Trade: Into uncharted waters

By Shawn Donnan

A 30-year trend of trade growing at twice the speed of the global economy has ended

The Tangerine Island, a bulk carrier sailing under the flag of the Marshall Islands, is moored in the Gulf of Panama after passing through the canal a few hours earlier. Off southern England, the 199-metre Turandot, a vehicle carrier, is setting a course for New York after leaving Southampton. In the Strait of Malacca off Sumatra, the Liberian-flagged Amazon River is steaming along at 16 knots.

This snapshot of the thousands of freighters crossing the oceans each day – as tracked this week on the £2.49 "Marine Traffic" app – suggests that the world's seaborne trade is in rude health. But this picture obscures a statistical mystery; one that some see as a warning about the future of globalisation.

Global trade this year is expected, for a second year in a row, to grow at close to or even less than global economic output. This is an anomaly.

For the past three decades, trade has regularly grown at twice the rate of world gross domestic product. Even allowing for the impact of the 2008 global financial crisis and the spectacular double-digit contraction in world trade that followed in 2009, trade in goods and services expanded almost 7 per cent a year on average between 1980 and 2011, according to the World Trade Organisation. Over that same period the global economy expanded at an average annual rate of 3.4 per cent, according to the International Monetary Fund.

Since then, the numbers have been unambiguously sluggish. This year, trade is expected to grow just 2.5 per cent, compared with GDP growth of 2.9 per cent. In 2012, trade expanded only 2 per cent. IMF and WTO forecasts for next year suggest trade growth will be 4.5 per cent against global GDP growth of 3.6 per cent.

This break from a roughly 2:1 historic relationship between trade and growth has sparked a debate among economists about whether we are merely experiencing a blip or a more fundamental structural twist in global commerce.

When GDP and trade growth narrow, it is usually ominous, as economist Gavyn Davies pointed out in a recent FT blog post. “One of the main motors behind the growth of the world economy in recent decades, the expansion of world trade, seems to have entirely lost its mojo,” he wrote.

His comments drew a prompt response from Paul Krugman, the Nobel laureate and New York Times columnist, who took a more sanguine view. Yes, the relationship between trade and GDP was changing as many of the factors that had driven globalisation over the past three decades were "receding in the rear-view mirror", he said. But that was not necessarily cause for angst. “Ever-growing trade relative to GDP isn’t a natural law, it’s just something that happened to result from the policies and technologies of the past few generations,” he wrote.

For trade and GDP growth to run so close is rare enough. But for it to happen in two consecutive years is extremely rare. That has not happened since the early 1980s. Since the industrial revolution, the only extended period in which trade grew less than global GDP was 1913-1950, in what some have dubbed the era of “deglobalisation”.

Many argue that, in our globalised world where multinational companies are dependent on international supply chains, trade can only pick up and head back towards previous norms.

HSBC this month predicted that global trade would grow by an average of 8 per cent up until 2030 thanks in large part to increased infrastructure spending in developing markets such as India. Maersk, the world’s biggest container shipping line by market share,
called the bottom of the global trade cycle when it predicted last month that worldwide demand for containers would grow 4 to 6 per cent in 2014 and 2015.

Regional trade negotiations also lend weight to the argument that trade can regain its former dynamism. Before the end of this year, the US wants to conclude a Pacific Rim deal with Japan and 10 other countries that make up almost a third of global GDP. The EU and US are discussing their own, potentially even bigger pact. Trade ministers from the WTO’s 160 member nations also hope to sign a deal in December to clear red tape at borders around the world, and bring some life back to the long-stalled Doha Round.

Patrick Low, who until August served as the WTO’s chief economist and is now a senior fellow at the Fung Global Institute in Hong Kong, is among those who think much of the lethargy in global trade of the past two years has been caused by the outsize impact of the recession in the eurozone. He also believes that when things return to normal in the global economy, trade will again resume its past trajectory. “You do see this clear pattern” in history, he says.

There are many, however, who suspect that world trade has veered into uncharted territory. George Magnus, senior economic adviser for UBS, sees a broader malaise hitting a world where “structural economic problems loom large” and political leadership “has gone missing”.

There are plenty of signs, he wrote in a recent report, that while globalisation is “big”, it is not too big to fail. The aftermath of the 2008 financial crisis has contributed to financial deglobalisation, he argued. Foreign direct investment around the world has been falling and it is not hard to find signs that foreign investors are becoming increasingly wary of doing business in places such as China.

The world has so far avoided the sort of surge in protectionism that marked the Great Depression in the 1930s, but Mr Magnus is also among those who point to a steady increase in “stealth” protectionist measures since 2008. “If it was just a blip in trade I wouldn’t be quite so worried,” he says. But “there are just so many other data points that something a bit weirder is going on.”

Some of the structural changes in the world economy are evident. Services, the international trade in which is already worth more than $4tn annually, are becoming an ever rising component of trade.

Critically, labour costs have been rising in China as the country moves up the value chain and, potentially, away from what has until now been its competitive advantage – low-skill mass manufacturing. The advent of 3D printing and other innovations are raising the possibility of another revolution in manufacturing. All this steers trade away from the model of low-cost foreign assembly.

Other long-held assumptions about the inevitable march of globalisation are also being tested.

The collapse of imports from the eurozone because of its recession may help explain much of what has happened to global trade in recent years, Mr Magnus and others point out. “But it is only one of many impulses that are spreading weak aggregate demand from the west to China, Asia, commodity producers, and back again,” he says.

China appears, for the time being, to have managed a soft landing for its slowing economy, which it last week reported was growing at an annual rate of 7.8 per cent. But Beijing’s battle to rebalance its economy away from an investment- and export-led model to one more reliant on domestic consumption could still misfire. Moreover, economies in Brazil, India, Indonesia, Mexico and beyond have all slowed over the past year.

The result, Mr Magnus says, is that the “recently fashionable idea” that emerging economies have decoupled from rich export markets in the EU and US and would become a “new, independent source of global economic growth is already out of date”.

Even more broadly, the big drivers of trade growth in recent decades – everything from falling transport costs and the advent of the internet to the end of the cold war and the rise of emerging economies – have all worked their way through the system.

When they pondered the future in their annual World Trade Report in July, the WTO’s economists and statisticians argued that the end of these macro trends meant it was unlikely that the ratio of trade growth to GDP growth would resume a two-times multiple “as the impact of the financial crisis recedes”.

They concluded that many of the big factors that had driven trade growth over the past three decades had been “exploited”, like an exhausted mineral resource. Coleman Nee, a WTO statistician who was one of the report’s authors, argues that these days, were the gap
to return, the multiple would more likely be closer to 1.5 and likely to close further in the years to come.

Against that background, there is the very real political problem of just who makes the case for globalisation nowadays? And whether they can still convince the masses?

In a July paper titled “The Hyperglobalisation of Trade and Its Future”, Arvind Subramanian and Martin Kessler of the Peterson Institute for International Economics, argued that the world faced two significant challenges just to sustain the status quo in globalisation.

The first was to maintain support for it in the US and other advanced economies. Weak medium-term growth prospects, rising fiscal pressures and decades of wage stagnation in those economies were “not the most propitious [conditions] for sustaining globalisation”, they wrote.

The second was ensuring that China – now the world’s biggest trading nation in terms of goods – continued to reform and open its markets to the outside world. The good news, the pair wrote, was that “China’s domestic needs are broadly outsiders’ wants”. But the nation’s reform efforts could still falter, they added, and if that happened “globalisation would suffer”.

The first challenge is destined to remain one for years to come as leaders in Washington and European capitals continue their struggle to bring economies back to life after the financial crisis. A partial answer to the second may come sooner, when China’s leaders gather to consider further economic reforms at their Third Plenum next month.

Still, Mr Magnus remains concerned. “Without strong political patronage, globalisation is quite capable of stalling or going into reverse,” he wrote. And neither the US nor China seem willing or able to provide that, he says.

All of which brings to mind The Wizard of Oz, Mr Magnus says. When he chose a quote to tag his report last week, he used Dorothy’s remark on feeling that she had ventured into an unknown world. When it comes to globalisation: “I have a feeling we’re not in Kansas any more.”

Protectionism: The dog that growled

The global economy may have been thrown off-course by the 2008 crisis but at least it was not made worse by repeating the mistakes of the 1930s and erecting myriad protectionist barriers.

But is that entirely true? Protectionism may widely be seen to be the dog that did not bark, but might it have growled?

Simon Evenett, a trade economist at the University of St Gallen in Switzerland and editor of the Global Trade Alert, says the G20 leading economies have introduced more than 1,500 protectionist measures since they announced a “standstill” in November 2008.

In a September report, the EU said it had counted a more modest total of 688 new measures between October 2008 and the end of May 2013. Still, that amounted to an average of 10 new measures a month, it said, “each of them with the potential to negatively and unnecessarily affect world trade”.

None has come anywhere near to rivalling the Smoot-Hawley Tariff Act of 1930 that raised to record levels the tariffs on thousands of imported goods into the US and, many economists believe, helped deepen and lengthen the recession that followed the 1929 stock market crash.

Prof Evenett believes the current wave of measures is pernicious, nonetheless. Moreover, he believes their introduction is accelerating, particularly in emerging markets and the Bric economies. That, he says, bodes ill for the future.

“You’re talking about a crisis that will take five to 10 years to unwind in its economic impact,” he says, “but a crisis that will take 15 years or more to unwind when it comes to trade.”

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