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GLO Policy Brief No. 3 – Special theme: COVID-19 and policy implications

COVID-19 and the Consequences for Free Trade

by

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The response to the COVID-19 pandemic has disrupted global trade, investment and value chains. There is a risk that newly imposed barriers to international trade and mobility will become permanent. Research shows that veiled protectionism in the wake

of the COVID-19 pandemic would be associated with greater risks and impede the economic recovery needed to avoid a new economic depression. We argue that failing to reboot free trade and to restore global value chains could aggravate an already difficult and delicate situation in regard to global economic development and poverty reduction. In order to reboot globalization, however, there needs to be a new approach. Simply going over old ground would be insufficient.



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W hat we should know

- Restrictions and lockdowns to address the COVID-19 pandemic have disrupted international markets and global value chains. The travel and trade restrictions imposed by many countries are extreme and unusual both in nature and their implementation, wreaking havoc on global trade and investment flows. These restrictions have been adopted despite lack of evidence of their effectiveness. Some measures go against the guidance by the World Health Organization (WHO) and the World Trade Organization (WTO).
- Protectionism and anti-globalization tides have been rising already before the COVID-19 pandemic, with Brexit and the China-U.S. trade war, as two examples. The policy response to the pandemic now risks to make the situation worse and constitutes a major disruption to global trade, investment and value chains. Early economic indicators suggest that this disruption is severely hurting growth and employment (Gopinath 2020).
- Global poverty and inequality are grounds for justifiable concerns. Research suggests that failing to ensure free and predictable markets would be associated with significant risks to poverty and inequality.

- Many policies to combat the coronavirus pandemic are actually causing both short-term problems for fighting the pandemic, as well as risks in regard to economic recovery, employment, development and poverty reduction over the medium and long term (Evenett 2020, Hoekman et al 2020, Zimmermann et al. 2020).
- Difficulties in getting supplies of medical equipment have triggered an increased interest in de-globalizing value chains (Miroudot 2020). Already before the pandemic, companies and countries were considering a regionalization or even a nationalization of global value chains. This due to a more adverse trade policy environment, rising wages in manufacturing strongholds and technological advances, e.g., in automation.

The state of free trade in the wake of COVID-19

- Unilaterally imposing high travel and trade barriers creates uncertainty for exporters and importers of goods and services, as well as for foreign investors. Research indicates that uncertainty about the stability of the rules of the game has a major negative impact on trade and investment, beyond the barriers imposed by the rules themselves (see, e.g., Handley and Limao 2013).
- Temporary policies risk becoming permanent. They could become precedents for trade barriers and unilateralism in the future.
- Asymmetric timing for when countries reopen and asymmetric epidemiological strategies, pose real risks of triggering protectionism (Bown 2020). For example, when one country is back to full production and shipping, countries that still have not reopened their economies will likely face rising pressure to 'protect' domestic businesses.
- Less-developed countries are more exposed to the risks associated with a failure to reboot and revitalize international trade, investment and value chains. They often face additional difficulties in handling the pandemic itself because of their relatively weaker health care systems. Existing and new trade barriers, such as export restrictions on medical products and food, will exacerbate this situation (Hoekman et al. 2020). Moreover, capital is now fleeing from poor to richer countries. The poorest and most debt-ridden countries can thus be hit twice in the form of the pandemic, and globalization in reverse.

A reboot and a new approach to globalization is needed

- In the short term, a coordinated approach among the major economies on measures to address both the pandemic and its economic consequences are needed. A first step should be to tear down the border and trade barriers put up in the wake of the pandemic (Stellingner et al 2020).
- In the short to medium term, it is necessary to formulate a strategy to reduce the risks from asymmetric timing in reopening and from differences in the fight against the pandemic.

- A head-on measure would be to introduce a new free trade and investment agreement that abolish all tariffs and other barriers to trade and investment in pharmaceuticals, medical devices, and other equipment used to prevent or combat pandemics (Bown 2020b, Stelling et al 2020).
- Business leaders should act to encourage more resilient and sustainable global value chains, for example by having more suppliers, warehouses and using modern technology to monitor the chains and their resilience in real time (Miroudot 2020). This would be a win-win for the climate and for economic growth.
- Governments must refrain from top-down attempts to address current and future difficulties of getting supplies by reshoring production of various goods and services (Stelling et al. 2020). There is ample research on the harmfulness of import-substitution policies.
- In the longer term, countries need to safeguard both global health and prosperity through common strategies and commitments, concrete measures for future crises and mechanisms for consultations. New and even more serious pandemics cannot be excluded. Countries will have to be able to act quickly, in a coordinated fashion and in a transparent way.
- A new approach is needed to reboot and revitalize globalization, with the aim to design a system which reduces the risk of both pandemics and protectionism.
- Mechanisms for applying and enforcing stringent requirements on countries to live up to standards and obligations put in place to minimize the risk of pandemics should be evaluated.
- The concept of sustainability within the global trading system could be extended to encompass not only environmental and social aspects, but also aspects that more clearly impact public health and epidemiological risks. Increased cross-institutional links between bodies such as the WHO and the WTO should also be created to promote knowledge exchange and technical assistance.

The policy response to the COVID-19 pandemic has disrupted international markets. However, simply restoring free trade would mean ignoring massive human suffering caused by the COVID-19 pandemic. A new approach is needed to reboot and revitalize globalization, with the aim to design a system which reduces the risk of both pandemics and protectionism. Leaders and policymakers must make concerted efforts to: carefully lift restrictions on travel and trade while protecting health; commit to liberalize essential trade for fighting pandemics; address how to deal with calls for protecting domestic industries in the presence of asymmetric economic reopening; and sustain international yet resilient value chains. The aim should be to develop the international trading system to both reduce the risks of pandemics and protectionism.

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