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a **COVID-19** briefing

FREIGHT EXPECTATIONS

Post-pandemic prospects for global trade

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Summary

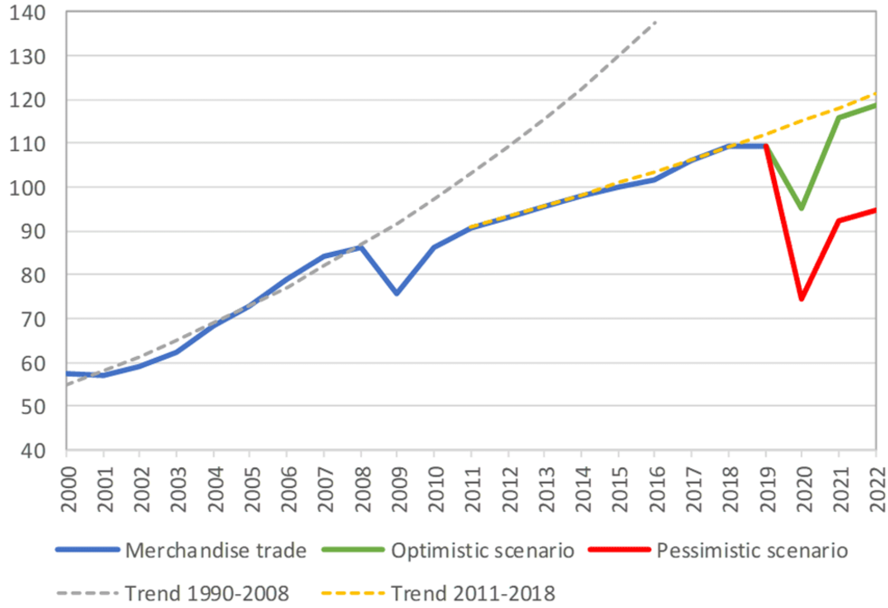
- The World Trade Organization has predicted that global trade in goods will drop by between 13 and 32 per cent in 2020 as a result of the pandemic.
- The last time trade volumes dropped substantially, during the financial crisis of 2008, they recovered – but not at pre-crisis rates of growth.
- Before the current pandemic, trade tensions had already led to a slight fall in global trade in goods in 2019.
- In addition, there were several other pre-coronavirus trends that looked likely to have a negative impact on the global trade in goods, including concerns over the Chinese government, new technology, and environmental issues.
- With the exit of the relatively free-trading UK, the EU is in danger of succumbing to more protectionist voices. In the US, Donald Trump was elected on a platform that included promises to address what he saw as unfair trade practices.
- The current economic slowdown has also potentially exposed the fragility of global supply chains and exacerbated those concerns over trading with China.
- While it can be expected that global trade will bounce back in 2021, the nature of the recovery is not yet clear, but it may not recover to the same level or trajectory as seen prior to lockdown.
- This briefing paper examines the factors that will determine whether the recovery in trade volumes will follow the WTO's optimistic or pessimistic scenario.

Introduction

In April 2020, the World Trade Organization (WTO) published its latest trade forecast. It predicted that global trade in goods will drop by between 13 per cent and 32 per cent in 2020 as a result of the economic impact of the pandemic. Fortunately, global trade is expected to bounce back in 2021, but the nature of the recovery is not yet clear. Rather than attempting to give an exact number, WTO forecasters have wisely considered both pessimistic and optimistic scenarios.

The WTO's forecasts are illustrated in Figure 1. It shows the growth of global trade from 2000 to the financial crisis of 2008/9, the resulting dip in global trade, and the subsequent recovery and growth from 2011 to 2019. It then shows a stalling of growth in trade in 2019, just before the current pandemic induced slowdown, after which the graph projects both pessimistic and optimistic scenarios up to 2022.

Figure 1: Global merchandise trade volumes, 2000-2022



Source: WTO (100 = global trade volumes in 2015).

Figure 1 clearly shows that the growth in trade (blue line) was dented by the financial crisis of 2008-09. While the growth in trade volume recovered, it did not return to the growth trajectory before the crisis (dotted grey line).

Based on this experience, WTO forecasters provide an optimistic scenario (green line) with growth volumes recovering to just below the trajectory of growth from 2011 to 2018 (yellow dotted line). A pessimistic scenario foresees a much slower growth trajectory (red line).

While both scenarios see trade volumes recover, this briefing paper looks at the factors that will determine whether they will recover in line with the pessimistic or optimistic scenario.

Factors affecting the recovery of trade volumes

Perception and confidence

WTO forecasters believe that a strong rebound in trade volumes is more likely if businesses and consumers view the pandemic as a temporary, one-time shock and resume capital investment and consumer spending once lockdowns are ended. It is assumed that the rebound will be weaker if lockdowns continue or if the outbreak is prolonged, especially if there is a second wave of infections.

Supply chains

Lin and Lanng (2020) argue that ‘the coronavirus crisis has revealed the fragility of the modern supply chain’. In response, some companies may seek to build more robust supply chains by diversifying suppliers, possibly building in redundancy (duplication) if waste can be avoided, or increasing stock/storage if they are able to afford to or can share the risk of building up larger inventories.

One response being discussed is the possibility of re-shoring, relying more on local production or local suppliers, but this may lead to increased costs, concentration of risk and greater dependence on good industrial relations. Companies considering re-shoring will ask themselves whether the factors that led to reliance on suppliers across the globe are still valid if they faced difficulties during the current lockdown. Of course, many supply chains have proved remarkably resilient and some are disrupted due to a collapse in demand rather than due to problems with suppliers. Once economic activity picks up, not all companies will be able afford to pay for more expensive local suppliers and many will be prepared to take the risk that there will not be another major pandemic or disruption for many years.

Trade tensions

Whether economists like it or not, trade policy and foreign policy are often intertwined. Global trade is affected by disputes between governments and governments often use trade policy as a part of their foreign policy.

Long before he was elected US President, Donald Trump was expressing concerns about the US trade deficit. His platform during the election campaign included promises to address what he saw as unfair trade practices. This has resulted in the US renegotiating the North American Free Trade Agreement (NAFTA) (White House 2018) with Canada and Mexico, withdrawing from the Trans-Pacific Partnership (TPP) with Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam, as well as announcing tariff and non-tariff barriers against producers from China and the European Union. In addition, the Trump administration has refused to appoint new judges to the Appellate Body of the World Trade Organization, which adjudicates on trade disputes. As Bown and Keynes (2020) have warned, ‘without a referee, the danger is that trade disputes blow up into trade wars’.

But it would be unfair to blame the US President alone. With the withdrawal of the relatively free trading United Kingdom, the European Union is in danger of succumbing to more protectionist voices. Long before the UK referendum in 2016, there were already tensions between EU member states over trade. Von der Burchard et al. (2019) have suggested that ‘after decades of championing the dissolution of barriers and borders, Europe is battening down the hatches’.

These trade tensions combined with slower economic growth were already having an impact before the outbreak of Covid-19. Trade volumes in goods fell in 2019 by 0.1 per cent (3 per cent in US dollar value).

Concerns over the Chinese government

Politicians, commentators and human rights activists have become increasingly concerned over the Chinese government's suppression of dissent, human rights abuses, foreign policy, blind eye to violations of intellectual property rights, cyber attacks, technology espionage and currency manipulation.

Suspicions have also increased over the Chinese government's reaction to the outbreak of the Covid-19. Many politicians and journalists across the world believe that the Chinese government has not been entirely open about when and how the outbreak started and was slow to inform the World Health Organization (WHO) and other countries.

In addition, while governments in relatively liberal, democratic nations are focused on getting through the current crisis, while being held to account at daily press conferences and by opposition parties, the Chinese government, facing little accountability, is able to plan for the post-coronavirus world. Some politicians and foreign policy experts are already warning that 'China is using the coronavirus crisis to its advantage' or of a Chinese government 'plan for world domination' (Agence France-Presse 2020). Less strident voices suggest that China is 'manoeuvring for international leadership as the United States falters' (Campbell and Doshi 2020).

In a recent foreign policy discussion, the author was told by a political risk analyst that the Chinese government is engaging in strategic thinking about how to emerge from the crisis in a stronger position. While you would expect and perhaps hope that governments would think strategically, such forward-thinking by the Chinese government will arouse suspicion and could lead to a backlash from other governments and consumers. Given that China's imports and exports of goods have grown from 3 per cent of global trade in 1995 to 12 per cent of global trade by 2018 (China Power Team 2019), negative attitudes towards trade with China may well affect global trade volumes.

Technology

While we are considering the disruption to our lives caused by Covid-19 and the lockdown, it should be remembered that firms and whole industries face disruption and discontinuities all the time due to innovation and advances in technology. One such potential disruptive technology is 3D printing or additive manufacturing, which allows products and components to be printed on site rather than having to be purchased from an external supplier. If the product or component is currently sourced from suppliers in other countries, this will have an impact on global trade. A report from ING Bank estimates that 3D printing could account for 50 per cent of all manufactured goods between 2040 and 2060. It also estimates that world trade could be 23 per cent lower by the year 2060 ‘if the growth of investments in 3D printers continues at the current pace’ - but if investment were to be accelerated, domestically printed goods could replace 40 per cent of world imports by 2040 (Leering 2017).

3D printing is increasingly being employed by industrial machinery, aerospace, automotive, consumer electronics, medical equipment and dental devices manufacturers, driven by lower labour, material, capital investment and transport costs. However, its adoption is being held back by its inability to cope with high-speed production, high prices of raw materials, lower quality and the lack of skilled designers. These inhibitors are expected to be overcome with future generations of 3D printers.

Also, it is not clear whether 3D printing will replace all current trade in manufactured goods. A recent World Bank report suggests that so far there ‘is no evidence that 3D printing shifted production closer to consumers and displaced trade’ (Freund et al. 2020). The report examines the production of hearing aids and dental products where 3D printing has replaced existing manufacturing processes of products which are then shipped across the world. Nevertheless, it would be surprising if 3D printing had no impact on global trade in manufactured goods.

Environmental measures

As more countries set dates to achieve net-zero carbon targets, there have been concerns that companies will simply switch manufacturing to other countries and effectively outsource emissions to countries such as China, India and North Korea. As part of the EU Green Deal, the European Commission has opened a consultation on introducing carbon border adjustment mechanisms, probably in the form of tariffs on goods from companies in countries with lower environmental standards. It has done so because it is worried that 'efforts to go climate-neutral by 2050 could be undermined by lack of ambition by … international partners.'[1]

In addition, consumers in some countries are increasingly concerned about the impact of long supply chains on the environment and have been demanding more local produce. Some UK supermarkets extol the virtues of products grown locally, giving the impression that this is more environmentally friendly. This may not always be the case given that more journeys may be needed overall to transport smaller volumes from more local producers and that the extra energy and fertilisers required for growing some produce in colder climates may more than outweigh so-called food miles.

One study found that 'the majority of food's climate impact is due to non-CO2 greenhouse gas emissions such as nitrous oxide and methane' (Weber and Matthews 2008). However, this may well be reduced as farmers adopt more environmentally-friendly methods. Reducing imports from producers in poorer countries may also lead to less jobs and more poverty, reducing incentives and the ability of these countries to clean up the environment. One other side effect may be that it leads to more emigration from poorer countries, which may also have a slight environmental impact. As a development economist once told the author 'either you take our products or you take our people'.

Whatever the merits of local production, there is no doubt that there will be more pressure to reduce imports of food and of products from countries deemed to have lower environmental standards.

Inertia to lift temporary restrictions

In response to the Covid-19 pandemic, the WTO reports that 'eighty countries and customs territories so far have introduced export prohibitions or restrictions'. The new controls mostly cover medical supplies such as face masks, pharmaceuticals, ventilators and other medical equipment, but have included other products such as food and toilet paper (WTO 2020a).

1 See: 'EU Green Deal (carbon border adjustment mechanism)' (https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12228-Carbon-Border-Adjustment-Mechanism).

While these restrictions are probably intended to be temporary, we should be aware of Milton Friedman's warning that 'nothing is so permanent as a temporary government program' (Friedman and Friedman 1985). If governments are slow to lift these restrictions and prohibitions, this will have an impact on global trade volumes.

Reasons for hope

While the paper thus far has highlighted reasons that growth in the global trade of goods may be inhibited once lockdowns are eased, there are also some reasons to be optimistic.

Trade in services

While trade volumes in goods fell in 2019, the value of commercial services exports rose 2 per cent to US$ 6.03 trillion. While services only accounted for approximately 22 per cent of overall global trade in 2018,[2] the proportion of trade in services has been growing over the years and looks likely to continue to do so.

Pledge to open trade

In April 2020, the WTO also announced that 49 countries, led by Canada, had pledged to:

- Not disrupt the global food supply chain.
- Not impose food export restrictions.
- Ensure that the response to Covid-19 remains targeted, proportionate, transparent and temporary.
- Exercise restraint in establishing domestic food stocks of agricultural products that are traditionally exported.
- Quickly notify the WTO about Covid-19 response measures.

2 'World trade in services', Eurostat (https://ec.europa.eu/eurostat/statistics-explained/index.php/World_trade_in_services).

The 49 signatory countries account for 63 per cent of global exports of food and agriculture products and 55 per cent of global imports and have called for other countries to sign (WTO 2020b).

Competition between the EU and UK

With the United Kingdom's departure from the European Union, there were some fears that this would see a relatively free trading nation becoming increasingly protectionist. As a member of the EU, the UK was bound by the EU's Common External Tariff under which only 47 per cent of the UK's trade with the rest of the world was tariff-free. Under the new UK Global Tariff announced in May 2020, a number of EU tariffs are eliminated, leading to 60 per cent of UK trade being tariff-free (Department for International Trade 2020). This has set the marker for the UK to attempt to be a leading voice for global free trade.

While the EU may be tempted to become more protectionist, it may also be tempted to burnish its free trade credentials and 'compete' with the UK. Before the 2016 UK referendum on EU membership, the EU resisted demands from UK Members of the European Parliament to open trade negotiations with countries such as Australia and New Zealand. Once the UK voted to leave, the EU announced the opening of trade negotiations with both these countries. This might be evidence of competition between the UK and EU to sign trade agreements with third countries.

Conclusion

The Covid-19 pandemic has disrupted economic activity and global trade in goods. While it can be expected that global trade will recover once the lockdowns are lifted, there were a number of trends that were evident before the crisis that suggest it may not recover to the level or trajectory of growth before the shutdown. A recent IEA paper on pandemics predicted that ‘we will almost certainly see a resurgence of protectionism, much reshoring of production and shortening of supply chains, greater hostility to migration and an emphasis on domestic production of certain kinds of product – particularly food … [T]his is an intensification of a trend that was already under way’ (Davies 2020).

This paper examined these trends and how they will determine whether global trade recovers in line with either the pessimistic or optimistic scenario forecast by the World Trade Organization (WTO).

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