Trade in a time of COVID-19 and the future of multilateral trade co-operation

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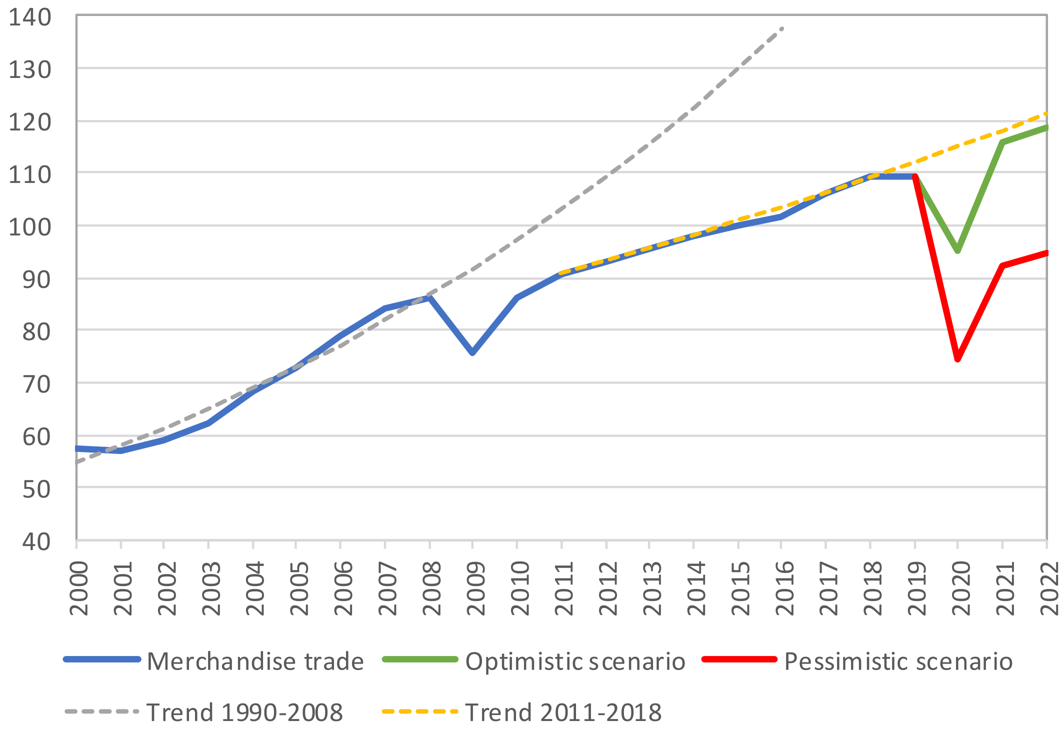
June 2021

FOR TRADE WHAT WE SAID A YEAR AGO - WTO EXPECTS SIGNIFICANT DECLINE IN GLOBAL TRADE FOR 2020 AND POTENTIAL FOR SLOW RECOVERY IN 2021

Chart 1 - World merchandise trade volume, 2000-2022
Index, 2015=100



Source: WTO Secretariat.

Trade Developments as of April 2021

Global trade very adversely affected by COVID-19 – WTO estimates about 5.3% decline in global trade volumes for 2020. Much less than our initial views last fall.

Our central trade forecast for 2021 is 8% growth, and for 2022, 4.0%. But we have upside scenario (+2.5%) and downside scenario (-2.0%)

Yet, compared to the GFC international trade has been surprisingly resilient in 2020

- Trade decline is smaller in relation to GDP decline – roughly 2.5x GDP, while in GFC 2008/9 it was roughly 6x the GDP decline.

Goods trade plummeted in first half of 2020, but rebounded stongly in second half of 2020.

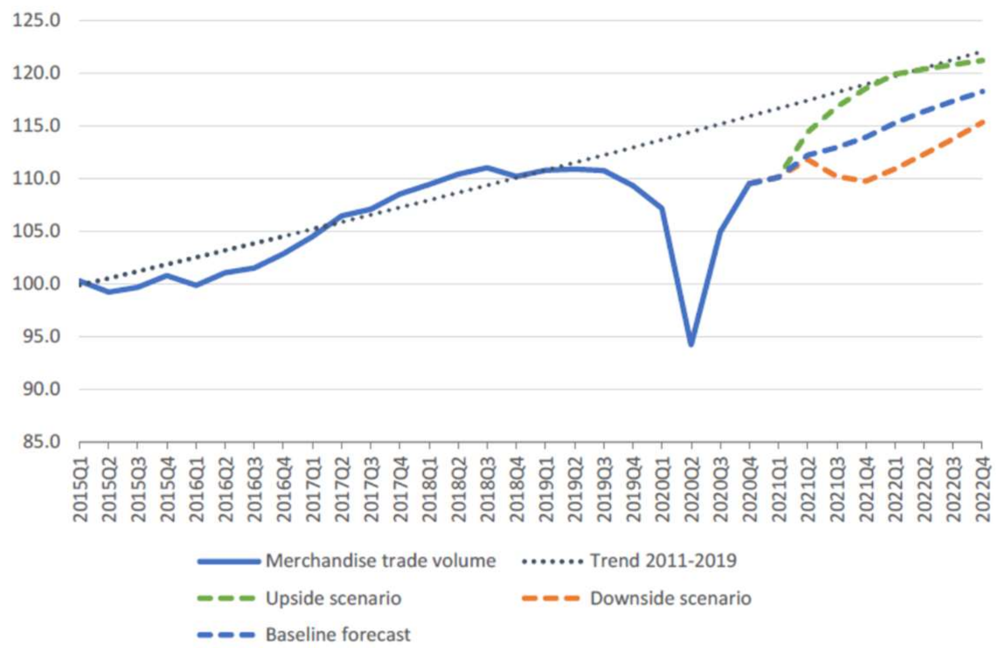
- Trade in medical goods was very strong and trade in agricultural goods was steady compared to 2019.
- Trade in GVCs-related goods has been resilient.

Trade in Services was very badly hit by the pandemic overall

- Services requiring personal interaction strongly affected
- Some uptick in other services such as IT.

Chart 1: World merchandise trade volume, 2015Q1-2022Q4

Index, 2015=100

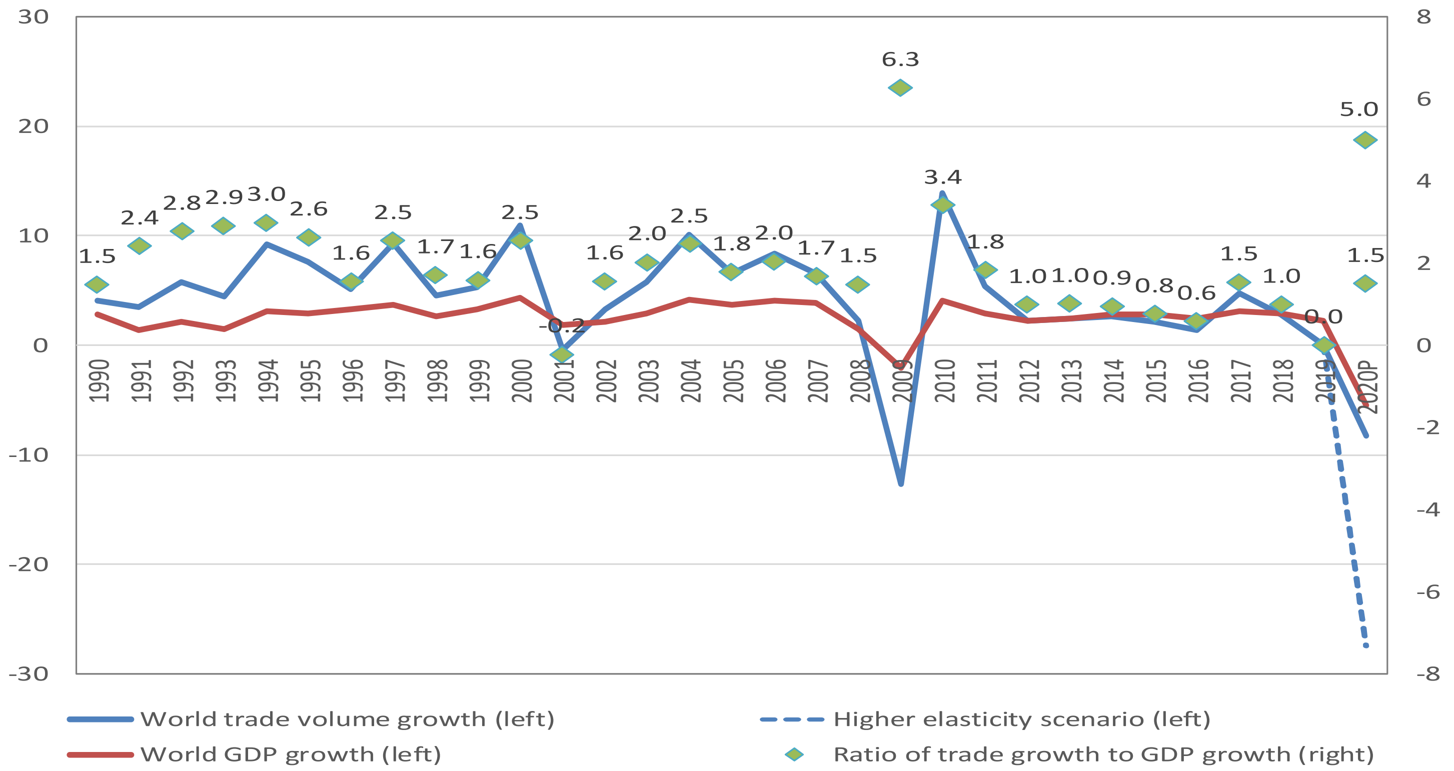


Sources: WTO and UNCTAD for trade volume data; WTO for forecasts.

Trade and Growth Relationship Has Changed Overtime: But for understandable reasons.

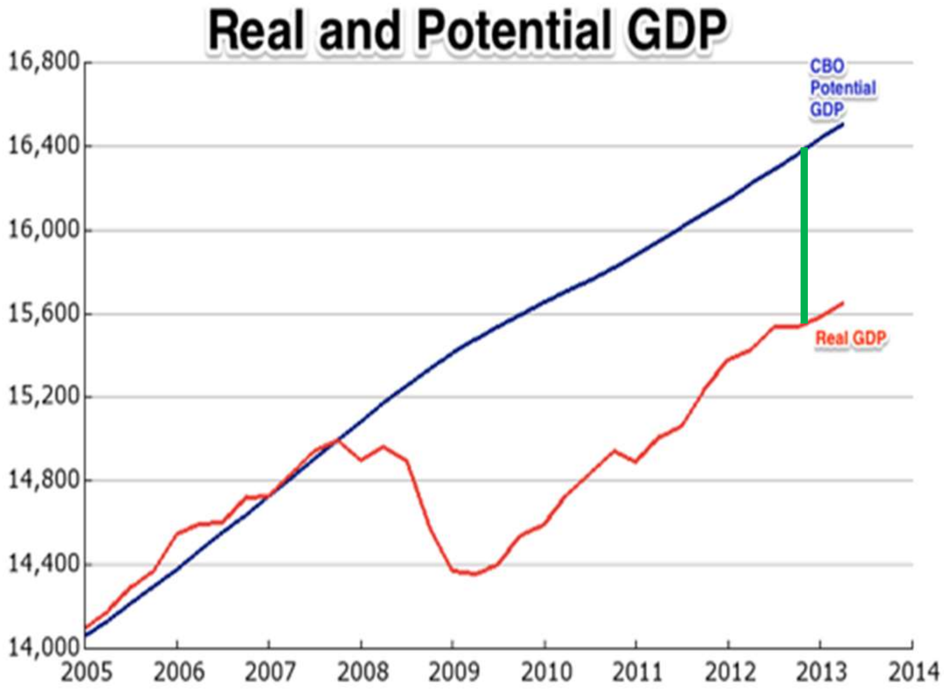
Recent relationship between trade and economic growth, 1990-2020

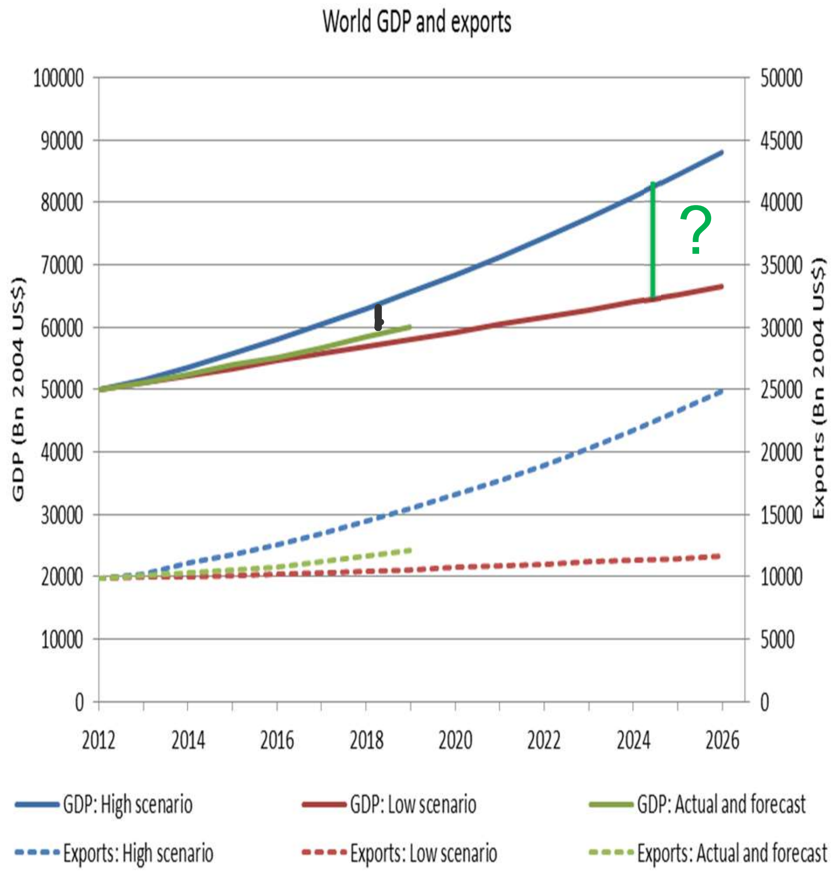
(% change and ratio)



Sources: WTO Secretariat for merchandise trade volume, consensus estimates for real GDP at market exchange rates.

Bottom line…slower long term growth adding up to significant foregone income and consumption – this is the global menace





COVID-19, Trade Tensions and Global Economic Developments

Bottom lines –

Direct effects of tariffs (trade wars) are small (lost triangles and moving around rectangles.)

Indirect of tariffs can be large – increased uncertainty affecting components of aggregate demand – particularly Investment, and Consumption.

Biggest effects of trade are longer term – shifting out the production possibility frontier.

So while tariffs and rising trade costs cause a lot of trade diversion and some fragmentation of a fairly globalized economy, a negative investment shock lowers long term growth and a technology war could fragment the world digital economy into two or three spheres – China, US and European.

COVID major driver right now ..Will trade tensions of last few years continue?

Global trade 2017 $22 Trillion - $17 goods and $5 services

US-China Trade 3% - US China trade conflict small direct negative impacts – less than 2/10ths of a percent off global growth, but some much bigger redistributive effects – producer consumer surplus, trade diversion

Global automobile trade 8% - Auto tariffs bigger effects, particularly for US, MEX and Canada. Auto sector globally hit hard. But potential gains for other countries if large amount of global investment diverted from US? Diversion of investment vs. contraction?

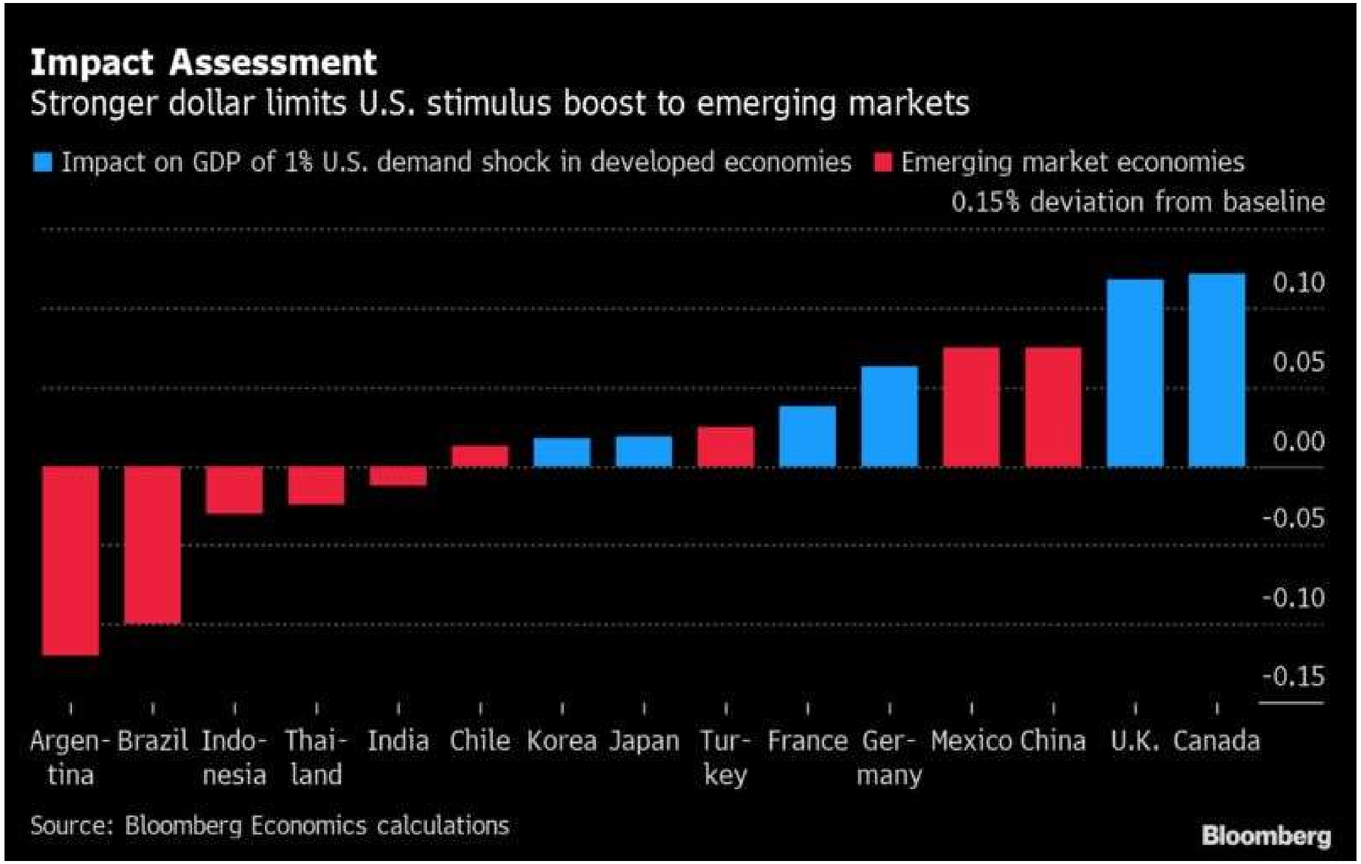
Breakdown in global cooperation on tariffs (all countries go to optimal tariffs) – 2% off global growth, global trade declines by 17%. Including GATS, TRIPS, etc gets bigger effects. Distribution across countries quite varied. Small countries have greater adverse effects.

Total trade under WTO MFN - 81%, majority of which is MFN = 0, trade under preferential tariffs is 19%.

Future could look quite different…China rebalancing, changing comparative advantage, build back better/green?…

COVID-19 – A dramatic global shock for macroeconomic and trade outlook

- **IMF Real GDP regularly revised upward throughout the year – now projecting a stronger recovery for the global economy compared with January forecast, with growth projected to be 6 percent in 2021 and 4.4 percent in 2022 after an estimated historic contraction of -3.3 percent in 2020.**
- **Big driver of recovery? Swift policy actions, including $16 trillion in fiscal policy support, and extensive liquidity provision (equivalent to another $10 trillion), particularly in advanced economies.**



COVID stimulus – The next driver of trade tensions?

Why the conflict? Many reasons

Unbalanced growth – globally, regionally, nationally, and sub-nationally, and by sector, labor/skill category, demography, households.

Many drivers and many “margins” of adjustment.

Not a surprise to economists (for instance H/O and specific factor stories have been around for long time) – but a challenge for economists to tell a full/big picture story, and for policy makers to developed nuanced and effective policies for a complex, dynamic environment.

So technological change, trade, changing consumer preferences, economic geography (think cities vs rural areas - and diversified cities vs specialized cities), efficiency of labor markets, efficiency of property markets, market power, changing institutional relationships…

Easy answers – blame someone/something else…particularly trade and immigration

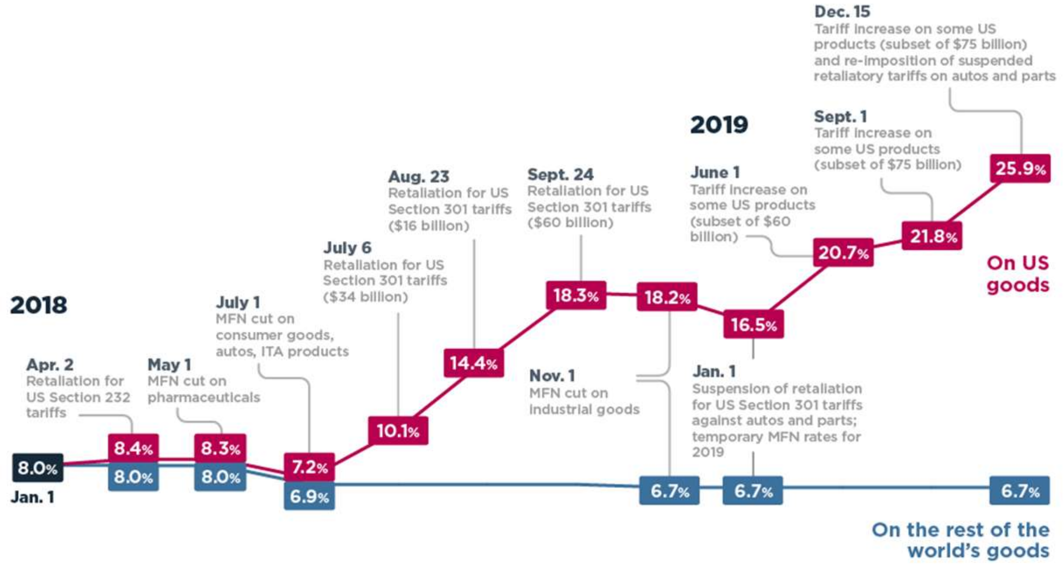
What is the current state of global trade policy and why does it matter?

- Trade conflict between the US and China – rising tariff rates, increasing uncertainty in bilateral trade. Figure from Bown PIIE.
- What else is going on?
  - WTO appellate body
  - US looking at autos
  - Korea-Japan tensions
  - …Long list of actions, potential actions quite out of line with historical trends.
  - Other risks include things like climate change and a decline in trust in established institutions.

- What does it all mean?

Figure 1

China's average tariff rate is climbing on US goods and falling for the rest of the world



PIIE

ITA = Information Technology Agreement; MFN = most favored nation

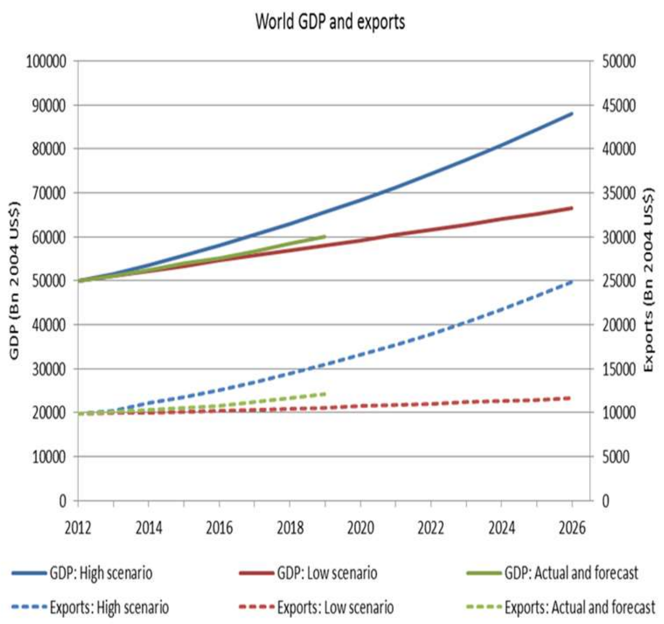
Note: Trade-weighted average tariffs computed from product-level tariff and trade data, weighted by US exports to the world in 2017.

Sources: Updated on August 23, 2019, from Bown, Jung, and Zhang (2019). Constructed by the author with data from Trade Map and Market Access Map (International Trade Centre, marketanalysis.intracen.org) and China's Ministry of Finance's announcements.

WORLD TRADE ORGANIZATION

Forces driving growth and trade

- What drives trade growth? What drives economic growth?
- Macro matters C+I+G
- Investment most “trade intensive”
- Liberalization policies – maybe 25% of trade growth – tariff increases work the other way of course.
- Why bother? Long term growth – shifting out PPF/dynamics effects of trade liberalization
- Falling behind.

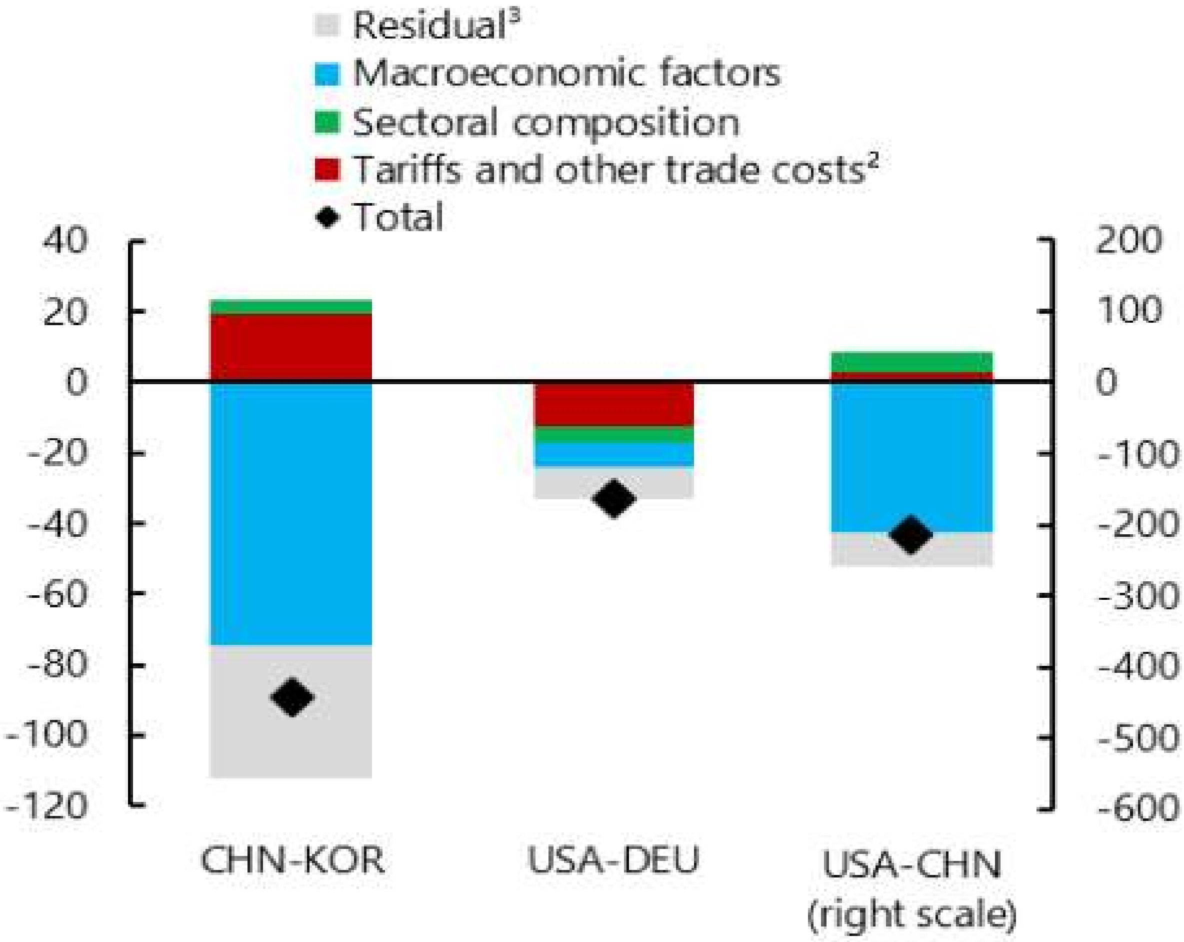


Global imbalances caused by tariffs and subsidies?

"Countries are cheating and screwing us…"

More likely fundamental macro forces – savings and investment, demographics, etc.

IMF: Drivers of changes in selected bilateral trade balances, 1995-2015 (billions of US dollars)



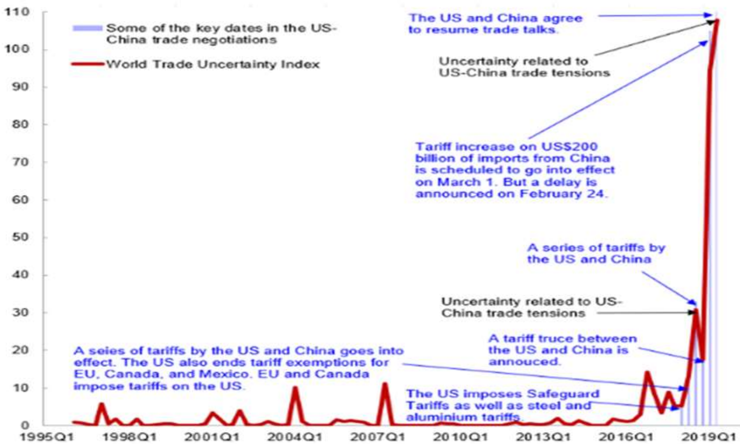
Sources: OECD Trade in Value Added database, and IMF staff calculations.
Note: Data labels use International Organization for Standardization (ISO) country codes. 1 Average value 2010-2015 minus average value 1995-1999. 2 This includes tariffs and free or preferential trade agreements. 3 This residual is the sum of the model residuals plus the approximate error.

While trade costs have fallen for many years they are now rising and, more importantly, so is uncertainty around those trade costs (and other things!). And remember tariffs are only one part of trade costs

Uncertainty surges after 20 years of stability

In the past year, the World Trade Uncertainty index in the past year jumped 10-fold from previously recorded highs as the US-China trade war escalated.

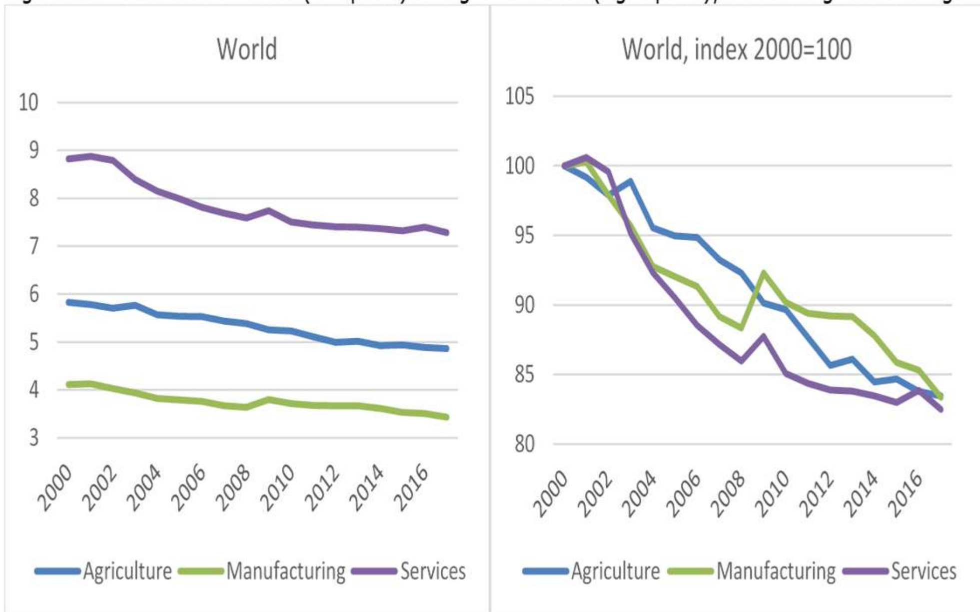
(WTU index, GDP weighted average)



Source: World Uncertainty Index. Ahir, Bloom, Furceri (2018). The source for the data on key dates in the US-China trade negotiations comes from Bown and Kolb (2019).
Note: The font in blue indicates the tariff measure taken, and the font in black indicates the narrative of the World Trade Uncertainty index. A higher number means higher trade uncertainty.

INTERNATIONAL MONETARY FUND

Figure 1: Trade cost in levels (left pane) and growth rates (right pane), trade-weighted average



Note: The level of trade cost can be interpreted as how many times higher is international trade cost compared to domestic trade cost. Hence, trade cost in services in 2017 (7.28) corresponds to an ad valorem equivalent of 628 per cent. Trade cost in manufacturing in 2017 (3.43) corresponds to an ad valorem equivalent of 243 per cent.

Trade costs are the highest in services and the lowest in manufacturing.

Level Playing Field? There are many reasons a "playing field" can be unlevel. Natural, one size tilts the field in their favor, or one side tilts the field NOT in their favor, or some combination of all of them.

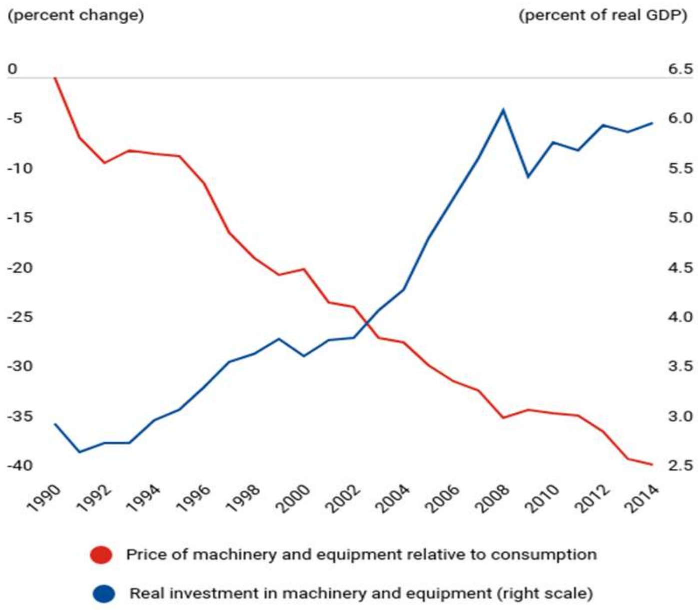
Natural – bad design?

Distorted- by whom?

IMF: Is Slowing Trade Reform Impeding Investment and Growth?

- The relative price of investment goods, such as machinery and equipment (M&E), is a major driver of real investment rates. Investment rates, in turn, drive economic growth.
- Declining relative prices of M&E were in large part due to trade integration and relatively rapid productivity growth in sectors that produce capital goods.
- This suggests that the slowing pace of trade reform since the mid-2000's—and especially the possibility of reversal in some AEs—could now interfere with investment and growth.

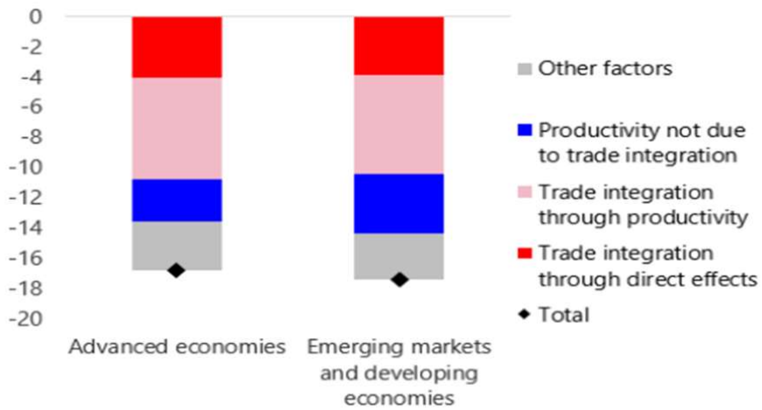
Closely linked
The rise in real investment in emerging markets and developing economies coincided with large drops in the relative price of machinery and equipment.



Sources: Penn World Table 9.0 and IMF staff calculations.

INTERNATIONAL MONETARY FUND

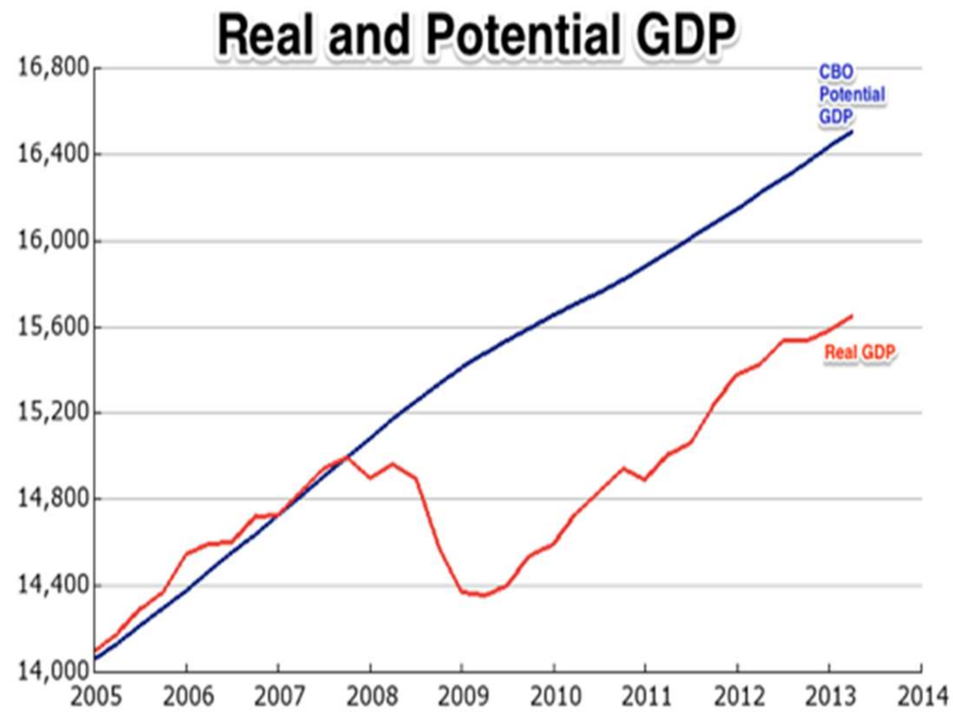
Trade matters most
The decline in the price of capital goods relative to consumption has been mainly supported by deepening trade integration.
(contributions to changes in relative producer prices of capital goods, 2000–11, percent)

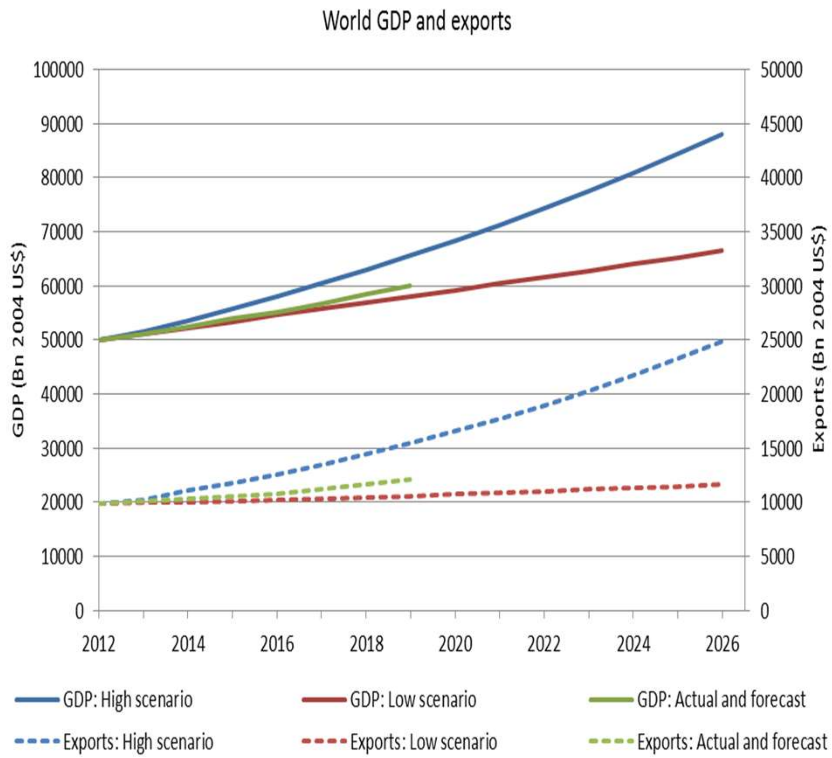


Source: IMF staff calculations.

INTERNATIONAL MONETARY FUND

To repeat…slower long term growth adding up to significant foregone income and consumption – death by a thousand cuts (welfare triangles), death by increased rent seeking (rectangles), and death from heart failure (reduced investment)?





Summary

- Trade war tariffs – direct effects – small. Efficiency impacts/reallocation effects. What we see is a range of sectoral effects and trade diversion. Certainly has validated traditional trade models!
- Trade war tariffs – indirect effects – potentially very large – discourage investment and consumption – macro impacts.
  - We see this starting, but in some countries has been offset or diminished by fiscal and monetary policy actions.
- Trade war uncertainty – tied to indirect effects – potentially large and long term impacts – reduce current growth, and reduce future potential growth from reduced investment and relatively less efficient investment.
- Fragmentation of global economy into blocs?
- Continued fragmentation of countries as policies not addressing most of the underlying challenges – technology, changing preferences, demographics, economic geography.
- Which battle do you fight? Who, or what, is the problem (enemy?)