The Economist INTELLIGENCE UNIT

A new era: global trade in 2020 and beyond

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Contents

Executive summary

The coming 12 months are poised to be volatile for the global economy, but especially so for international trade. Hesitant optimism from many quarters at the start of the year has given way to much gloomier prospects. The spread of the coronavirus is affecting production in Asia, disrupting supply chains across the world and depressing consumer demand. As of April 7th, over one-third of the world's population was under some form of lockdown.[1] Movement has been restricted, work hampered and consumer spending patterns disrupted. Markets have sustained significant losses, shaking investor confidence. Economic forecasts that measure the depth of the looming recession vary, but there is a widespread consensus that the global economy will contract much more sharply than during the 2008-09 global financial crisis.[2]

This report, written by The Economist Intelligence Unit and sponsored by Basware, focuses on the key factors that will drive global trade and, by extension, business transactions over the coming year. The findings are based on in-depth interviews with experts in global trade. Despite the interviewees' breadth of experience and their geographic spread, they are almost entirely synchronised in their views. The following five drivers were unanimously identified:

- Covid-19
- US-China trade relations
- US-EU trade relations
- Rising non-tariff protectionism
- Taxing digital trade

These topics are closely intertwined and their overlapping nature means their combined impact is difficult to anticipate. However, the overarching view of each of our interviewees is a sense of pessimism about prospects for global trade over the coming year.

The covid-19 pandemic and its knock-on effects will have a far-reaching and long-lasting impact, interviewees believe. That impact is turning countries inwards and increasing the temptations of protectionism. Export controls have already been introduced by many countries, mainly on medical equipment and agricultural supplies.[3] This backdrop makes it highly uncertain whether World Trade Organisation (WTO) members will agree to extend a moratorium on customs duties on electronic transactions. This was originally due to be decided in June at the WTO Ministerial Conference in Kazakhstan, but the conference has been postponed with no alternative date yet announced. It is possible that the moratorium will hold until the conference is eventually held, but it could unravel if some countries opt to impose unilateral taxes on electronic transmissions before then.

All of this presents global businesses with the challenge of being adaptive in their supply chains and responsive in their financial operations at a time of great uncertainty.

[1] Juliana Kaplan, Lauren Frias, Morgan McFall-Johnsen, "A third of the global population is on coronavirus lockdown", *Business Insider*, April 17th 2020. https://www.businessinsider.in/international/news/a-third-of-the-global-population-is-on-coronavirus-lockdown-x2014-hereaposs-our-constantly-updated-list-of-countries-and-restrictions/slidelist/75208623.cms
[2] Benjamin Laker, "3 Severe Implications Of Coronavirus On Global Trade", *Forbes*, April 7th 2020. https://www.forbes.com/sites/benjaminlaker/2020/04/07/3-severe-implications-of-coronavirus-on-global-trade/#1835eda33d11
[3] Reuters. 3 April 2020. "Trade Restrictions on Food Exports Due to the Coronavirus Pandemic". https://www.reuters.com/article/us-health-coronavirus-trade-food-factbox/trade-restrictions-on-food-exports-due-to-the-coronavirus-pandemic-idUSKBN21L332

However, amid considerable disruption there is also an opportunity for companies to restructure to match the new environment. Crises are often catalysts for innovation, and companies may find that newly-introduced processes and techniques leave them more agile, sustainable and impervious to disruption than before.

About this report

A new era: global trade in 2020 and beyond **is a report written by The Economist Intelligence Unit and sponsored by Basware. It draws on in-depth interviews with the following experts and executives conducted between March and May 2020.**

- Deborah Elms, founder and executive director, Asian Trade Centre
- Simon Evenett, professor of International Trade and Economic Development, University of St. Gallen, Switzerland; founder, Global Trade Alert
- Stanley Kang, chair, Joint Foreign Chambers of Commerce, Thailand; deputy general manager, TIC Group
- Mia Mikic, director of Trade, Investment and Innovation Division, UN Economic and Social Commission for Asia and the Pacific
- Pavida Pananond, associate professor of International Business, Thammasat Business School, Thailand
- Antoine Sautenet, public affairs manager, Michelin
- Stephen Vaughn, partner, King & Spalding; former general counsel, Office of the United States Trade Representative; former acting US Trade Representative

We would like to thank all the interviewees for their time and insight. The report was written by Kate Parker and edited by Pete Swabey.

Introduction

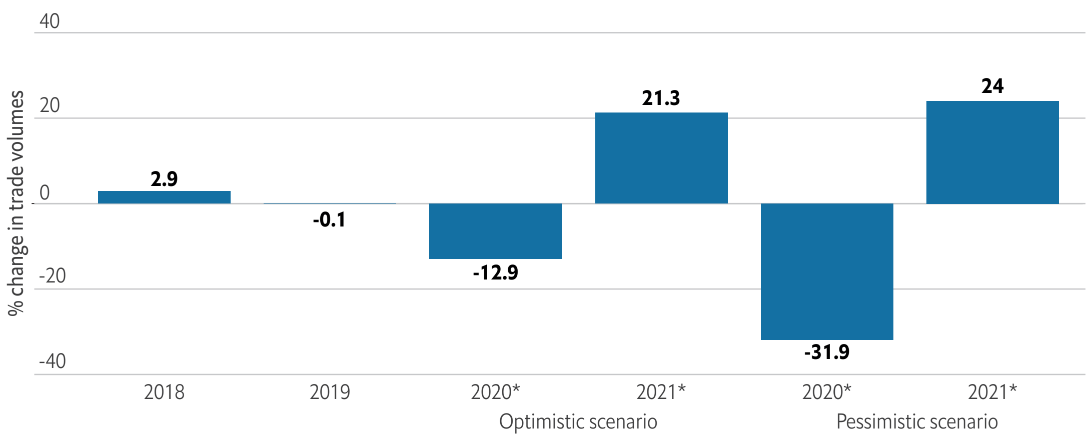
World trade has staged a steady, if unspectacular, recovery since the 2008-09 financial crisis. Volumes of merchandise goods trade collapsed by 12% in 2009, rebounded strongly in 2010, and since then have grown by an annual average of 2.8%. Trade in services has been growing faster, meanwhile: it grew by 5.4% annually on average between 2005 and 2017, according to the WTO. Until very recently, prospects for 2020 were fairly encouraging. The IMF's World Economic Outlook for January was tentatively positive. Stronger market sentiment, firm consumer spending and improved business investment were all identified as elements that would drive an acceleration in global GDP growth. World trade volumes of goods and services were forecast to grow by 2.9% in 2020, up from an estimated 1% in 2019.

More recent forecasts have been sobering, however. In early April, the World Trade Organisation (WTO) issued an "optimistic" forecast of a 13% drop in trade volumes for physical goods, counterbalanced by a 21% increase in 2021. Its pessimistic scenario involves a 32% drop in 2020 followed by an increase of 24% the following year (see Figure 1).

Although not included in these projections, the WTO adds that trade in services "may be the component of world trade most directly affected by covid-19 through the imposition of transport and travel restrictions and the closure of many retail and hospitality establishments".

As this suggests, the pandemic has already dented global trade and will hamper the world economy more broadly this year—and most likely beyond. Global trade is driven by a mix of demand and supply factors in major trading countries which are in turn affected by policy decisions made by governments. The covid-19 pandemic is unique in that it influences all of the component drivers of global trade in all major markets as well as indirectly impacting government policy. Our interviewees unanimously agree that its impact should not be underestimated.

Figure 1. A sobering prognosis
The World Trade Organisation's predicted change in global trade volumes following covid-19



* forecasts
Source: WTO, April 2 2020

Chapter 1: Covid-19

The December 2019 outbreak of a novel coronavirus in Wuhan, the capital of China's Hubei province, has resulted in a worldwide pandemic. The Chinese government placed the province under lockdown, thereby restricting a region that is important to both national and international supply chains. Economic activity in other regions, including Beijing and Shanghai, has also been disrupted by quarantine measures and reduced demand for goods and services. In addition, restrictions of movement have had a significant impact on the consumption of travel and tourism services within China and abroad.

The knock-on implications of the virus are disrupting both international business operations and global supply chains. The worst-affected regions in China are crucially important to many global industries. Hubei, for example, is the heart of China's "optics valley" where firms produce essential components for use in telecoms networks. Around one-quarter of the world's optical-fibre cables and devices are manufactured there,[4] as are vast numbers of smartphone microchips and more basic goods such as iron and steel components or chemicals. Although Chinese factories were starting to re-open, as of early April 2020 the fact that the coronavirus has spread across the world is severely undermining consumer demand in key export markets.

The pandemic prompted a growing recognition of the interconnectedness of consumers and producers around the world and the importance of flexibility and transparency in supply chains.

of the world's fibre optic cables and associated devices are made in Hubei
Source: AIR Worldwide

The need for alternative suppliers was already apparent to businesses back in early 2019 when Brexit and the US-China trade conflict cast uncertainty over the future of global trade. In a survey of finance and procurement executives conducted then by The Economist Intelligence Unit and sponsored by Basware, 37% of respondents said they were preparing for growing uncertainty by developing alternative sourcing options. This was the second most common response behind reviewing their processes and practices.[5] Given the disruption to supply chains that has occurred as a result of the covid-19 pandemic, this percentage is likely to have risen even further as companies put mitigation and contingency plans in place.

The ripple effects of supply chain difficulties will be widely felt, says Deborah Elms, founder and executive director of the Asian Trade Centre. She describes a hypothetical scenario of a factory producing titanium

[4] Barbara Chang, "The growing impact of the coronavirus on global supply chains", *AIR Worldwide*, March 9th 2020. https://www.air-worldwide.com/blog/posts/2020/3/the-growing-impact-of-the-coronavirus-on-supply-chains/
[5] "What's Now And Next For Finance And Procurement?", *The Economist Intelligence Unit*, 2019. https://eiuperspectives.economist.com/strategy-leadership/whats-now-and-next-finance-and-procurement-automation-digitisation-and-future-global-trade

screws, a component on which vast numbers of manufacturers depend. Disruption to the production of the screws would halt production in factories far beyond the areas directly impacted by the disease and supply chains would continue to be affected long after the current outbreak of the virus subsides. “I don’t want to sound alarmist but we have a major set of problems related to the virus that people are incredibly slow to understand in my view,” she says.

Stanley Kang, chair of the Joint Foreign Chambers of Commerce in Thailand (JFCCT) and deputy general manager of TIC Group, expects the second quarter of 2020 to pose severe challenges for companies operating in Asia. The shock waves emanating from the virus outbreak will require global companies to be highly adaptive. “Firms need to be very flexible to adjust to a changing market,” he explains. “People will travel less and spend less. Cash flow in the supply chain will be highly problematic.”

Simon Evenett, professor of International Trade and Economic Development at St. Gallen University and founder of the Global Trade Alert initiative, shares these concerns. Time is crucial, he says, because the longer the outbreak lasts, the more it will discourage capital investment. This contributes to a “negative macroeconomic feedback loop” that will reduce firms’ productive capacity further down the line.

Supply chain impact

All of our interviewees believe the virus will have a long-lasting, structural impact on the way in which firms manage supply chains and supplier relations. Many supply chains rely on smaller companies which could go out of business before the virus disappears. Small and medium-sized businesses do not have capital to survive for months without any sales. So it is not just that stocks are dwindling amid lower production, it is that firms in the supply chain may well go out of business

before a turnaround. This places even greater pressure than usual on larger firms to manage their cash flow effectively.

For the time being, many firms are running down stocks and delaying decisions about structural changes to their operational models. But some are already reconfiguring supply chains. Pegatron, a Taiwanese electronics manufacturer that supplies both Apple and Samsung, announced in late January that it would be moving production to Vietnam.[6] Tech giants Google and Microsoft are also accelerating their efforts to shift production of hardware (which until now has been mainly produced in China) to other parts of Asia, including Vietnam and Thailand.[7]

Pavida Pananond, associate professor of International Business at Thailand's Thammasat Business School, emphasises that this trend predates the covid-19 outbreak. Tensions between the US and China over trade had already prompted some companies to shift from Chinese bases to South East Asia (see chapter 2), she says, but the covid-19 pandemic is expected to prompt a fresh wave of supply chain reconfiguration . Companies will no longer want to "put all of their eggs in one basket". Instead they will look at setting up subsidiaries both elsewhere in South-east Asia and closer to their home markets.

This is not the first time supply chains have adapted in response to crises. But previous events—such as severe flooding in Thailand in 2011 or the Japanese earthquake and tsunami of the same year—prompted only temporary adjustment, highlights Mia Mikic, director of the Trade, Investment and Innovation Division of the UN Economic and Social Commission for Asia and the Pacific (ESCAP). The current situation is different as there is no near-term end in sight.

The covid-19 pandemic is expected to prompt a fresh wave of supply chain reconfiguration.

This feeds into the overwhelming likelihood of structural changes to supply chains. Stephen Vaughn—partner at US law firm King & Spalding and former acting US Trade Representative—acknowledges that US policymakers are still wrestling with the long-term ramifications for the US economy but believes the crisis will raise much greater domestic awareness of the vulnerability of such a high exposure to China for key parts of the US supply chain. He believes there will be a greater focus on diversifying supply chains within Asia, potentially to countries like Vietnam, Indonesia and Malaysia, but a robust debate is also likely to take place about "relocalising" manufacturing in the US.

Other interviewees echoed these sentiments. "Supply chains will definitely change," says Mr Kang. "Vietnam, Thailand, Indonesia and the Philippines will compete aggressively for foreign investment." Ms Pananond points out that these markets becoming important in their own right is an additional factor that is likely to drive corporate investment and

[6] "Taiwanese Apple partner Pegatron to set up production in Vietnam, as companies move to diversify from China", *South China Morning Post*, January 21st 2020. https://www.scmp.com/tech/article/3046957/taiwanese-apple-partner-pegatron-set-production-vietnam-companies-move
[7] Arjun Kharpal, "Apple, Microsoft, Google look to move production away from China. That's not going to be easy", *CNBC*, March 4th 2020. https://www.cnbc.com/2020/03/05/coronavirus-apple-microsoft-google-look-to-move-production-away-from-china.html

a diversification of supply chains in these economies. She predicts that firms will seek to benefit from both export trade to traditional Western markets and increasing intra-regional trade in Asia.

Businesses are likely to consider diversifying their range of service providers by mixing local firms with lower-cost outsourced provision.

Supply-chain management in the context of covid-19 has raised a wealth of questions for goods trade, but the impact on the services market will also be important. Just as firms have tended to rely disproportionately on a small number of markets or companies for goods supply chains, service outsourcing has also tended to be concentrated. Providers of outsourced technology services, for example, are often located in countries with low labour costs. India's information technology (IT) outsourcing firms have reportedly struggled to maintain services for clients when most employees are working from home.[8] Businesses are likely to consider diversifying their range of service providers as a result by mixing local firms with lower-cost outsourced provision.

More broadly, difficult operating conditions will make it even more important for companies to be able to monitor and manage their supplier relationships effectively. They must be able to spot the warning signs of supply chain disruptions and take evasive action if necessary.

At the time of writing, the initial impact of the crisis has been felt most directly on supply-side factors of production. However, this is inevitably feeding through to the demand-side. Greater consumer and business uncertainty, containment efforts and rising financial costs reducing spending ability will be features experienced by most countries in the coming year. The IMF has quantified this, stating that experience suggests around one-third of the economic losses from the disease will be direct costs: from loss of life, workplace closures and quarantine measures. The remaining two-thirds will be indirect, reflecting a retrenchment of consumer confidence and business behaviour and a tightening in financial markets.[9]

As a result, there has been less analysis about the impact on large consumers in Europe and North America, including on the supply chains of firms selling or distributing goods and services in these regions. Given that most countries are under lockdown with closed shops and services and many people remaining at home, the impact in these markets is likely to be significant. Even as lockdowns begin to be lifted, this will be a gradual process and introduced very cautiously in stages. Businesses and consumers will not return to pre-virus levels of production and spending for some time.

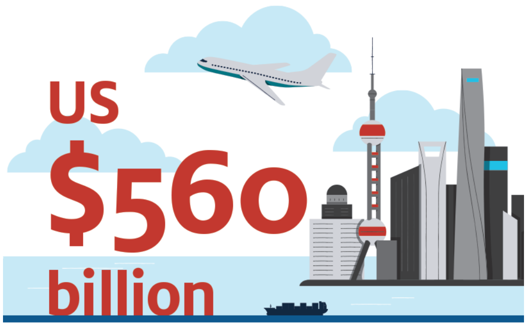
[8] Benjamin Parkin, "India coronavirus shutdown hits outsourcing groups", *Financial Times*, March 20th 2020. https://www.ft.com/content/00611a21-9e43-430b-b46e-de0a50c0383a
[9] Kristalina Georgieva, "Potential Impact of the Coronavirus Epidemic: What We Know and What We Can Do", *International Monetary Fund*, March 4th 2020. https://blogs.imf.org/2020/03/04/potential-impact-of-the-coronavirus-epidemic-what-we-know-and-what-we-can-do/

Antoine Sautenet, public affairs manager at French tyre manufacturer Michelin, notes that these markets are now suffering the full brunt of the pandemic. Michelin has been forced to stop industrial activities in affected countries. Commercial, logistics and administrative activities continue to operate, but there has been some disruption to its supply chains. However, with consumer confidence surveys in Europe and the US showing that households are wary about expenditure, particularly for big-ticket items, demand in the US and Europe is likely to take a sharp hit even after Michelin's factories are again operational.

The IMF also stated that pass-through effects on tourism, commodity prices and financial markets call for additional policy responses to support demand and ensure an adequate supply of credit. Many governments are starting to put facilities in place to make it easier for struggling firms to access cash, but given the large number of industries that are being affected there are concerns about whether enough money will be available. Governments acknowledge the need for emergency financial aid in order to prevent companies from going under, but there are serious questions about whether supply will be sufficient to meet demand.

Chapter 2: US-China trade relations

In 2019, US-China bilateral trade represented around US$560bn, according to the US Department of Commerce. Before covid-19, tension in this trading relationship was the biggest cloud of uncertainty hanging over global trade—in the 2019 finance and procurement executive survey, respondents identified the escalation of the US-China trade war as the most significant trade trend[10]—and it will continue to be a crucial factor shaping global trade in the coming year.



Value of US-China bilateral trade in 2019
Source: US Department of Commerce

In mid-January 2020, both countries signed "phase one" of an accord after two years of tension. However, the deal was aimed more at preventing the tariff war from escalating than finding an end to the dispute with the agreement preserving existing US tariffs on around US$480bn of Chinese goods. The deal's most visible provisions revolve around China's pledge to buy around US$200bn of US exports, spanning manufactured goods, agriculture, energy and services.

The coronavirus outbreak puts this agreement in a new context. It will constrain China's ability to meet these purchase pledges given strains on logistics networks, weaker domestic demand and the fact that policymakers' attention is diverted. Because of the interconnectedness of modern supply chains, the business activities of virtually all sectors and countries are linked to each other: even firms that do not deal directly with US-Chinese trade will still suffer indirect effects. Tariffs essentially raise costs for businesses. Manufacturers in particular are cutting internal spending and postponing planned investment in an effort to cushion the impact of the US-China trade tensions.

Ms Elms does not expect the conditions of the phase one agreement to be met, especially following the covid-19 crisis. The key question is how the US will respond to this, she says, which in turn will be affected by domestic political developments in the context of the US presidential election in November.

She believes there are two possible scenarios. In the first, US president Donald Trump shows leniency in light of the health crisis. In the second (and, in her view, more probable) scenario, he uses China's failure to meet the terms of the phase one agreement as pretext to escalate tensions.

Other interviewees are similarly pessimistic about the direction of relations. The US Congress as a whole is becoming increasingly sceptical of China, Mr Evenett argues, and views its growth as a threat to the US.

When the first-phase agreement was signed, both sides indicated that more difficult issues in the US-China trade relationship—including how China treats foreign investors, how they subsidise industry and how they treat intellectual property transfer—would be

[10] "What's Now And Next For Finance And Procurement?", *The Economist Unit*, 2019. https://eiuperspectives.economist.com/strategy-leadership/whats-now-and-next-finance-and-procurement-automation-digitisation-and-future-global-trade

negotiated under a planned "second-phase" agreement. However, there was broad-based agreement among interviewees that there is little chance of anything substantive occurring during these potential phase-two negotiations.

Mr Vaughn has a different interpretation, pointing out that it is very much in China's interests to comply with the terms of the phase one accord. Given that China's economy will already slow sharply this year as a result of the covid-19 crisis, a renewed tariff war would do further damage. "If what they say about their economy is true, they should be able to comply with the terms," he says.

None of the interviewees consider the US presidential election to be an opportunity for significant change in bilateral trade relations. While there may be differences in style between the two parties (with the Democrats probably being less abrasive towards China) there is unlikely to be a fundamental shift in substance, says Mr Evenett. "The presidential election may be important for the fireworks, but Congress won't shift significantly in its stance towards China."

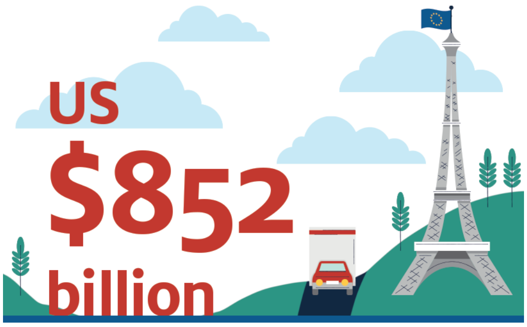
This volatility will limit businesses' ability to plan their supply operations with confidence. "Unpredictably causes problems," explains Mr Kang. "Supply chains need certainty and that is currently lacking."

The uncertainty caused by US-Chinese trade relations is likely to raise buyers' costs by forcing firms to hold higher levels of stocks. Planning will also be complicated as companies are forced to budget for greater contingency in order to mitigate the heightened risks. The volatility is likely to prompt procurement departments to think about reducing their exposure to a possible resumption of the US-China trade war, including possible product re-routing or alternative sourcing. It is difficult to quantify the extent to which this is occurring as such information tends to be closely guarded by companies. However, firms may well feel that it is worth considering production and investment shifts to make the supply chain more predictable and resilient.

Ms Pananond summarises this sentiment succinctly: "For companies that were thinking about relocating because of Trump, the coronavirus will be a wake-up call that they need to think about this soon. It will expedite an existing trend."

Chapter 3: US-EU trade relations

Although tensions with China are ongoing, US trade officials are paying more attention to Europe. That trade relationship is almost as pivotal: US-EU trade totalled nearly US$852bn in 2019 according to the US Department of Commerce.



Value of US-EU trade in 2019

Source: US Department of Commerce

US-EU trade relations have been under strain since mid-2018 when the US government launched an investigation into the national security implications of imports of foreign-made cars and parts and threatened to raise tariffs on European auto imports by 25%. Although the US appears to have withdrawn the threat for now, tensions persist on a number of fronts. In October 2019, the US imposed tariffs on a range of EU goods after the WTO ruled that EU subsidisation of European aircraft maker Airbus was unlawful. The US has also threatened additional tariffs on France after its efforts to implement a digital-services tax.

Finally, the EU's new Green Deal—which aims to shift the EU from a carbon-intensive to a low-carbon bloc—could also prove to be contentious. In early March, the European Commission unveiled the European Climate Law which would bind the bloc to specific reductions in emissions and launch a process to enact a new tax on products from countries that are not working to reduce their emissions. Such a rule could leave US companies at a disadvantage as they compete for business in the EU.[11]

If anything, the risk of a trade war between the US and the EU has only increased following the coronavirus outbreak, some interviewees believe. Ms Elms argues that trade is an "easy lever" for the US president to pull to exert influence.

Mr Vaughn agrees that both the US and EU will suffer economically from the impact of covid-19 but views Europeans as less enthusiastic about resolving trade tensions with the US. The European desire to link trade with legal and regulatory issues does not sit well with the US government, causing obstacles to bilateral relations.

What is clear is that progress on trade talks is likely to remain slow and the EU is unlikely to concede significant ground on agriculture. A truce appears to have been agreed between the US and France over the so-called GAFA tax (referring to large digital companies such as Google, Apple, Facebook and Amazon). France has agreed to suspend collection of a 3% tax on digital revenue sales for all companies that earn over €750m globally and €25m in France until the end of 2020. This is designed to allow a period of discussion between the US and various governments about digital transactions. However, if bilateral trade ties deteriorate between now and

[11] Justin Worland, "How Europe's Border Carbon Tax Plan Could Force the U.S. To Act on Climate Change", *Time*, March 4th 2020. https://time.com/5793918/european-union-border-carbon-tax/

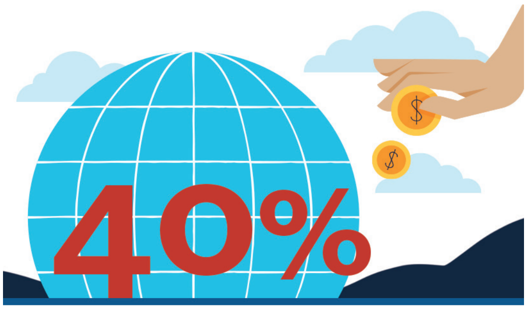
then it is possible that France might seek to reintroduce the tax, particularly if region-wide initiatives—such as efforts by the OECD to devise a unified approach—fail to do so.

Any of these disputes could spark a damaging trade war between the US and the EU. If the US does impose tariffs on EU auto imports, the impact on the EU economy (the world's second largest) would be severe: the auto industry accounts for about 6% of total jobs in the EU. Beyond the immediate fallout from lower exports to the US and third countries, there would be a sharp hit to business confidence in core EU countries. The EU would be forced to retaliate, raising the risk of a global trade war as third countries are forced to choose sides. This would raise costs for businesses and dent corporate profits. Sometimes firms can look to pass on extra costs to consumers through higher retail prices, but if domestic demand is struggling as a result of the impact of the coronavirus, firms will have to absorb these costs internally.

Chapter 4: Rising non-tariff protectionism

Tariffs—which are taxes levied on imports—have received a significant amount of global press attention. However, several of our interviewees spoke at length about the impact of non-tariff barriers to trade such as subsidies which take the form of direct financial support provided by governments to specific sectors and/or firms. These can be seen as another form of protectionism, distorting the price of goods and the ability of companies to access markets.

"Tariffs are the tip of the iceberg," says Mr Evenett. "Much of what governments have been doing is on the subsidy front, not just the tariff front."



Share of global trade affected by distortionary measures

Source: CEPR

"Tariffs are the tip of the iceberg. Much of what governments have been doing is on the subsidy front, not just the tariff front.

Simon Evenett, professor of International Trade and Economic Development, University of St. Gallen, Switzerland

The share of global trade affected by distortionary measures—which include both tariff and non-tariff barriers—began to rise during the presidency of Barack Obama but have risen more sharply under Trump, currently standing at around 40%.[12] At the same time, the number of trade reforms has fallen in the past few years as governments have increasingly looked inwards.

Such measures are certain to accelerate in the post-covid-19 world as governments take exceptional measures in order to prop up domestic industry and services.[13] Mr Vaughn spoke of policymakers potentially being more willing to impose new regulations in order to achieve domestic or foreign policy goals.

Indeed, it was the last economic crisis that catalysed the recent uptick in non-tariff protectionism, Mr Evenett argues. When markets froze and firms lost access to capital they could have requested government tariffs to encourage buyers to switch from overseas suppliers to local ones—but this would have taken a long time to work through the system. Instead, governments opted to provide cash through direct government subsidisation which boosted company balance-sheets immediately and was deemed the most effective short-term solution.

Subsidies are notoriously difficult to unwind because they become entrenched in corporate calculations of costs and revenue.

[12] Simon Evenett, Johannes Fritz "Going it alone: The 25th Global Trade Alert", *Centre for Economic Policy Research*, December 2019. https://www.globaltradealert.org/reports/48
[13] "Policy Responses to covid-19", *International Monetary Fund*, May 2020. https://www.imf.org/en/Topics/imf-and-covid19/Policy-Responses-to-COVID-19

Governments see lifting subsidies as risky both in times of hardship when it could make things worse and in times of growth when it might derail progress.

This held true in the recovery from the 2008-09 crisis. The number of non-tariff measures has increased as governments have focused on boosting export-led growth through export promotion agencies and favourable tax measures.

Non-tariff measures have not captured headlines as much as tariffs in recent times, but most of our interviewees expect them to be extremely significant in shaping global trade over the coming year. With almost all major economies becoming more protectionist, others have no choice but to behave similarly or risk losing global market share.

The rise of tariff and non-tariff protectionism essentially raises costs for firms and injects greater uncertainty into supply chains. Firms can address this through risk mitigation, better supply chain management and long-term planning. Companies that have agile supply chains in place and stronger supplier relationships will be better placed to deal with changes in global trade policy, including rising protectionism.

Chapter 5: Taxing digital trade

Since 1998, WTO members have agreed not to impose customs duties on electronic transmissions. While "electronic transmissions" is not defined specifically the term encompasses anything from software, emails and text messages to digital music, films and games.

WTO member states have to decide whether to extend the moratorium for a further two years at the biennial WTO Ministerial Conference.[14] The issue was discussed at a General Council meeting of the WTO in December 2019. Members then agreed to refrain from imposing customs duties on electronic transmissions for the six-month period leading up to the 12th Ministerial Conference (MC12) that was scheduled to be held in Kazakhstan on June 8th-11th. The conference has since been postponed with no new fixed date.

Of all of the issues highlighted in this report, this is currently the lowest-profile having received scant coverage in the international press. Yet all of our interviewees spoke with concern about the risk of the moratorium not being renewed.

Ms Elms expects the worst given the growing hostility towards digital platforms from many quarters. "Many governments believe that there's money to be made from taxing import of services or placing customs duties on these imported services, or both," she explains. "They believe that this won't cause any negative effect on their own economies, which is a mistake."

Ms Mikic notes that the pandemic makes a collapse of the moratorium much more likely. Governments will have huge bills to cover after extending financial support to ailing airlines, the frozen hospitality sector and struggling manufacturers. Taxing electronic transactions would provide a new source of revenue at a time when public finances are under strain.

The moratorium may survive until the postponed Ministerial Conference is eventually held, but there is also the risk of its collapse before that happens. How such taxes would work is difficult to fathom—not to mention their implications. If firms have to pay tax whenever they provide some digital service overseas, bills would quickly mount. Ms Elms points out that consumers in some smaller markets could find themselves cut off from some digital services altogether if their provision becomes uneconomical.

It is not just service-based sectors that would suffer. Mr Kang speaks of the increasingly essential use of digital technology and automation in goods-producing sectors such as autos and textiles. "Speed and simplicity of digital transactions is very important," he says. "International trade will suffer if firms are unable to transact digitally and use data easily."

"International trade will suffer if firms are unable to transact digitally and use data easily.

Stanley Kang, chairman, Joint Foreign Chambers of Commerce in Thailand

[14] "WTO Moratorium on Customs Duties on Electronic Transmissions – A primer for business", *ICC Chamber of Commerce*. https://iccwbo.org/publication/wto-moratorium-on-customs-duties-on-electronic-transmissions-a-primer-for-business/

Given the pivotal role of the digital economy, the possible expiration of the moratorium poses a major threat to global trade in the coming year. Not only would it hamper existing firms, but it would also curtail opportunities for new digital businesses to expand and flourish.

Conclusion

While this report has highlighted five main issues that will have a significant bearing on global trade in 2020 and beyond, the first—the covid-19 pandemic—is particularly important.

The impact of the outbreak will undoubtedly be felt across the world, but little else is certain. At the time of writing, it is unclear how consumer demand will recover once quarantine measures are lifted, how governments will react if there is a serious second wave of the virus and how cross-border trade and supply chains will be affected.

However, the interviewees for this report believe it is likely to exacerbate the pre-existing trends that were already dampening global trade. Protectionism—both tariff and non-tariff based—is likely to intensify. The reaction of the US government in particular will prove critical.

The potential collapse of the WTO moratorium on digital transactions is a wider reflection of a shift in how governments perceive trade and trade policy. The rules of the game are set to change in the coming year, with far-reaching implications for global trade.

The year 2020 is set to be a watershed for the global economy. Even when coronavirus itself is eventually contained, no company should expect a quick and easy return to "normal". The businesses that survive, and even thrive, in the new normal will be those that identify how these disruptions affect their business and adapt accordingly—sooner, rather than later.

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