T7 Task Force Sustainable Economic Recovery

POLICY BRIEF

LOOKING FOR A POSSIBLE LOCOMOTIVE TO LEAD INTERNATIONAL TRADE

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Daehee Jeong, Director, Korea Development Institute (KDI)

Deokryong Yoon, Visiting Senior Fellow, Korea Development Institute (KDI)

Jung-hyun Lah, Specialist, Korea Development Institute (KDI)

Minjoung Kim, Research Associate, Korea Development Institute (KDI)

Joowon Yoon, Research Associate, Korea Development Institute (KDI)

Jiwon Kim, Research Associate, Korea Development Institute (KDI)

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Abstract

The recent COVID-19 pandemic and cross-border political conflicts have posed great risks to international trade which is vital to economic growth and prosperity. Despite the apparent benefit of international trade, the global community's efforts to manage and expand fair trade has not been active enough to achieve a sustainable economic recovery. Many countries increasingly consider national security as an important factor when reinforcing trade policies and have become far more selective in choosing their economic partners.

To alleviate the disruption of supply chains, especially of strategically important goods, we suggest accomplishing a standstill of trade restriction policies by forming a cooperative network among like-minded countries. Strengthening the role of OECD as the supervisor of protectionist activities could help expand trust among participating countries and stabilize the GVCs. Moreover, the inclusion of additional countries with high shares of global trade to the G7 could enhance economic influence to facilitate international trade and would become a new engine for trade market growth.

Challenge

International trade is an essential factor for economic growth and prosperity. By allowing access to otherwise-unachievable resources and technologies, foreign trade lifts global living standards and reduces the economic gap between members of the international community. International trade is regarded as a win-win game in which all participating countries profit from their trading partners' comparative advantages. For sustainable and equitable allocations of profits among the participants, the maintenance of trade order to ensure fair trade serves a crucial role. However, this fundamental premise of international trade has not been not well kept in recent times, and consequently, the growth of international trade has been slowing down.

In recent years, the growth rate of international trade has continued to fall below the growth rate of world economy. As seen in Figure 1, during the period in which global trade was actively growing, the global economy also showed a high rate of growth. Likewise, the global economic growth exhibited a stagnating pattern in line with the low growth of trade. Efforts to provide the impetus for restoring growth in international trade are necessary to boost a sustainable economic recovery worldwide.

A new emergent problem in international trade is a supply chain disruption. With rapid globalization, almost all countries, only differing in levels of imports and exports, rely on other countries in both production and consumption. Lately, the stability of global value chains (GVCs) has been severely disrupted owing to the COVID-19 pandemic as well as cross-border political conflicts. As a result, the international community standards for selecting trade partners are changing. While, in the past, delivering cost-savings and improvements in efficiency was the foremost element, now securing stability has overpowered the former. This security factor has become an additional hindrance to the growth of trade.

(Unit: %)

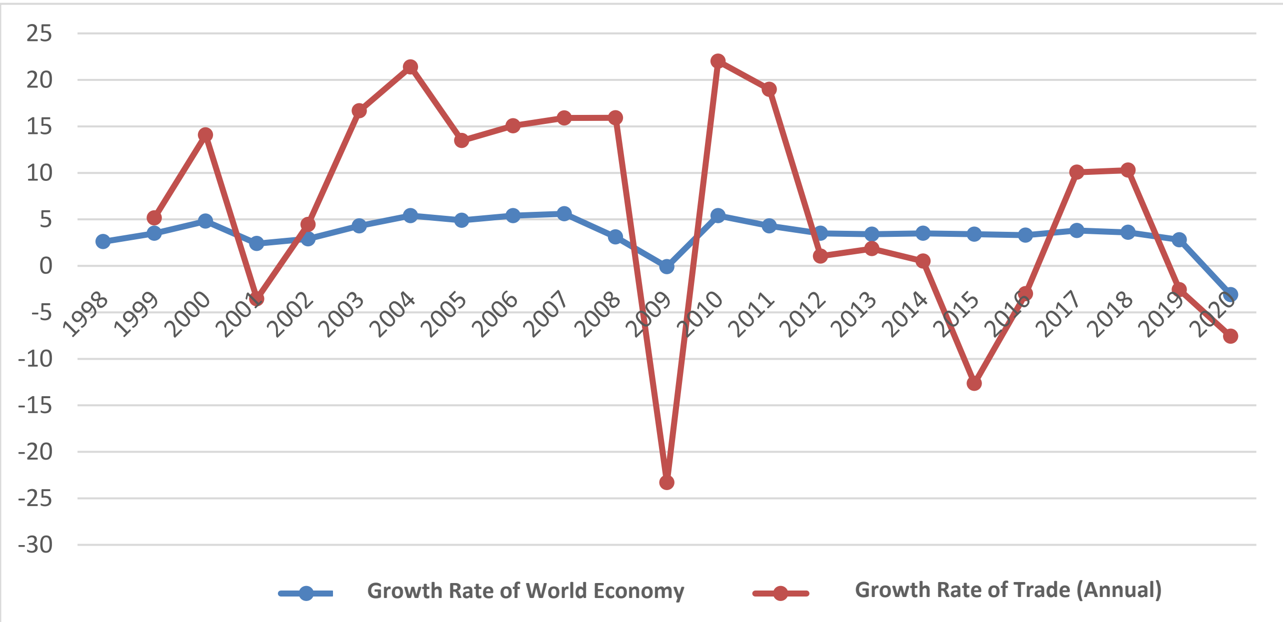

Figure 1: Growth Rate of World Economy and Trade

Source: IMF, Direction of Trade Statistics (DOTs); Author calculation.

The following issues represent challenging aspects that lower the growth rate of recent international trade.

- First, protectionism to protect domestic jobs in response to economic deterioration
- Second, industrial policy interventions such as government subsidies to expand domestic industries
- Third, international political conflicts. There is an increasing number of cases of using import or export restrictions as a political means to harm a specific country. The Russia-Ukraine war has triggered a series of sanctions that not only affect Russia but also the global trade flows.
- Fourth, the increase in international regulatory measures due to policies addressing climate change. Even the most necessary institutional changes can pose a risk to international trade without the provision of acceptable approaches taking the gap between emerging and developed countries into account.
- Fifth, supply chain disruption caused by global pandemics or natural disasters.

Despite the apparent benefit of expanding fair trade, the international community's efforts to do so are not active. Although the WTO should lead fair trade management and trade expansion, its role is limited because member countries are more focused on their interests and are passive in cooperation. Now, a new locomotive is needed to expand trade and promote international cooperation.

Proposals

Standstill of policy measures weakening GVCs

Global leaders would need to cope with the existing challenges by preserving the status quo. For example, a ‘standstill’ agreement was made at the 2008 G20 summit in Washington, D.C. to prevent the rise of trade protectionism.

The increasing number of trade sanctions is being implemented to weaken GVCs. Historically, sanctions were generally imposed to protect domestic industries. Now, the weakening of GVCs through various restrictions, such as the enforcement of permit system or bans on imports/exports, stems from political reasons or diplomatic strategies. The agreement by relevant countries not to increase the number of import/export sanctions is imperative to prevent the aggravation of slowed economy.

To promote a standstill, the WTO or the OECD could have monthly reports on measures that weaken GVCs and apply “peer pressure” together with member countries to redress the situation. A country which thinks it has been sanctioned could call for a rectification and report the relevant data and information to the WTO or OECD.

Cooperation to secure strategically important GVCs

The impact of COVID-19 on GVCs revealed that an unavoidable situation such as an infectious disease could weaken the strategically important GVC and therefore cause problems in economic security. Also, rising conflicts between countries and the expansion of economic sanctions worldwide could weaken the supply chains of raw materials or unprocessed components. In consequence, the costs are not only levied on sanctioned targets but also the sanctioning country due to the disruption of the global value chain.

After categorizing the types of GVCs by their importance, appropriate cooperative measures should be examined. Generally, the strategically important GVCs are food, energy, cutting-edge technologies, and materials. Especially, the G7 and other like-minded countries could form a global alliance to take collaborative action and protect GVC networks.

Measures to enhance trust between countries

It is important to build mutual trust between like-minded countries for securing GVCs. For example, the U.K. consolidated a new ‘D-10’ leading democracies for addressing vulnerable supply chains. Policies to expand trust among participating countries are needed to stabilize the GVCs. Countries with the same or similar values could establish a cooperative network. Then they could employ a strategy of “binding hands” that expands mutual trade and investment and also induces self-harm for those who betray the agreement. Hence sufficiently reliable countries should be able to cooperate to promote the stability of trade without shrinking international trade.

Implementations

Strengthening the role of the OECD

Currently, the interests within WTO members and observers are too conflicted, making it difficult to reach an agreement. To achieve a standstill, the WTO could receive reports from countries that believe they have been sanctioned for protectionist purposes, and it can then apply peer pressure to correct as well as to investigate them.

Moreover, the OECD could receive reports on protectionist measures from member countries and requests for the correction of such actions or implements countermeasures at the OECD level. OECD countries are relatively easier to reach an agreement than the WTO because they are partners countries that have attained economic power and a level of development above a certain standard. The 38 member countries of the OECD could concur with one another and cooperate to influence the movement of the world economy. If the OECD plays an active role in achieving fair trade and stabilizing GVCs as well as a standstill, accordingly, it will contribute to the enhancement of international trade and economic growth.

New locomotive to lead international trade

International trade today is faced with the task of ensuring trade expansion and stability. Since international trade reflects various interests domestically and abroad, stable growth is possible only when countries that trust each other can cooperate closely to create a win-win situation. In that sense, strong G7 leadership is needed more than ever, as the G7 countries possess a large share of economic power and the level of economic development.

However, since the G7 countries' share of world GDP has been continuously decreasing, there is a need for additional partner countries to enable their decisions and cooperation to have greater international influence. Candidate countries must share common values as a like-minded country, hold a high proportion of trade in the world, and have considerable economic power. Among countries other than the G7, those that satisfy these conditions include Korea, India and Australia, possibly including the EU. If the G7+ (Korea, India, Australia and the EU) form an alliance, this group of eleven would have increased its share of GDP and trade in the world from 45.5% to 60.3% and from 32.7% to 56.1% in 2020, respectively.[1]

As seen in Figure 2, the Korea Development Institute (KDI) has studied the level of trade intensity between the G7 countries and found that it has hardly expanded over the past 20 years and is rather weakening.[2]

Such passive cooperation proves insufficient to stabilize GVCs, and a measure to intentionally encourage more active economic exchanges is required. The combination of the G7 and Korea, India, Australia and the EU intensifies the relative size of trade compared the global volume and, therefore, is able to exert greater influence to facilitate international trade.

In conclusion, if the G11 builds new FTA agreements and establishes a cooperative network for trade expansion and GVC stabilization, it would become a new powerful engine for trade market growth.

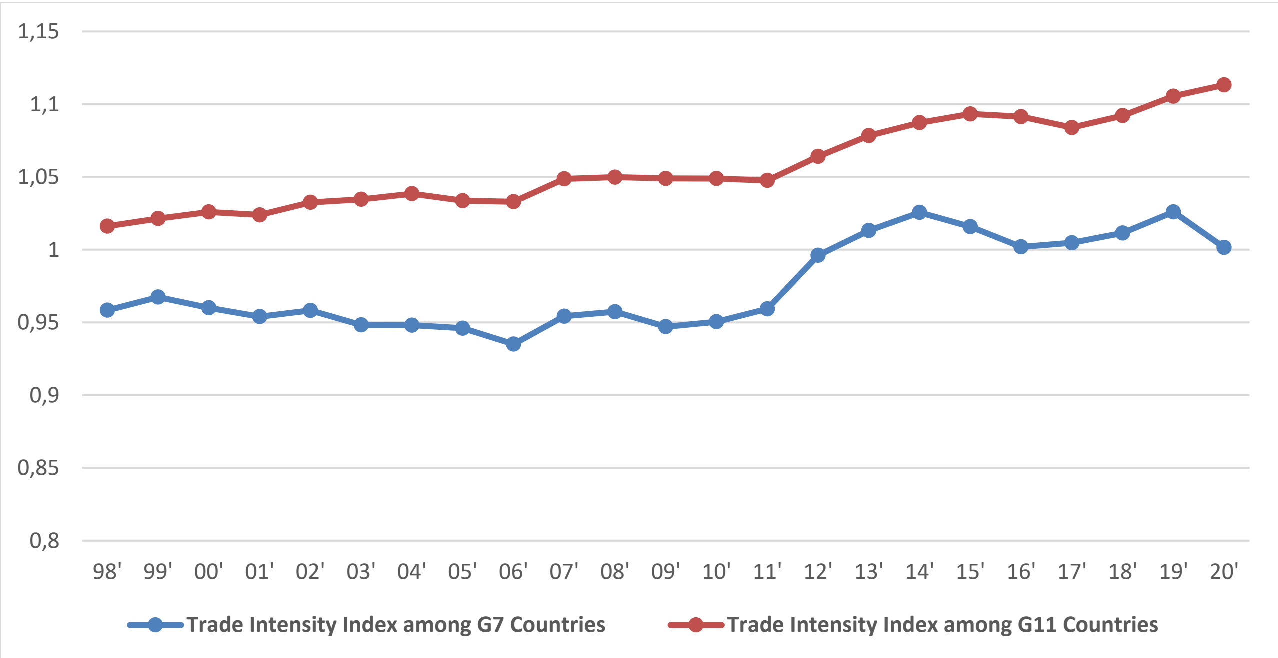

Figure 2: Trade Intensity Index of G7 and G11 Countries

Source: IMF, Direction of Trade Statistics (DOTs); Author calculation.

Endnotes

[1] Data from IMF, World Economic Outlook (1998-2021).

[2] The index of trade intensity is obtained by dividing the share of intra-G7 trade in the G7's overall trade by the share of its trade in global trade. It has advantage over simple trade share because it does not suffer from size bias.

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About the Authors

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The Korea Development Institute (KDI) is Korea's leading publicly funded, policy-oriented research institution. Since the institute's founding in 1971, KDI has established a long history of delivering rigorous research and leading the public policy discourse. For five decades, KDI has consistently provided policy recommendations and guidance based on in-depth analyses of international and domestic economic conditions and projections while conducting preemptive and empirical studies. The KDI's Office of Global Economy seeks to advance multilateral approaches by addressing key G7/20 issues such as international finance, global governance, digital transformation and climate change.

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