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Prospects for Global Trade

Prepared by the IMF and World Bank

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(The views expressed in this paper do not necessarily represent those of G20 members.)

PROSPECTS FOR GLOBAL TRADE[1]

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Global trade slowed further in 2015 — most prominently in Emerging Asia, where an import contraction appears to be related to a gradual shift in the level and composition of aggregate demand. The trade slowdown affected other emerging regions during the year, and there are now signs that it may be widening further, with the risk of amplifying global weakness through commodity markets and global value chains. To boost global growth, a collective effort is needed to reinvigorate trade integration, so as to capture the large gains available from further liberalization in traditional areas and by lowering barriers to services trade and in other trade policy frontiers. The G-20 is uniquely placed to provide the leadership and guidance needed to build on efforts, such as those at the regional level, and to secure trade and trade-related policy reforms, ideally multilaterally through the WTO.

A. The Slowdown in Global Trade Worsened in 2015

Already-weak trade growth slowed further during 2015, triggered by weaknesses in global investment and in emerging markets. Despite 3 percent estimated global GDP growth in 2015, world import volume growth is estimated to have slowed to 2 percent (Figure 1).[2] This further slowdown prolongs weak trade growth since the global financial crisis. A slowdown and gradual shift in the composition of aggregate demand may be a key factor weighing on trade; such a demand shift may affect trade disproportionately because capital goods and raw materials are highly traded. Emerging market economies (EMs) contributed most to the trade recovery after the global financial crisis (GFC), but EM trade growth turned negative in 2015. Declines in their import growth accelerated late in the year, reducing average EM import growth to -0.8 percent during the year.

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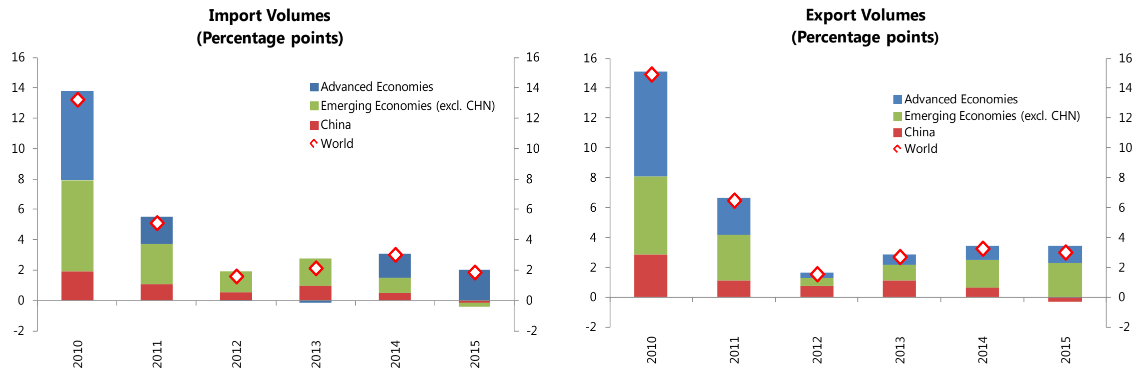
[1] This is an update of a previous note prepared jointly by staffs of the IMF and World Bank in May 2015. It has benefitted from comments from staff of the WTO.

[2] Real GDP growth is taken from the World Economic Outlook database, while import volume growth is based on data from CPB Netherlands Bureau of Policy Analysis.

Figure 1 Contribution to growth in world trade volume, 2010-2015

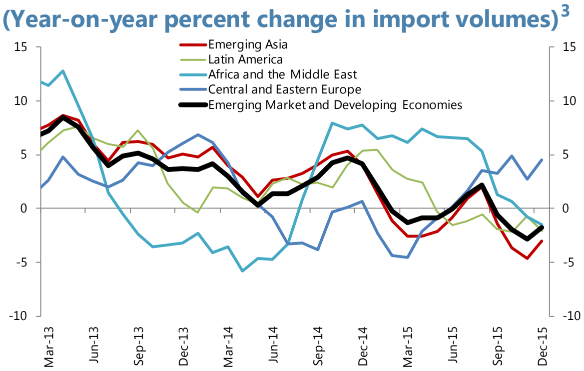


Sources: CPB Netherlands Bureau of Economic Policy Analysis, CEIC China and IMF staff calculations.

The trade weakness in EMs has been prominent in Emerging Asia, including China (Figure 2). Despite positive economic growth, emerging Asian import volumes were on track through November to contract by more than 3 percent for the year, with its exports faring only slightly better. Emerging Asia's trade weakness is of systemic importance since it constitutes 30 percent of world trade and the bulk of emerging markets' trade. The decline in trade volumes has stemmed principally from the incipient rebalancing of domestic demand in China and some sectoral oversupply, with a deceleration of imports linked to investment and a subduing effect on commodity prices. With China in a downstream position in many global value chains, these factors also played a role in transmitting the shock: Chinese export weakness and the gradual process of onshoring (substituting domestic for foreign inputs) has decreased Chinese demand for imported inputs.

Figure 2 EMDC imports, 2013-2015

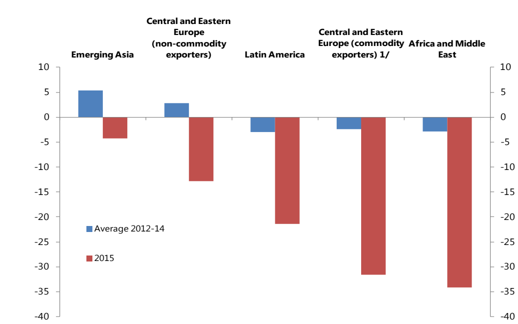
(Year-on-year percent change in import volumes)[3]



Source: CPB Netherlands Bureau of Economic Policy Analysis.

Figure 3 EMDC export growth, 2012-2015

(Annual percent change in export values)



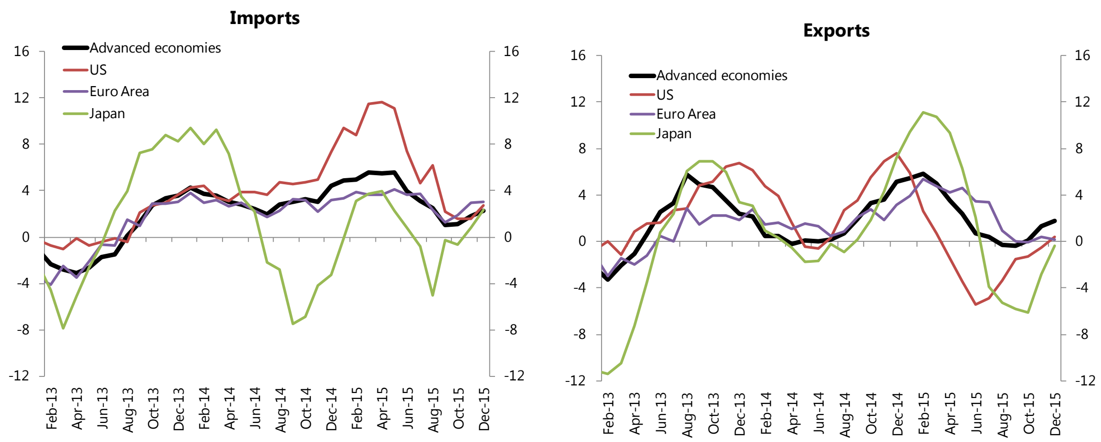
Source: WTO. Data for 2015 are Q1-Q3.
1/ Includes Belarus, Russia, and Ukraine.

[3] Three month moving averages. As an example of the calculation, the December 2015 data point is the percent change in October-December 2015 over the same period in the previous year. This approach avoids seasonal adjustments, which can be unreliable for some major EMs.

Trade of other emerging markets has also been affected, including through lower commodity prices (Figure 3). The fall in export revenues in many EMs outside Asia (importantly, through lower terms of trade) has led to a significant import contraction in these countries. In particular, export values appear to have fallen in 2015 by 20-35 percent in commodity-reliant regions such as Latin America, Eastern Europe, and Africa and the Middle East, with prices accounting for much of this.[4] Falling export receipts implied sharp import adjustments by many commodity exporters that faced more stringent balance of payment conditions. As a result, imports of commodity-exporting economies such as Brazil and Russia have contracted substantially.

Trade growth in advanced market economies (AMs) has not compensated for EM weakness (Figure 4). While relatively resilient during early 2015, AM imports have not countered the weakness in other regions, despite significant windfall gains from the terms of trade shift in some cases. Since Spring 2015 AM imports have shown increasing weakness, with only an uptick in imports of the Euro area in late 2015. U.S. import growth – which had previously led advanced economies – has faded in recent months despite a stronger dollar, and net exports appear to be starting to drag U.S. growth. Flagging global trade may have now begun to affect AM exports.

Figure 4 Trade volumes of advanced economies, 2013-2015
(Annualized percent change)[5]



Source: CPB Netherlands Bureau of Policy Analysis.

[4] On a global basis, world export prices dropped by 14 percent (year-on-year) as of December 2015.

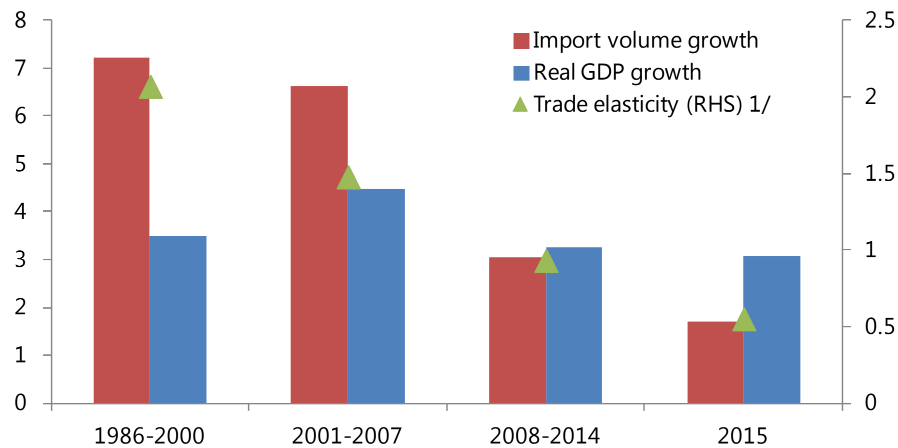
[5] Six month moving averages. For example, the December 2015 data point is the annualized percent change in the seasonally-adjusted July-December 2015 average over the seasonally-adjusted January-June 2015 average.

B. Cyclical and Structural Factors behind the Slowdown

Recent trade developments should be seen in the context of a deceleration in trade growth since the early 2000s, and particularly since the Global Financial Crisis. Figure 5 shows that global trade volume growth was approximately 7 percent a year on average from 1986 to 2000 (sometimes called "the long 1990s"), roughly two times world real GDP growth. The trade elasticity (the ratio of trade growth to GDP growth) fell to 1.5 for the period from 2001 to 2007. From 2008 to 2014, international trade grew at half the rate of 1986-1990 and at the same pace as global output, with the trade elasticity falling to unity.

The trade slowdown has reflected both cyclical and structural factors. Constantinescu, Mattoo and Ruta (2015) estimate the relationship between world trade and GDP over the last four decades and find that the long-term trade elasticity rose significantly in the 1990s, then declined in the 2000s. They decompose the trade slowdown and find that short-term determinants (or cyclical factors, e.g. weak global demand) mainly drove the trade slowdown during the global financial crisis (GFC) and initial recovery.[6] More recently, however, long-term (or structural) factors explain as much as half of the trade slowdown (Figure 6). Trade appears to have grown more slowly not only because global growth is lower, but also because that growth has become less trade-intensive.

Figure 5 Average growth in global trade and GDP, 1986-2015
(Percent change, annual average)



Sources: IMF World Economic Outlook and CPB Netherlands Bureau of Policy Analysis.
1/ Ratio of real import growth to real GDP growth.

Figure 6 Decomposition of world trade growth, 2001-2015

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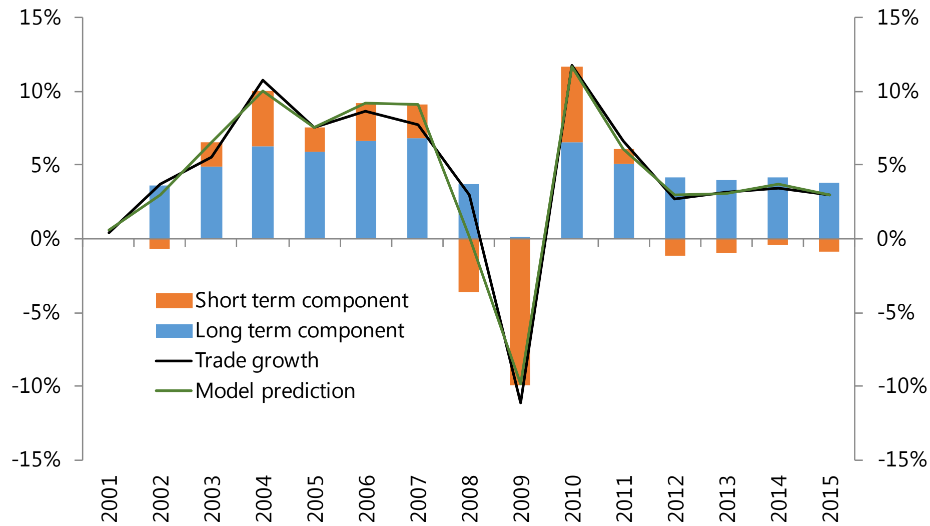
[6] Figure 6 shows the growth rate of global trade, the model estimate of this variable and its decomposition into its short-term and long-term components.



Source: IMF World Economic Outlook and authors' calculations.
Note: Growth rate for 2015 is the projection in the October 2015 WEO Vintage.

Cyclical factors such as weak demand in advanced economies, post-GFC– and currently in emerging markets – have contributed significantly to the global trade slowdown. Historically, the negative effect of a crisis on trade performance has tended to persist beyond the crisis itself (Freund 2009; Abiad, Mishra and Topalova, 2014). Weak import demand recently is symptomatic of overall weakness in aggregate demand. Not surprisingly, trade weakness has been initially most pronounced at the epicenter of the crisis – in advanced economies, notably the United States and the Euro zone. In 2015, lower EM imports were a key driver; China's transition to a new growth path that is less dependent on (import-intensive) investment appears to be playing a large role. Constantinescu, Mattoo and Ruta (2016) estimate that countries more exposed to China, as measured by China's share in their total exports, tended to see a greater contraction in the value of their exports in the first three quarters of 2015 compared with the same period in 2014.

Structural factors also appear to be contributing substantially to the trade slowdown. Key structural factors such as the changing degree of economic convergence, the composition of world income, maturation of many global value chains, and slower pace of trade liberalization may be contributing substantially to the slowdown. Escaith and Miroudot (2015) argue that the faster income convergence across countries observed after 2000 may explain the rapid expansion of world trade, and the slowdown of this convergence after the 2008-2009 crisis is likely to have deprived world trade of this structural driver. Moreover, the changing composition of GDP can explain the lower trade growth after the financial crisis, particularly due to the decline in investment (which is the more trade-intensive component of GDP) (Boz et al. 2014). Both these first two factors are relevant to the post-crisis slowdown, but do not explain the observed lower elasticities after 2000. Constantinescu, Mattoo and Ruta (2015) present evidence that changes in international vertical specialization have contributed to the slowdown in world trade. The long-run trade elasticity increased during the "long 1990s" as production was fragmented internationally through global value chains, leading to a rapid surge in trade in parts and components, and decreased in the 2000s as this process matured. Lastly, the dearth of trade reforms and the gradual buildup of protectionist measures may be structural factors that also help explain the slowdown in global trade growth. In particular, the slower pace of trade liberalization in the 2000s relative to the 1990s may have contributed to the lower trade elasticity.

Past major trade policy reforms have matured and new initiatives have lagged. Developing countries' unilateral reforms in the 1980s and 1990s and the implementation of major initiatives such as EU expansions and the conclusion of NAFTA (1992), the Uruguay Round (1994), and China's WTO accession (2001) greatly improved the global trade policy landscape and promoted the growth of global value chains. But major reform initiatives have since languished; most recently, trade ministers at the December 2015 WTO Ministerial in Nairobi neither agreed to continue the Doha Round nor articulated a new agenda that could attract broad support – leaving the multilateral trade system without a clear WTO negotiating agenda or path forward. Recent progress on mega-regional agreements (including the signing of the Trans-Pacific Partnership) and the conclusion in the WTO of the Trade Facilitation Agreement and the expanded Information Technology Agreement may provide useful elements from which to build a broader agenda.

C. Policy Implications: Reinvigorating Trade and Investment Reforms

Trade flows should be monitored especially closely in the current environment. Signs of potential spillovers through trade channels appear to be emerging, which could amplify current weaknesses and slow global growth further. Policymakers and the IOs should be especially alert in the current juncture to a risk of spillovers through the trade channel, carefully monitoring trade developments.

Setting an ambitious yet achievable trade policy agenda would help to bolster global growth. At a country and global level, trade reforms complement other reforms in goods and services markets – boosting productivity by enhancing efficiency, promoting competition, and encouraging innovation. While trade priorities vary in each country, there are some common threads across country groupings (Box 1). Unilateral and regional approaches can both be effective for the countries involved. Regional agreements can provide opportunities to push the frontiers on certain trade issues, but they need to be open and transparent to reduce the risk of fragmenting the trade system. The WTO should remain at the center of global trade governance, offering the ideal forum to advance reforms on a large scale and providing its well-established legal and institutional foundations to ensure that such reforms are implemented and endure.

A growing stock of new protectionist measures may have begun to weigh on trade flows. Legal commitments, G-20 pledges, a strong global institution in the WTO, and recognition of potential economic damage from trade restrictions have helped to discourage countries from widespread resort to new restrictions, particularly during the global financial crisis.

Nonetheless, there has been a gradual buildup of new measures since 2008. The WTO's semi-annual Report on G-20 Trade Measures for the period through mid-October 2015 indicates that G-20 countries have implemented 1441 new trade restrictions since 2008, and that only a quarter of these (354) have been removed. The 1087 new restrictions in place are a 5 percent increase over the stock six months earlier and affect some $850 billion (6 percent) of G-20 imports. Other assessments indicate even greater cause for concern: Global Trade Alert found that the resort to new trade distortions by G-20 countries increased 40 percent in January-October 2015, compared to a year earlier (Evenett and Fritz, 2015).

Box 1: General Trade Challenges Common to Various Country Groups

While trade policy priorities vary considerably from country-to-country, IMF (2015) highlighted a number of elements that are common among each of the main country income groups.

Advanced economies can address remaining protection in traditional trade areas (e.g., agriculture and textiles), further open services markets (e.g., transport), make their regulatory systems more coherent, and advance other trade policy frontiers. When taken unilaterally or regionally, the preference should be for non-discriminatory approaches that will minimize fragmentation and facilitate raising these initiatives to the multilateral level.

Many *emerging markets*, including in Latin America and South Asia, can still benefit greatly from integrating via traditional liberalization, including on a unilateral basis; they should strive to anchor their economies to global value chains, moving further away from failed import-substitution policies and avoiding protectionism through opaque nontariff measures. In many of these countries, trade reform will complement and reinforce the strengthening of policy and institutional frameworks.

Most *low-income countries*, to promote development and growth, need to prioritize trade facilitation in order to integrate to global value chains, especially by upgrading their hard and soft trade infrastructure and improving economic institutions. They should also address traditional trade barriers and promote competition in those service industries that are critical to local participation in global value chains, such as transport and finance services. Technical assistance can support the development of trade infrastructure, address the fiscal implications of reform, and help to sequence and to coordinate the reform process.

A determined effort is needed to halt and roll back trade restrictions before they start having significant global implications. New trade restrictions do not appear, as yet, to be a main factor in the trade slowdown. Henn and McDonald (2014) found that early post-crisis trade restrictions (up to 2010) had reduced global trade by only about 0.25 percent in total; however, in the specific products affected, the reduction was between 5 and 8 percent. This suggests that the further accumulation of new measures since 2010 may be having a greater aggregate effect that – if unaddressed – will take a growing toll on trade and global growth.

Despite frustration over the Doha Round, several developments may help to point a way forward. Among these are several developments inside the WTO:

- **The WTO Trade Facilitation Agreement (TFA)** was concluded in December 2013 to reduce trade costs by strengthening customs practices, and takes effect when two-thirds of WTO members have completed the domestic ratification processes. Binding on all WTO members, the TFA provides for a variable pace of implementation in developing countries and for expanded technical assistance for implementation.
- **The expanded WTO Information Technology Agreement (ITA)** was agreed in December 2015 to eliminate tariffs on an additional 201 information technology products. The 53 participants undertake a WTO legal obligation to eliminate tariffs on these products when imported from any member country—that is, on an MFN (nondiscriminatory) basis.
- WTO trade ministers agreed in December 2015 to **eliminate remaining agricultural export subsidies**. This step could be recorded in the schedules of the individual countries (and made enforceable through WTO dispute settlement) as part of a broader trade agreement in the future.

Among the recent major developments outside the WTO:

- **The Trans-Pacific Partnership (TPP)** was signed on February 4, 2016 by twelve countries[7] that account for some 40 percent of global GDP – greater than any existing trade agreement outside the WTO. When implemented, it will further expand the nature of obligations that so many countries are now including in trade agreements, particularly with its provisions on environmental matters, investment and capital flows, labor, regulatory coherence, state-owned enterprises, and trade in services. The TPP countries have indicated that the agreement will be open to other countries willing to take on its obligations.

The challenge now becomes to harness such steps to reinvigorate trade integration more broadly, considering the inclusion of new issues in the WTO agenda and adopting more flexible approaches to negotiation. NAFTA's conclusion created a positive example for, and lent urgency to, efforts to conclude the multilateral Uruguay Round and to establish the WTO. Similarly, recent progress on mega-regional agreements could spur a greater collective focus on multilateral negotiations. The path should be grounded in addressing new issues facing the global economy, while preserving a development agenda. The path should also reaffirm the role of the WTO at the center of global trade governance, preserving and

[7] Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, Viet Nam, and the United States.

promoting coherence among preferential and multilateral efforts. More flexible approaches to negotiation within the WTO may be needed to allow different speeds and depths of liberalization; the approaches used to achieve recent WTO successes on the TFA, ITA, and on agricultural export subsidies provide useful experience in this respect.

D. Conclusion

Reinvigorating trade integration will require leadership and a collective effort. There is the potential for large gains from (i) further traditional liberalization in many countries and many sectors, (ii) lowering barriers in new trade policy frontiers (services, regulations, investment), and (iii) further extending and deepening GVCs. At this critical juncture in global trade policy, there is a need to avoid a long inter-regnum without a clear WTO negotiating agenda and to re-establish a direction that is meaningful and achievable.

The G-20 is uniquely placed to provide the leadership and guidance needed to build a path forward. It can help to resume the role of trade as a key driver of global growth and prosperity by working toward a strategic vision for trade negotiations at the global level and through concrete efforts to reduce trade costs, including with respect to low-income developing countries outside the G-20.

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