Highlights 2. The impact of the pandemic on foreign trade and foreign direct investment in the world in 2020

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The coronavirus pandemic has triggered a series of reactions such as the introduction of epidemiological measures and changes in consumer and producer behavior, which have negatively affected the economies of all countries of the world. Strong fiscal and monetary stimulus mitigated these effects in terms of both intensity and duration, but the net effects of the pandemic remained negative. In this Highlight, we analyze how the coronavirus pandemic and the epidemiological measures initiated by it during the previous year affected international trade in goods and services, as well as foreign direct investment in the world. After that, conditional estimates are given on how long it will take for foreign trade and foreign direct investments to return to the pre-crisis level from 2019, after the pandemic is suppressed.

1. The impact of the pandemic on international trade

Based on data for the first three quarters, it is estimated that international trade in goods worldwide fell by about 7% in 2020, which is almost twice less than during the great economic crisis in 2009, when it fell by 13%. Similar to 2009, the decline in the value of world trade in 2020 is significantly higher than the decline in GDP, which is a consequence of the high income elasticity of demand for imported products.[2] The decline in international trade in goods, in addition to the decline in economic activity, was also influenced by epidemiological measures that made it difficult or even impossible for people to move between countries.

The slight decline in international commodity trade began as early as the first quarter of 2020, when strong epidemiological restrictions were introduced in some countries. During the second quarter, most countries introduced strong epidemiological restrictions which banned certain activities and restricted the movement of people, as a result of which world merchandise exports[3] fell by -16.4% compared to the same period last year. In the third quarter, the value of trade in goods in the world increased significantly, so that exports of goods decreased by only -3.7% compared to the same period last year, while compared to the previous quarter they increased by 15.7%. The recovery of world exports in the third quarter is partly due to the mitigation of epidemiological measures in the world[4], while partly due to the adjustment of the economy to business in a pandemic.

Foreign trade in goods recovered very quickly in 2020, unlike in 2009, when the year-on-year decline in world exports was between -13.6% and -18.5% during the first three quarters of that year, while the year-on-year decline lasted as long as five quarters. The longer decline in international trade during 2009 is a consequence of the nature of the crisis at the time, which was caused by the internal weaknesses of the economy, which took several years to resolve. The current crisis was caused by a pandemic and epidemiological constraints, not internal problems, so the recovery of the economy in the second half of 2020 was relatively fast, and it started immediately after the easing of epidemiological constraints. It is estimated that it will take one to two years for the return of world trade to pre-crisis levels after the pandemic has subsided. However, if the pandemic and epidemiological restrictions persist, there is a growing risk that problems will accumulate in some countries' economies, such as unsustainable growth in public and private debt, rising corporate and bank bankruptcies, and rising unemployment, which could lead to a new crisis or slow down the recovery of the economy and thus international trade.

The movement of the value of international trade during the pandemic period varies significantly by product groups[5]. The value of international trade in clothing and basic foodstuffs has risen, while other foodstuffs and chemical products have seen a small decline in trade. Trade in basic metals, communication equipment, furniture, etc. decreased on average, while trade in cars and other transport equipment, and oil and its derivatives had a strong decline. Similar to production, it is observed that the decline in international trade is greatest in the case of non-existent products, such as durable consumer goods and capital goods, while the decline in trade in existential products is smaller or even absent.

As a result of changes in supply and demand[6], during the previous year large changes happened in the dollar prices of products traded on the world market. The prices of energy, and above all oil and oil derivatives have dropped significantly, while the prices of food and basic

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2 Hooper P. At all. (2000)

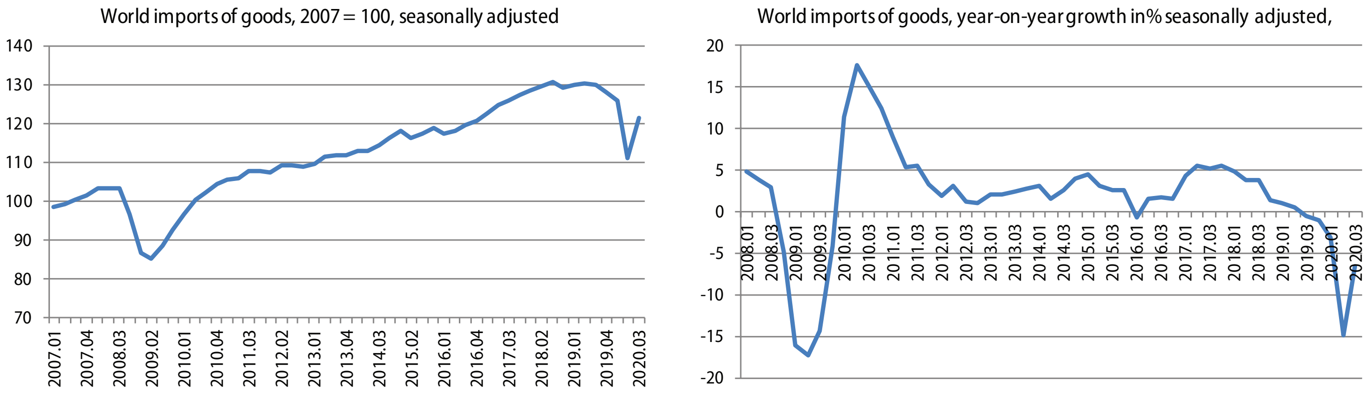
3 The decline in world imports in the second quarter was 14.9%.

4 The unweighted average of the severity of epidemiological measures at the global level in the third quarter eased by about 20% compared to the second quarter, according to the Oxford stringency index.

5 UNCTAD (2021)

6 The rise in the price of food products is predominantly a consequence of the fall in supply, which occurred due to the fall in yields during 2020 in a number of countries, large producers and exporters of agricultural products.

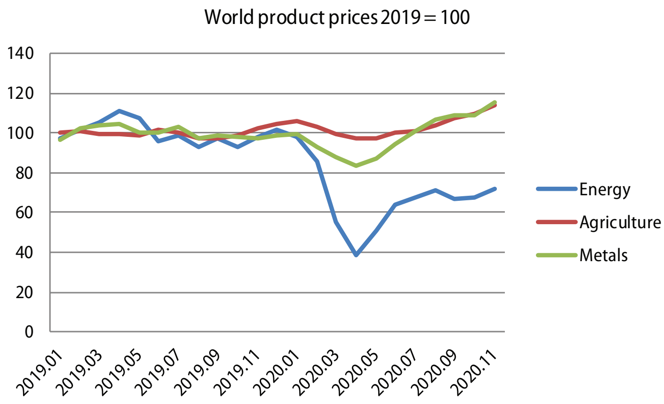
Graph 1. World imports of goods



Calculated based on WTO data

metals have risen. Changes in world prices have affected the results of individual countries in terms of foreign trade balance and GDP. Changes in relative prices have contributed to improving the foreign trade balance and mitigating the decline in GDP in countries that import oil and export food products and base metals, such as Serbia, while they have negatively affected the GDP of countries that export oil and import food and base metals. The movement of product prices on the world market shows strong cyclical oscillations, so it is expected that energy prices will return to pre-crisis levels along with the recovery of the world economy, while food prices will fluctuate in accordance with weather conditions in major food producer countries and exporters.

Graph 2. World product prices, 2019-2020



Source: World Bank (2021)

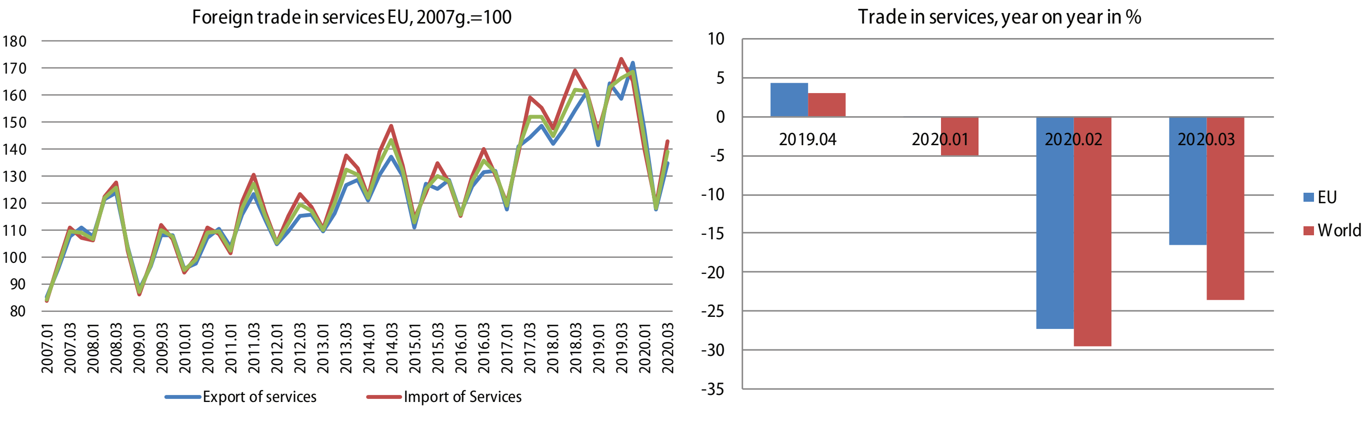
The value of international trade in services fell significantly more during the pandemic than the value of trade in goods. In the first three quarters of 2020 the value of trade in services at the global level was lower compared to the same period last year by 19.3%, while the decline in the value of international trade in services of EU member states was 14.6%[7]. The decline in the value of trade in services of EU countries during the previous year is significantly higher than it was during the crisis in 2009 when the value of trade fell by 11.8%, which was a smaller decline than the decline in trade in goods. The much larger decline in the value of international trade in services during the COVID-19 pandemic is a consequence of epidemiological measures, which restrict the movement of people between countries. Therefore, international tourism services had the largest decline in the world, whose value fell in the first three quarters of 2020 by as much as 57.6%. In the same period, international transport services had a high decline (20.3%), while the value of services related to goods decreased significantly less (13%)[8].

For now, pessimistic forecasts prevail regarding the time it will take for the value of international trade in services to return to pre-crisis levels. Pessimism is especially present regarding the assessment of the recovery of tourism services, where forecasts prevail that it will take 3-4 years to return to the pre-crisis level, after the pandemic has been suppressed. Although there are factors that may affect the slowdown in the recovery of international tourism services it is estimated that the factors that will influence the recovery of tourism services in the period of two years after the end of the pandemic will dominate. On the demand side, after the pandemic is suppressed, demand for international tourism services will increase significantly to "compensate" for delayed travel during the pandemic, while the growth of citizens' savings during the pandemic will be an important source of financing these travels. On the supply side, favorable conditions are expected in terms of tourism facilities and prices with which tourism companies will try to attract as many tourists as possible, in order to compensate for the losses from the pandemic period. The recovery of tourism services could be slowed by a reduction in business travel, due to the adoption of the practice of

7 Source: WTO database

8 Source: WTO database

Graph 3. International trade in commercial services



Source: WTO database

holding business meetings online or due to a possible new economic crisis that would increase the level of unemployment. When it comes to other international services, such as transport or services related to goods, it is estimated that their recovery will go in line with a general recovery of the economy and international trade in goods.

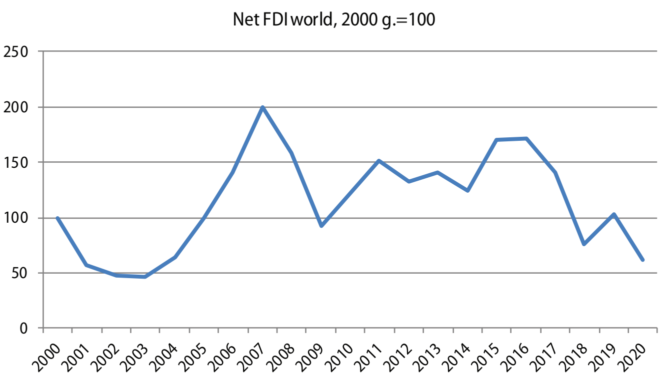
Impact of the pandemic on Foreign direct investment

Foreign direct investment (FDI), similarly to total investment show a strong pro-cyclical trend, with the amplitudes of cyclical oscillations of FDI being significantly higher than for total investment. According to estimates by international organizations FDI worldwide fell by about 40% in 2020 compared to the previous year, which is a similar decline as in 2009, when FDI fell by 42%. During the third quarter of 2020, when the effects of the crisis were fully manifested FDI declined in almost all activities[9]. Unlike commodity trade which was largely recovered during the third quarter of 2020, FDI were just slightly higher in the third quarter than in the previous quarter.[10]

A high drop in FDI of over 50% was realized in utilities, construction, mining, logistics, agriculture and a number of industrial activities, such as the automotive industry, oil refining, machinery and electrical industry and metallurgy. A smaller decline of 30% was realized in only a few activities such as IT, telecommunications, pharmaceutical industry, financial services and real estate.

Based on the experience from previous crises it is estimated that FDI will stagnate in 2021 or even have an additional minor decline, and that it will take several years to reach the pre-crisis level of FDI. The underlying causes of the prolonged decline and then the slow recovery of FDI are similar to those of total investment. The crisis has affected the deterioration of the financial performance of companies and the state, because the debts of companies and the state have increased during the crisis, the percentage of companies operating at a loss has increased, and the number of corporate bankruptcies is expected to grow. In addition, the speed of recovery in demand for some products is uncertain, which affects the postponement of previously planned investments. An additional reason for the larger decline in FDI during the crisis, as well as the slower recovery after the crisis, is the existence of a company's bias towards investing in the home country. Despite the significant increase in international capital mobility, there is a tendency of companies to invest more in their own country than is rational on the basis of economic calculations.[11]

Graph 4. Net FDI world



Source: World Bank Database

One of the important questions is whether the current crisis will change the allocation of FDI in the regions of the world. Over the past few decades, much of the

9 World Bank (2020)
10 World Bank (2020)

11 Feldstein M, Horioka C. (1980) , Lucas R. (1990), Aizenman, J. and other (2007)

FDI of western countries has been directed to China and other far eastern countries. In the past, the main drivers of high investment in China were market size, cheap labor, low taxes, low protection of workers' rights, low environmental standards, etc. However, over the past two decades, labor costs in China have risen significantly, taxes have increased and significantly higher environmental standards have been introduced. The question therefore arises as to whether it is still economically viable for European producers to invest in production in China, especially in the case of products intended for sale in Europe and other parts of the world, or whether it is more profitable to invest in less developed parts of Europe. Less developed parts of Europe, such as the Balkans, now have lower wages than China, transport costs are lower, while China still has advantages in terms of tax burden and market size.

Cost-effectiveness could encourage manufacturers to shift investment to less developed parts of Europe, which have a solid infrastructure and a solidly educated workforce, and are geographically close to the large Western Europe market. The reallocation of investment from China to Europe could also be influenced by geopolitical factors, which are manifested in the growing rivalry between China and Western countries. A favorable circumstance for less developed European countries is that China and other Asian countries have high savings rates, which allows them to increase investments abroad. Investing in less developed European countries where production costs and environmental standards are lower and workers' rights are weaker, and which also have duty-free trade agreements with the EU, is a good opportunity to increase Chinese exports to the EU. Therefore, it is estimated that less developed parts of Europe can increase participation in FDI in the medium term, worldwide, provided that they improve the environment for investment, i.e. to maintain macroeconomic stability, build infrastructure, harmonize education systems with market demands, etc. Serbia, as the largest country in the Western Balkans, the least developed part of Europe, has a chance to attract significant foreign investment in the future.

Conclusion

The economic crisis triggered by the coronavirus pandemic has had a strong negative impact on international economic relations. The strongest negative impact of the crisis during 2020 was in the case of foreign direct investment, followed by trade in services, while the negative impact on trade in goods was the mildest. It is estimated that, after curbing the pandemic it will take one or two years to return international trade to pre-crisis levels, while it will take about two years for services to recover. Foreign direct investment is expected to recover the slowest and will take 3-4 years after curbing the pandemic to reach pre-crisis levels.

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