FOCUS · A downturn in international trade and global value chains?

We have explored the phenomenon of the slowdown in world trade over the last few years several times in this *Monthly Report*. For instance, we have analysed the poor investment trend in advanced countries, the shift in China's economic growth pattern, the deceleration in the liberalisation of trade and rising protectionism as important factors in the downturn in world trade.[1] This Focus looks at the slowdown in the formation of global value chains (GVCs) as a significant event in the changing pattern of trade.[2]

Between the end of the 1980s and early 2000s, three factors led to the emergence of GVCs. First, falling transport costs, especially by air, as a consequence of technological advances in the sector. Second, extensive liberalisation which resulted, among other things, in much lower customs duties (from above 30% to below 3% for the global average). Last, advances in ICT were also key as they drastically reduced the cost of coordinating the many different production stages carried out in different countries.

This rise in GVCs provided a huge boost for trade flows, which grew much faster than GDP (see the chart). The reason is that goods and services started to cross borders several times during the production process (see the figure).

However, in the last few years the rate growth of new global chains has decelerated (some analysts are even suggesting a reversal) and the effect on the slowdown in world trade is expected to be significant. Several studies attribute between 25% and 50% of the slowdown in trade to this factor.[3] China is a case in point: it is still the world's leading exporter of manufactured goods but the share of imported inputs in its exports has gone from 60% in the mid-90s to 35%. China's exported goods are therefore less integrated in GVCs than they used to be.

Fewer new GVCs are being created primarily for three reasons: trade costs are falling more slowly (because commercial liberalisation has eased, for instance), the formation of GVCs has now reached a mature stage, and the composition of world economic activity has changed.

Regarding the composition effect, the growing importance of services in the world's economic activity is particularly striking. By way of example, in the BRICs services have gone from an average of 40% of GDP in 1990 to 60% today. Services are generally less tradables and those that are traded have a much less fragmented production chain than manufactured goods. Substantial growth rates in these sectors therefore entail slower growth rates in trade flows and the formation of GVCs.

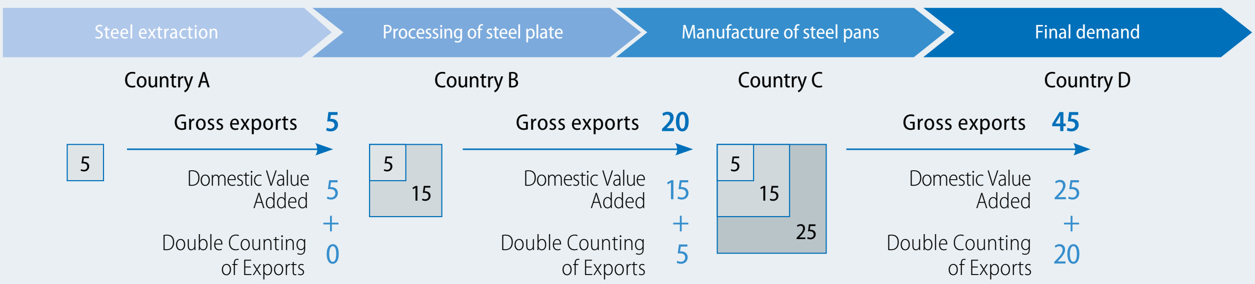
In short, as the growth in GVCs has run out of steam, the recovery in international trade will be limited. Some experts therefore argue that the previous growth rates for trade flows (7%) were exceptional and the current environment is merely a return to «normal».

*World GDP and international trade **

Average annual change (%)

Notes: ** GDP in real terms and at purchasing power parity. Volume of trade in goods and services; the years 2007-2010 are not included due to the effect of the crisis. ** Estimate for 2016. *** Forecasts for 2017-2021.*
Source: *CaixaBank Research, based on IMF data (WEO, October 2016).*

Exports in a global value chain



Source: *CaixaBank Research.*

1. See the Focuses «Slowdown in world trade and investment» and «Global trade slowdown: the role played by protectionism» in MR12/2016 and MR02/2017, respectively.
2. Global value chain refers to the division of the production of a good or service into different production stages located in different countries.
3. See Al-Haschimi, A., Gächter, M., Lodge, D. and Steingress, W. (2016), «The great normalisation of global trade», VoxEU, October; Constantinescu, C., Mattoo, A., Ruta, M., (2017), «Trade Developments in 2016: Policy Uncertainty Weighs on World Trade», Global Trade Watch, World Bank, Washington, D. C., IMF (2016), «Global Trade: What's behind the Slowdown?», WEO, October, chapter 2.