



EU - Gulf Cooperation Council (GCC) Dialogue on Economic Diversification

EU – GCC Dialogue on Economic Diversification Gulf Cooperation Council (GCC) countries

Project Identification No.

EuropeAid/138630/DH/SER/Multi

Service Contract No. PI/2017/393165

Trade diversification and policies for economic resilience

Briefing on World Trade Organization World Trade Report 2021 Economic resilience and trade

February 2022



This project is funded by
the European Union



A project implemented by
GFA Consulting Group
Centre for European Policy Studies

Your contact persons within
GFA Consulting Group GmbH are

Mr. Lukas Kudlimay (Project Director)
Mr. Douglas Aitkenhead (Team Leader)
Ms. Daniela Stratulativ (Key Expert, Trade and Foreign Direct Investment)

**EU-GCC Dialogue on Economic Diversification
Gulf Cooperation Council (GCC) countries**

Contract Number PI/2017/393165

**Trade Diversification And Policies For Economic Resilience – Briefing On World Trade
Organization World Trade Report 2021 Economic Resilience And Trade**

Author:

Ms. Daniela Stratulativ, Key Expert, Trade and Foreign Direct Investment

Disclaimer

This publication was produced with the financial support of the European Union. Its contents are the sole responsibility of GFA Consulting Group GmbH and Ms. Daniela Stratulativ, and do not necessarily reflect the views of the European Union.

GFA Consulting Group GmbH
Eulenkrogstr. 82
D-22359 Hamburg
Germany Phone: +49 (40) 6 03 06 170
Fax: +49 (40) 6 03 06 159
E-mail: lukas.kudlimay@gfa-group.de



An EU funded project
managed by the Service
for Foreign Policy
Instruments (FPI)

Implemented by



Contents

1	Purpose.....	3
2	What is economic resilience	3
3	The role of trade in economic resilience	4
4	The role of information and communication technologies in economic resilience	7
5	The role of international cooperation in building economic resilience.....	7
6	References.....	10

List of Figures

Figure 1	Economic resilience is a multidimensional process	4
Figure 2	An increasing number of trade-opening measures have been adopted to fight the COVID-19 pandemic	6



An EU funded project
managed by the Service
for Foreign Policy
Instruments (FPI)

Implemented by



1 Purpose

The health and economic crisis caused by the COVID-19 pandemic has highlighted both the vulnerabilities and the strengths of the interconnected global economy, which has at its core the multilateral trading system.

This briefing of the World Trade Organization “World Trade Report 2021 – Economic resilience and trade” presents the WTO concept of economic resilience, discusses how trade plays a pivotal role in developing resilience, and in what ways the global trade system can be improved to allow countries to prepare for, cope with and recover from crises.

2 What is economic resilience

The WTO World Trade Report 2021 defines “economic resilience” as the ability of a system, including households, firms, and governments, to prevent and prepare for, cope with and recover from shocks. Accordingly, economic resilience can be viewed as a process by which different actions and strategies can be deployed to prevent, reduce and manage as much as possible the risk of shocks, minimize the economic cost of such shocks, and accelerate recovery and adaptation to prevent future risks and shocks. Although economic resilience focuses on the economic cost, sustainable economic resilience cannot be achieved without environmental and social resilience.

Building economic resilience capacity requires an understanding of economic challenges and opportunities, as well as the ability to anticipate, evaluate and manage risks. While economic resilience is determined by the level of predictive risk reduction and prevention implemented, preparedness for risks that can never be fully eliminated is also critical.

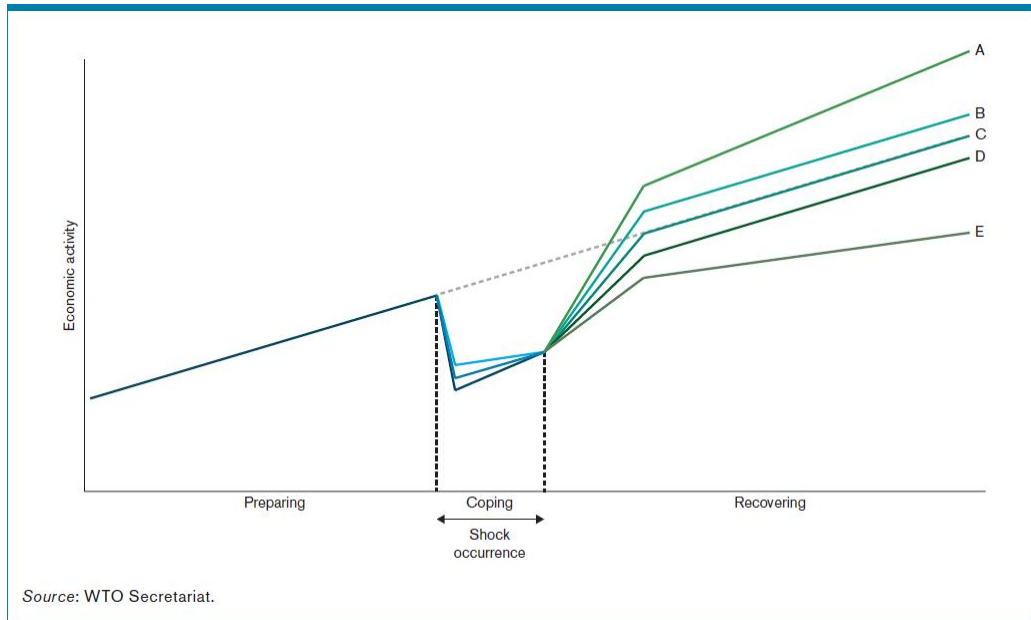
When a shock strikes, economic resilience operates on two interrelated temporal dimensions:

- **Static economic resilience**, sometimes called robustness, refers to the ability of the system to use available, possibly scarce, resources to continue functioning when shocked.
- **Dynamic economic resilience** refers to the ability of the system, once the shock is over or under control, to hasten the speed of recovery by efficiently allocating and using possibly scarce resources to enhance productive capacity and investment for the repair, reconstruction and support of parts of the economy affected by the shock, including by adapting to changes.

The three stages of the economic resilience process are illustrated in Figure 1.



Figure 1 Economic resilience is a multidimensional process



3 The role of trade in economic resilience

The COVID-19 pandemic highlights a paradox: globalization has created a world that is both more vulnerable and more resilient to crises. On the one hand, economic integration makes us more dependent on far-flung trade networks and more exposed to cascading risks and shocks. On the other hand, economic integration also allows us to diversify suppliers, pool resources, and share information and expertise. The same features that make the global economy susceptible to crises – openness, interdependence, networked technologies – also make it adaptable, innovative, and better able to withstand crises when they hit. Strengthening trade, by making it more diversified, inclusive and cooperative, is also central to making the global economy more resilient to current and future crises, from pandemics to climate change.

Although trade can be a spreader and magnifier of shocks, it can also enable countries to prepare for shocks, cope better with shocks and recover quicker after shocks have occurred. Therefore, the diversification of production and trade helps trade to play a beneficial role.

Trade can be a spreader of shocks:

1. if the conditions under which goods and services are traded are subject to shocks. Volatility in transport costs and variability of trade policies can make trade a source of instability. This implies that a multilateral trading system guaranteeing stable trade policies is of paramount importance for trade to be conducive to economic resilience,
2. pandemics may spread through trade in live animals, and through travel and tourism. Indirectly, trade has an impact on natural disaster shocks through its role in climate change. Although trade contributes to emissions through increased production and transportation, it also fosters the spread



of green technologies. This could be further complemented by domestic climate change policies such as carbon-pricing schemes and incentives for low-carbon technologies and projects.

Trade can be a shock absorber and can enable countries to prepare better for, cope with and recover from shocks in various ways:

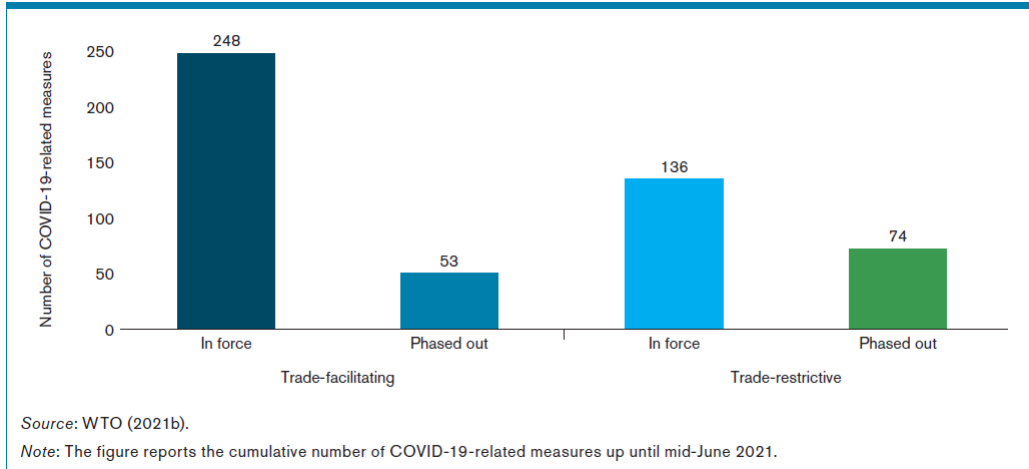
1. **Services trade** can be a source of economic growth and thus increase the available technical, institutional, and financial means to prepare for disruptions. Furthermore, services trade plays a vital role in the availability of crucial services during disasters, such as weather forecast services, insurance, telecommunications, logistics and health services.
2. Trade is also important for **efficient government procurement** during crises.
3. **Trade facilitation policies** are crucial to ensure smooth imports of essential goods and services during a crisis.
4. Trade enables countries to **adjust better to natural disaster shocks** that are the result of climate change. A general principle is that trade makes it easier for countries to adjust to shocks, by enabling them to switch the sources of supply in case of domestic shortages or to change the market where goods are sold in case of a fallout of domestic demand.
5. **Trade policy measures** such as suspension of import-related taxes and government procurement can also facilitate the coping process during shocks.
6. Trade plays a critical role in the **provision of essential goods** to cope with crises such as the COVID-19 pandemic. Trade promotes specialization and knowledge spillovers, thus fostering technologies needed to confront shocks. Trade also makes it possible to import essential goods quickly in case of local shocks. With global shocks, it is crucial that trade can flow freely, and that essential goods are distributed in a fair way. While countries have an incentive to impose export restrictions and resort to domestic production, in the long run this makes the production process less efficient.
7. Trade can play a beneficial role in **speeding up economic recovery, by benefiting from sustained foreign demand on the export side and the availability of intermediate inputs on the import side**. Trade seems to have played a beneficial role in hedging countries against the adverse effects of the COVID-19 pandemic. During recovery, countries can implement trade reforms to improve economic outcomes. Various reform policies, such as supply chain due diligence laws, trade facilitation and digitalization, can help countries to build a more resilient trading system as they recover from COVID-19.

Trade diversification makes it more likely that trade will play a beneficial role in promoting economic resilience, as measured by reduced macroeconomic volatility. With a high degree of specialization, trade can magnify the impact of sector-specific shocks, as has been happening in regions dependent on tourism as a result of measures to contain COVID-19. With a diversified economic structure, however, the benefits of trade in coping with shocks will dominate, because trade enables countries to import goods in case of domestic shortages or export goods in case of a fallout in domestic demand.



Achieving diversification can be challenging, given the economies of scale in some traded sectors and the large, fixed costs (for example, in obtaining information) involved in entering markets and establishing trade relationships with foreign firms. Moreover, in knowledge-intensive sectors, the fear of expropriation of intellectual property or imitation can prevent companies with intangible assets from engaging with a wide range of suppliers. Indeed, aggregate data show only a small increase in diversification in recent decades, while the extremely limited data at the firm level indicate high levels of trade concentration.

Figure 2 An increasing number of trade-opening measures have been adopted to fight the COVID-19 pandemic



Policies that can be implemented to promote economic diversification:

- an appropriate incentive framework (predictable business regulation, appropriate trade policies, and policies fostering competition)
- reduction in trade costs
- policies targeting market, policy, and institutional failures
- policies supporting adjustment, such as skills-development policies and policies reducing gender inequality

Trade and the resilience of Global Value Chains (GVC)

Trade through international value chains can both be a shock absorber and a shock propagator, depending critically on the structure of the value chain. Trade can be a shock propagator in complementary GVC but can act as a shock absorber with diversified sources of supply. The presence of choke points – sectors crucial for the functioning of value chains – can make production more vulnerable to sudden increases in trade costs or other disruptions. Policies fostering supplier, customer, and trade route diversification can help make value chains more resilient. Other policies to enhance GVC resilience are diversification of sources of supply, raising inventory stocks, and fostering flexible production across sites.



Trade diversification and vulnerable groups: Micro, Small and Medium-Size Enterprises (MSMEs), women-owned and women-led businesses

A lack of diversification and a predictable trade policy can impact more vulnerable groups, particularly women and MSMEs, especially hard. However, the lack of the required detail in trade statistics and substantial levels of informality make these impacts challenging to assess. Nevertheless, these groups may depend heavily on international trade, due to their reliance on large firms for inputs or demand. These groups are also often involved in informal, cross-border trade, so they are particularly affected by the closure of land borders.

4 The role of information and communication technologies in economic resilience

COVID-19-induced economic crisis created opportunities for alternative and innovative solutions based on digital technologies to cope and recover from the pandemic.

The increased adoption of teleworking and wider use of e-commerce, including in digital healthcare services, have allowed firms to sustain production and consumption. As a result, online business-to-consumer and business-to-business activities have been growing, including in low-income countries, since the beginning of the pandemic.

Digital technologies offer a large number of opportunities to recover faster and in a more inclusive way from the pandemic. They can also facilitate risk prevention and preparedness for future shocks. Yet, there remain shortcomings in the current paradigm of digital infrastructures that prevent an inclusive recovery and enhanced preparedness from fully materializing. The digital divide is still significant, with only slightly over 51 percent of the world population having access to the internet in 2019, according to the International Telecommunication Union. Many MSMEs, particularly those in developing economies, continue to face important obstacles to adopt, access and use ICT tools. Similarly, although women's digital inclusion has increased, it remains limited in many developing economies.

Although significant barriers to physical infrastructure and human capital development still exist, digital trade can be an important vector for the economic recovery of all segments of the global economy, including MSMEs and disadvantaged groups, by providing new market opportunities.

Reducing the digital divide and improving the quality and access of ICT infrastructure, equipment and services are therefore key to building and supporting economic resilience.

5 The role of international cooperation in building economic resilience

Governments adopt different strategies, some of which involve trade policies, to prepare for future disruptions and enhance their economic resilience capacity. They also respond to shocks and stimulate recovery with various trade and non-trade policy measures.

Although the term “resilience” does not appear in the WTO agreements, the **WTO framework supports the conditions underpinning economic resilience** by reducing trade barriers, streamlining customs



An EU funded project
managed by the Service
for Foreign Policy
Instruments (FPI)

Implemented by



procedures, encouraging transparency, building trade capacity in poorer countries, and collaborating with other international organizations to strengthen the global economy and make it more secure.

How international cooperation can help building economic resilience:

1. **Before disruptions and shocks strike, governments can benefit from cooperating on risk prevention, reduction, and preparedness.** Shocks that originate in one country may propagate to others through trade or other vectors of transmission. Risk reduction measures and resilience policies in one country will have positive spillovers in other countries, independently of whether the shocks are local, regional or global. In the presence of such spillovers, countries acting non-cooperatively may adopt less risk prevention, reduction and preparedness policies than would be optimal from a global perspective. International cooperation can help them move closer to the optimum level of risk reduction.
2. **International cooperation can leverage synergies to promote economic resilience.** International cooperation on economic resilience can play an important role in preparing for, coping with and recovering from shocks. It can amplify the positive cross-border spillovers effects of individual policy actions taken to promote economic resilience. It can also mitigate possible negative cross-border spillovers from individual policy actions. Trade-restrictive domestic measures adopted in anticipation or response to shocks are often characterized by negative cross-border spillovers, such as those associated with export restrictions, which can undermine economic resilience. Global policy coordination can, therefore, be an important means to prevent trade policies from becoming a source of shocks and to mitigate the risks from trade policy uncertainty.
3. **Open and predictable international markets are key to supporting economic resilience** by enabling import and export diversification. Although governments can open up to trade unilaterally, international trade cooperation can help to achieve a higher level of openness and predictability and can limit the use of protectionist trade policies in response to crises. International cooperation at the multilateral or regional level can help governments to open their markets to services that play a key role in handling shocks, such as weather forecasting, insurance, telecommunications, transportation, logistics and health services.
4. **International cooperation can also play an important role in increasing the resilience of global value chains and securing the supply of essential goods and services,** including COVID-19 vaccines, at reasonable cost. Besides discouraging reshoring policies, international cooperation can help promote transparency, in particular on production capacities; to identify and avoid bottlenecks; to facilitate cross-border trade; to enhance mutual recognition of standards; and to manage inventories to prevent excessive stockpiling.
5. **International cooperation can usefully complement national diversification or stockpiling policies.** International cooperation at the WTO contributes to supporting economic resilience. Although the term “resilience” does not appear in the WTO agreements, the existing WTO framework supports the conditions underpinning economic resilience by contributing to more open and predictable international markets, through more transparent and predictable trade policies. The WTO obligation to publish relevant laws and regulations, the Trade Policy Review Mechanism or the trade policy monitoring reports significantly enhance multilateral transparency. The WTO



Trade Facilitation Agreement helps to smooth customs procedures for the importation of critical goods in times of crisis.

6. **Cooperation through mutual recognition agreements on Technical Barriers to Trade (TBTs) and the Sanitary and Phyto-Sanitary Standards (SPS) on essential products enhances predictability and contributes to ensuring supplies** of essential goods in times of crisis. Initiatives such as Aid for Trade, the EIF and the STDF support more diversified import and export structures in developing countries. Collaboration between the WTO and other international and regional organizations contributes to greater policy coherence regarding economic resilience.
7. **In a number of areas, the WTO could help members further enhance economic resilience through improved access to, and coordination of, relevant trade policy information.** All WTO agreements provide, one way or the other, for the transparency of trade policy measures (mainly through publication and notification) and, during the COVID-19 crisis, the rate of notification and the speed at which governments notified to the WTO policies with potentially significant trade impact – such as import facilitation measures or export restrictions – were quite high. Given the negative spillovers that can be generated by export restrictions during crises such as the COVID-19 pandemic, international cooperation is needed to discipline or discourage the use of such export restrictions and to find alternative approaches, in order to increase the supply of essential goods.
8. **Tariff reductions or elimination can reduce the cost of essential goods.** Trade facilitation reforms can help smooth customs procedures for the importation of critical goods in times of crisis. Negotiations on the domestic regulation of services could assist in overcoming the scarcity of essential services in some countries, particularly in the health or telecommunications sectors.
9. **Greater cooperation to improve the predictability and transparency of measures affecting cross-border mobility** is also essential to limit barriers to the provision of cross-border services and the delivery of essential goods.
10. **Global rules on electronic commerce** could further facilitate the delivery of services and goods. Promoting access to government procurement and the international coordination of domestic procurement policies could allow more effective use of public resources, particularly in the procurement of medical products, including vaccines. New initiatives in relation to intellectual property (IP) and investment could also promote access to relevant technologies in middle and low-income countries.

Although trade and trade policy can play an important role in building and supporting economic resilience, they cannot overcome other obstacles that may prevent economic resilience from fully materializing.

Given the broad spectrum of risks and shocks and the cross-cutting nature of economic resilience, strengthening the cooperation between the WTO and international and regional organizations specializing in aspects that are key for economic resilience, such as risk prevention, disaster relief, public health, climate change, environmental protection and financial stability, is key to promoting coordination and coherence in the various efforts to build and support economic resilience.



6 References

World Trade Organization. 2021. *World Trade Report 2021: Economic resilience and trade*. Geneva, Switzerland.

Report available at: https://www.wto.org/english/res_e/reser_e/wtr_e.htm



An EU funded project
managed by the Service
for Foreign Policy
Instruments (FPI)

Implemented by

