Decades of trade opportunities at risk

Policy uncertainty and structural changes threaten prospects

by Ben Robinson in London

Mon 4 Sep 2017

After years of low growth, world trade volumes are recovering and expected to increase throughout the third quarter of 2017, according to latest data from the World Trade Organisation. Air freight and container port volumes, good measures of overall demand, have seen year-on-year growth of around 10% and 7%, respectively. Trade in electronic components and agricultural raw materials is expanding after a period of below-trend growth, indicating strengthening activity in downstream industries that use these inputs to create more complex final products.

The increase in the WTO forecast is encouraging, but policy uncertainty and structural changes in the world economy hamper trade prospects. Countries facing problems from the trade slowdown need to adapt by changing their policy focus towards creating supportive domestic environments for developing competitive service industries and attracting foreign direct investment. This includes strengthening intellectual property protection and reforming education and skills training. The international framework for services trade, too, requires unprecedented modernisation to facilitate cross-border flows.

Last year was the first time in 15 years – and only the second time since 1982 – that trade grew below world GDP, at 1.3% against global output of 2.3%. That trade-to-GDP ratio of 0.6:1 is a marked reduction from the more than 2:1 averaged between the 1990s and mid-2000s.

Since the 2008 financial crisis world trade has grown at the same pace as world output. Low trade growth impacts overall demand, economic development, export prices, foreign reserves, government budgets and employment, among other issues.

The 1:1 ratio is partly the result of cyclical factors. These include the slow post-crisis recovery and a large fall in investment spending, which is the most trade-intensive component of import demand.

Another significant cause is structural change resulting from China. It has rapidly increased its productive capacity in everything from steel to semiconductors. Rather than simply assemble components made elsewhere, as in the past, China is drawing more of the value chain into its domestic economy and shifting production further into its interior provinces.

As a result, China is exporting goods with a higher portion of domestic value-added, which is impacting the amount of intermediate goods it imports from elsewhere and then re-exports as part of the production process. The expansion of trade in such intermediates as supply chains developed during the 1990s was a key cause of the earlier trade-GDP expansion.

Politicians are struggling to devise effective measures to deal with these challenges. The current focus on trade protection and economic nationalism in many leading economies fails to address the most important causes for these shifts.

Since the 1970s services have grown to over 70% of global GDP from 53%, and are still rising. In developed economies services contribute up to 85% of GDP. The manufacturing sector, meanwhile, has fallen as a share of global GDP to 16% from around 27%, and is still declining.

Despite these shifts, the amount of services in global trade has remained stable over the last few decades, at between 20%-25%. Manufacturing and goods trade still accounts for around 70% of total trade, despite contributing a declining share of global GDP. The result is a growing disconnect between GDP growth and trade expansion.

Unlike goods trade, services have yet to see a successful large liberalisation agreement at the multilateral level, in part because of the deep behind-the-border issues that services depend on. Moreover, some services are inherently non-tradable or require face-to-face interactions. Others are 'embedded' in manufactured exports and are not captured by traditional trade statistics.

Crucially, many services are delivered directly into other countries by establishing a presence through foreign direct investment, which acts as a substitute for trade in these cases. Over 60% of the global stock of FDI is in services, according to statistics from the United Nations, with the value of foreign affiliate trade in services outweighing the value of cross-border service trade by more than 3:1.

All these factors suggest the global trade-to-GDP ratio is unlikely to reach previous highs, even if global growth starts to accelerate. Leading economies need to refocus on polices to facilitate higher trade growth. If they do not, the world faces decades of lost opportunities.

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