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World Trade: Pirated by the Downturn

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World trade is often measured by the total amount of merchandise exports in the world in a given year.¹ In real (inflation-adjusted) terms, world trade increased faster than world gross domestic product (GDP) in 49 of 58 years from 1951 to 2008 (see chart). For 2009, the World Trade Organization projects a decline in export growth of 9 percent, which would be the largest decline since 1951. This essay examines why 2009 will likely be a record-setting year.

A post-World War II record decline in world trade is likely in 2009.

The first explanation for this decline in world trade involves the current global recession. World trade declined in just five years—1958, 1975, 1981, 1982, and 2001—for the period under consideration. World GDP increased by 1.1 percent, on average, for these five years, which was substantially slower growth than the 3.8 percent average for the entire period. World GDP did not fall in any of the five years with trade declines; in fact, world GDP has *increased every year* from 1951 to 2008. For 2009, however, the International Monetary Fund and the World Bank are forecasting 1.4 and 2.9 percent declines in world GDP, respectively. When GDP declines, the demand for traded goods generally falls as well.²

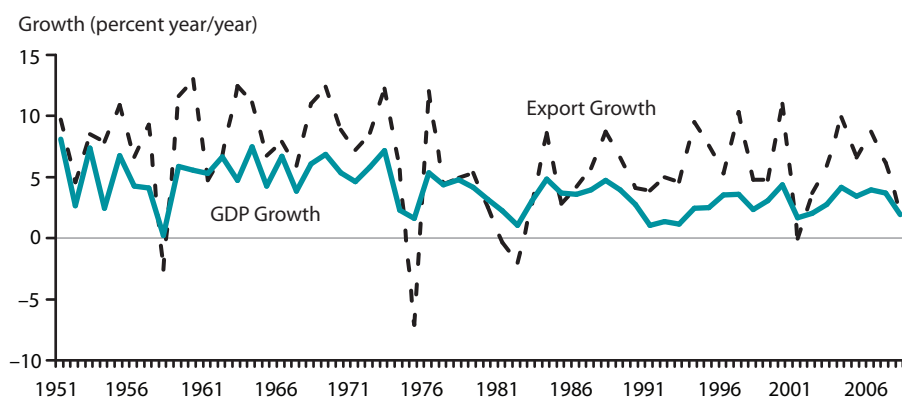
The second factor reducing trade flows follows from the current disruption of financial markets, which has tied up credit for international trade. The financial crisis has adversely affected both the availability of funds and the borrowing terms to finance international trade, which have contributed to declining trade volumes.³

The third factor stems from the increasing importance of global supply chains. The recent increase in global supply chains, also termed “vertical specialization,” causes trade to rise at a faster rate than production because countries tend to specialize more in steps of the production process rather than in the complete production of a final product. With global supply chains, components and partially finished goods cross borders several times before a product is completed—increasing world trade. Thus, declining production will reduce trade even more in the current downturn than in previous downturns.

Governmental actions to favor domestically produced goods at the expense of foreign goods might turn out to be a final factor, although its effect has been minimal thus far. Without question, protectionist pressures increase during downturns. Yielding to these pressures by implementing trade restrictions on foreign products will reduce trade flows and likely prolong the downturn.

A post-World War II record decline in world trade is likely in 2009. Although piracy of a different sort remains an important issue for world trade, the “pirates” in the

World Merchandise Export Growth and GDP Growth, 1951-2008



SOURCE: World Trade Organization (WTO). “International Trade Statistics, 2008,” Table A1a; www.wto.org/english/res_e/statis_e/its2008_e/its08_appendix_e.htm; WTO Press Release. “World Trade 2008, Prospects for 2009.” March 23, 2009, Table 1; www.wto.org/english/news_e/pres09_e/pr554_e.htm#table1.

present case are the global slowdown, trade financing difficulties, and the increasing importance of global supply chains. Protectionism also lurks on the horizon. ■

¹ World exports measure world trade; one country's exports are simply the imports of other countries.

² A similar comment applies to trade in services, which is not examined in the current essay.

³ A recent article in *The Economist* ("The Nuts and Bolts Come Apart," March 28, 2009, pp. 79-81) states that the credit crunch has caused a shortage of \$100 billion in trade finance. Trade finance plays a role in 90 percent of world trade.

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Views expressed do not necessarily reflect official positions of the Federal Reserve System.