

Global Trade: Slowdown, Factors, and Policies

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Growth in global trade has been slow since 2012. While global trade downturns are not unprecedented, the observed change in the relationship of trade to GDP poses the question whether the trade slowdown is a transitory deviation or a more long-lasting phenomenon brought about by structural changes. This new dynamic, coupled with the rise of protectionist policies and rhetoric in many countries, positions trade at the forefront of policy discussions. This brief reviews recent patterns in global trade, examines the factors affecting trade—distinguishing between transitory and structural components of the slowdown—and discusses policies shaping the path of future trade, including the rise of protectionism and the relevance of multilateral and bilateral trade agreements.

Recent Patterns in Global Trade

In the aftermath of the global financial crisis of 2008–09, global trade has not grown at the same rate as in previous decades. From 1985 to 2007, world trade grew 6 percent, on average—almost twice as fast as global GDP—while since 2012, it has been hovering around an average of 3.1 percent (figure 1). During the global financial crisis, the growth rate of traded goods and services collapsed around 10 percentage points (IMF 2016a). The slowdown was particularly pronounced in high-income economies. For example, at the peak of the financial crisis, trade growth dropped in Germany, Japan, and Spain by 12 percent, 15 percent, and 20 percent, respectively.

Since the crisis, the slowdown in global trade has been uneven. For example, developing economies largely sustained world trade growth in 2012 and 2013. High-income countries took the lead in 2014–15, while developing economies lagged because of declining commodity prices, depreciation of currencies against the US dollar—accompanied by higher import prices—and macroeconomic rebalancing in China (Constantinescu, Mattoo, and Ruta 2016b). The median growth of exports and imports declined across all regions and among high-, middle- and low-income countries from 2010 to 2016. The worst year for global trade

since the global financial crisis was 2015. In 2016, growth improved, driven by the Europe and Central Asia and East Asia and Pacific regions. Furthermore, developing countries experienced more variability of exports and imports growth than high-income countries. This variability was most pronounced in the Middle East and North Africa and Sub-Saharan Africa.

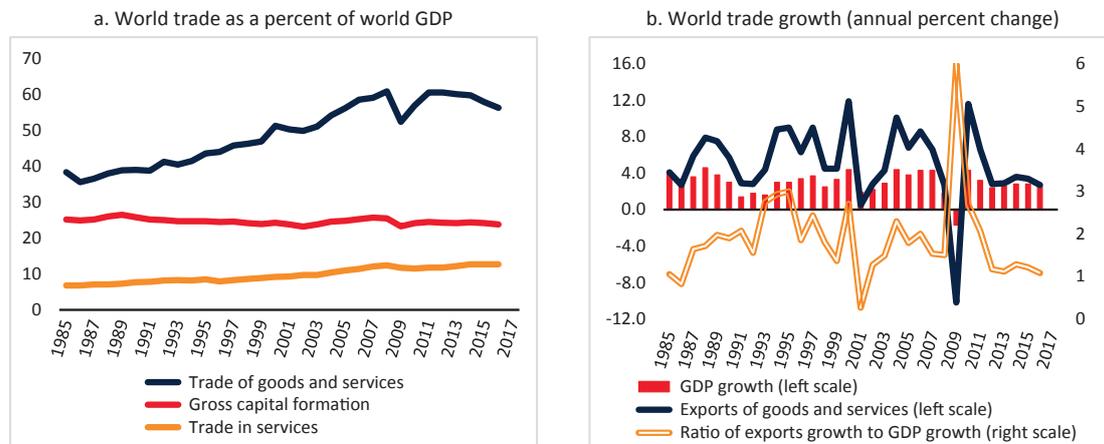
Primary and manufacturing goods were more affected than services. The sharpest decline, however, was in capital and durable goods given their higher sensitivity to income shocks. Boz, Bussière and Marsilli (2015) suggest that the income elasticity for durables is nearly four times higher than for nondurables. Global trade continues to remain lackluster, despite growth due to increased investment in the third quarter of 2016 and improved external and internal demand in the first half of 2017 (IMF 2017).

Factors Affecting the Trade Slowdown

The decline in trade growth since the global financial crisis can be explained largely by two distinct but interconnected factors: transitory and structural. Transitory factors are short-lived changes expected to revert to previous levels in a relatively short period, while structural changes are permanent or long-lasting shifts in the composition or dynamics of

Figure 1. World Trade and World Trade Growth, 1985–2016

World trade as a percentage of world GDP has barely moved since 2010, while world trade growth—measured by exports—was flat from 2011 to 2016.



Source: World Development Indicators and World Bank staff calculations.

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the economy. While both are important, weaker economic activity as fallout of the crisis may explain most of the trade slowdown (Boz, Bussière, and Marsilli 2015, and Aslam, et al. 2017).

Transitory Factors

Trade is highly sensitive to changes in economic activity—particularly in the short term. The decline in income in the aftermath of the global financial crisis led to a reduction in the demand for consumption imports, especially durable goods. Likewise, lower expectations and higher uncertainty about future growth caused a fall in investment, inducing a decline in the demand for imported capital goods (Aslam, et al. 2017). The evidence suggests that the drop of trade growth was sharpest for capital goods, followed by intermediate goods and then consumption goods (Boz, Bussière, and Marsilli 2015, and Aslam, et al. 2017).

In developing economies, declining commodity prices in 2014 and 2015 were a major factor in the slowdown of trade growth (Constantinescu, Mattoo, and Ruta 2016b). In the first place, lower commodity prices reflected a decline in the demand for commodities, especially in China and advanced countries, and their trade around the world. In the second place, lower commodity prices meant lower income in oil and mineral exporting countries, consequently leading to a contraction in their demand for import goods.

Liquidity conditions during and after the financial crisis also played a role in the global trade downturn. Exporting and importing firms are more dependent on external financing than domestic-oriented firms and, therefore, are more vulnerable to financial contractions (Ahn, Amiti, and Weinstein 2011). The credit crunch had an impact on all aspects of trade—exporters' finance to produce and commercialize, transportation costs, wholesale and retail transactions, and importers' consumption and investment credit. The trade effects were larger in more credit constraint countries, for clients of troubled financial institutions, and for sectors more dependent on external financing (Chor and Manova 2012, and Bems, Johnson, and Yi 2013).

The policy uncertainty that prevailed during the global financial crisis and its aftermath also affected trade. The relationship between policy uncertainty and trade is strong, negative, and nonlinear (Gangnes, Ma, and Assche 2015). When uncertainty is low, a marginal increase in uncertainty will have little impact on trade (Taglioni and Zavacka 2013); however, if uncertainty passes a threshold, it can lead to a significant decline in trade. One empirical study, for instance, finds that 75% of the decline in trade growth rates between 2015 and 2016 can be associated with an increase in policy uncertainty during 2016 (Constantinescu, Mattoo, and Ruta 2017).

Structural Factors

Structural factors have also shaped the trade slowdown. Some began to change as early as the 2000s. This is suggested by changes in the elasticity of trade to GDP (defined as the percentage points by which trade changes for a 1 percentage point increase in income). Estimates for this measure of trade elasticity have ranged between 1 and 3.5, where higher values illustrate more responsiveness to GDP. Constantinescu, Mattoo, and Ruta (2016a) find that long-term trade elasticity rose significantly in the 1990s but

started declining in the 2000s, revealing a slower pace of the process of vertical specialization through global supply chains.

The development of global value chains in the last two decades is key to understanding the pattern of trade in an interconnected world (Gangnes and Assche 2016, and Korniyenko, Pinat, and Dew 2017). Historically, trade was merely a transaction between two countries. In contrast, over the past two decades, international trade has involved many countries, each contributing to the production of a finished product. This new pattern initially fostered a sharp jump in trade growth. Lately, however, the maturation and slower pace in growth of global value chains has contributed to the overall trade slowdown.

Having contributed enormously to the expansion of trade in the 1990s and 2000s, China's growth reduction and "rebalancing" in the last few years has also contributed to the trade slowdown. The rebalancing of the Chinese economy has involved several interrelated phenomena, mainly, more consumption and less investment, less imports of capital goods and more production of domestic intermediate goods, and less exports to favor consumption (Constantinescu, Mattoo, and Ruta 2016b, and IMF 2016a, b). These changes are consistent with China's lower overall GDP growth and the economy's maturation towards development.

Finally, it has been suggested that the process of income convergence between developed and developing countries may be a structural determinant behind the long-term evolution of international trade, as reflected in the decline in the trade-GDP elasticity (Escaith and Miroudot 2015). During the 1990s and 2000s, developing economies converged more quickly, given that they had started from a lower income level, but in the 2010s this process is naturally slowing down.

Policies and the Future of Trade

In an integrated world, international trade will be driven by fundamental forces such as demographic changes, technological improvements, energy and natural resource availability, transportation costs, and infrastructure facilities (WTO 2013). It is unclear whether these fundamental forces may imply a renewed trade expansion or a convergence towards a possibly lower steady-state level. There is little doubt, however, that future trade will be more reliant on digital technologies. The ever-evolving information and communication technologies (ICT) are facilitating the inclusion of more firms in the world economy, opening markets to previously isolated workers and enterprises (World Bank 2016). Their success greatly depends on having the right policies and institutions, the "analog" complements to the digital technologies (Dollar and Kidder 2017, and Hallward-Driemeier and Nayyar 2017).

Of special importance are public policies related to international trade. They can support the fundamental forces driving trade and improve their social and economic effect or they can interfere and disrupt the process of international integration. There are three major scenarios to consider, from least to most optimistic. Under the first scenario, global trade growth enters an accelerated decline due to increasing protectionism and conservatism. The

second scenario considers a trade framework where countries engage more in regional or bilateral agreements. A third scenario involves a reinvigorated World Trade Organization (WTO) with enforcement powers to pursue deepening worldwide integration.

Increasing protectionist policies will weaken the global trade structure and diminish growth prospects if they materialize. The IMF (2016a) emphasizes that the protectionist measures that have been implemented, coupled with slower pace of globalization, could have serious repercussions. They could reverse the gains achieved from the mid-1980s to the mid-2000s (Evenett and Fritz 2017) regarding incentives for innovation, productivity growth, and technology diffusion (Akcigit, Ates, and Impullitti 2017).

The WTO (2016) points out that 2,978 restrictive measures were put in place from 2008 to 2016, and 2,238 of those were still standing in 2016. The imposition of new restrictions may have peaked in 2013, but they still grew by more than 15 percent from 2015 to 2016. Most G20 and all G7 countries have increased trade restrictions since the global financial crisis. The United States, India, Russia, and Argentina lead in the number of discriminatory interventions implemented from 2008 to 2017, whereas South Africa, Canada, the Republic of Korea, and Mexico have employed fewer (Evenett and Fritz 2017). According to Global Trade Alert, harmful interventions to trade have exceeded liberalizing measures in trade of both goods and services in each year over the past decade (see figure 2).

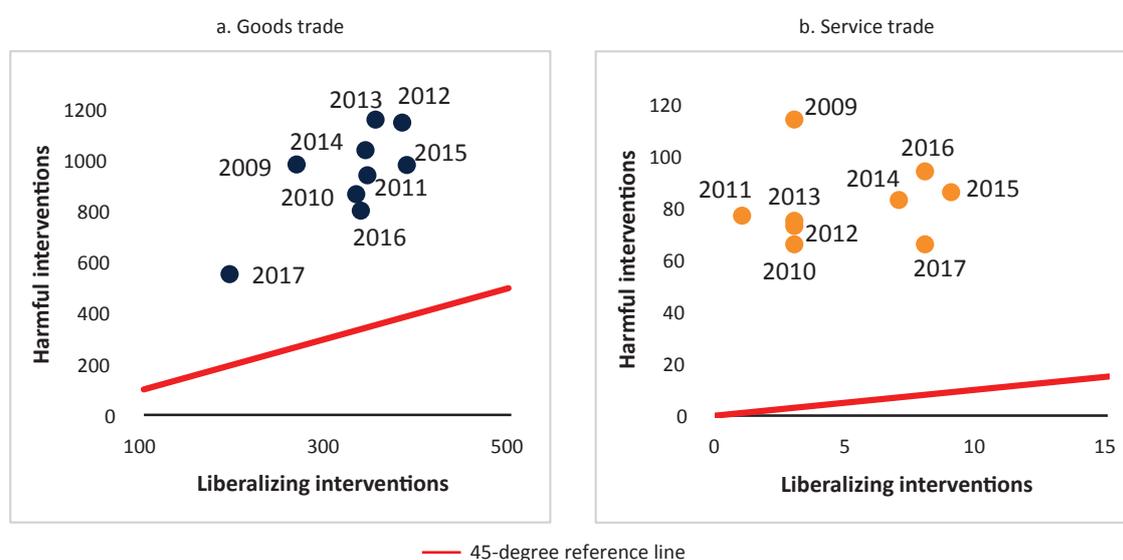
A second possible path for trade policy is the proliferation of new bilateral and multilateral agreements. Countries might look for access to other markets and standardize business operations through alternative bilateral and regional agreements. While bilateral trade agreements are easier to negotiate and go into effect faster, they can generate a series of competing bilateral agreements among other countries. Multilateral trade agreements, on the other hand,

may facilitate trade further by standardizing trade and business regulations and enforcing legal procedures among a larger array of trading partners.

Recent preferential trade agreements are deeper and cover a broader spectrum of measures than tariffs alone. Figure 3 shows that since the 1990s, the number of agreements within regions and intercontinentally increased significantly. Notable examples include MERCOSUR (1991), the ASEAN Free Trade Agreement (1992), NAFTA (1994), and the European Economic Area (1994). Deeper and larger agreements tend to have a bigger impact on trade growth (Baccini, Dür, and Elsig 2015) and may reduce trade costs for nonmember countries, creating a positive spillover effect (Mattoo, Mulabdic, and Ruta 2017). The export gains are higher when emerging markets have trade agreements with advanced markets (Ahmed Hannan 2016). Deep preferential trade agreements are also associated with higher trade related to global value chains (Osnago, Rocha, and Ruta 2016).

A third trade path involves worldwide trade liberalization, harmonization of procedures, and regulation to promote fair trade (OECD/WTO 2017). This would require a renewal of the WTO, making it more dynamic and forward-looking, especially in the face of new technologies, and providing it with greater enforcement power to ensure compliance by member states. How could this be achieved in the current state of international affairs? While it may appear counterintuitive, the threat of protectionism is an opportunity for the WTO to step in and fill in the vacuum with a newfound leadership. Although no country today offers leadership and steadfast commitment to open markets, many countries would cooperate if the WTO were to offer an attractive forum for countries to engage in international trade and a credible institution to enforce international rules and policies, temper tensions, and mitigate eventual trade conflicts.

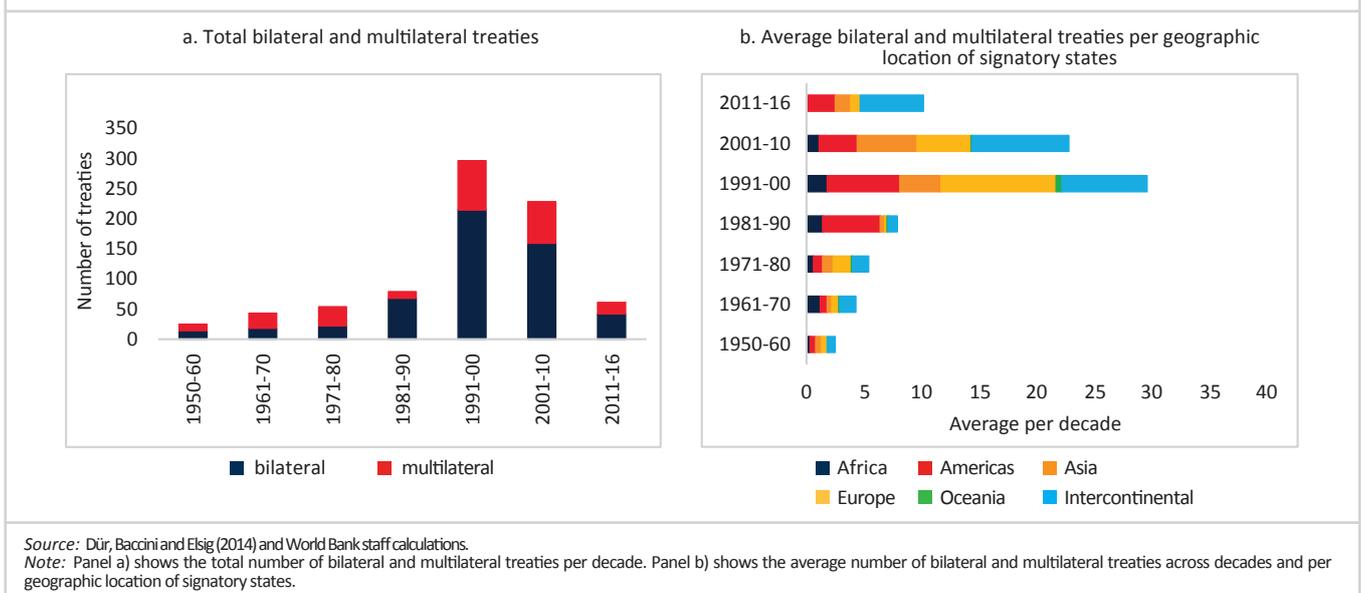
Figure 2. Harmful Interventions to Both Goods and Services Trade Have Exceeded Liberalizing Measures Since 2009



Source: Global Trade Alert and World Bank staff calculations.

Note: Total number of new implemented interventions per year since November 2008. The figure shows all state interventions implemented worldwide affecting commercial trade flows in goods and services (Global Trade Alert 2018).

Figure 3. Bilateral and Multilateral Trade Agreements Soared in the 1990s



Conclusion

The global trade slowdown since the global financial crisis can be explained by both transitory and structural factors. The evidence suggests that most of the slowdown is due to transitory factors related to the crisis fallout—export demand contraction and tighter financial constraints. However, structural factors linked to the maturation of global supply chains and the rebalancing of the Chinese economy imply that global trade may not grow as fast as it did in the two decades before the crisis.

International trade in the future will be affected by demo-

graphic changes, income convergence across countries, and especially the evolving information and communication technologies. One consequence is that trade in services will become increasingly more important. Another is that more people and firms could reach and participate in international markets. The potential beneficial effects of international trade are large, indeed. They are, however, under threat of protectionism. Perhaps paradoxically, this offers an opportunity for regional and global trade agreements, led possibly by a revitalized WTO, to step in and present a pragmatic way to expanding international integration.

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