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World Trade Report 2013 – Factors Shaping the Future of World Trade **World Trade Organization, 2013**

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if I had had the temerity to do so, the result would not have been as good as Van Grassek's splendid contribution to what the world trading system is all about, how it originated and where it is headed. If there is a single publication that is now required reading on the subject, this is it. Congratulations, Craig.

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World Trade Report 2013 – Factors Shaping the Future of World Trade
World Trade Organization, 2013

Why has world trade grown so much over the last few decades? How will world trade evolve in the future and raise challenges for the multilateral trading system? These are the questions the WTO's World Trade Report 2013 aims to answer. The report starts off by documenting the pattern and trend of world trade in the last few decades. Four facts stand out. First, world merchandise trade, measured in gross terms, has grown substantially since 1980: 7 per cent per year on average, or an over seven-fold increase. Second, service trade grew even faster, averaging about 8 per cent per year over the same period. Services accounted for a much larger share of trade when measured in value added than when measured in gross terms. Third, developing economies have become increasingly more important in driving trade, thanks to the rise of China as an industrial powerhouse and the development of regional production networks in Asia, Europe, and North America, respectively. Finally, countries' export portfolios have become more similar when developing nations were catching up.

The list of factors behind these developments is long, and each country has its own story. The report organizes the extensive discussion of these factors effectively around five broad themes, namely demography, technology, energy and natural resources, transportation costs, and institutions. It provides a balanced overview of what has happened to the global economy in the last four decades, with arguments often supported by data. Besides examining the determinants, the report also explores several social and political issues that have been affected by trade, and will likely shape future trade policy matters. Implications for pressing issues, including inequality, environment, and sustainability, as well as macroeconomic and financial performance, are discussed. Guided by an extensive synthesis of theory and evidence, the report concludes by laying out the challenges facing the multilateral trading system and governments around the world.

In addition to the four stylized facts, the report highlights the increasing regionalization of world trade and its implications. Despite increasing multilateral trade liberalization and declining transportation costs, trade has become more geographically concentrated. Intra-regional trade accounted for over half of Asia's trade and close to half of North America's trade in 2011. If EU member states were treated as separate entities, 75 per cent of the EU's trade would be intra-regional. Behind the regionalization of trade is the rapid development of the hub-and-spoke regional production network in each of the three continents. At the hub of the network is a high-income country that specializes in research and development (R&D), product

designs, marketing, and other types of headquarter services (e.g., United States, Germany, Japan, and increasingly so the Republic of Korea). Constituting the spokes are other countries in the same continent, which share production in the network based on economic fundamentals and policies. These spoke-and-hub networks have evolved over time. More research and development (R&D) and innovation activities are now being undertaken in the spokes, with increasing intra-regional technology spillover. Three of the top five countries in terms of patent applications are now in Asia (Japan, China, and the Republic of Korea); the remaining two are the United States and Germany). This can be partly attributed to increasing foreign direct investment (FDI) and goods trade that embody technology. While FDI has been an important factor, a majority of patents were actually granted to the residents in the host countries. In addition to global production sharing, the geographical dispersion of R&D and thus knowledge diffusion have made countries' export portfolios more similar.

The changing nature of trade, featuring increasing production fragmentation and regionalization, has pushed policy makers and researchers to develop new frameworks and statistics. Traditional trade models that focus on final-good trade have become increasingly limited in explaining the world economy that is dominated by production sharing and trade of intermediate inputs. Moreover, intermediate inputs may cross country borders multiple times along the global value chains (GVC) and can be double-counted in gross trade statistics. International organizations and research institutions, such as the WTO, OECD, UNCTAD, and IDE-JETRO have devoted plenty of resources to construct reliable data on value-added trade using input-output tables. The way policy makers and researchers view trade and conduct trade policy is destined to change.

Based on the new value-added trade statistics, several previously overlooked facts have emerged. First, almost 30 per cent of total global trade consists of re-exports of intermediate inputs. Second, the share of double-counting has increased by 10 percentage points since the mid-1990s. Third, service trade is significantly more important than what was commonly perceived. In value-added terms, services accounted for close to half of global trade in 2008, compared to less than a quarter when measured in gross terms. As the report points out, this realization of the significance of services in trade has important implications for trade as well as domestic policies that regulate the service markets. Since trade models and statistics have traditionally focused on manufacturing, the determinants and effects of service trade are much less understood compared to merchandise trade. More research and data collection on service trade are needed, as manufacturing production and trade become more service-intensive.

The majority of the report is about the main determinants of the observed trends and patterns of world trade. It provides an extensive overview of the declining transportation and trade costs, due to technological advancement, domestic reforms, multilateral coordination, and waves of bilateral and multilateral trade liberalization. Above and beyond the standard factors, the advancement of information and communication technologies (ICT) has lowered long-distance communication costs substantially, allowing deeper economic integration between countries. In the near future, ICT will continue to reduce the distance between countries, making more tasks offshorable.

Besides the transaction-cost factors, the report emphasizes the significance of demography, which has been an overlooked factor in the study of trade. It postulates that the world has been enjoying demographic dividends over the last 40 years, defined by a persistently low old-age dependency ratio in many countries. However, the combination of low fertility and population ageing poses a new threat to economic growth in many countries. In particular, China will no longer be able to supply a large and young labor force to produce for the global goods markets, due to the one-child policy implemented by the Chinese government in the late 1970s to tackle overpopulation. India, on the other hand, will have years ahead to enjoy its demographic dividends. On the demand side, the rising middle class in some of the emerging markets will change the structure of consumption. It is important, as the report argues, to take into account these demographic factors when analyzing countries' trade and long-run economic growth.

Several political and socio-economic factors are also discussed. Recent research shows that institutions (legal, labor, and financial institutions) can be both causes and consequences of trade. Institutions can serve as a source of comparative advantage, beyond the effects of factor endowments. While improvement in domestic institutions may induce trade, trade liberalization can in turn result in institutional changes. To the extent that trade may be responsible for higher income volatility and inequality, it may increase demand for more redistribution, and for safety nets to be provided by governments. Knowledge about these relationships is crucial for understanding the challenges to trade policy making.

The report also explains how natural resources will remain an important factor shaping world trade, international business cycles, capital flows, and politics. Without an effective substitute for essential natural resources, suppliers will continue to use their monopoly power to manipulate prices. Supply as well as prices of natural resources, in particular oil, will remain volatile due to unexpected events, such as natural disasters and inter-state conflicts.

How will global trade look over the next few decades? The report analyzes several benchmark situations and emphasizes the sensitivity of the predictions to changes in assumptions. Some trends are more certain than others – developing nations will continue to catch up, contribute more to trade, and have more influence on multilateral trade policy setting; GVC will continue to rule the day; and advancement in ICT will keep promoting production fragmentation over long distances. It is hard to imagine any event that could jeopardize these macro trends, but there will always be risks. In the next few decades, the changing demographic structure in different countries may result in a significant reorganization of global production across nations. Environmental degradation, if not tackled effectively, will threaten the sustainability of long-run growth in many developing nations. The continuing regionalization of GVCs may trigger a new wave of regionalism. The “servicification” of manufacturing will require new policy thinking and multilateral frameworks. In addition, the outcomes of the current territorial disputes on different continents remain uncertain in the short run. Such risks and policy uncertainty will raise challenges for the WTO and other international organizations alike to safeguard the multilateral cooperation system.

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