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Does the global trade slowdown matter?☆

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Abstract

Since the Global Financial Crisis, world trade growth has been subdued and lagging slightly behind GDP growth. Trade is growing more slowly not only because global GDP growth is lower, but also because trade itself has become less responsive to GDP. This article reviews the reasons behind the changing trade−income relationship and then investigates its consequences for economic growth. On the demand side, sluggish world import growth may adversely affect individual countries' economic growth as it limits opportunities for their exports. On the supply side, slower trade may diminish the scope for productivity growth through increasing specialization and diffusion of technologies. We find preliminary evidence that the changing trade−income relationship matters, although the quantifiable effects do not appear to be large.

JEL classification: F14; F61; F62

Keywords: Trade slowdown; Trade-income relationship; GDP growth; Productivity growth

1. Introduction

World trade grew at 3% or less in 2012−15, less than the pre-crisis average of 7% for 1987−2007 and less than the growth of GDP. Proximate explanations of the trade slowdown

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link it to changes in GDP and, hence, to the fallout of the Global Financial Crisis. While weak global demand matters for trade growth as it depresses world import demand, cyclical factors are not the only determinants of the trade slowdown. In previous work (Constantinescu, Mattoo, & Ruta, 2015), we have shown that trade is growing slowly not only because GDP growth is sluggish, but also because the long-run relationship between trade and GDP is changing. The elasticity of world trade to GDP was larger than 2 in the 1990s and declined throughout the 2000s. Among the leading causes of this structural change in the trade−income relationship is a shift in vertical specialization. The long-run trade elasticity increased during the 1990s, as production fragmented internationally into global value chains (GVCs), and decreased in the 2000s as this process decelerated.

Economists disagree regarding the implications of the trade slowdown for economic growth (and welfare). Some believe that the slowing down of global trade has no real consequences for economic growth. For instance, commenting on the global trade slowdown, Paul Krugman noted that “The flattening out is neither good nor bad, it’s just what happens when a particular trend reaches its limits” (Krugman, 2014). Others take the opposite view. For instance, in a speech as governor of the Central Bank of India, Raghuram Rajan concluded that “We are more dependent on the global economy than we think. That it is growing more slowly, and is more inward looking, than in the past means that we have to look to regional and domestic demand for our growth” (Rajan, 2014).

Both views have elements of truth but neither may be completely right. On the one hand, the impact of the trade slowdown should not be overstated. Most economies are more open today than they were in the 1990s. In so far as openness per se is associated with dynamic benefits, trade will continue to foster growth. On the other hand, there is a risk of understating the implications of the trade slowdown. If the expansion of trade growth in the 1990s contributed to countries’ economic growth, one may suspect that the flattening of this trend will imply that the contribution of trade to the growth process will be lower.

This paper is a first attempt to try to investigate the economic consequences of the recent trade slowdown. It focuses on two channels through which the changing trade−income relationship documented in the literature may affect countries’ economic performance. The demand-side Keynesian concern is that sluggish world import growth may adversely affect individual countries’ economic growth as it limits opportunities for their exports. The supply side (Adam) Smithian concern is that slower trade may diminish the scope for productivity growth through increasing specialization and diffusion of technologies. In particular, a slower pace of GVC expansion may imply diminishing scope for productivity growth through a more efficient international division of labor and knowledge spillovers.

Preliminary evidence is mixed. On the demand side, we find that the elasticity of exports to global demand has decreased for both advanced and developing economies in the 2000s relative to the 1990s. We also find that the sensitivity of domestic growth to export growth is higher, and has increased more over time, for developing economies compared to advanced economies. These results, however, hold only when we measure exports in traditional gross terms. When we use value-added exports, which are more relevant for the demand-side mechanism, the change in estimated elasticities is smaller and not statistically significant (although a qualification is that value-added trade data are available for a shorter period and fewer countries).

We try to assess the Smithian concern by focusing on the growth implication of a slowing pace of GVC growth. We do this in two steps. First, we report estimates from our related work (Constantinescu, Mattoo, & Ruta, 2016b) of the impact of vertical specialization on productivity growth. These estimates indicate that increasing backward specialization has a positive impact on