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Globalization on hold or in reverse?

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Globalization on hold or in reverse?

Country after country has now imposed restrictions on international travel, and foreign trade is collapsing in tandem with falling demand and disruptions in supply chains. The coronavirus has put globalization on hold. But will globalization be reversing in the longer term? Magnus Lodefalk provides perspectives from research in international economics.

In 1665 the plague ravaged the United Kingdom and as a precaution, the University of Cambridge was closed for just over a year. During his leave from the university, student Isac Newton arrived at the Law of Gravity, which describes how the force of attraction between two bodies depends on their mass and the distance between them.

In fact, the Law of Gravity has also been applied in the social sciences. And it is useful for analyzing the corona pandemic's effects on globalization. By globalization, I refer to an economic process of integrating the world economy through increased trade, but also increased cross-border investment. In the international economy, the gravity model means that two countries trade more with each other the greater their economic "mass" and the closer they are to each other.

The measures to combat the coronavirus pandemic can be expected to cause a substantial economic decline, which, under the gravity model also decelerates foreign trade. The downturn affects small, open and highly trade-dependent countries like Sweden and Belgium as well as large countries like the United States and China. In the financial markets, we have already seen double-digit stock prices that are larger than, or at least in par with, the stock market fall of 1987 and the stock market crash of 1929. In March, the US Dow Jones Average Index lost just over a third of the share value within a couple of trading days. Although the stock markets have now recovered somewhat, we can expect continued large price movements during the pandemic.

Down the road, we can also expect strong economic effects in terms of increased unemployment, falling real wages and more bankruptcies. Perhaps the downturn will subsequently be compared with, or rather be significantly more severe than during the financial crisis in 2009.

Emergency measures and foreign trade

It is very uncertain how well countries will be able to mitigate the sharp economic downturn, thereby also preventing an extreme slowdown in foreign trade. Both in Sweden and abroad, a number of measures have been taken to counteract the economic effects of the pandemic and of its medicine.

Central banks around the world are now pursuing increasingly expansionary monetary policies by purchasing government bonds to increase the amount of money in circulation and they have been given increased opportunities to lend to the banks. On the other hand, many of them can hardly lower the policy rates from the already low levels so that it has a greater effect. Governments have announced a range of fiscal measures - ranging from "helicopter dropping" where every individual receives a certain amount of money, to business loans, and to governments paying for laid off personnel.

Further government measures are expected and they will probably include both support to individuals, different types of businesses and industries, as well as support for regions that are particularly hard hit. At the same time, governments need to be clear that the restrictions imposed to prevent the spread of the infection will be brief, to avoid severe long-term consequences in the form of persistently high unemployment and the death of fundamentally viable companies.

Travel restrictions - such as the entry bans of the US, EU and India - and related halts to international air travel also complicates airfreight. For many businesses, this can create barriers to trade. A comprehensive literature shows the relationship between personal mobility and economic globalization. Reduced mobility obstructs information flows, contacts and network building between countries, and this will have a negative impact on both foreign trade and direct investment.

Although the World Health Organization (WHO) recommends countries to avoid restrictions on international travel, because they are not very effective or may even worsen the situation, a large number of countries have taken measures to minimize foreign travel.

In a modern variant of the gravity model, trade policy instruments such as customs and other types of trade barriers or rules that make trade more difficult are usually included. The corona pandemic has prompted some 60 countries, such as Germany, the United States, Turkey, India and Russia, to impose restrictions, seemingly without World Trade Organization (WTO) consultations, or even to ban the export of various types of medical equipment and pharmaceutical products [1]. Even trade between EU countries has been limited, with, for example, France being reported to prevent the supply of protective masks from a French supplier to the British health care [2]. Export restrictions have been introduced, although they are likely to conflict with both EU and WTO regulations. Now the EU itself has imposed restrictions on exports to other parts of the world [3]. In addition, the United States has conditioned state emergency aid to small businesses in the corona crisis with the companies buying US goods as much as possible.[4] These barriers to trade come in addition to existing duties and, for example, rules that already make it more difficult to trade in goods needed to fight the corona pandemic.

The current trade restrictions are in other words unusual both in nature and their implementation. They can also be in conflict with international regulations.

All in all, we can expect an extreme decline in foreign trade due to shrinking economies that are distancing themselves from each other and at the same time introducing trade barriers. And particularly hard hit is trade in the products that are needed the most to fight the pandemic.

Three mega trends

There are three trends from the last few decades that may interact with the current corona crisis: the integration of international value chains, trade policy liberalization and technological progress.

Over the past 50 years, business operations have been increasingly divided into various elements that have since been relocated to their own subsidiaries or to completely different companies - the value chains have been fragmented. Not infrequently, companies have benefited from, for example, technological know-how or cheap labor abroad for the production of certain elements in order to focus on the core business in the home country or on integrating increasingly service content into what the customers are offered. The concept of "Made in Sweden" has, just like for Volvo Cars in its marketing, rather become "Made by Sweden", where production in some sense is global.

The integration of value chains has been facilitated by both trade policy liberalization and technological progress. In the area of trade policy, great progress has been made. Several successful rounds of negotiations within the WTO and its predecessors GATT, as well as the entry of a large number of new member countries, have greatly reduced barriers to trade in goods and provided more certainty to trade in services.

They have set ceilings for how high barriers may be for both goods and services trade, increased transparency in trade policy and lowered the level of conflict through an effective dispute resolution procedure.

Today, the average tariff on industrial goods in the OECD countries is only a few percent. In the middle of the last century, the corresponding figure was 25 to 40 percent. Trade, including both intermediate and end products as well as end services, has traditionally increased faster than the economies have grown. Today, trade accounts for around 60 percent of the world's GDP, which is comparable to just under 30 percent in the early 1970s.

Technological advances have also contributed to globalization, including the fragmentation of value chains. These include, for example, the "containerization" of transport, where goods are packed in standardized boxes that are easily moved between different means of transport rather than having to be packed over and over again. But also advances in information technology have facilitated globalization so that, for example, a company can adjust the temperature of its container for sensitive goods in real time when it is being transported from one continent to another while keeping in touch with the customer via e-mail and Skype.

Globalization on hold?

The question is now whether the corona crisis will be a key factor behind a reversal and not merely a pause in globalization through the interaction with the latest developments of the three previously mentioned trends.

In the area of trade policy, as mentioned above, high barriers to cross-border trade and personal mobility are now being introduced, the latter also being a way of delivering and consuming services. The obstacles create uncertainty for both exporters and importers of goods and services. Research shows that uncertainty about the stability of the rules of the game has a major negative impact on trade, in other words, it is not only the obstacles themselves that reduce foreign trade. The restrictions imposed now do not seem to have been coordinated in the WTO, between the G20 countries or initially even between the EU countries. The restrictions have been introduced quickly and without cooperation between countries. In the near future, the risk of such sharp fluctuations in trade policy will remain and they also risk being seen as a precedent for trade barriers in the future. WTO seems here to have a difficulty functioning as an rules-based anchor, consultation mechanism and an analytical support in the current situation. And so far the EU has not been a coordinating force.

These trade policy entanglements come in addition to recent heavy blows to globalization in recent years, perhaps most evident in the installation of Donald Trump as the US President. The new administration has brought a paradigm shift from building up common international institutions and jointly liberalizing world trade to unilaterally imposing additional duties on products such as steel, with reference to national security, liberalizing trade with individual countries and disabling the functioning of the WTO Appellate Body. Brexit also means an European integration in decline. All in all, the trade policy climate has become more protectionist and much more unstable.

An increasingly mercantilist and unpredictable global trade policy environment and new technological advances have already had companies and countries considering a regionalization or even the nationalization of global value chains. The corona virus blocks value chains by preventing components and goods from arriving or being delayed so that they are no longer in demand when they arrive. For the value chains that have previously been based on "just-in-time"-deliveries rather than stocks, this becomes a major challenge. Certainly, more and more companies are asking themselves if they cannot find suppliers in or near their home country or in the end-customers' markets. Some are probably wondering whether they should reshore production to the home country by replacing foreign labor with robots at home. And some countries are already considering moving production back home as export bans make it difficult or extremely expensive to get the necessary medical supplies.

However, the conclusion should rather be to build more resilience into the value chains, for example by having more suppliers, warehouses and using modern technology to monitor the chains in real time, than to move home production which is advantageously done abroad [5].

Moreover, the differences both over time and between countries where the virus wreaks havoc, and between how countries fight the pandemic also constitute risks to globalization in the short and perhaps medium term [6].

Suppose that one country chooses to try to isolate the virus through draconian restrictions on the freedom of people and companies, while another chooses to allow a large part of the population to become infected and thus get so-called flock immunity. Or suppose that the virus affects countries at different rates, some of which only have a few numbers infected while others have many. Or suppose that some countries test large sections of the population and openly report the statistics of those infected while others keep both the extent of the testing and the results secret. Of course, this kind of differences means that mobility between countries in the form of passenger traffic and other transport will encounter patrol. The country that tries to suppress the infection and the country that does not yet have the infection will both want to ban or at least severely cut physical contacts with countries that have been more severely affected by the infection, have chosen another strategy to fight the virus or darken the spread of the infection.

We have already seen that China, which recently has claimed to have reigned in the contagion, has required a 14-day quarantine for entrants into the country and subsequently introducing an entry ban. The EU has also introduced a general entry ban on persons outside the Community and related countries. However, some EU countries have also imposed restrictions on travel also within the EU, such as Poland, which temporarily has closed its borders.

Shrinking markets

What would a globalization in reverse, rather than on hold, mean? In short, our common resources would be smaller the greater the degree of "self-catering" introduced. In this way, we are given less resources to, for example, fight future pandemics. Firstly, globalization on retreat means that specialization between countries is reduced and thus production resources are not being used in the best way at global level. Second, companies will not produce for an equally large market, and consumers and businesses will not have access to an equal supply of goods and services. Both reduced scale in production and poorer supply have a negative impact on welfare. Third, the competitive pressure is lower and it reduces the productivity of the economies. Fourthly companies are expected to generally invest less in innovation and therefore to be less productive when their innovations can only be sold in a smaller market. Another effect is that the trade policy environment becomes even more uncertain for both companies and countries, which in itself is negative for the economy.

Although everyone country's economic well-being and resilience to pandemics are diminished by a globalization in reverse, some countries will be hit much harder than others. Simulations of what lay on the table in the recent and now diminished WTO round of negotiations in the late 2000s - the so-called Doha Round - pointed out that those who benefited most from liberalization were the smaller and less developed countries.

This indicates that an opposite development would hit them hardest. At the same time, one would expect that it is precisely these countries that will have the most difficulty in handling the corona pandemic with a great human suffering as a result. When health care, soap and clean water, food for the day and social distance are central to survival, one does not even want to think about what it looks

like, for example, for those living in the large slums that exist in the large cities of many poor countries. The less developed countries' own barriers to imports, for example in the form of customs duties, but especially rich countries' newly introduced export restrictions on medical

products will make it even more difficult for the less developed countries to deal with the current pandemic. Moreover, capital is now fleeing from away from poor and to richer countries. The poorest and most debt-ridden countries can thus be hit twice in the form of coronavirus pandemic and globalization in reverse. It is also the poorest countries that are losing out in an increasingly non-multilateral trading system.

Finally, it is worth adding that a retreat of globalization cannot be captured solely in economic terms. The opportunity to travel, meet, exchange views, study and work across borders has a freedom dimension and can bring people and cultures together and thus counter conflicts between countries, which was a motive behind today's EU.

Restarting globalization

How can we reduce the risk of a permanently lower degree of globalization in the wake of the current pandemic and in association with future pandemics? In the short term, discussion and coordination among EU member states as well as between the EU and other countries is needed. This is to both ensure that economic rescue efforts are powerful and that restrictions imposed on communities and on foreign travel as well as trade are as temporary and balanced as possible. The risk of repeated waves of contagion and subsequent severe restrictions should as far as possible be avoided.

In the medium term, a strategy is needed to reduce the risk of asymmetric geometries in transmission and differences in the fight against the corona pandemic, which would create long-term obstacles to personal mobility and trade. International liberalization of trade in goods and services that are particularly needed to fight pandemics is also important.

In the slightly longer term, countries, the EU and the larger international community need to safeguard both globalization and prosperity through common strategies, concrete measures for future crises and mechanisms for consultations.

A positive example from the recent financial crisis was that the countries of the G20 managed to stand united around free trade, avoiding a vicious circle of protectionism as in the 1930s. Similar efforts would have been desirable this time. It is noteworthy that the EU countries have acted so uncoordinated in this crisis and that the EU has recently itself imposed restrictions on trade in medical products while relying on imports of other medical products and medicines from other countries.

A number concrete measures which even a layman realize ought to be considered are the construction of emergency stocks and contingency plans at various levels, a greater capacity in emergency medical care, better monitoring and information systems and action plans that are triggered according to predetermined criteria, but also enhancing the controls of the health of travelers. There is a risk that the next time we will encounter a virus that is as contagious as the corona virus it will be as deadly as, for example, Ebola. This means that countries must be able to act quickly, together and transparently to deal with the spread of an infection, while at the same time avoiding too ineffective, drastic and above all long-term measures to avoid also creating an economic pandemic.

In order to safeguard globalization, leadership of a different caliber than today is needed, both at national and international levels. It requires political leaders who are both rooted in people's everyday lives and withstand the pull of protectionism and nationalism when economies contract and ideas about self-sufficiency comes to the fore. We need leaders who regain and renew the vision of an interdependent and a democratic world, with common rules, freedom, openness, and the belief that

foreign policy is not a zero-sum game. There is also needed for experts who contribute with their knowledge to translate visions into reality in the best possible way. The origins of Brexit show how not to do - politicians who shift their focus from their own

shortcomings to international cooperation and who lower the protection of the weak of society, and experts who take too lightly on the distributional effects of various reforms. Examples of the day is also a deterrent - where several countries are blaming each other for the being the origin of the corona virus and seemingly spreading disinformation about the pandemic and other countries' actions, this for their own personal gain. These types of actions of countries create greater tension in world politics.

At best, the corona virus's ravages around the world leads to an understanding of how intertwined and interdependent we are. Here we may all in the fasting and quarantine time examine our priorities, imaginations, and what we pass on to each other. Pandemics, climate change and an increasing number of refugees in the world are some of the current challenges that should give rise to reflection, commitment and new visions. When the worst of the corona pandemic is over, we might need meetings like at the end of World War II in Bretton Woods, USA, where they were planning for a better world. Meetings where leaders gathered to sketch on institutions and agreements that proactively can be used to address the key challenges and promote a more open and prosperous world after the coronavirus pandemic. However, these types of meetings, like many others, no longer always need to take place physically, but can easily take place virtually. Among those who have now had to work from home or have been quarantined, many have probably been surprised at how extraordinarily the new technology for virtual meetings works. A paradigm shift in the perception of the need for physical meetings instead of virtual meetings can also bring people and companies in different countries and parts of the world closer together. Maybe we will also see several distributed international companies - companies where the employees do not gather physically but online from different geographical locations. Such a development would both reduce the climate impact of globalization but also promote globalization in line with the gravity model.

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[1] Evenett, S. (2020). "Sickening your neighbor: Export restraints on medical supplies during a pandemic.", VOX, CEPR (<https://voxeu.org/article/export-restraints-medical-supplies-during-pandemic>).

[2] Tsang, A. (2020). "EU Seeks Solidarity as Nations Restrict Medical Exports.", New York Times, March 7, 2020 (<https://www.nytimes.com/2020/03/07/business/eu-exports-medical-equipment.html>).

[3] Bown, CP (2020). "EU limits on medical gear exports put poor countries and Europeans at risk.", Trade and Investment Policy Watch, Peterson Institute for International Economics (<https://www.piie.com/blogs/trade-and-investment-policy-watch/EU-limits-medical-gear-exports-put-poor-and-countries>).

[4] Companies must certify that they "will, to the extent feasible ... purchase only American-made equipment and products." (www.sba.gov/sites/default/files/2020-04/PPP%20Borrower%20Application%20Form.pdf).

[5] Thoms, A. (2020). "Tit for tat.", Financial Times, Trade Secrets Email List, Interview, April 6, 2020.

[6] An uncertainty factor here is when a virus is available on a large scale. It seems as if a widely available vaccine is years ahead of months.