more resilient, thus decreasing their vulnerability and avoiding supply shocks. This includes engaging developing countries in the supply lines and as part of a re-globalization.
5. Regional integration: Regional trading blocks should be complementary to multilateralism rather than becoming alternatives and/or substitutes, thus avoiding a further fragmentation of the world economy along geopolitical lines.