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**TRADE IN 2022:
TRENDS TO WATCH**



— THOUGHT LEADERSHIP

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TRADE IN 2022: TRENDS TO WATCH

As global supply chains continue to be hampered by COVID-19, and geopolitical competition escalates in many parts of the world, trade policy is set to be a crucial issue for businesses and governments in 2022. Here are six trends to watch.

Heightened trade tensions show little sign of easing in 2022

Many will have hoped that, a year on from both Brexit and the end of a US Administration which saw trade wars as "good and easy to win," 2022 would signal a return to a more open and predictable global trading environment. But while we are unlikely to see trade policy develop in real time via tweet in 2022, much of the underlying trade friction that has been evident in recent years is likely to continue into 2022; including in the following areas:

- **Trade relations with China remain fraught.** Relations with China continue to be a defining feature of global trade policy, and trade tensions between China, the US and the EU show little signs of easing in 2022. US-China supply chains continue to be impacted by Section 301 tariffs imposed by the US on over \$350 billion of Chinese imports and despite the potential reinstatement of exclusions for certain industries, there seems to be a limited prospect of major reform to the policy in 2022. Indeed, US Trade Representative Katherine Tai has not ruled out an additional Section 301 investigation into Chinese subsidy practices – which could set the scene for even greater pressure on the US-China supply chains in 2022 and beyond. The EU and Australia are also grappling with an increasingly fraught trading relationship with China, as security concerns and diplomatic issues increasingly spill over into the trade relationship. This has led to both Australia initiating two WTO challenges to Chinese tariffs on wine and barley, and the EU challenging restrictions on imports from Lithuania.
- **A new EU-UK relationship emerges...slowly.** A year on from the conclusion of the Brexit transition period, the EU-UK trade relationship continues to be a source of uncertainty and friction. From agriculture, to customs administration, to financial services, the relationship between the UK and the EU has not yet settled into a new normal. A durable long-term solution to the Northern Ireland Protocol is likely to be a prerequisite for regularising the trade relationship between London and Brussels, but the technical details of any deal remain almost as challenging to resolve as the political hurdles. Progress on the Protocol is also critical to unlocking the relationship between London and Washington, with the Biden Administration indicating that the removal of US Section 232 tariffs on UK steel and aluminium, and progress on a UK-US FTA, may depend on the EU and the UK soothing tensions over Northern Ireland.
- **Trump's broader tariff legacy endures.** While the Biden Administration has adopted a more diplomatic tone on trade policy, it has shown no urgency in removing Trump-era tariffs on a range of products from steel and aluminium, to washing machines, to solar panels. While the US's removal of additional tariffs on steel and aluminium from the EU and Japan (subject to quota limits) suggests that the Biden Administration is willing to consider a rollback of Section 232 tariffs on a case-by-case basis, the absence of a deal with the UK or other allies highlights that the Biden Administration is in no hurry to roll back key aspects of the Trump Administration's tariff-focused trade policy. The continuation of section 232 tariffs may come under new pressure during 2022; several WTO challenges to the tariffs are set to be released during the year, which will test both the Biden Administration's attitude to the WTO dispute settlement system, as well as the strength of its resolve to continue a Trump-era tariff policy.

As multilateralism struggles, plurilaterals fill the gap

The World Trade Organization is facing the most challenging period since it was established in 1995. With new Director General Ngozi Okonjo-Iweala's attempt to reinvigorate discussions all but thwarted by the indefinite postponement of the Twelfth WTO Ministerial Conference (MC12) in November 2021, and the WTO Appellate Body remaining in a state of hibernation, the prospect of a major breakthrough at the WTO in 2022 is slim. However, while progress at the multilateral level is slow, plurilateral initiatives – both under the auspices of the WTO and through regional grouping – are filling some of the gaps. The Regional Comprehensive Economic Partnership (RCEP) – covering Australia, Brunei, Cambodia, China, Indonesia, Japan, South Korea, Laos, Malaysia, Myanmar, New Zealand, the Philippines, Singapore, Thailand, and Vietnam – is the world's largest trade bloc by population and entered into force on 1 January 2022, making the tangle of FTAs in the Asia-Pacific region easier for businesses to use. Other key points to watch in 2022 include:

- **The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) is set to become more comprehensive.** 2021 saw a wave of economies express interest in joining the Asia-Pacific trade bloc, with formal applications now received from the UK, Taiwan, Ecuador and China, and interest from South Korea and Thailand. The UK will be first off the mark to start accession negotiations in 2022, with existing CPTPP members likely to use the UK's accession as a precedent for future accession negotiations.
- **The US is unlikely to join anytime soon.** Despite being an original architect of the Trans-Pacific Partnership (the basis for CPTPP), the US, under President Biden, has shown little appetite for pursuing new trade liberalisation. Trade Promotion Authority expired in July 2021, potentially impacting the Administration's future trade negotiations. However, US desire to maintain influence in the Indo-Pacific has the potential to see increased cooperation with trading partners in the region on a targeted set of issues, with US Trade Representative Katherine Tai indicating that the United States may establish a new Asian economic framework in 2022.
- **Progress on multilateral reforms at the WTO continues to be slow.** COVID-19 saw the postponement of the Twelfth WTO Ministerial Conference (MC12) in December 2021, and uncertainty remains about if and when the talks will be rescheduled. Progress on institutional reform of the WTO (particularly the dispute settlement mechanism, the scope of special and differential treatment for developing countries, compliance with notification obligations, and the setting of future negotiating priorities) will be critical to breaking the longstanding deadlock in the WTO's negotiating agenda. While the Biden Administration has indicated a greater willingness to engage at the WTO, its focus on US domestic priorities means that any progress on WTO reform in 2022 is likely to be incremental.
- **WTO plurilateral discussions are maintaining some momentum.** The longstanding gridlock in the WTO negotiating agenda has seen the development of several initiatives among a subset of WTO members – with some sitting only loosely within the formal WTO architecture. The conclusion of new rules on services domestic regulation in December 2021 illustrates the potential of these initiatives to drive progress in the WTO negotiating agenda – albeit with relatively limited ambition compared with some modern FTAs. Look out for progress on similar initiatives on E-Commerce, Investment Facilitation and Trade and Sustainability in 2022.
- **The UK remains in deal mode:** With the UK's first wave of FTAs now under its belt (with continuity agreements reached between the vast majority of EU FTA partners, and new deals inked with Australia and (almost) New Zealand), the UK now faces the challenging prospect of negotiating a deal with India alongside its accession to CPTPP. While preferential access to what will soon be the world's third biggest economy would be a true Brexit dividend, the UK is likely to face an enormous challenge in negotiating a commercially meaningful deal with New Delhi, which has historically been reluctant to open its market through FTAs.

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The EU's strategy of "open strategic autonomy" continues to take shape

The EU's pursuit of a trade policy based on "open strategic autonomy" has seen the development of an active regulatory agenda, which is set to continue in 2022. This contains a raft of proposals of interest to EU trading partners, including foreign subsidy reform, anti-coercion regulation, a CBAM, environmental and human rights due diligence, digital services regulation and more. It also comes on the back of an increasing number of EU countries requiring FDI filings. This multifaceted set of reforms sends a strong message that access to the EU single market requires exporters to subscribe to an increasingly broad set of EU objectives relating to sustainability and a level playing field. Some particular areas to watch in 2022 include:

- **Anti-coercion:** In response to the increasing use of tariffs and trade barriers as a means of exerting political and economic pressure, the EU has **proposed a new mechanism** enabling it to use trade countermeasures (including tariffs and other restrictions) against instances of economic or political coercion by other States. The instrument is likely to attract significant scrutiny from trading partners and businesses, as it reflects a growing trend by many States towards weaponising trade measures (outside the confines of the WTO dispute settlement system) to achieve broader policy objectives.
- **International Procurement Instrument:** A longstanding EU proposal to increase reciprocity in access to public procurement looks likely to advance in 2022, following approval by the European Parliament's Committee on International Trade in December 2021. Among other things, the latest iteration of the proposal would, in some instances, require EU public contracting authorities to apply a pricing penalty to bids from suppliers in third countries that have been designated by the Commission as engaging in restrictive or discriminatory procurement practices.
- **Foreign Subsidy Regulation:** While WTO subsidy rules have traditionally focused on disciplining subsidies granted by governments to domestic producers of goods, the EU has become increasingly concerned at the potential for subsidies granted by non-EU governments to distort competition *within* the EU single market for goods and services (either by facilitating the acquisition of EU enterprises, or facilitating participation in public procurement). Similar subsidies would, if they were granted by the government of an EU Member State, in some instances be subject to EU state aid rules and potentially blocked – leaving a perceived gap in coverage from the perspective of EU regulators. A European Commission **proposal** seeks to close this gap through a series of measures that would require companies undertaking significant EU investments or procurement to make extensive disclosures of financial contributions received by non-EU governments. However, the compliance obligations associated with the implementation of the regime in its current form would be extremely broad-ranging in scope, and may face push-back from multinationals and EU trading partners.

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Digital trade, tech, and national security

As governments race to keep up with the rapid evolution of the digital environment – in areas including AI, cloud storage, encryption, telecommunications, self-driving vehicles and blockchain technology – tensions between national security interests and tech protectionism are on the rise. Areas to watch in 2022 include:

- **Digital trade agreements continue to be on the rise.** While the US's FTA agenda looks to be mostly on ice in 2022, digital trade agreements – potentially covering everything from rules on data localisation, to recognition of e-signatures, to principles for AI regulation – could be an area of focus for the USTR in the Indo-Pacific in 2022. Building on a range of existing digital trade agreements among US partners in the region, including the Digital Economy Partnership Agreement (DEPA), CPTPP, the US-Japan Digital Trade Agreement, and most recently, the UK-Singapore Digital Economy Agreement (DEA), a US-led digital agreement could form part of its broader strategy for countering Chinese influence in the region.

- **Some digital supply chains are becoming increasingly disconnected.** While the US seeks to retain influence in the Indo-Pacific, China continues to pursue its own strategy of "cyber sovereignty," introducing new cyber and data security laws in late 2021 that impose further restrictions on cross-border data flows – further disconnecting digital supply lines between the US and China. At the same time, 2021 saw China sign up to its most wide-ranging commitments on e-commerce and data transfers through RCEP, indicating a potential willingness by China to open up some areas of its digital economy (at least within Asia, where it has the potential to lead the development of the regional digital economy).
- **Investment screening retains a focus on tech.** Concerns about foreign influence in critical technologies are growing, with investment screening in the US, the UK, the EU and elsewhere increasingly focused on the technology sector. 2022 began with the entry into force of the UK's National Security and Investment Act, which allows increased regulatory scrutiny of investments in critical sectors (with a heavy focus on emerging technologies). This builds on broader global trends in the area, including an increased focus on tech transactions under the US's CFIUS regime, and greater coordination between EU Member States on investment screening. At the same time, the US-led "Clean Network Initiative" has seen the US increasingly seek to limit Chinese tech firms' involvement in telecommunications networks, while in Europe EU Member States are restricting foreign participation in 5G networks through the implementation of the 5G Toolbox.

Trade and ESG considerations becoming increasingly intertwined

The increasing focus by governments and businesses on climate change, human rights and environmental issues will have continued impacts for trade policy and supply chains in 2022. Some key areas of focus this year include:



- **The rubber hits the road for Carbon Border Adjustments.** The EU's proposal for a carbon border adjustment mechanism (CBAM) has kick-started a new era in the debate about the relationship between trade policy and climate action. However, there remain divergent views (both within the EU and among key EU trading partners) about the final design and scope of a CBAM. While the first phase of a CBAM is currently scheduled to come into effect from 2023, it remains to be seen whether this deadline will be met – with debates set to continue during 2022.
- **A CBAM is not the only game in town.** While a CBAM is the most developed proposal for a trade-related climate measure, several other trade and climate measures are also in the mix. The US-EU Global Arrangement on Sustainable Steel and Aluminium, agreed during COP26, envisages the potential establishment of a plurilateral mechanism to incentivise trade in low-emissions steel and aluminium –but the mechanism (particularly its climate credentials) remains thin on details. Within the EU, Germany has signalled a desire to develop a "carbon club" during its 2022 G7 Presidency, and it remains to be seen how such a mechanism will interact with a CBAM itself. Other countries, including the UK and Canada, are also considering CBAM-style measures, and we expect CBAM to be a key topic of discussion in plurilateral discussions on Trade and Environmental Sustainability, which were launched by a group of 70 WTO Members in December 2021.
- **Regulating trade in products linked to deforestation.** The EU, the UK and the US all have proposals in train to restrict imports of a range of commodities originating from deforestation (including wood, beef, palm oil and several others). While UK and US proposals focus on preventing imports of commodities linked to *illegal* deforestation, the EU's proposals are potentially much broader; extending to all products produced on land deforested after 31 December 2021. The WTO's consistency in relation to these proposals is likely to come under increasing scrutiny from affected countries and businesses in 2022, as countries seek to balance non-discriminatory trade objectives with environmental considerations.



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- **Human rights due diligence and import restrictions.** An increasing focus on forced labour concerns saw the Biden Administration pass into law the *Uyghur Forced Labor Prevention Act*, banning imports from the Xinjiang region of China unless an importer can demonstrate through "clear and convincing" evidence that the products are not produced using forced labour. While the EU has not yet followed suit, European Commission President Ursula von der Leyen has announced a ban on products made using forced labour – with any criteria established by the EU for new import restrictions likely to be closely scrutinised by trading partners. The EU's long-awaited proposals for mandatory human rights and environmental due diligence are set to be released in February 2022, placing renewed attention on the ESG dimension to global supply chains.

The green industrial revolution sees the return of more active industrial policy

The fragility of global supply chains that was exposed by COVID-19, combined with a desire to boost domestic manufacturing in a range of strategic sectors, has seen a resurgence in industrial policies designed to support domestic production in key sectors. With China's 10-year "Made in China 2025" strategy to accelerate the development of high-tech manufacturing (including semiconductors, electric vehicles, robotics and AI) bearing fruit, 2022 looks set to see the US and the EU introduce government-led initiatives to catch-up. Some areas to watch include:

- **Semiconductor competition escalates.** The European Commission kicked off 2022 with the publication of a proposed *European Chips Act* designed to stimulate the creation of an EU semiconductor industry and double the EU's global market share of semiconductor production by 2030. The proposal looks set to include a ground-breaking "adaptation of state aid rules" to permit enhanced public support for the semiconductor sector, a signal that the Commission is willing to permit enhanced state intervention in order to ensure EU competitiveness in the sector. The capital-intensive semiconductor sector (together with EV batteries, pharmaceuticals, and critical minerals) is also a centrepiece of President Biden's supply chain initiative; a multipronged effort to onshore strategically important industries and shore up supply chains.
- **Local content requirements on the rise.** As states compete to secure a share of the "green jobs" being created through the energy transition, governments are increasingly looking to measures designed to incentivise the use of locally produced content in key manufacturing industries. A recent US proposal to provide tax credits for electric vehicles produced in the United States; has been met with strong opposition from Canada and Mexico, with fears that such a proposal could disrupt the supply chains organised around rules of origin that were painstakingly negotiated under the USMCA. In Europe, the EU has raised concerns about alleged local content requirements associated with the UK's incentives for offshore wind farm development – with speculation that the dispute could escalate to the first post-Brexit WTO dispute between the EU and the UK. The dispute would not be the first time the WTO has grappled with local content requirements associated with renewables incentives – with India, Canada and the US all having previously sought to defend such measures before WTO panels.

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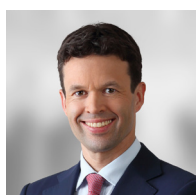
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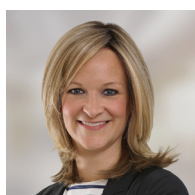
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