

31
OCTOBER
2021

INTERNATIONAL TRADE AND ECONOMIC RESILIENCE STRATEGIES: a view from Barcelona

Patricia García-Durán Huet, Associate Professor of International Economic Organization at the University of Barcelona; Associate Researcher at CIDOB

Marc Ibáñez Díaz, MA in Global Affairs, Yale University; Research Assistant at CIDOB

The seminar "International trade and economic resilience strategies: a view from Barcelona", organised in collaboration with the Barcelona Metropolitan Area, took place in hybrid format on September 17th 2021. The experts in attendance contributed key proposals for ensuring Barcelona's economic resilience.

As an economic node integrated into both global and European value chains, Barcelona and its metropolitan area face an uncertain international context. The COVID-19 pandemic has complicated a global landscape in which the various economic actors were already positioning themselves through the digitalisation of economies. **The major economic powers are also affected by this tension**, with the growing competition between China and the United States leading to a trade war and obstructing the functioning of the World Trade Organization's (WTO).

Chartering a way through this landscape, which is defined by its uncertainty, requires us to identify the most likely future scenarios in the field of international trade. As **Oriol Illa**, Director of International Relations and Cooperation of Barcelona Metropolitan Area (AMB), explained, for Barcelona to adapt and emerge stronger from the current challenges proper forecasting is needed.

The seminar began with a presentation on the current state of international trade by Yale professor **Gary Horlick**. Applying a concept from game theory he called for international cooperation. Today's trading powers face a "prisoner's dilemma" similar to that faced at the end of the Second World War, he argued: if one power takes

unilateral protectionist measures and the others do not, the former wins (e.g. China's discrimination against foreign companies); however, if all powers take such measures they are all worse off (as in the US-China trade war). Cooperation (e.g. agreeing WTO reform) is the only way to ensure everyone wins.

The rest of the seminar was structured into two roundtables and the other experts echoed the call for more international cooperation, emphasising that the best future scenario is one in which states reach agreements on common rules that regulate international trade and preserve trade openness. The first debate, which featured the participation of various international organisations and was moderated by Patricia García-Durán, focused on how resilience strategies affect international trade. The second, moderated by Marc Ibáñez, included representatives of various European organisations and focused on the European Union's (EU) trade strategy.

Resilience strategies and international trade

Unilateral action like that of the United States in recent years has begun to break down the international trading system, including the functioning of the WTO.

Meanwhile, public policies seeking to build resilience by guaranteeing manufacturing capacity (e.g. through subsidies) and/or access to the assets needed for national strategic industries (e.g. the semiconductors used in digital technology) have created a thin line between resilience and protectionism. The message from the first part of the seminar was that securing international trade is the only way to ensure resilience, and that requires common standards and trade openness.

Anabel González, Deputy Director-General of the WTO, presented international trade (and global value chains) as a source of strength, although she recognized that trade routes can play a role in spreading diseases like the Black Death. During the COVID-19 pandemic, trade in medical supplies has grown by 16% and global value chains have made it possible to keep national markets stocked with all kinds of goods. For González, trade openness and economic resilience are mutually reinforcing, but there is a need to ensure greater transparency in the measures governments take.

Both **Fabrizio Operti**, Manager of the Integration and Trade Sector at the Inter-American Development Bank (IDB), and **Elisa Carbonell**, General Director of Internationalisation at the Spanish government's ICEX Trade and Investment, explained that from a business perspective resilience and open markets are mutually reinforcing rather than opposing forces. Companies are already striving to ensure their supply chains are resilient. Above all they are looking to diversify supply. In some cases this means a renewed commitment to proximity via nearshoring and reshoring in order both to evade geopolitical tensions and to guarantee supply. Carbonell says that diversification is also a strategy for exporting companies. Exporters are obliged to compete not only in price terms but also on quality and intangibles like labels and standards, which promote resilience by reducing the effects of commercial restrictions. Operti, meanwhile, argued that governments must offer companies the right framework in which to operate. Hence the IDB bases its work on a three-pronged strategy: investment in promoting exports and drawing

Securing international trade is the only way to ensure resilience, and that requires common standards and trade openness.

Increased diversification is also important, understood not only as a multiplicity of collaborating suppliers and countries, but also of trade routes, destinations and participants in the trading system. Including underrepresented groups such as small and medium-sized enterprises and women can also be a source of resilience.

Silvia Sorescu, Policy Analyst in the Development Division of the OECD's Trade and Agriculture Directorate, identified 2012 as the year when global value chains reached their peak. Since then their growth has slowed down and even regressed, especially given the protectionist measures put in place since 2015. To achieve economic resilience Sorescu believes that states must ensure that their value chains are strong by investing in infrastructure, digitalisation and trade facilitation at borders. Facilitation should include reducing and standardising the bureaucratic procedures required at the border. Alongside improvements to logistics infrastructure and digitalisation, this reduces dispatch time and speeds up the transit of goods. Sorescu also underlined the importance of transparency: stability was maintained in primary markets during the pandemic thanks to the system of information on agricultural markets kept by various international organizations. Achieving this level of transparency in other sectors and value chains would increase predictability and accurate assessments of production capacities, as well as allowing companies and governments to stress-test value chains.

foreign direct investment; infrastructure construction (both physical and digital) to make trade more agile; and regional economic integration, by eliminating tariffs and deepening trade facilitation. According to their data, public investment in these policies is more than offset by their high economic returns.

One of the biggest worries from the public was the high price of transport: in less than a year, naval freight costs have more than tripled. This is causing many companies problems to both export and import, creating bottlenecks in value chains and making products more expensive. Both **Anabel González** and **Silvia Sorescu** considered this to be a transitory problem caused by port closures brought by COVID-19 (especially in China) and the increased demand for goods resulting from the Western economic recovery. However, it was agreed that work needed to be done to improve competition in the transport sector.

Finally, another topic discussed was the relationship between value chain resilience of and the supply of human capital. Several businesspeople described their issues attracting talent at all levels, from workers with professional training to those with university degrees. For production networks to function properly access to human capital must be guaranteed. **Anabel González** argued that increased flows of people were needed and referred to the freedom of movement of workers within the European single market as an example.

Resilience strategies and EU trade policy

The second roundtable discussed the EU's response to trade challenges, particularly the European trade strategy proposed by the European Commission in early 2021. Antonio Fernández-Martos, Head of Unit in the European Commission's Directorate General for Trade (Multilateral Affairs and WTO), began the discussion, followed by: Luisa Santos, Deputy Director General of the BusinessEurope association; Óscar Guinea, Senior Economist at the ECIPE think tank; and Enrique Feás, Researcher at the Elcano Royal Institute.

The EU's resilience strategy is based on strengthening both European and global value chains. The new industrial policy (presented in 2020 and revised in 2021) seeks the former, while the new trade policy strategy aims to ensure the latter. As **Fernández-Martos** explained, the new industrial policy is based on the idea that the internal market should be at the heart of the COVID-19 response – a more digitalised, greener internal market that drives growth. However, it became clear during the subsequent debate that this will be no easy task: to implement a European industrial policy the EU needs increased powers and funding. The member states differ on how to achieve this. Ever since the failed merger between Alstom and Siemens, for example, opinions have diverged on the role of competition policy in the domestic market.

When it comes to trade policy, the new strategy is based on the concept of Open Strategic Autonomy. **Fernández-Martos** said that each word was relevant in trade terms: *autonomy*, because the EU must have the capacity to decide for itself (without being coerced); *strategic*, as it wants to project its values (such as sustainability); and *open*, as the best path to resilient global value chains. This policy also pursues three goals: supporting the economic recovery, establishing the new global sustainability rules, and protecting the EU's interests with greater assertiveness. To achieve them, it establishes that work must be done in six areas: (1) WTO reform; (2) supporting the green transition and promoting responsible and sustainable value chains; (3) supporting the digital transition and trade in services; (4) strengthening the EU's regulatory impact; (5) strengthening the partnership with the European neighbourhood; and (6) focussing on the implementation of agreements and ensuring a level playing field. For Fernández-Martos, the core idea of this trade strategy is that there can be no resilience without open trade policy, but that rebuilding the international trading system based on common rules will take time. In the meantime, the EU must be able to defend itself against the actions of third countries (especially China and the United States).

The other speakers agreed that *resilience* should not mean protectionism and that the EU economy would have much to lose if the world enters a phase of unilateralism and protectionism. The EU is one of the world's leading exporters – between 30% and 40% of its GDP depends

on foreign trade – and global growth is expected to be concentrated in emerging markets like China and India. Europe cannot miss the opportunity to use trade with emerging markets as a lever for growth.

The discussion centred on whether the proposed trade policy is really open. **Óscar Guinea** warned that the instruments of the new trade policy are mainly defensive and therefore reflect a negative view of trade: that it represents a threat rather than an opportunity. Among these tools are the Carbon Border Adjustment Mechanism (CBAM), the instrument to address the distortions of foreign subsidies, the mechanism to counteract coercive actions and the regulations to apply and enforce international trade rules. That all of these may make it more difficult for foreign companies to sell their products in Europe brings the danger of third countries retaliating against European exports, with the consequent negative impact on growth and employment. That a trading superpower like the EU is normalising these policies may also embolden other countries to apply similar rules.

In Guinea's view it is crucial for the EU to understand that its greatest comparative advantage is knowledge. At a time when much production depends on highly technological processes, knowledge of how these processes work allows the EU to act to handle any shock. In this sense, investment in education is investment in resilience. Meanwhile, the solution to dependence on third countries is diversification not domestic production. If Europe focusses on substituting medical supply imports, resources will be diverted from higher value-added goods like vaccines towards more basic products like masks.

Finally, Guinea argued that resilience must be created not only to face external shocks but also internal ones. That is why economic collaboration with countries outside the EU makes us more resilient. Internal shocks that disrupt production are more likely to affect neighbouring countries than far-off ones. Foreign trade can therefore help cushion the impact of such shocks on the EU's production processes by diversifying the supply chain with providers from outside the bloc. To do this, the external dependencies of the EU's economic agents must be known and detailed and exhaustive analyses must be produced on how possible bottlenecks may affect the single market.

Along the same lines, **Luisa Santos** argued that repatriating all production to Europe is impossible and that notions of self-sufficiency should not form part of open strategic autonomy. Striving to be self-sufficient would be too expensive for European companies. For example, travelling back in time to manufacture all textiles in the EU would divert necessary resources from other sectors with more added value. Europe also lacks the raw materials needed to produce every single thing. Trade links, on the other hand, allow Europe to benefit from innovations made by other countries without having to pay for research and development costs. And

by helping neighbouring regions develop economically EU trade relations play an important role in easing problems such as migration flows. According to Santos, companies' need for stability (above all in order to invest) will cause a shift that draws certain supply chains closer together. However, we shouldn't expect large amounts of reshoring or nearshoring. The most likely outcome is the geographical diversification of suppliers.

Enrique Feás was less radical when defending trade openness as a way to ensure resilience in Europe. Although he agrees with Guinea and Santos that seeking to produce everything in Europe is neither possible nor desirable, he believes it may be necessary to make efforts to ensure Europe produces strategic goods. At the start of the pandemic, the nanofluids used in messenger RNA vaccines were produced in the United States, but with European Commission assistance production facilities were repurposed so that these nanofluids could be manufactured on the continent, while resilience

The speakers agreed that achieving competitive neutrality vis-à-vis China requires WTO reform. With its main functions currently blocked amid resurgent unilateralism, the current state of the organisation leaves the trading system without the stability and predictability companies need. That is why the international trading system requires in-depth reform that covers the three key functions: negotiation, supervision and dispute resolution. The experts agreed that the EU has an important role to play in this reform as a bridge between the other powers.

Finally, the roundtable discussed whether trade policy is a good instrument for tackling climate change. The CBAM proposed by the European Commission would impose tariffs on imports that reflect their carbon content and which should never exceed the prices of the EU's internal emission permit mechanism. This mechanism has raised considerable controversy, with many countries opposing it, including the United States and China. Third countries may fight back by starting a trade war

According to the experts present, the best thing for Barcelona would be stronger international cooperation, successful WTO reform, supply chain diversification and streamlining, increased transparency, a commitment to a knowledge economy and understanding its own weaknesses.

was boosted by placing the whole of Pfizer's vaccine production line in Europe.

How to deal with China was also discussed. **Fernández-Martos** explained that the Asian giant's economic system discriminates against foreign companies. Among other instruments, China uses industrial subsidies, offers public financing below market rates, forces foreign companies into technology transfer and has public companies that do not follow market-based investment criteria, which produces overcapacity in markets.

In general, the speakers agreed that Europe should not allow itself to be dragged along behind the United States. **Santos** proposed resurrecting the EU-China investment agreement frozen by the European Parliament after China imposed sanctions on several MEPs. This would improve European companies' access to the Chinese market and reduce the disadvantages European companies face compared to those from other countries. Because while a trilateral forum on WTO reform to address the challenges posed by the Chinese economy exists between the EU, the United States and Japan, the EU's two partners already have preferential agreements with the Asian giant. The EU must also ratify the trade agreement with MERCOSUR – if it does not China will fill the gap.

with the EU. Meanwhile, the measure will only directly affect 9% of global imports and will not solve all carbon leakage problems. For **Luisa Santos**, the CBAM does not solve the underlying problem: that other countries are not doing enough to prevent climate change. In general, the participants advocated multilateral rather than local solutions: the WTO should be a forum for addressing these measures.

Conclusion

The seminar showed that there are three possible future scenarios for the international trading system: cooperation, conflict, or a combination of the two. Cooperation would contribute the most to reduce uncertainty by allowing international economic relations to take place within a framework of shared rules. The worst of the three would be conflict, where the trading system fragments into different blocs around the main trading powers. This could occur if, in the name of resilience, the major powers take unilateral protectionist measures in search of relative advantages (over other countries). Finally, in the third scenario cooperation is achieved in certain areas or between certain countries, but conflict exists in the other areas or between blocs of countries. This would

inevitably lead to trade fragmentation in some sectors. What happens on WTO reform will give a hint of which way we are heading, but it will take time.

Faced with this uncertainty, the speakers at both roundtables agreed that economies must develop resilience and that this is compatible with economic openness. We must avoid falling into protectionism – the easiest way to end up in the conflict scenario. According to the experts present, the best thing for Barcelona would be stronger international cooperation, successful WTO reform, supply chain diversification and streamlining, increased transparency, a commitment to a knowledge economy and understanding its own weaknesses. These are the objectives of EU trade policy. Local administrations can assist by helping develop the local brand, promoting exports, investing in physical and digital infrastructure, attracting foreign investment and training human capital.

Pol Morillas, Director of CIDOB, closed the session by calling for cooperation to be incentivised for both the global and local good.