

## ARTICLE – World trade in constant change

The freer world trade seen over the last thirty years has had positive effects on the global economy and has also benefited Sweden. Since the World Trade Organization (WTO) was founded in 1995, average tariff rates have shown a downward trend, which has resulted in increased productivity and higher real incomes in many countries. Decreased protectionist elements have also resulted in changed trade patterns and in increasing numbers of companies participating in complex global value chains. However, since the financial crisis, these protectionist elements have increased, which can partly explain the lower growth in world trade. The ongoing trade conflict between the United States and China is thereby a continuation of a trend towards increased protectionism over the last decade. Recent years' favourable global economic growth has instead been driven by domestic demand, which, in turn, has been supported by a substantially expansionary monetary policy. If protectionist elements dominate in the future, global growth will be restrained and become lower than in the Riksbank's current assessment. Demand for Swedish exports would then also decrease.

### Freer world trade over the last thirty years

Over the last thirty years, world trade has been of growing significance for the global economy. Global exports and imports have grown as a proportion of global GDP, from just below 40 per cent in 1990 to just over 60 per cent in 2018 (see Figure 4:20). The trend towards more multilateral and regional trade agreements have played a major role for this favourable development.

In 1995, when the General Agreement of Tariffs and Trade (GATT) changed into the World Trade Organization (WTO), support for multilateral trade agreements and

reduced trade barriers increased. At about the same time, 1993, the European Union (EU) was set up as a replacement for the European Community (EC), forming the world's largest free trade area. At present, the Union is made up of 28 member states.<sup>25</sup>

Other important free trade agreements in recent years include the agreement between the EU and Canada and the agreement between the EU and Japan. The common characteristic of these two free trade agreements – which, together, give European companies access to a market of over 150 million people – is that they involve the removal of tariffs for most goods.<sup>26</sup> Outside Europe, it is worth mentioning the Trans-Pacific Partnership (TPP) free trade agreement, which was adopted in 2016 and which changed into the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) after the United States withdrew in 2017. Eleven countries in the Pacific region are included in the free trade agreement, which aims to lower tariffs between the countries and also reduce other trade-restrictive measures.

These multilateral and regional trade agreements have led to a decrease in the global average tariff rate, from about 14 per cent in 1990 to an estimated level of just over 5 per cent today (see Figure 4:21). However, in recent years, tariffs have risen due to the increases planned and implemented by the United States and China in 2018–2019. Despite the ongoing trade conflict between the two countries, the average global tariff rate is currently low from a historical perspective.

**Figure 4:20. World trade**

Exports and imports of goods and services as a share of global GDP, per cent

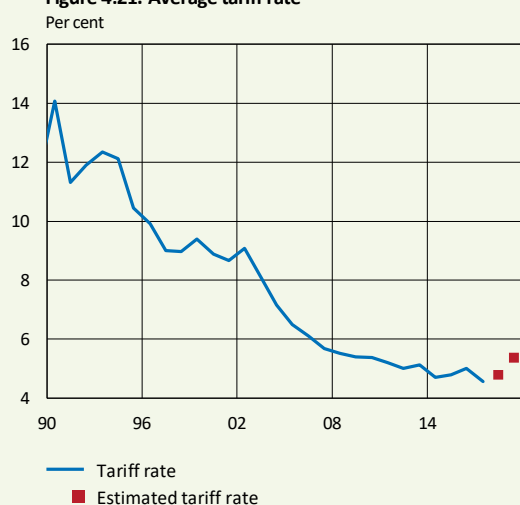


Note. The value for 2018 (dotted line) is based on data from the IMF.

Sources: World Bank, OECD, IMF and the Riksbank

<sup>25</sup> Including the United Kingdom.

<sup>26</sup> In addition, companies gain better access to the countries' markets for public procurement and it will also become easier to trade in services.

**Figure 4:21. Average tariff rate**

Note. Import-weighted average of applied tariff rates. The tariff rate for 2018 and 2019 has been calculated by including implemented and planned tariff increases in the United States and China for 2018–2019. In the calculations, all other tariffs are assumed to be unchanged.

Sources: WITS (UN statistics division), UNCTAD, WTO and the World Bank and the Riksbank

Among economists, there is strong agreement over the positive aggregate effects of free trade, due to increased productivity, higher real incomes and access to a greater supply of products and services.<sup>27</sup> However, even if the long-term effects are generally positive, there are distribution effects among various groups in the shorter term.<sup>28</sup> Some – often low-skilled workers – can be disadvantaged when companies move production abroad or when companies enter bankruptcy due to import competition, with lower incomes or increased unemployment as a result. Less free trade also has distribution effects as people with lower incomes have been able to purchase products more cheaply and have benefited from the greater supply. When there is less free trade, products instead become more expensive and supply decreases. The allocation of the gains and losses of changed trade between different groups becomes an economic policy issue.

<sup>27</sup> See Melitz, M. (2003), “The Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity”, *Econometrica*, vol. 71, no. 6, pp. 1695-1725 and Melitz, M. and Ottaviano, G. (2008), “Market Size, Trade, and Productivity”, *Review of Economic Studies*, vol. 75, pp. 295-316.

<sup>28</sup> See, for example, Goldberg, P.K. and Pavcnik, N. (2007), “Distributional Effects of Globalisation in Developing Countries”, *Journal of Economic Literature*, vol. 45, no. 1, pp. 39-82 and Ebenstein, A., Harrison, A., McMillan, M., and Phillips, S. (2014), “Estimating the Impact of Trade and Offshoring on American Workers Using the Current Population Surveys”, *Review of Economics and Statistics*, vol. 96, no. 3, pp. 581-595.

<sup>29</sup> Value-added is the value of a company’s output minus the value of the input goods used, which is to say the company’s contribution to GDP.

<sup>30</sup> See IMF (2019), “Trade Tensions, Global Value Chains, and Spillovers: Insights for Europe”, Department Paper No. 19/10.

<sup>31</sup> About 70 per cent of Europe’s exports can be related to global value chains. The corresponding figures for America and Asia are 40 and 45 per cent, respectively. See

### Changed trade patterns and the emergence of global value chains

As trade-restrictive measures decreased, transportation costs became lower and communication technology became more advanced, trade patterns also changed. Many companies now participate in global value chains. The significance of global value chains is often measured as the sum of foreign value-added in a country’s gross exports and the export of input goods used for exports to third countries.<sup>29</sup> The same input goods and services thus cross international borders more than once, meaning that, when gross exports are calculated, the number of transactions with the rest of the world is ‘counted double’. International studies point to several positive effects of global value chains, such as higher productivity, increased investments and strengthened human capital.<sup>30</sup>

Global value chains are particularly important for European countries, while they have a less prominent role in the United States, for example (see Figure 4:22).<sup>31</sup>

### Trade in global value chains has levelled off since the financial crisis

Trade in global value chains has levelled off in recent years and may partly explain the relatively weak growth in trade. Several factors have probably contributed to this, for example that trade has become more restricted due to increased protectionist elements or that companies have restructured their value chains due to increased uncertainty.<sup>32</sup> Another explanation may be that technology has developed towards more automated production and digitalisation, which reduces companies’ incentives to outsource parts of their operations to countries with lower labour costs. Instead, it is possible for the production of input goods to take place in the companies’ home markets to a greater extent. Working tasks and production are therefore returned to the country of origin. This means that the extent and length of global value chains is decreasing, and so, therefore, is also participation in value chains measured as a proportion of exports.<sup>33</sup>

IMF (2019), “Trade Tensions, Global Value Chains, and Spillovers: Insights for Europe”, Department Paper No. 19/10. It is uncertain exactly how much trade lies in global value chains, and different sources give different figures. However, what the sources have in common is that comparisons of countries tend to give the same qualitative image.

<sup>32</sup> ECB (2016) “Understanding the Weakness in Global Trade – What Is the New Normal?”, ECB Occasional paper series, no. 178, and IMF (2017), “Global Trade: What’s Behind the Slowdown?”, chapter 2 of World Economic Outlook provide a number of explanations for why trade in value chains may have declined after the crisis. One of these is that logistics chains have become shorter due to increased uncertainty and a need for control by companies. Other factors are connected with the localisation of production close to end markets, partly due to increased regulation and demand for local content.

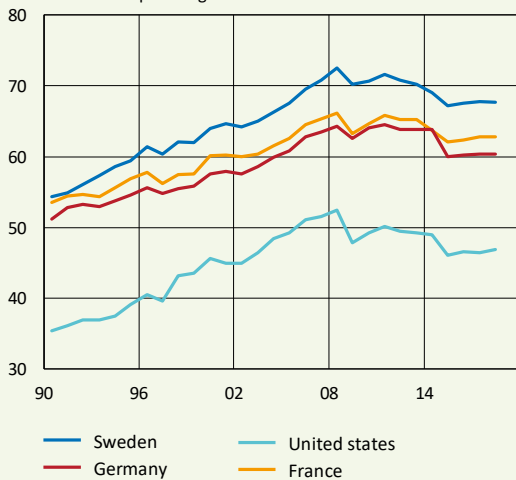
<sup>33</sup> See IMF (2019), “Trade Tensions, Global Value Chains, and Spillovers: Insights for Europe”, Department Paper No. 19/10.

**The service sector is a part of global value chains**

In several countries, the service sector has become increasingly important for total output, above all in developed economies. These days, the service sector is also included in global value chains and a majority of jobs within the export sector can be linked to the service sector. Sectors such as transportation, telecommunications and distribution, for example, support the manufacturing sector with various types of service.<sup>34</sup>

In most OECD countries, but also in emerging market economies such as China, India and Indonesia, the export sector has also shifted from low-skill working tasks towards more medium and highly-qualified working tasks. Global

**Figure 4:22. Proportion of exports linked to global value chains**  
Per cent of exports of goods and services



Note. Global value chains are measured as the sum of foreign value-added in the country's exports and the export of input goods used for exports to third countries.

Source: UNCTAD-Eora GVC Database - Eora MRIO

value chains also mean that employment in these countries has shifted from the manufacturing sector alone to areas such as research and development, logistics and marketing, which are activities located at the start and end, respectively, of the value chain. Activities at the two ends of the value chain mostly have a high proportion of value-added, while activities in the middle typically have a lower proportion of value-added. Activities in the middle of the value chain are often performed in emerging market economies with low costs, while activities at the start and end of the value chain are more common for OECD countries.<sup>35</sup>

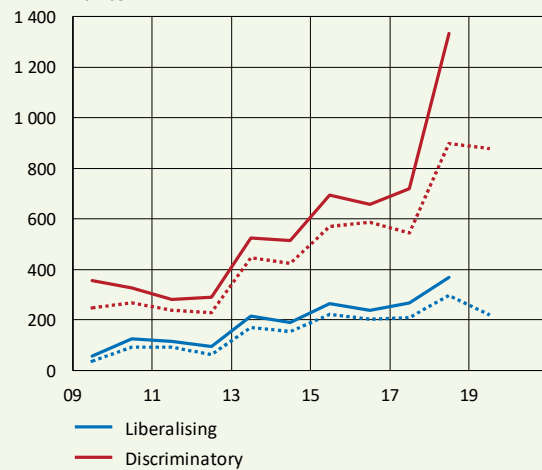
**Protectionist elements have increased since the financial crisis**

Growth in global trade slowed down after the financial crisis of 2008, in which world trade fell heavily.<sup>36</sup> Instead, growth in many countries has been supported by strong domestic demand and expansionary monetary policies. One cause of the downturn in world trade is that protectionist elements have increased. While tariffs are certainly at historically low levels today, other trade barriers have increased instead (see Figure 4:23).<sup>37</sup>

In addition to these trade barriers, increased uncertainty over future trade policy may have negative effects on growth. For example, the trade war between the United States and China has led to increased uncertainty, which has presumably affected economic activity negatively, even if it is difficult to assess by how much. A recently published study examines how investments among US companies have been affected by higher uncertainty over future trade policy. The authors of the study consider that the increase in uncertainty measured between 2017 and 2018 may have restrained investment in the US business sector by about one per cent.<sup>38</sup>

A substantial increase of protectionist elements in the period ahead would lead, overall, to lower productivity and reduced specialisation. Global growth would be restrained and would become lower than the Riksbank's current

**Figure 4:23. Trade-influencing measures by G20 countries**  
Number



Note. Discriminatory (liberalising) measures are measures that, according to Global Trade Alert's assessment, increase (reduce) discrimination for the benefit of domestic producers. The broken lines refer to measures for each single year until and including October 16.

Source: Global Trade Alert

<sup>34</sup> See OECD (2016), "Global Value Chains and Trade in Value-Added: An Initial Assessment of the Impact on Jobs and Productivity", OECD Trade Policy Papers, no. 190.

<sup>35</sup> Ibid.

<sup>36</sup> However, world trade increased relatively rapidly in some years after the financial crisis, such as 2010 and 2017.

<sup>37</sup> Examples of such measures include rules for public procurement rules that are distorted, state support and obstructions to international transactions.

<sup>38</sup> The estimated effect refers to the level of investments in the private business sector, excluding housing investment, one year after uncertainty over future trade policy had increased. See Caldara, D., Iacoviello, M., Moligo, P., Prestipino, A., and Raffo, A. (2019), "The Economic Effects of Trade Policy Uncertainty", *International Finance Discussion Papers*, no. 1256.

assessment.<sup>39</sup> Demand for Swedish exports would decrease. The existence of global value chains means that more countries than those introducing the trade-influencing measures would probably be affected. Inflation – at least in the short term – would probably increase in those countries introducing measures to make imports more expensive.<sup>40</sup> Lower growth and higher inflation make monetary policy considerations more difficult.

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<sup>39</sup> Some countries would be able to benefit from increased protectionism by moving production facilities across borders with the aim of avoiding tariffs. Nevertheless, however, the overall effect on the global economy is expected to be negative.

<sup>40</sup> For the effects of the worldwide spread of protectionism and the effects of bilateral trade wars, see the article “Economic consequences of increased protectionism” in the Monetary Policy Report, April 2017.