

## **International Trade Committee Inquiry: The COVID-19 Pandemic and International Trade**

**Evidence submitted by the UK Trade Policy Observatory (UKTPO),  
Sussex University**

### **About the UK Trade Policy Observatory:**

The UK Trade Policy Observatory (UKTPO), a partnership between the University of Sussex and Chatham House, is an independent expert group that: initiates, comments on and analyses trade policy proposals for the UK; and trains British policy-makers, negotiators and other interested parties through tailored training packages. The UKTPO is committed to engaging with a wide variety of stakeholders to ensure that the UK's international trading environment is reconstructed in a manner that benefits all in Britain and is fair to Britain, the EU and the world. The University of Sussex has the largest collection of academic expertise on the world trading system in the UK, with specialists on trade policy, trade law and trade politics and European law and economy. The team includes experts in economics, international relations and law.

### **Terms of reference (referred to as TORs in the text below):**

1. What impact will the global COVID-19 pandemic have on UK businesses trading internationally, in the short-, medium- and long-term?
2. How effectively has the Government responded, both in the UK and in overseas posts, to the short-term negative impact of the pandemic on UK businesses trading internationally? What further steps could be taken to mitigate this impact?
3. What medium- and long-term negative impacts could arise from the pandemic for UK businesses trading internationally? What steps could the Government take to mitigate these impacts?
4. What steps can UK businesses take to mitigate the negative impacts of the pandemic on international trade?
5. How best can the UK Government facilitate trade in essential goods during the pandemic?
6. How should the Department for International Trade work with the rest of central government, as well as devolved, local and regional government, to deliver a coordinated response to the pandemic?
7. How can the UK Government engage with countries at the World Trade Organization and bilateral trading partners – including those with which the UK has a significant trading relationship or one facilitating trade in priority goods – to promote international cooperation and a coordinated global response to the pandemic?
8. How might the pandemic impact global trade patterns and international supply chains in the long-term?

## Executive Summary

- The impact of COVID-19 on UK businesses, and those trading internationally, is a mutually reinforcing triple shock: demand, supply, and trade. The impact on economic output and trade is likely to be larger than that following the financial crisis in 2008-09.
- The immediate negative effects on businesses will depend on: the decline in demand which will vary across sectors; the complexity and lack of resilience in domestic and international supply chains; levels of trade intensity; the degree of diversification with regard to sales and the supply base; the labour intensity of production; and on the exposure to limited inventories.
- Digital services are inherently less affected by the trade inhibitors that afflict merchandise goods trade, and ICT services have proven critical to the global effort to combat COVID-19 and enable people to work from home. Given that the UK is one of the most services-oriented economies of the world, this could create new sources of comparative advantage or increase dependencies from foreign online platforms, or both.
- The Government should resist the pressures of a slide into protectionism, and play an active role in encouraging international cooperation and coordination with key allies and trading partners, and to encourage and not inhibit the free flow of goods and services. Policy needs to focus as closely as possible on the underlying market failures causing difficulties for businesses.
- In the medium-term, a key problem for many firms will be the debt they have built up. This cannot be resolved through trade policies, and alternative policies, such as extended loan repayment periods or 'clean-slate debt forgiveness' programmes, may be needed. There will need to be more cross-Government coordination of policies as they relate to trade, industrial strategy, and competition policy.
- Both firms and the government will need to address the issue of the resilience of supply chains, and whether it is privately or socially optimal for supply chains to be reconfigured. This could be through simplification, diversification, automation, inventory management. Reshoring production domestically is not necessarily the solution.
- The supply, demand and trade issues are interrelated. Recovery will be stronger and faster the more each of these are dealt with in a consistent fashion. Reinforced multilateral and bilateral international cooperation will be key to ensure that trade can support and complement domestic policies, and that the UK is not adversely affected by policies in other countries.
- Ending the UK-EU Brexit transition period at the end of 2020 will exacerbate the difficulties facing UK firms. We urge the government to extend the transition period, or negotiate a medium-term implementation period.
- The WTO is the natural locus for cooperation on trade matters. In the immediate term, the UK should sign and promote the "Declaration on Trade in Essential Goods for Combating the COVID-10 Pandemic" proposed by New Zealand and Singapore. Such cooperation could easily be extended by a mutually beneficial agreement between importers and exporters which commits each party to maintain current liberal trade policies and not to introduce trade restrictions.
- It is also not too early to start thinking about the long-term health of the multilateral trading system. In conjunction with the promotion of multilateral trade policy coordination, the UK Government should also promote bilateral/plurilateral cooperation. The UK will be hosting the G7 summit in 2021 which should be seen as opportunity to show leadership in this regard.

## 1. Short-run impact of COVID-19 on UK businesses (TOR1):

1. The impact of COVID-19 on UK business, and those that trade internationally can be seen as a mutually reinforcing triple shock: a demand shock, a supply shock, and a trade shock. These arise because of the reductions in demand, reductions in supply, and the emergence of trade inhibitors. All of these are the result of the lock-down restrictions in place across many countries.
2. Before looking at these in more detail it is worth considering what lessons might be learnt from the great trade collapse following the 2008 financial crisis. In nominal terms between 2008 and 2009 UK exports fell by around 25% and imports by closer to 20%. There were also significant compositional effects. For example, the decline in exports and imports of food and beverages was around 11% and 15% respectively, while for capital goods the respective declines were much higher at 35% and 40%. Similarly intermediate inputs saw declines of around 30% in both imports and exports.<sup>1</sup> There were several factors driving the collapse in trade in 2008-09. These were: a fall in demand, changes (falls) in prices, supply chain linkages which magnified the trade collapse, a decline in trade credit, and the rise in protectionism. Services trade generally proved more resilient during the 2008-09 crisis with single-digit declines in both imports and exports. One reason for the resilience of services trade was because of the lower elasticity of demand in export markets, especially for business services.<sup>2</sup>
3. A key similarity between 2008-09 and the COVID-19 shock is that both shocks are highly synchronised (affecting many countries simultaneously), both shocks are characterised by a dramatic fall in consumer demand, and in both cases supply chain linkages work to transmit effects between countries and to exacerbate the shock.
4. However, there are also some important differences. COVID-19 is a much more dramatic supply side shock as production comes to a halt or is greatly reduced across most sectors, which in turn results in a decline in intermediate input demand by firms. Secondly, the ability of goods to be shipped between countries is being inhibited in different ways – this might be because of new border controls / restrictions, protectionist barriers on particular products, or the impact on logistics/ distribution as e.g. haulage companies and drivers adjust to the new circumstances, and reduced workforce availability. In 2008-09 the restrictions on trade were driven in part by protectionist actions by governments (including ‘buy national’ campaigns), but in good part by a drying up of trade credit. With COVID-19 there is some evidence of new protectionist policies, but as yet there does not appear to have been an impact on trade credit. However, that could yet emerge as an issue – as the situation of indebted companies gets worse, their need for credit may rise, and if the financial sector itself is affected.<sup>3</sup>
5. Given that COVID-19 is a larger shock, it is highly likely that the economic impact and that the impact on trade will be larger than in 2008-09. Indeed, the WTO forecasts that trade could fall by as much as 32% in 2020 due to the pandemic.<sup>4</sup> In order to understand that impact on UK businesses and the appropriate policy responses it is important to separate out the different factors underpinning the immediate (short-run) impact of the triple shock - Box 1 below.

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<sup>1</sup> Source: UN Comtrade, based on the BEC classification.

<sup>2</sup> Ariu (2016), Borchert and Mattoo (2009). For the United States, there were interesting patterns within services: unsurprisingly, trade in goods-related transport services and crisis-related financial services declined, as did expenditure on tourism abroad. But trade in a range of business, professional, and technical services were still increasing as of February 2009.

<sup>3</sup> <https://ftalphaville.ft.com/2020/04/22/1587546427000/Governments-should-backstop-trade-credit/>

<sup>4</sup> [https://www.wto.org/english/news\\_e/pres20\\_e/pr855\\_e.htm](https://www.wto.org/english/news_e/pres20_e/pr855_e.htm)

**Box 1: Short-run features of the triple shock:**

1. **Reductions in domestic and export demand**, driven by:
  - Reduction in final consumer demand resulting from:
    - Lack of access to shops, other than primarily online purchases
    - Decline in income as jobs are lost or workers are furloughed
    - Uncertainty regarding future employment
  - Reduction in intermediate (input) demand because of reductions in supply (see 2).
2. **Reductions in supply**, driven by:
  - Lower consumer demand (see 1)
  - (Temporary) ceasing of production because of lock-down measures
  - Inability to produce due to lack of availability of inputs
    - because inputs are not being produced due to the lock-down measures, or because there is insufficient production in the world to meet global demand (e.g. with regard to personal protective equipment (PPE))
    - logistics / distribution problems which mean the inputs cannot be shipped (see 3)
    - protectionist measures introduced by other countries (e.g. export restrictions) (see 3)
3. **Trade shock (trade inhibitors):**
  - Arising from trade measures introduced by governments designed to impact either on a country's imports or exports (e.g. export restrictions). For example, from the Global Trade Alerts report we have identified over 160 COVID-related trade measures introduced by countries since January 2020, over 71% of which discriminate against foreign commercial interests.<sup>5</sup>
  - Logistics / distribution issues:
    - Checks on borders, and lack of access into given markets
    - Lack of personnel (e.g. truck drivers)

- i. The direct (short-run) impact on UK businesses will therefore depend on their exposure to each of these three aspects. Specifically, and prima facie one might think the immediate (short-run) effects would be bigger:<sup>5</sup>
- ii. The greater the decline in demand – both final demand and intermediate demand.
  - a. **Non-essential goods and services.** This comes from the demand side shock, as this sort of consumer expenditure can be more easily postponed, and is less essential.
    - Eg. tourism, hotel and catering, airlines.
    - Durables in manufacturing, e.g. cars, white goods.
  - b. **Intermediate demand:** Declining final demand translates into a decline in demand for the intermediate input necessary to produce the good. Declining supply, also translates into a decline in intermediate demand.

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<sup>5</sup> see [www.globaltradealerts.org](http://www.globaltradealerts.org)

- iii. **Where there are disruptions to national or international supply-chains:** Firms that require intermediate inputs from other suppliers are vulnerable if that supply chain is disrupted. This applies to all supply chains, which may be domestic or international.
- a. **The more complex and lengthy is the supply chain**, the higher is the reliance on the production of other firms, and on transport and distribution, and therefore the higher the exposure to supply shocks.
  - b. The nature of the **contractual relationship** within the supply chain will also matter. Networks underpinning complex supply chains are costly to form, and so firms may be tied more closely to particular suppliers and may find it harder to adjust, making the shock worse. This may also be true in the case of trade between affiliates of the same firm (intra-firm trade).

On the other hand, being able to rely on an established network of buyers/suppliers might help firms survive, as they might receive trade credit from each other, or shift/rely on activity in less affected countries (or resume operations in some countries in case of non-synchronous lifting of lockdowns across countries), or more simply able to rebound faster once the lockdown is lifted. Trade between affiliates may be easier to control, and firms are less vulnerable to the independent actions of their suppliers.<sup>6</sup>

- iv. Any increase in the difficulty of shipping goods (or services) across borders, will impact on firms exporting intermediate or final goods, and those importing intermediate goods. This is a potential additional impediment therefore to those producers relying more heavily on international supply chains.
- a. **Import intensity:** For firms, the negative impact of COVID may be higher the more they depend on imported intermediates and the more they are part of complex international supply chains. This will be particularly the case for those supply chains where goods cross borders multiple times, both because of the greater reliance on distribution networks and because of the need to deal with multiple border controls.

It is also worth noting that the higher the share of imports in domestic consumption the bigger might be the impact on UK consumers. For example for broad sectors such as 'rubber and plastics', 'basic metals', and 'other non-metallic minerals' the share in intermediate inputs in total imports is over 80%. For 'basic metals' 70% of UK total domestic consumption is from imports, and other sectors where domestic consumption is more dependent on imports are 'other transport equipment'.<sup>7</sup> Prima facie these are industries that may be more affected.

- b. **Export intensity:**
  - The higher the share of exports in production (or turnover) the more firms will be hit by any increase in trade impediments such as export restraints introduced by national governments and by logistics and distribution issues in the export markets. Similarly, the greater is the export of intermediates, the greater is the likely impact of supply chain disruptions.

Once again looking at broad sectors, there are five sectors where the share of exports in production is 50% or more ('chemicals and pharmaceuticals', 'basic

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<sup>6</sup> Stronger resilience of intra-firm trade has been found in previous cases of macroeconomic shocks, such as the 1997 Asian crisis (Bernard et al., 2009) and the 2008-09 financial crisis (Lanz and Miroudot, 2011).

<sup>7</sup> Authors own calculations based on data from OECD's TiVA database. Data on import intensities based on authors' data on production, trade and domestic consumption collected from OECD and COMTRADE.

metals', 'computer, electronic and optical', 'machinery and equipment', and 'other transport equipment'). The five sectors with the highest share of intermediates in exports are: 'wood and wood products', 'paper products and printing', 'rubber and plastic', 'other non-metallic minerals' and 'basic metals'. Once again prima facie these are industries that may be more affected.

- Changes in demand in export markets will also impact on firms, but whether exporting firms are more or less exposed than firms selling only domestically depends on whether the changes in export markets are greater or smaller than changes in domestic demand. However, as international supply chains are plausibly more likely to have a bigger negative shock, firms selling to international supply chains may see a greater impact.
- c. **Distance:** The trade shock is likely to have a larger impact the greater the distance from the UK, in particular if multiple border crossings are involved. The role of distance, however, may be less important than the underlying supply chain configurations, in particular if the pandemic hits industrial centres (such as Milan) harder than, for example, tourist destinations such as Rome.
- v. The smaller the degree of **diversification**.
  - a. Diversification of sources of supply: Goods / sectors with a narrow (and critical) supply base may be more vulnerable, as the opportunities to source inputs from elsewhere will be more limited.
  - b. Diversification of sales markets: Firms depending largely/entirely on sales to one market (domestic or international) are more vulnerable to changes in demand in that market.
  - c. Product diversification: firms that produce a single product are more vulnerable to changes in demand for that product. Larger, more diversified, firms may be able to adjust more easily.

Diversification at the firm level is hard to measure as there is a lack of data availability. If we take the most detailed level at which harmonised trade data is available (HS 6-digit - which comprises more than 5000 products), we can calculate how concentrated exports or imports are in terms of the number of partner countries that the UK trades these products with. A useful indicator for this is the *trade concentration index* (TCI) which ranges between 0 and 1. If the TCI were equal to 1, this would mean the product was traded with just 1 partner. The smaller is the TCI the more diversified is the trade. Out of the UK's top 20 exports six of these have a TCI greater than 0.2, and on the import side there are 12 with a TCI greater than 0.2. This implies a low level of partner diversification.

- vi. Labour intensive goods: Where the goods are produced using more labour intensive methods it is harder to maintain social distancing, and these sectors are more likely to see a reduction in supply, and a slower return to production as countries exit from lockdown restrictions.
- vii. Goods with lean inventories:
  - a. An initial response to the supply shock is to draw down inventories. In sectors with small inventories (e.g. electronics) built around flexible supply arrangements, the lack of inventories will cause supply problems to emerge more quickly.<sup>8</sup>
  - b. The demand shock is likely to have the opposite effect, causing an accumulation of inventories and rising inventory carrying costs. This is currently affecting many UK

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<sup>8</sup> See <https://www.economist.com/international/2020/02/15/the-new-coronavirus-could-have-a-lasting-impact-on-global-supply-chains>

retailers, but can also cause a reduced demand for intermediates by firms along a chain of production.

- c. It can also create problems where retailers ordered supplies prior to the crisis, but which are now not saleable.
6. Not all industries will be negatively affected, as the crisis has also engendered increased demand for some goods and services. Hence, in contrast to the list of characteristics above, the situation is different for many businesses that sell and trade certain services.
7. First, digital services (often called e-services) are inherently less affected by the trade inhibitors that afflict goods trade.<sup>9</sup> In addition, certain services, especially as they relate to online communications, have experienced a massive positive demand shock as UK businesses had to cope with lockdown and social distancing measures. The crisis and the associated social distancing restrictions have ushered in a technology impetus to substitute online services for conventional (face-to-face) transactions. The hallmark of most services that are helpful for business continuity in times of social distancing are digitally enabled and digitally delivered services. As such, the crisis has probably only precipitated long-run secular trends that have produced 3D printing, artificial intelligence and big data usage, the Internet-of-Things (IoT) and the emergence of digital platforms.<sup>10</sup> Some of these services originate from abroad, e.g. remote conferencing or cloud computing services.
8. ICT services have proved especially critical to the global effort to combat COVID-19 including, for instance, e-health services to allow daily medical services to be delivered to millions of patients; e-learning services to allow teachers to continue the education of millions of pupils and students, and generally teleworking facilities to allow workers to stay at home but continue to sustain economic activity, and digital payment and financial services to enable e-commerce, which is particularly critical to sustain at least some part of the economic activity that would otherwise have to shut down.<sup>11</sup> The substantial (sunk) investments in distance working, including training etc, is likely to facilitate trade in services now and post-shock.
9. There are two implications for services in the medium and long run. First, these services and solutions that have proved useful for weathering the crisis can be delivered at nearly the same cost domestically or internationally, and the additional cost for firms of transacting such services across international borders is very often negligibly small. Given that the UK is one of the most services-oriented economies of the world, this could create new sources of comparative advantage or increase dependencies from foreign online platforms, or both. Second, once businesses have incurred the fixed (and often sunk) costs of changing their business processes accordingly, the changes spurred by the crisis are likely to be permanent.

**Note:** Combining these different factors outlined above is complex and involves a detailed examination of the underlying trade and production statistics. The UKTPO intends to undertake more detailed empirical work and to assess which industries are more likely to be impacted and why in its future work.

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<sup>9</sup> At least when services are traded via the Internet. The travel ban has affected the movement of natural persons as service suppliers (Mode 4) drastically, as it does for consumers travelling abroad (Mode 2).

<sup>10</sup> Drake-Brockman (Lead author) et al (23 April 2020).

<sup>11</sup> Drake-Brockman (Lead author) et al., 23 April 2020.

## **2. Medium-term impact and long-term impacts and what steps could be taken to mitigate against the impacts (TOR 3, 8):**

10. Current UK government economic policy in response to COVID-19 for businesses and individuals is aimed at responding to the immediate needs given the lockdown policies in the UK and elsewhere. Those policies are primarily aimed at shielding firms and individuals through schemes such as the Coronavirus Job Retention Scheme, the Coronavirus Business Loan Interruption Scheme, and support for the self-employed. There is not the scope in this submission to fully detail the appropriate policy responses, nor is there at this stage enough information. So the discussion of policy below is intended more as agenda setting as opposed to a prescriptive list.
11. As economies emerge from lock-down there will be considerable pressure on government policy to address COVID-19 related challenges for firms and individuals. Part of that pressure is likely to be with respect to the use of trade instruments / policies, and to respond to the introduction of such policies by other countries. Existing policies (sensibly) are aimed at short-term alleviation / shielding, but they do not address the medium or longer term consequences, and the challenges that will face the UK economy. For example, the Job Retention scheme helps firms with one major element of their costs (wages), but not with other elements such as rent. The Business Loan Interruption scheme is designed to make it easier for firms to access finance and lower the cost of that finance. However, it involves firms building up more debt at a time of great business uncertainty. It may be the case that in order to survive now, firms will have to build up that debt, but at the same time it makes their future viability more difficult – and thus impact on their ability to trade and willingness to take risks such as exploring new markets.
12. If we consider COVID-19 as a triple shock – supply, demand, and trade – then policy will be needed to address each of these. There are three key points to make here. First, in the setting of policy a key principle is that the government needs to identify as closely as possible what the problem is (what economists would term as the market failure), and then policy needs to address the cause of the problem as closely as possible. Second, and although it might seem obvious the point does need to be made – the three issues (supply, demand and trade) are interrelated. Recovery will be stronger and faster the more each of these are dealt with in a consistent fashion. In that regard, reinforced international cooperation on the multilateral level as well as bilaterally, e.g. in FTA negotiations, will be key to ensure that trade can support and complement domestic policies, and that the UK is not adversely affected by policies in other countries. Third, while trade will be an important element of the recovery, it cannot be a solution to that recovery.
13. As the worst of the crisis passes and lockdown measures start to get lifted on the supply side the economic priority will be for economic activity to resume – for firms to start producing, on the demand side to ensure the incomes of individuals. As much UK economic activity is traded it will also be important to address any trade inhibitors and the ability of firms to both import and export:

### **Trade:**

14. As this submission is to the ITC we first deal with trade related issues / policies. There is a clear risk that governments around the world will resort to trade distorting and protectionist measures with the aim of supporting their domestic industries. This may include import impeding policies such as tariffs, and export promotion policies such as export subsidies (and more broadly production subsidies, or financial support measures, which also impact on



trade). At a minimum we are already seeing politicians and policy makers suggesting that globalisation may have gone ‘too far’<sup>12</sup> and that more production should be re-shored to domestic economies<sup>13</sup>. A recent joint statement from the European Commission President and the President of the European Council stated that “The COVID-19 pandemic has shown the pressing need to produce critical goods in Europe, to invest in strategic value chains and to reduce over-dependency on third countries in these areas”. Industries too are pressing for such a shift, for example with the European Aluminium Association arguing that “This crisis shows we cannot depend on the supply of critical raw materials from other regions. It highlights the urgent need to recognise strategic value chains for Europe, both in the context of the announced actions under the new EU Industrial Strategy and the upcoming COVID-19 Recovery Action Plan”<sup>14</sup>

15. Some of the future trade policy responses are likely too, to be in response to (sometimes supposed) actions of another government, for example countervailing duties. Even prior to COVID-19 there were concerns about this, most notably manifested by the actions of the US / Trump – with protectionism being introduced for national security reasons, or because of broader policy objections (technology transfer, IP abuses), or to ‘safeguard’ particular industries. Governments will be under pressure to resort to more such policies. Much of this may well not be WTO compliant, however given the pressures being faced, this is unlikely to prove much of a constraint, but to the extent that countries may be concerned they may try and justify policy as a countervailing duty (in response to another country’s action), or as a safeguard action, and/or to invoke GATT Article XX or XXI. We are thus more likely to be subject to trade measures that the WTO may not be in a position to constrain.
16. As there is considerable risk of a slide into protectionism it is important that the government acts to resist this pressure, and more than that tries to play an important role to encourage international cooperation and coordination with key allies and trading partners to prevent this from happening. The UK will be hosting the G7 summit in 2021, which may give it an opportunity to demonstrate leadership in this regard. A first key objective should be to seek international cooperation and agreement to resist the pressures to resort to trade restricting practices, and to maintain the free flow of goods and services. The second objective, is much more ambitious. It is to try and influence the debate on the changes needed to the multilateral trading system and practical steps that can be taken to avoid the emergence of destructive nationalism. This is discussed in more detail below.
17. In this context:
  - Protectionism should not be seen as part of the solution. It would not address the problems firms face (see discussion below). Trade will be part of the solution to global problems of supply and demand and should not be restricted without good reason.
  - To the extent that trade can help countries emerge from such a crisis, there may be an incentive to use export promoting policies. Indeed these, as well as support for domestic production, and national procurement policies, were an important part of the response to the great trade collapse. While supporting exports and production, such policies can be a barrier to imports, and affect other countries adversely. There is then a risk here of a competitive subsidies war between countries. In response to this, countries are likely to

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<sup>12</sup> Thierry Breton cited in, *le Figaro*, 2 April 2020;

<sup>13</sup> Interview with President Macron, *FT*, 17 April 2020.

<sup>14</sup> <https://www.euractiv.com/section/energy-environment/opinion/why-the-covid-19-crisis-highlights-the-importance-of-recognising-strategic-value-chains/>

respond with countervailing duties. The widespread adoption of subsidies is more likely to exacerbate firms' problems than the opposite.

- It will be important for governments to facilitate the free flow of goods and services as much as possible. This matters both for facilitating UK exports for UK firms, but also to facilitate UK imports and as part of growing world demand. In an increasingly digital economy, the free flow of goods and services is linked to cross-border data flows. A lot could be done—as part of the G7 or at the WTO—in terms of trade disciplines for data flows or e-commerce that respect legitimate public policy objectives whilst facilitating the flow of data and e-services. It is a particularly important element in maintaining international supply chains. Governments may also need to consider other policies which help to facilitate trade be this in terms of border checks and smarter frontiers, or other policies which impact on logistics and distribution, and at a minimum to resist the spread of new barriers.
- Given the impact on many digital services, there is a renewed urgency for international coordination on rules that affect services trade, and areas that are integral to digital services such as cross-border data flows and intellectual property rights, so as to reap the benefits of digitisation as it relates to international trade in an inclusive and equitable way. For instance, the massive reliance on online conferencing or e-health services, respectively, potentially involving sensitive personal data, brings a whole new sense of urgency to the policy area of internationally effective and enforceable privacy protection.
- Another issue beyond the immediate remit of this inquiry, but which it is important to address, is that the triple shock of COVID will be much greater for many developing countries. This is primarily because the ability of their health services to cope with the pandemic will be weaker. It is important that the UK government consider the policies that it can put into place to support developing countries.

18. **Supply:** In the medium term there are likely to be several issues facing firms: Firms that survive the immediate COVID-19 shock will have built up more up debt, or at the minimum, will have been winding down their cash reserves. They will be financially in a much weaker position. Second, there may be on-going problems with sourcing intermediate inputs – either domestically or internationally. Third, there may be a lack of demand as consumer and other firms continue to reign back spending. Finally, and as discussed above there may be increased barriers to trade, and entry barriers to export markets may increase.
19. There will be widespread pressure on the government to support firms and industries. The government will need to prioritise, decide when support is needed, what sort of support, and how much support. There is a long list of possible policy options, such as: subsidies (production or export); public ownership, or part equity ownership; public procurement policies (e.g. buy British), help in finding new markets / suppliers; debt-forgiveness; or trade credit facilitation. The government will need to consult domestically and internationally and establish a clear set of criteria as to the circumstances under which intervention is a justifiable response and is needed.
20. For example, it is very likely that for many firms a key internal problem will be the debt they have built up. That will impact on their ability to survive, and certainly on investment and innovation. So dealing with debt will be a priority. Increasing exports or domestic sales at the expense of imports is unlikely to resolve this. Therefore the challenges facing firms, cannot be resolved through trade policies, and alternative policies will need to be considered. For example, extended loan repayment periods may enable more firms to survive and might be sufficient for some firms. Nevertheless, even this is likely to impact on investment and innovation and the ability of firms to seek and establish sales in new markets. The

government may need to consider seriously the feasibility and cost of programmes of support which clear the additional debt firms have built up as a result of coronavirus – some form of “clean slate debt forgiveness”. However, first there has to be a clear rationale and justification for such a policy and why intervention is needed, and second, such policies too would be better carried out in a framework of international cooperation otherwise they too may engender countervailing duties.

21. More broadly the preceding underlines that in the post-COVID work there will probably need to be more cross-Government coordination of policies (including cross-House of Commons committee coordination) as they relate to trade, industrial strategy, and competition policy.
22. The COVID-19 crisis may lead to a substantial shake-out across the economy that can be expected to be particularly severe in backbone services sectors, which underpin domestic activity as much as international trade. For instance, at the time of submitting this evidence the aviation industry is already under immense pressure. Australia’s second-largest airline is going into administration, raising the prospect of a near-monopoly there post-crisis, South Africa’s flag carrier is about to cease operations, and in Europe the Swedish and Danish affiliates of Norwegian have gone into administration. Hence, with such consolidations in a post-COVID world, there may be a bigger role for competition policy to ensure that international trade is not adversely affected by reductions in supply (and competitive pressure) of services that grease the wheels of commerce.
23. In both the great trade collapse and as a result of the COVID-19 shock, supply chain integration served to transmit and exacerbate the effects. Sensible policy should consider whether and how supply chains should be reconfigured, in order to provide greater resilience to shocks, while maintaining the well documented advantages from closer integration (specialisation, technology transfer, innovation...). As discussed earlier, supply chains are not only international – and it is an error to view them solely in this light. In considering policies with regard to supply chains, the first step (for firms) should be to identify what makes any given supply chain vulnerable or to lack resilience, and whether or not more resilience is needed. For policy makers it is important to identify for which industries more resilience could be desirable (e.g. medical equipment) because it is less than socially optimal, and to identify whether or not there is need for intervention, and why the private sector cannot resolve the issues. Only then can appropriate interventions be justified.
24. Greater resilience is likely to require some combination of:
  - Simplification – making supply chains shorter (and possibly more reshoring). Note the last decade has seen an increase in reshoring, so the COVID-19 shock is likely to accelerate this trend.
  - Diversification of sources of supply: such that firms and industries are less reliant on single countries / single suppliers in countries. This will be difficult for small(er) firms and hence policy may need to consider how to support smaller firms in this regard, but this would require justification as to why government support should be given.
  - Rethinking the advantage of lean inventories, and whether or not there is need for large stocks or precautionary inventories.
  - More automation and use of robotics – easier to maintain production if social distancing is required.

- Address the complementarity between goods and service production and trade. Producing goods increasingly requires services as part of the supply chain. In some sectors the importance of service personnel being able to travel across borders will be important, in other sectors the development of (more) secure forms of digital delivery will need to be considered, which in turn may raise cyber security issues.

#### **Demand:**

25. Much policy has, perhaps understandably, focussed on support for firms. However, as a result of the crisis it is also the case that individuals either as consumers, or self-employed workers will also have considerably built up debt levels as their incomes have shrunk or as they have lost their jobs. The government may therefore need to consider policies to address / boost incomes and demand.
26. **BREXIT:** In the context of the COVID induced supply, demand and trade shocks, ending the UK-EU transition period at the end of 2020 can only exacerbate the difficulties facing UK firms. There will be a large number of new trade procedures introduced that will take time to adjust to. The added uncertainty over the EU relationship, the increased costs of accessing the EU market, and the reduced access to imports from the EU will all make life harder for UK firms. This means that more firms will struggle to survive, and for many that do they are less likely to invest, innovate, or seek new markets. Once the transition period has ended the UK is liable to face the possibility of EU anti-dumping and countervailing duties. We therefore strongly urge the government to extend the transition period, or negotiate a medium-term implementation period. .

### **3. Trade in Essential Goods (TOR 5)**

27. COVID-19 has resulted in a substantial increase in demand for certain medicines and also for personal protective equipment (PPE). As few countries are self-sufficient in these this has led to a combination of restrictive policies being put in place by numerous countries ranging from tariffs to export restrictions.<sup>15,16</sup> The WTO has recorded 70 different measures taken by various WTO members in response to the coronavirus. Some of these are trade facilitating (removing tariffs, simplifying requirements for conformity assessments), others are trade restricting (export restraints, import restraints). Our analysis of Global Trade Alerts reports suggests that there have more than 160 COVID-related measures introduced since January 2020.
28. For example the EU initially adopted export restrictions on a range of Personal Protective Equipment (PPE), including surgical gloves, protective spectacles, masks and other protective items. According to the [EU regulation 2020/402](#) such items would need an export authorisation before they can be exported outside the EU (this excludes the four EFTA countries and overseas territories). Before any exports to a third country are authorised, it

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<sup>15</sup> International Principles on Export Restrictions in the COVID-19 Pandemic Tuesday, April 7, 2020, US Chambers of Commerce, <https://www.uschamber.com/issue-brief/international-principles-export-restrictions-the-covid-19-pandemic>

<sup>16</sup> <https://voxeu.org/article/export-restraints-medical-supplies-during-pandemic>

must be shown that there is an adequate supply of the product to fulfil the EU demand. The export restrictions were to be in place for a period of 6 weeks to begin with. To its credit the EU then withdrew from most of these restrictions on the 14<sup>th</sup> April<sup>17</sup> and outlined a new regulation set to apply for a period of 30 days from the 26 April 2020. Consistent with the UK's status under the Withdrawal Agreement, the UK implemented the same restrictions. The revised regulation adjusts the export authorisation scheme to apply only to protective masks. In this product category the UK imports only around 32% of its products from the EU, and exports around 37% of its products outside the EU.<sup>18</sup>

29. Of the 34 products that the restrictions initially applied to, the UK imports around 38% of these from the EU and over 60% from non-EU countries.<sup>19</sup> Any retaliatory restrictions imposed by the exporting countries would therefore have affected the UK.

**Table 2: UK trade in PPE (average 2018-2019)**

	Trading partner				
	EU	China	USA	ROW	Total
UK exports £m	1209.9	27.9	176.3	412.7	1826.86
Share of UK exports (%)	66.2%	1.5%	9.7%	22.6%	100%
UK imports £m	1152.6	800.1	211.9	901.8	3066.43
Share of UK imports (%)	37.6%	26.1%	6.9%	29.4%	100%

Note: data from HMRC covering the 34 products identified as PPE in EU's regulation 2020/402

30. Looking more broadly the WTO (April, 2020) identified four categories of medical essential goods:

1. Medicines (Pharmaceuticals)– including both dosified and bulk medicines;
2. Medical supplies – refers to consumables for hospital and laboratory use (e.g. alcohol, syringes, gauze, reagents, etc);
3. Medical equipment and technology; and
4. Personal protective products – hand soap and sanitizer, face masks, protective spectacles

UK trade in these goods is summarised in the tables below<sup>20</sup>. The first two columns give the value of trade, the second two columns give the share of those product in the UK's total trade. Columns 5 & 6 indicate the share of each category which is trade with the EU, and the final column gives the current EU average tariff on each category.

**Table 3: UK Trade in Medical Essential Goods**

	Imports (\$B)	Exports (\$B)	Share of total imports	Share of total exports	Imp Share from EU	Export share to EU	EU tariff
Medicines	25.17	24.34	3.67%	5.24%	85.13%	41.17%	0
Medical Supplies	6.29	5.73	0.92%	1.23%	67.58%	47.57%	2.30%
Medical Equip.	4.48	4.17	0.65%	0.90%	63.27%	44.23%	0.31%
PPE	5.04	3.73	0.73%	0.80%	64.10%	63.66%	3.54%

31. The overall share in UK trade is low for all of the categories (except for in medicines). While for medicines a substantial share of our imports is sourced from the EU, for the other

<sup>17</sup> <https://trade.ec.europa.eu/doclib/press/index.cfm?id=2132>

<sup>18</sup> Face masks assumed to cover the two products falling under the category "mouth-nose-protection equipment" in regulation 2020/402

<sup>19</sup> Based on trade data for 2018-2019 so does not reflect changes in trade since the virus outbreak.

<sup>20</sup> Source: own calculations based on UN Comtrade data and compiled using TradeSift software.

categories, around 40% of imports are sourced from the rest of the world, while most favoured nation (MFN) tariffs are comparatively low. This highlights the potential importance of maintaining access to imports, though this depends on the extent of domestic supply, and the risks from introducing protectionist actions in an attempt to assure local supplies.

32. The policies and changes in policy reflect the current volatility in approaches taken by governments with regard to essential supplies, as well as the lack of coordination. There have been numerous calls for more international coordination and cooperation on policy with regard to essential medicines and PPE.<sup>21</sup> We strongly support such calls for coordinated action and discuss this in more detail in Section 4 below.
33. A range of services are also essential for both domestic production and international trade. The Coalition of Services Industries has suggested, for instance, that financial services, ICT services, retail and distribution, and transportation and logistics services are all examples, though not exhaustive, of critical enablers of trade in goods and agri-food products, amongst others.<sup>22</sup>

#### **4. WTO, multilateral and plurilateral responses (TOR 5,7)**

34. At this stage, governments are responding unilaterally to COVID-19 to save human lives in their own countries. Some measures, such as export controls of medical products and foods and lack of transparency in public procurement, disrupt international trade and make many countries difficult to access to essential products at the time of crisis. The current unilateralism is plainly dysfunctional, and the UK Government should seek actively to foster international cooperation.

##### **Strengthening multilateral cooperation: the short, medium and long runs**

35. The WTO is the natural locus for cooperation on trade matters since it is non-discriminatory and hence generates efficient outcomes at the global level.
36. In the immediate term, the UK should sign and then promote the “Declaration on Trade in Essential Goods for Combating the COVID-10 Pandemic” (“the WTO Declaration on COVID-19”) proposed by New Zealand and Singapore on 16<sup>th</sup> April.<sup>23</sup> By doing so, the UK would demonstrate its strong commitment to tariff elimination; prohibition of export restrictions; removal of non-tariff barriers; and trade facilitation in essential goods for combating the COVID-10, all objectives explicitly espoused by the government. As a major economy, the UK’s support would help promulgate the Declaration widely and encourage others to join it. Doing so would grant the UK a leadership position commensurate with ‘Global Britain’ in a critical area. It is, frankly, difficult to understand why the government has not done so.
37. The Declaration is aimed at eliminating some of the inefficiencies shackling current trade in key medical supplies and food. But, in fact, it could be easily extended to achieve medium term goals and perhaps to reverse the trend of destructive nationalism that is currently besieging policy-making processes. The countries that have recently reduced their barriers to imports of medical supplies and those that have imposed export restrictions on such

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<sup>21</sup> For example, Evenett op.cit; US Chamber of Commerce, op.cit; Beattie, A., Financial Times, 20 April 2020, “Can this mad, global scramble for protective gear be avoided in future?”

<sup>22</sup> CSI (2020).

<sup>23</sup> World Trade Organization, Council for Trade in Goods, G/C/W/777 (16 April 2020), “Response to the Covid-19 pandemic: Ensuring the free flow of trade in essential goods for combating the Covid-19 pandemic”.

goods could each benefit from an agreement that commits importers to maintain their current, more liberal, policies and exporters to commit to constrain (but not eliminate) their ability to restrict exports. Evenett and Winters (April, 2020) spell out a proposal in some detail.<sup>24</sup>

38. Evenett and Winters' aim is to ensure that world markets for medical supplies are efficient and equitable, with production occurring at efficient scale and in appropriate locations, while guaranteeing that supplies will be available when required for non-producers. This calls for open trade and specialisation, but in a form that recognises that it is not reasonable either
  - For countries which curtail imports of key goods in good times in order to protect their local producers suddenly to emerge onto the world market in a crisis and expect there to be sufficient supplies for them; or for
  - For countries which expect to be able to sell key goods to other countries in times of plenty to curtail the supply when these things suddenly become more valuable.
39. The proposal is perfectly compatible with the WTO, would be open to all WTO members, could come into operation immediately and, the authors suggest, operate initially for five years so that members can 'try it for size'. It could ensure that even if there is a second wave of COVID, world markets supported rather than hindered health objectives. Importers would have some assurance of supplies and exporters more open markets to sell into and thus more incentive to invest in capacity. Exporters that were signatories to the agreement would be more attractive suppliers because of their longer-term commitment to supply and could, in fact, signal this in marketing material or labelling.
40. There is also a long-term perspective. The last three years have seen a serious worsening of trade cooperation, led by, although not confined to, President Trump and the USA; the COVID crisis appears only to have made this worse. Although the crisis still rages, it is not too early to start thinking about the long-term health of the multilateral trading system. During World War II international thinking about the post-war system had begun by mid-1941, years before the parties thought it could be implemented. *The Atlantic Charter* of August 14, 1941 called for 'access, on equal terms, to' trade; the UK-US *Mutual Aid Agreement* of 23<sup>rd</sup> February 1942, spoke of 'the elimination of all forms of discriminatory treatment...', and over 1942 Percy Bidwell of the USA and James Meade of the UK formulated separate but quite similar plans for an International Trade Organisation.
41. The UK should convene and support high level political and academic groups to develop realistic plans for the future trading system. The task will require significant diplomatic effort and specialist input, but the system is in flux and the UK is a new player with little past baggage. This combination offers a unique opportunity to exhibit UK leadership in both thought and action.

### **Promoting plurilateral/bilateral cooperation**

42. In conjunction with the promotion of multilateral trade policy coordination, the UK Government should also promote bilateral/plurilateral cooperation.
43. The "WTO Declaration on COVID-19" and the Evenett-Winters proposals are narrowly focussed, in order to appeal to a wide range of WTO members and avoid the need for time-

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<sup>24</sup> Evenett, Simon and L Alan Winters (April, 2020) *Preparing for a second wave of COVID-19: A trade bargain to secure supplies of medical goods*, UKTPO Briefing Paper No. 40

consuming negotiations. Thus, there is also scope for plurilateral/bilateral cooperation that goes deeper with a subset of partners on issues such as:

- Intellectual property rights of drugs and medical products for combating COVID-19;
- Regulatory standards cooperation/adaptation of international standards to guarantee the quality and safety of medical equipment;
- Promoting transparency in COVID-19 related national measures that may affect international trade and FDI;
- Mobility of healthcare professionals to support countries in need;
- A sound framework to protect cross-border digital interactions on COVID-19

The UK government should lend its support to such discussions.

44. The UK also has a direct interest in cooperation with the EU since it imports and exports a substantial proportion of COVID-19 medical supplies to/from the EU. The structures of the EU Customs Union and Single Market are no longer available, but such agreements could still form part of CETA-type FTA with the EU, as they could in other UK FTAs. Such FTAs could even include agreements to limit export restrictions between the partners, citing the Canada-Chile and Canada-Costa Rica FTAs and NAFTA as precedents (Korinek and Bartos, 2012).
45. Cooperation over fighting COVID-19 is more foreign diplomacy than pure economic diplomacy, such as FTAs, and so would require a whole of government approach. However, trade cooperation could form the heart of such efforts.



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**Data sources:** Global Trade Alerts, [www.globaltradealerts.org](http://www.globaltradealerts.org); Comtrade database on trade and tariffs accessed through the World Integrated Trade Solution (WITS) of the World Bank, [www.wits.org](http://www.wits.org); OECD Trade in Value Added database, <https://www.oecd.org/sti/ind/measuring-trade-in-value-added.htm>

