Box 2.2

GLOBAL TRADE FLOWS AGAINST THE BACKGROUND OF THE PANDEMIC

The COVID-19 pandemic has caused some international trade distortions, most of which were temporary.[1] Thus, although the global closure of borders in the early months of the COVID-19 crisis prompted a severe decline in world trade, there was a turnaround towards end-2020. As a result, international trade flows had by then recovered their pre-pandemic levels (see Section 1.2 of Chapter 1 of this Report).

An example of the temporary nature of some of the distortions arising as a consequence of the pandemic were the protectionist measures many countries temporarily adopted in respect of trade in medical products, in light of the supply problems that were particularly prominent in March and April last year[2] (see Chart 1.1.). More recently, some restrictions have been placed on the distribution of vaccines against COVID-19. Although these will foreseeably be lifted once the pandemic is under control, their presence might hamper the effective distribution of vaccines globally.

Notwithstanding, several geopolitically geared initiatives launched recently might indeed have a lasting effect on the relocation of activity and the reorganisation of global value chains (GVCs). For example, countries such as the United States, Japan and South Korea have announced incentives in recent months for the renationalisation of productive processes by means of subsidies and tax credits. Within the EU, some countries, such as France, have also approved budget funds to support the return of companies. The EU itself has undertaken several initiatives under the so-called "open strategic autonomy" strategy, which seeks to increase the robustness of European production chains and to lessen the dependence on third countries in some strategic areas.[3]

However, when assessing these developments, it is important to bear in mind that, in the current crisis, those firms whose production is more integrated into GVCs are precisely those that have performed better and which have experienced least disruption in their output. The evidence available, moreover, suggest that these companies have a greater capacity to recover following an adverse shock.[4] Conversely, resorting to a higher amount of national inputs usually increases the volatility of GDP because it reduces the degree of risk diversification.[5] Indeed, there has been proof[6] in this crisis that, although those sectors of the EU countries, Japan and the United States most integrated into the GVCs bore the brunt of the initial external shock originating in China, when the pandemic also hit domestic markets, it was these firms that performed comparatively better (see Chart 2.1).

To interpret the recent measures, it should be borne in mind that these developments are part of a larger-scale pre-pandemic process that partly called into question the WTO rules-based multilateral framework. Notable milestones in this process have been the escalation of US-China trade rivalry in recent years (see Chart 1.2) and Brexit. While globally these episodes have not led to a generalised increase in tariff barriers, they have actually caused a notable rise in trade uncertainty,[7] adversely affecting global trade, and they have prompted trade flow diversions. Specifically, the United Kingdom's withdrawal from the EU will increase non-tariff barriers between the two areas and will necessitate numerous bilateral agreements between the United Kingdom and third countries[8] (see Chart 1.4). In Spain's case, it has also been apparent since the June 2016 Brexit referendum how Spanish firms (in particular those with greater trade exposure) have reduced their purchases from and sales to the United Kingdom and have increased trade with the EU. That has entailed a 14% decline in Spain-UK bilateral trade in goods in January 2021, compared with the same

1 For a fuller discussion on long-term trends in world trade, see I. Kataryniuk, J.J. Pérez and F. Viani (2021), *(De-) globalization of trade and regionalization: a survey of facts and arguments,* Occasional Paper, Banco de España, forthcoming.

2 See C. García, C. Martín and F. Viani (2020). "International trade in medical products during the COVID-19 pandemic", Box 4, Economic Bulletin, 4/2020, Banco de España.

3 See P. L'Hotellerie-Fallois, M. Manrique and A. Millaruelo (2021), "Open strategic autonomy in the EU", Box 5, *Economic Bulletin,* 1/2021, Banco de España.

4 See S. Miroudot (2020), "Resilience versus robustness in global value chains: Some policy implications", in *COVID-19 and trade policy: Why turning inward won't work,* pp. 117-130.

5 See OECD (2020), *Shocks, risks and global value chains: insights from the OECD METRO model,* 29 June.

6 See A. Espitia, A. Mattoo, N. Rocha, M. Ruta and D. Winkler (2021), *Pandemic Trade: COVID-19, Remote Work and Global Value Chains,* Policy Research Working Papers, no 9508, World Bank.

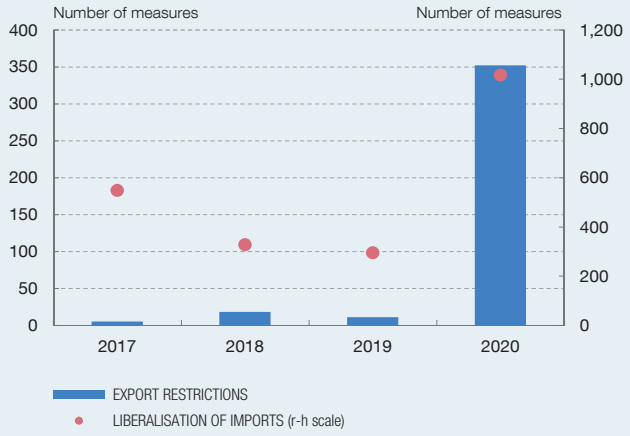
7 See S. Albrizio, A. Buesa, M. Roth and F. Viani, *The real effects of trade uncertainty,* Working Paper, Banco de España, forthcoming.

8 See A. Buesa, I. Kataryniuk, P. L'Hotellerie-Fallois and S. Moreno, "The EU-UK Trade and Cooperation Agreement", Analytical Articles , *Economic Bulletin,* 1/2021, Banco de España.

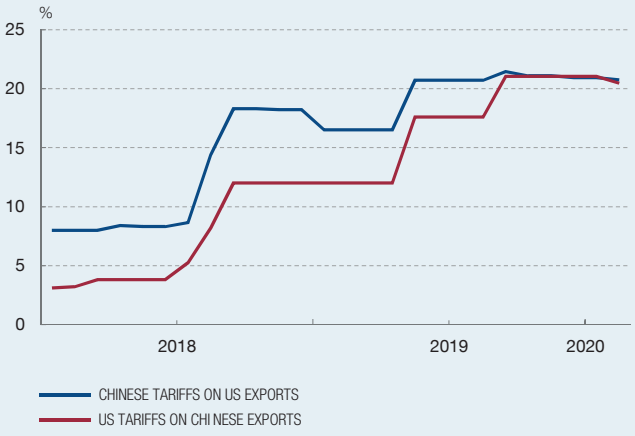
month a year earlier.[9] Apart from this case, in recent years the increase in non-tariff barriers[10] has been global in scope (see Chart 1.3), largely reflecting the generalisation of higher environmental, social and labour market standards in respect of production processes for tradable goods and services.[11]

Chart 1
TRADE BARRIERS AND BILATERAL AGREEMENTS

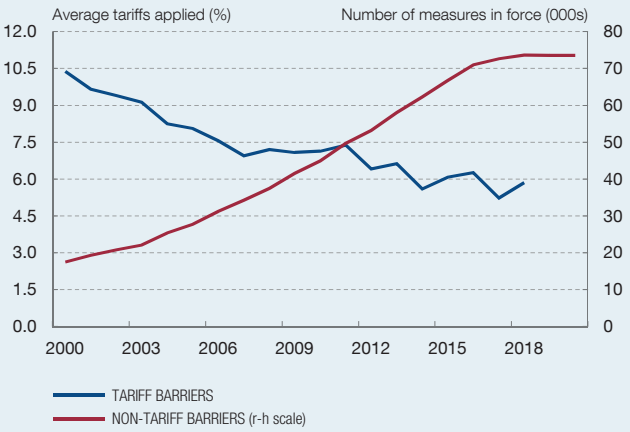
1 TRADE POLICY MEASURES AFFECTING TRADE IN MEDICAL PRODUCTS (a)



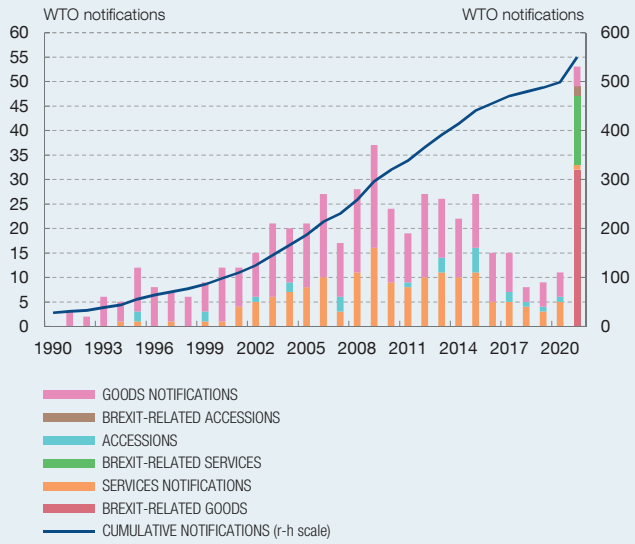
2 US/CHINA BILATERAL TARIFFS



3 TARIFF AND NON-TARIFF BARRIERS (b)



4 BILATERAL TRADE AGREEMENTS



SOURCES: Global Trade Alert, OMC, Bown (2019), UNCTAD and own data.

a Number of measures per HS4 code, according to the WTO classification of medical products.
b Effective tariffs applied refers to the lower of preferential tariffs and Most Favoured Nation tariffs.

9 E. Gutiérrez, A. Lacuesta and C. Martín, "Brexit: Trade diversion due to trade policy uncertainty", Working Paper, Banco de España, forthcoming.

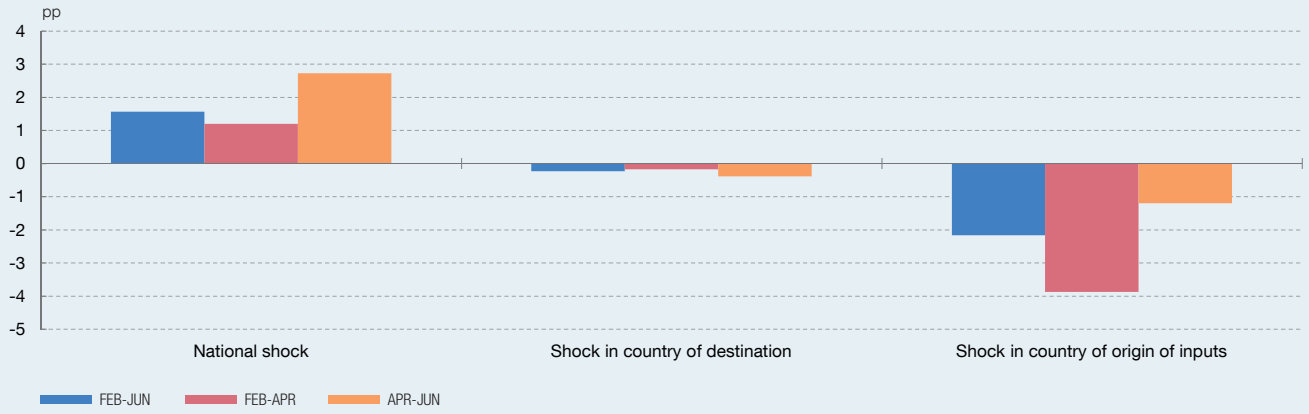
10 Effective tariff barriers are defined as the lower of preferential tariffs and the Most Favoured Nation tariffs applied under the WTO framework. The series does not include the tariff measures applied by the United States to imports from China and from other countries as from 2018 against the background of the trade dispute.

11 See F. Lopez, J. Timini and N. Cortinovis (2020), *Do trade agreements with labor provisions matter for emerging and developing economies' exports?,* Working Paper, no 2017, Banco de España, and Timini, J. and M. Conesa (2019), "Chinese exports and non-tariff measures", *Journal of Economic Integration,* 34(2), pp. 327-345.

Another process under way prior to the outbreak of the pandemic was the slowdown in international trade in goods. Various factors are estimated to have contributed here. In particular, the lower weight of international trade in goods as a percentage of global GDP in recent years (see Chart 2.2) would partly be the result of: the transition in China to a growth model based to a lesser extent on external trade;[12] a tailing off of the dividends arising from the trade liberalisation measures adopted across the board in the decades prior to the financial crisis; and the slowdown in the scope for fragmentation of GVCs, which had already attained very high levels of complexity. Yet it should be mentioned that this slowdown in world trade in goods is proving compatible with an increase in regional

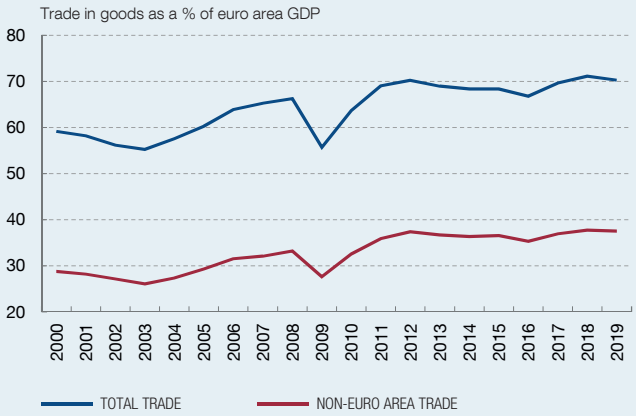
Chart 2
TRADE OPENNESS AND GLOBAL VALUE CHAINS

1 RELATIVE IMPACT OF THE PANDEMIC ON BILATERAL EXPORTS (a)



2 TRADE OPENNESS

3 TRADE OPENNESS OF THE EURO AREA



SOURCES: World Bank, Comtrade, Eurostat, OECD, IMF, ASEANStatPortal and Espitia et al. (2021).

a The bars show the differential effect on bilateral exports of a share in global chains of a value of 1 percentage point higher, in the face of different shocks. The chart thus shows the results of the estimate of the effect on exports of a supply-side shock in the country of origin of the exports (left), a demand-side shock in the country of destination (centre) and a supply-side shock in the countries from which the inputs used come (right), at different times in the pandemic: February-April, when the input-supplying countries, such as China, were more affected; April-June, when the pandemic spread, and the aggregate. For more information see Espitia et al. (2021).

12 See, for example, M. Roth, D. Santabárbara and B. Xu (2019), "Global impact of a slowdown in China", *Economic Bulletin,* 4/2019, Banco de España; and Timini, J. (2017), "China's economic imbalances and the role of the financial sector". *Economic Bulletin,* 4/2017, Banco de España.

trade, against a background in which trade ties among member countries of a single region have strengthened in many areas, in particular in North America and in the EU (see Chart 2.3).[13]

The counterpoint to the slowdown in trade in goods is a rising trend in global trade in services, which might be reinforced as a result of the pandemic. Indeed, services have become progressively more tradable in recent years – owing mainly to technological progress and digitalisation – and their weight in the productive processes for certain manufactures has increased.[14] Recent experience might strengthen this rising trend, by highlighting how digitalisation can make certain services tradable when they were previously not deemed to be so. This is the case, for instance, of so-called "tele-migrants"[15] who, through digital technologies, can live in one country and provide services in others.

In conclusion, there is clear evidence that sustaining a global framework of shared multilateral rules contributes to increasing the robustness and resilience of national economies. In particular, diversification and trade integration have helped tackle the impact of the current crisis and they will be a fundamental factor in driving the recovery. The pandemic has not affected the main factors stemming from the benefits derived from international trade, such as labour specialisation and the organisation of production. These have allowed the income of the world population to expand in recent decades. Moreover, some of the new emerging challenges – such as combating climate change and how the major digital corporations operate – are on a global scale, and should be addressed from a multilateral perspective.

However, recent experience might indeed strengthen certain previous trends, with a geopolitical backdrop, that may lead to a greater geographical fragmentation of the movement of goods, services, capital and people. On the one hand, growing geopolitical competition, which is particularly visible in the technological realm, might heighten insofar as the digitalisation of activity increases dependence on specific technologies provided by major global players based chiefly in the United States and in China. On the other, the advanced economies' diminished relative economic weight and rising inequality in these countries, which might fuel political and social polarisation processes, could prompt changes in agents' preferences with respect to globalisation.

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13 Trade ties in the Asia-Pacific region will also be strengthened by the RCEP, a trade agreement reached by a group of 15 economies belonging to this area, including China, South Korea and Japan.

14 Known as the "servicification" of manufactures. See M Lodefalk (2017), "Servicification of firms and trade policy implications". World Trade Rev., 16, pp. 59-83.

15 Baldwin, R. (2019). "EAEA16 Keynote Address: The Future of Globalization", Asian Economic Journal, 33(1), pp. 3-12.