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An update on world trade during the COVID-19 episode

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Abstract

The collapse of world trade in 2020 due to lockdowns in response of the COVID-19 pandemic has fuelled a rethinking of globalization with policies being reoriented towards strategic autonomy and local production by means of nearshoring and insourcing. Comparing the impact of the COVID-19 trade shock to the Great Depression, this article focusing on resilience and recovery argues that international value chains and the global trading system have helped to weather the impact of the global unprecedented response to a health shock.

Keywords

World trade, Covid-19, strategic autonomy, insourcing, nearshoring, world trade system.

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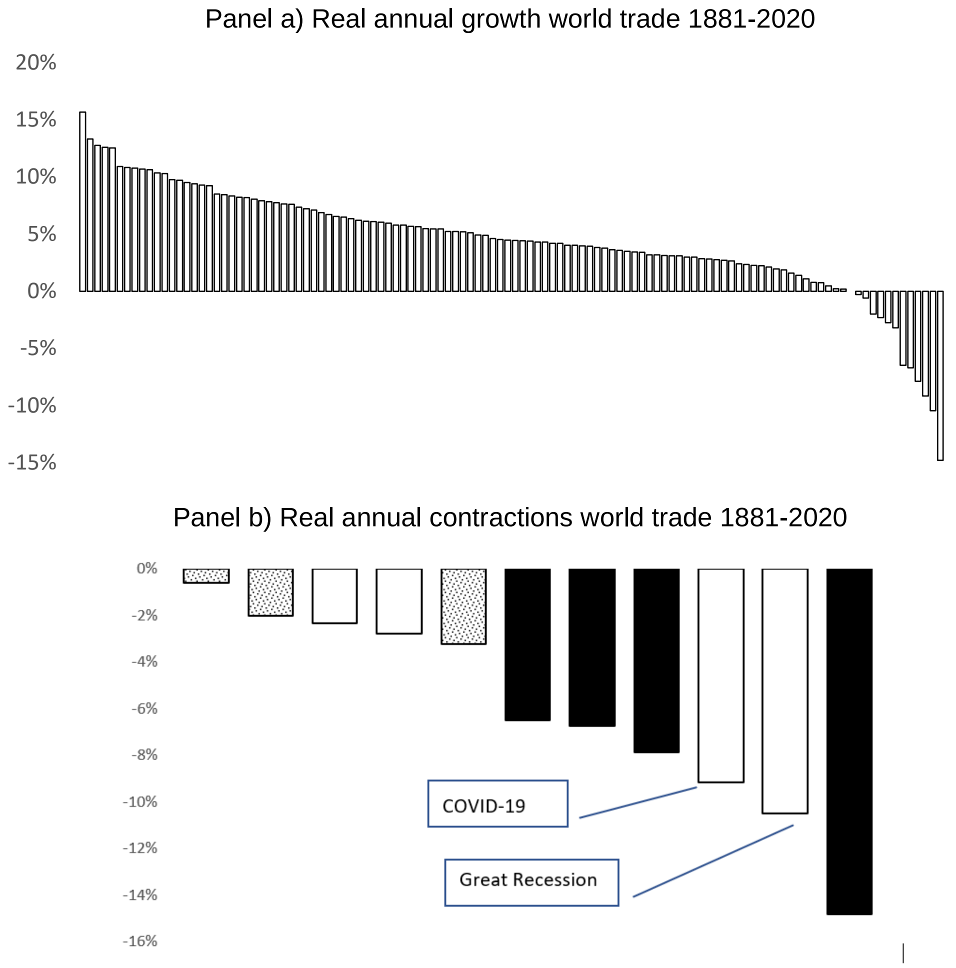
An update on world trade during the COVID-19 episode

1 Introduction

Real contractions of world trade, such as could be observed already two times since the start of the century – during the Great Recession in 2008/9 and the COVID-19 pandemic in 2020/1 – are extraordinary events. Typically, word trade has been on an upward trend as illustrated by the development of the world merchandise trade volume in Figure 1.

FIGURE 1
Contractions of world merchandise trade are exceptional



Note: 1930s in black, oil crises contractions (1975-1982) in gray.

Source: updated from Van Bergeijk 2010, Figure 1.3, p. 8 using calculations based on World Bank *World Development Indicators* accessed 22 March 2022, average of series NE.EXP.GNFS.KD and NE.IMP.GNFS.KD

Using annual trade data for the period 1881−2020, the top panel of Figure 1 illustrates the infrequency of negative annual growth rates for world merchandise trade: ninety per cent of the annual real growth rates is positive. Decreases in the volume of world merchandise trade are thus relatively unique in recent history, but they do occur.

It is, however, not only the fact that negative world trade growth happens to occur with a very low frequency which makes the 2008/9 and 2020/1 world trade collapses an intriguing phenomenon. Also, the strength of the decrease is remarkable, as illustrated by the bottom panel of Figure 1, that identifies three decades that consist of several recurring contractions of the world merchandise trade volume.

These phases of deglobalization are the Great Depression (marked in black), the oil crises of the mid 1970s and early 1980s (marked in grey) and the recent two trade collapses that are both in the top 3 of contractions since 1880. The two recent collapses thus stand out because of both their frequency and their strength suggesting that global trade is at risk at an intensity only observed during the Great Recession.

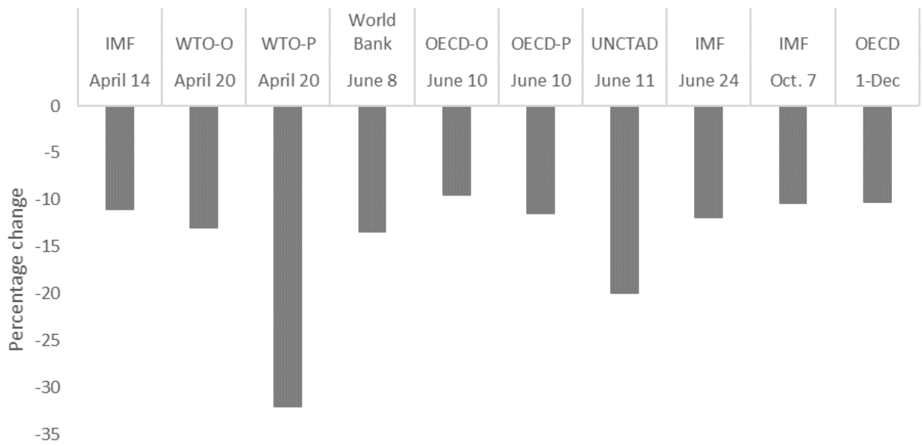
In this working paper, we will first take a closer look at these specific events. Section 2 puts the collapses of the world's merchandise trading volume during the 1930s and in the first part of the 21st century further into historical perspective while paying special attention to differences and communalities between the two periods. We will see that resilience during the two recent trade collapses was remarkable and that this is related to the avoidance of protectionism, the maintenance of long-run relationships in international value chains and the existence of a multilateral trading system.

Section 3 then discussed the threats to these stabilizing factors that can be observed in strategic trade policy developments of the major trading blocs: 'America First', 'Made in China 2025' and the EU's 'Strategic Autonomy' and the trade policy responses to the COVID-19 that have increased the stakes. We will see that COVID-19 has further stimulated thinking about restrictive trade and investment policies that would set limits to international specialization, and that may have shifted the balance in policy quarters. At the same time the pandemic, however, clarified that the costs of such a strategy while small for the major trading nations, are very high if not prohibitive for the small open economies that form the vast majority in the multilateral trade system. Most importantly, world trade has shown an unprecedented reliance to this shock and this to a large extent may be due to the activities that are organized by private firms in global networks and international value chains. Section 4 draws conclusions.

2 A historical perspective on the Great Trade Collapse and the COVID-19 Crunch

The impact of COVID-19 on world trade was from the start a cause for grave concern to international policy makers. Forecasts and intermediate assessments for the shrinkage of the 2020 volume of world trade ranged from minus 32 to minus 10 percent (see Figure 2). Currently the IMF (2022) estimates the contraction for the year at -8.2%.[1]

FIGURE 2
Forecasts for the volume of world trade
(international economic organizations; forecasts at different dates in 2020)



Source: updated from Meijerink et al., 2020

Note: O = Optimistic scenario, P = Pessimistic Scenario

The expected dearth of world trade, however, was – with hindsight – exaggerated. It is true that the world trade shrinkage was initially exceptionally strong. But trade bottomed out quickly especially when we compare the COVID-19 collapse with the two major historical episodes of trade collapse, that is the epoch of the Great Depression in the 1930s and period starting with the Great Recession. This suggests much stronger resilience of global export and import flows than anticipated by IMF, UNCTAD, World Bank, WTO and OECD.

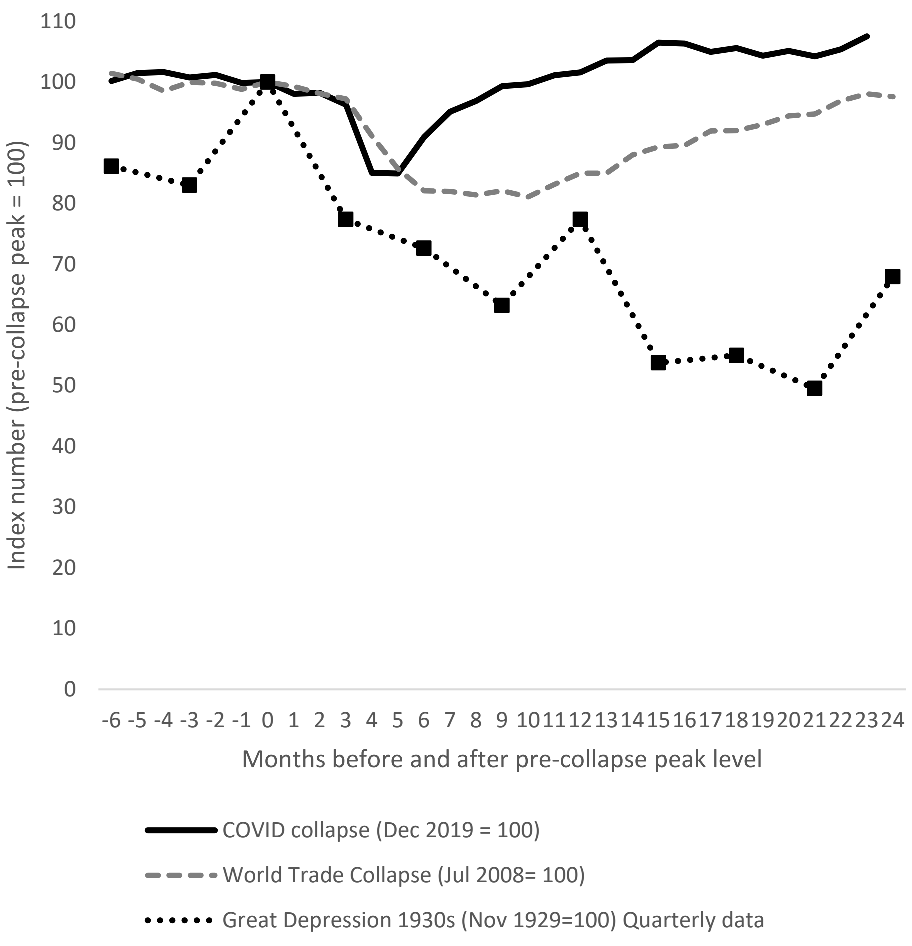
Figure 3 by way of comparison, illustrates how real-world merchandise trade during the three major world trade collapses changed (so that is: Great Depression in the 1930s, the Financial Crisis starting in 2008 and the 2020 lockdowns during the first wave of the COVID 19 episode.

The comparison starts six months before the pre-trade-collapse peak that identifies the 'zero'. The trade collapses in 2008/9 and 2020 both startto bite

[1] Economic data are always being revised for a considerable period after the end of a year (van Bergeijk 1995, 2017).

after a quarter but in the fourth month of the COVID collapse world trade was already 15 percent below previous peak level, while this was 'only' 8 per cent during the 2008/9 World Trade Collapse. Global merchandise trade in May 2020, however, bottomed out, and full recovery was achieved in October 2020. At the comparable point of the 2008/9 trade collapse the volume of world trade was still 17% below pre-crisis peak level. In the 1930s world trade one year into the collapse was 28% below pre-crisis peak level with further decreases to 50% below pre-crisis peak level on the horizon. Clearly, the two world trade collapses before the COVID-19 contraction were both deeper and much more protracted (van Bergeijk, 2019, 2021).

FIGURE 3
Comparing the COVID collapse to the 2008/9 world trade collapse and the Great Depression



Source: updated from Afesorgbor et al. 2022.

The resilience of world trade during the two most recent trade collapses has drawn scientific attention (van Bergeijk et al., 2017, Afesorgbor et al. 2022); the historic comparison with the 1930s, however, may be more relevant than the differences and communalities between the World Trade Collapse and the COVID-19 trade shock.

2.1 Communalities

From this historic perspective the 'Roaring Twenties' of a century ago and our own epoch (the 'Roaring 2000s') have a lot of similarities (Table 1). The starting point just before the onset of crisis is one of significant optimism and confidence in the future possibilities and persistence of globalization. Markets are open and international, if not global, and capital flows freely cross borders at an unprecedented level and speed. In the daily life, completely new products, financial innovations and an improved life expectancy create hope and strengthen confidence. New industries boost productivity and living standards and fuel stock exchange booms. A cluster of trade enhancing factors is also key in understanding these periods that although separated by a century share a common belief in globalization as an unstoppable force. This cluster covers key technological innovations, long-run reductions of trade costs and new modes of transportation and communication. The world's 'mental horizons' a shrinking so that new far-away markets were becoming increasingly realistic opportunities. In technical economic terms: the extent of potential markets increased significantly. That outlook, however, changes dramatically.

TABLE 1
Differences and communalities of the Great Depression and the 21st Century

	1930s	21st century
Long-run reductions of trade costs	●	●
New modes of transportation	●	●
Revolution in communication	●	●
Entry of new countries (recent capitalist countries)	●	●
Key innovations	●	●
Financial innovation and capital account liberalization	●	●
Changing hegemony	●	●
Pandemics	●	●
Banking and financial crisis	●	●
Substantial presence of international value chains		●
Multilateral trade governance		●
Protectionism	●	
Initial international policy coordination		●

First and foremost, there is the impact of the financial crises that gives rise to the idea of secular stagnation thereby increasing uncertainty. In the international arena the erosion of the hegemon's position and the emergence of previously peripheral countries in the global trade system are important elements, because countries in the periphery grow faster than the rich industrial countries in Europe and North America and this convergence with (if not competition from) the previous outs creates doubt on the future rules and norms of the world trading and investment system. Connectivity increases and global flows of people make a globalized world more vulnerable to the spread of contagious diseases. To some observers the pandemics of the Spanish Flu and COVID-19 could be signaling that the world has integrated to fast, and although this is an exaggeration, the pandemics are definitely a reminder that globalization also carries a cost that is often neglected. Pandemic risk has been associated with global travel, human–wildlife interaction, intensification of global food production, and densification of population (Daszak, 2012).

2.2 Differences

Of course, also important differences can be observed between these two periods. From a purely scientific point of view the differences are excellent news, because we could not learn if the Roaring Twenties and the Roaring 2000s were identical twins. Moreover, from a policy perspective the dissimilarities, as we will see, are even better news. After all, these differences to a large extent explain why the disastrous trajectory of the 1930s was avoided despite the fact that already two major trade collapses occurred since the turn of the century.

One important difference is the role of international networks of firms that self-organize into international value chains. Trade in the 1930s was mainly interindustry (that is: countries exported and imported dissimilar goods) being based on absolute and comparative advantages. Modern trade predominantly is intra-industry with export and import of similar goods by the same country although often at different stages of production. The mainstream analysis has argued that such networks are a key driver of recent trade collapse as problems in one country spill-over to other countries both downstream and upstream. To the casual observer this is what happened during the Great Recession when faltering demand in the US and USA impacted on emerging markets and developing countries as well as during the COVID-19 pandemic when lockdown measures restricted supply and thereby created shortages all around the world. These observations are missing two points. The first is the obvious argument that the same mechanism enhances the speed of recovery: once the trade system gets into reserve world trade recovers faster than without international value chains. The second point is less obvious. Trade in international value chains is often based on trust and long-run relationships that for example enable risk-sharing and the provision of informal trade credit between partnering firms (van Bergeijk, 2013; Đào and van Bergeijk, 2018). Trust is not destroyed by common adversity and may be one reason why trade relationships have been so quickly revived after the recent trade collapses.

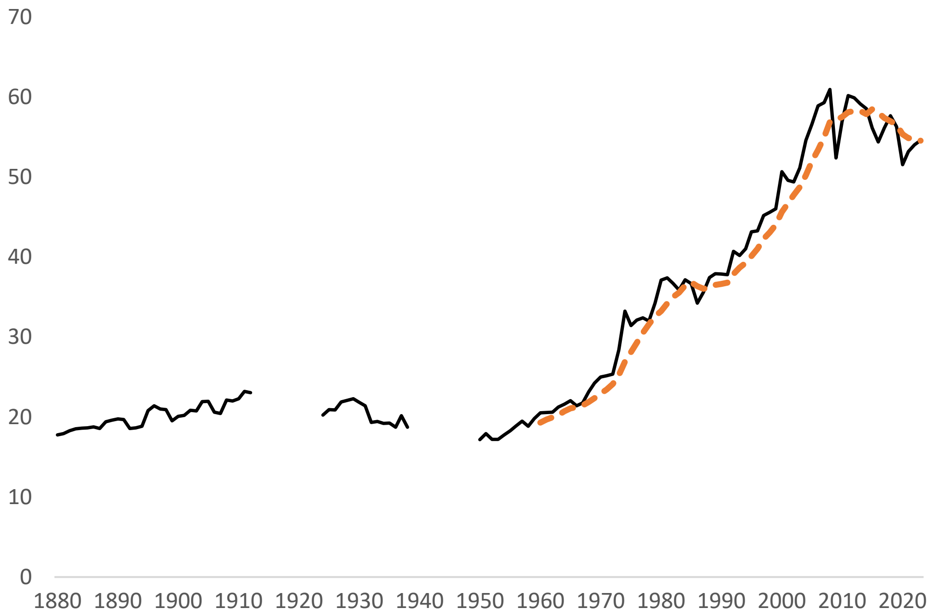
Policy-wise the availability of the multilateral trade governance of the World Trade Organization stands out as a saving buoy for the Great World Trade Collapse and the COVID-19 trade shock. It is true that trade governance was severely compromised by the US upholding appointments in the appellate body (Hopewell 2021), but the consequence was not a return to an epoch of rogue trading since the majority of countries exercised restraint and adhered by and large to the rules and regulations of an open multilateral trading system.

Indeed, the most important difference in my view is the fact that tit-for-tat protectionism was avoided in recent times. In the 1930s countries were leapfrogging beggar-thy-neighbor policies: competitive devaluations, tariff wars and buy-national procurements created the tsunami of protectionism that led to the contraction of world trade that actually led to a world that was less open in the 1950s than at the start of the 20th century. In recent times we have seen problems in currency alignment and the Trump trade wars, but the point is that this never became a self-reinforcing problem of ever-increasing protectionism. Counter measures were taken, but always the targets of foreign beggar-thy-neighbor policies exercised restraint. In this sense one of the major lessons of the 1930s was well received in policy quarters.

3 Strategic autonomy

There is, however, an area where concern is in order: the tendency towards deglobalization that can be discerned since the start of the Great Recession in 2008.[2] The strive for strategic autonomy is one of the symptoms of the deglobalization phase that characterizes the current international trading system. Figure 4 illustrates that openness since 2008 has been on a capricious but clearly downward trend as illustrated by the 6-year moving average (the dashed line in Figure 4).

FIGURE 4
Openness of the world economy
(1880-2023 world merchandise trade in percent of GPP)



Note: - - - - 6 year moving average

Source: Updated from van Bergeijk (2019) using World Bank World Development Indicators (accessed January 21, 2022) and IMF (2022) forecasts.

More important than the numbers, however, are the qualitative changes in the field of trade policy that have gained ground during the last decade and in particular the reevaluation of the mutual dependency that is inherent to international specialization. The three major trade blocks have their own guise of this reevaluation: 'Make America Great Again', 'Made in China 2025' and the EU's 'Strategic Autonomy' are all fruits from the same tree (van Bergeijk 2019, Akgüç 2021). Indeed, the analytical tools, findings and policy implications regarding neo-mercantilism and strategic trade policy apply to our current

[2] Early publications on deglobalization include Bello (2005) for a normative view and Hillebrand (2010) for a quantitative scenario analysis.

situation as well.[3] The main issue here is that trade policy arguments that are key for small open economies, including the analytical finding that unilateral steps towards trade liberalization are welfare enhancing, do not apply when we think about the largest actors in the world trading system. Large economies with monopolistic (supply) and monopsonistic (demand) market power can realize an improvement of their terms of trade when they restrict their demand and/or supply on world markets (van Bergeijk 2009). Typically, the costs of trade restrictive policies are small for large countries because large players are able to pass on these costs to their smaller counterparts.

The COVID-19 pandemic has brought the issue of 'strategic dependence' again on the policy agenda as the impact of international value chains has become clear in terms of shortages and scarcity driven price increases. Hence the buzz words of trade policy makers have changed from out-sourcing and off-shoring to in-sourcing, near-shoring (Gielens, 2021).

The vaccines and the scarcity of medical equipment have also brought to the fore export restrictions and intellectual property rights restrictions imposed by the advanced economies (Baldwin and Evenett, 2021; van Bergeijk 2022). While such restrictions may seem logical to health care policy makers under pressure of an unfolding pandemic such policies do not add value, at most buy very limited time and often are counterproductive. An example is the finding that the Trump tariff war against China actually reduced the availability of masks, face shields, respirators and protective garments before the outbreak of COVID-19, thus putting the US at a pandemic preparedness disadvantage (Bown, 2021, pp. 14-15).

While this literature off course has been stimulated by recent experiences, this issue has been on the table for longer (see Badwin and Freeman 2021 for an overview. These mechanisms can be recognized more generally in economic studies on the impact of limitations of value chain activity and international trade.

Firstly, recent economic research shows that in-shoring and near-sourcing and other forms of import substitution entail very high costs for small open market economies such as the Netherlands, Belgium, Ireland, and the Baltic States (Eppinger et al. 2021) and also that greater autonomy can limit their pandemic resistance.

In contrast the costs in percent of production for the large world trading nations and institutions are small. Large countries may thus be tempted to consider the trade costs of strategic autonomy to be a small price for potential geopolitical gains. Interestingly, this heterogeneity can be recognized in the positions that EU member countries take on the European Commision's plans for open, strategic autonomy (incidentally, a *contradictio in terminis*). Figure 5

[3] If you write as long on international trade economics as I do, then old work becomes topical again due to the policy cycle in trade policy making, see, for example, van Bergeijk and Kabel (1993). While the characters on the world stage have changed the analysis and implications survived three decades and have a direct bearing in today's trade policy context.

illustrates that the lower the costs of trade disruption, the more likely a member state is to embark on an inward-looking trade policy strategy.

FIGURE 5
Costs of value chain restrictions and policy orientation in the EU

Secondly, the problem with autonomy in the wake of a pandemic is that restricting trade and international value chain activities increases the reliance on the domestic sheltered sector of an economy that as we have seen during the pandemic is actually the most at risk during periods of non-pharmaceutical interventions such as restrictions on group size, firm closures and shelter at home strategies that all have been prominent instruments of health care policies (Bonadio et al 2021).

Thirdly, even for such obvious instruments as strategic stockpiles, empirical analysis reveals that alternative methods may be more appropriate (Wilges, 2008, Meltzer and Patel 2017), especially so because the two most important health care resources cannot be stockpiled. Machines and equipment can be produced in advance, but there is a clear limit to the number of well-trained medical staff and space for quality care during pandemics.

So it is clear that COVID-19 has further stimulated thinking about restrictive trade and investment policies that would set limits to international specialization, and that may have shifted the balance in policy quarters. At the same time the pandemic, however, clarified that the costs of such a strategy while small for the major trading nations, are very high if not prohibitive for the small open economies that form the vast majority in the multilateral trade system. Most importantly, world trade has shown an unprecedented reliance to this shock and this to a large extent may be due to the activities that are organized by private firms in global networks and international value chains. The outcome of these counterbalancing forces and powers is as yet uncertain, but students of global world trade and investment governance are well advised to monitor developments closely because these antipodal forces will determine the future of the international trade system.

4 Concluding remarks

The collapse of world trade in 2020 – due to unprecedented lockdowns in response of the COVID-19 pandemic – has fueled a rethinking of globalization with policies being reoriented towards strategic autonomy and local production by means of nearshoring and insourcing. This movements toward deglobalization is already clear before the events that made such big impressions on our generation, including the Trump Presidency, Brexit and the COVID-19 pandemic. Our comparison of the impact of on the one hand, the COVID-19 trade shock and the Great Recession and on the other hand the Great Depression, demonstrated significant resilience and speedy recovery – beyond the dismal expectations of international organizations early in the pandemic. These findings suggest that trade is not the problem but the solution. Indeed, international value chains and the global trading system in all likelihood have helped to weather the impact of the global unprecedented response to a health shock. Rather than developing costly inward looking policy responses, the world should embrace the contribution of global trade and investment.

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