

## Chapter II

# International trade

### Merchandise trade in times of crisis

In 2009, world trade volume contracted by almost 13 per cent, that is to say, more than 20 percentage points below its annualized 8.6 per cent trend growth during the period 2004-2007. Furthermore, international trade had already seen a deceleration to 3 per cent in 2008. In the outlook, a modest recovery of world trade of 5 per cent is projected for 2010, assuming that global recovery sets in. Given this projection, the total loss of world trade during the period 2008-2010, compared to what it would have been at trend growth and without the crisis, will be equivalent to nearly \$5 trillion, in other words, about 8 per cent of the annual world gross product (WGP).

Global trade activity follows the evolution of world income in a pronounced manner. A similar pattern is observed in the fluctuations of imports in the main regions of the world with respect to each region's growth of gross domestic product (GDP) (figure II.1a-e). In 2008, demand growth in developed countries decelerated to 0.5 per cent, down from an annual average of 2.7 per cent between 2004 and 2007. In 2009, developed-country GDP contracted by 3.5 per cent. As a result of the 4 percentage point decline in the growth rate, the volume of imports by developed countries showed a sharp reduction of about 12 per cent in 2009. GDP growth for developing countries (excluding East Asia) dropped by 6 percentage points (from about 5 per cent in 2008 to -1 per cent in 2009), while import demand fell by 17 per cent in real terms. In developing East Asia, the decline in import volume was 8 per cent, but since GDP growth dropped by only 2 percentage points, a higher implicit income elasticity of import demand is evident, the result of a greater weight of exports of manufactures with a high import content. More generally, trade in manufactures showed the greatest swings during the global crisis, being characterized by a higher income elasticity than trade in other commodities. Developed countries are the main importers of manufactures; hence the deep recession in these countries spread quickly, first to countries specializing in exports of manufactures (especially in East Asia) and subsequently to those countries providing industrial inputs and raw materials. Yet, the decline in export volumes during 2009 was greater among those regions with higher specialization in manufactures. Many Asian exporters, such as Indonesia, Japan, the Philippines and Taiwan Province of China, were among the hardest hit and saw their merchandise export revenues decline by 30 per cent or more year on year during the first quarter of 2009. Industrial production fell in tandem with trade, causing declines in demand for commodities and other industrial inputs, in turn affecting exports of developing countries and economies in transition.

The severe fall in global aggregate demand, which shocked trade activity and prices, was compounded by a considerable strain in global financial markets, resulting primarily in increased borrowing costs and a shortage of trade credits. There is an acute lack of data on the availability of trade financing, but some recent surveys and anecdotal evidence suggest that many countries experienced severe curtailment of access to trade credits, especially in the initial stages of the global crisis, a factor that most likely contributed to the

World trade growth has fallen more than 20 per cent below its trend

Changes in world income have led to dramatic fluctuations in trade, especially in manufacturing

Higher borrowing costs severely affected trade and production costs, particularly in developing countries

Figure II.1a  
Growth of world income and of imports, 2001-2010

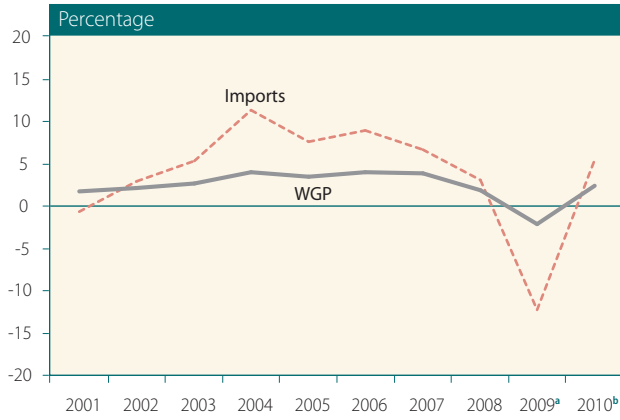


Figure II.1b  
Growth of gross domestic product and import volume: developed economies, 2001-2010

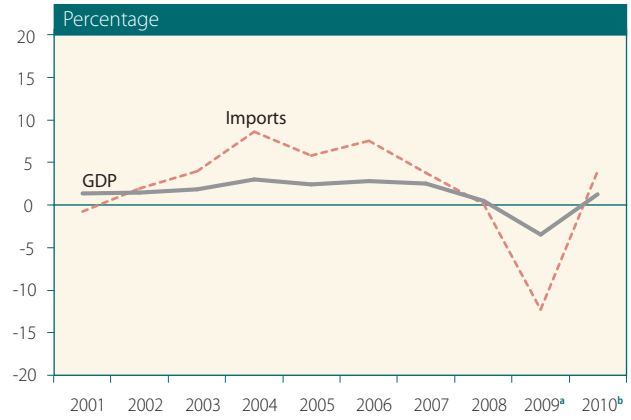


Figure II.1c  
Growth of gross domestic product and of import volume: economies in transition and developing economies (excluding East Asia), 2001-2010

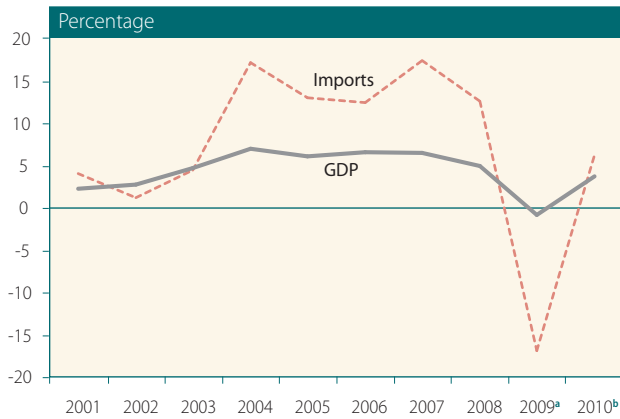


Figure II.1d  
Growth of gross domestic product and import volume: East Asian developing economies, 2001-2010

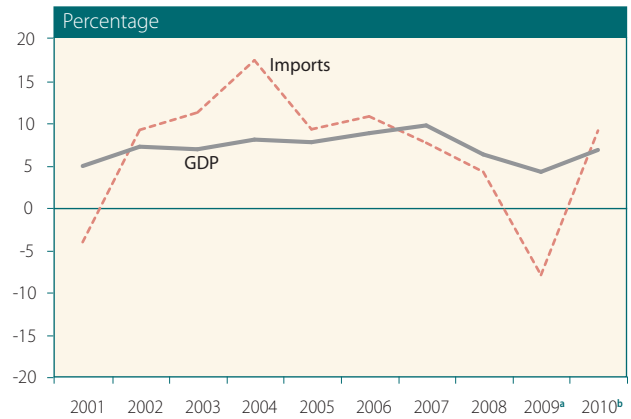
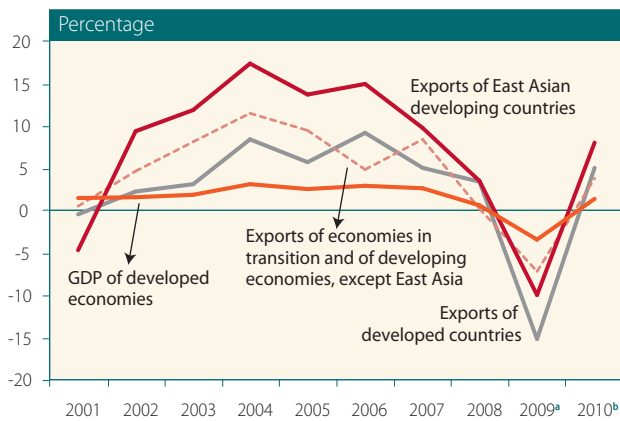


Figure II.1e  
Growth of gross domestic product of developed economies and of exports per region, 2001-2010



Source: UN/DESA and Project Link.

Note: Imports and exports are expressed in constant 2000 United States dollars.

a Partly estimated.

b Projections based on Project LINK.

decline in world trade in late 2008 and early 2009.<sup>1</sup> Steep increases in borrowing costs have equally affected trade. In India, for example, the spread over the six-month London Interbank Offered Rate (LIBOR) for trade credits increased from 50 to 150 basis points towards the end of 2008. Spreads increased even more for countries like Turkey and Brazil in the fourth quarter of 2008, severely affecting trade and production costs.

As discussed in more detail below, the decline in global import demand was accompanied by large swings in world commodity prices. Depending on the nature of trade dependence, some countries saw declines in export volumes compensated by improvements in their terms of trade, while others suffered even greater trade shocks because of unfavourable relative price shifts. Table II.1 shows a decomposition of trade shocks by country group.<sup>2</sup>

The *demand shock*, shown in the first row, reflects the fall in the *volume* of exports, estimated at about 3.5 per cent of WGP in 2009. No country or region was spared the adverse demand shock. The economies in transition, the European Union (EU)-15, Japan and countries in East and South Asia experienced demand shocks greater than 4 per cent of their GDP. The developed countries and the dynamic exporters in developing Asia felt most of the impact through the fall in demand for their manufacturing exports, as indicated above. Meanwhile, such falls in exports, and thus in industrial production in developing countries, were transmitted into falls in energy imports from the economies in transition. These are considerable when measured as a share of GDP of those economies that rely heavily on exports of oil and natural gas. Notably, the least developed countries (LDCs) were least affected by a decline in the demand for their exports, possibly owing to the relatively low income elasticity of demand for primary export products.<sup>3</sup> Nonetheless, the contraction in demand for LDC exports averaged about 1.6 per cent of GDP in 2009 and contributed to the substantial run-up of trade deficits amounting to 10 per cent of the combined GDP of the poorest countries.

*Terms-of-trade* shocks are calculated as the net effect of the annualized change in a country's export and import prices. Net importers of food and energy products generally witnessed positive terms-of-trade shocks in 2009. This holds true, on average, for the developed countries and developing countries in East and South Asia, as well as for some African countries, Mexico and most countries in Central America and the Caribbean. In contrast, energy and other primary commodity exporters suffered severe negative price shocks. For instance, Western Asia and the economies in transition experienced negative terms-of-trade shocks of 8.8 per cent and 5.7 per cent of their respective GDP. Half of these countries experienced an adverse price shock of greater than 10 per cent of GDP; in one third of the countries concerned it was even greater than 20 per cent of GDP. Some

The decline in global import demand has caused large swings in world commodity prices

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- 1 See, for example, the 2009 Trade Finance Survey conducted by the Bankers' Association for Finance and Trade (BAFT), in cooperation with the International Monetary Fund, available at [http://baft.org/content\\_folders/Issues/IMFBAFTSurveyResults20090331.ppt](http://baft.org/content_folders/Issues/IMFBAFTSurveyResults20090331.ppt). These and similar surveys stress that the major trigger for the global contraction of trade was the rapidly shrinking demand for imports worldwide.
  - 2 The trade shock decomposition was developed as part of the World Economic Vulnerability Monitor of UN/DESA. The trade decomposition analysis is a detailed account of volume and price fluctuations for about 170 countries for all merchandise trade disaggregated up to the three-digit Standard International Trade Classification (SITC) (covering about 250 products and product groups). See [http://www.un.org/esa/policy/publications/dpad\\_wespwevm.html](http://www.un.org/esa/policy/publications/dpad_wespwevm.html) for a description of the decomposition methodology and for more detailed results.
  - 3 A number of least developed countries (LDCs) could not be included in this study owing to a lack of data, most notably Angola, a country representing a significant share of the combined GDP of the LDCs.

Table II.1  
Trade shocks and changes in trade balances per country/region

Percentage of gross domestic product						
		<i>Demand shock: change in export volume</i>	<i>Terms-of-trade shock: net value change</i>	<i>Total trade shock</i>	<i>Change in import volume</i>	<i>Total change in trade balance</i>
World	2008	0.5	0.0	0.5	0.5	0.0
	2009	-3.5	0.0	-3.5	-3.5	0.0
Developed economies	2008	0.2	-0.7	-0.5	-0.3	-0.1
	2009	-3.5	0.8	-2.7	-3.7	1.0
United States	2008	0.5	-1.1	-0.6	-0.5	-0.1
	2009	-1.3	1.2	-0.1	-2.6	2.5
Japan	2008	0.1	-1.3	-1.2	-0.1	-1.2
	2009	-4.4	1.5	-2.9	-2.1	-0.8
EU-15	2008	-0.2	-0.6	-0.8	-0.6	-0.2
	2009	-4.4	0.7	-3.7	-4.3	0.6
Economies in transition	2008	2.3	4.7	7.0	2.0	5.0
	2009	-5.1	-5.7	-10.8	-5.3	-5.5
Developing countries	2008	2.1	1.1	3.2	2.6	0.6
	2009	-3.3	-1.1	-4.4	-2.7	-1.7
Africa	2008	2.1	2.9	5.0	4.2	0.8
	2009	-2.2	-3.3	-5.5	-2.1	-3.4
East and South Asia	2008	2.9	-0.6	2.3	2.4	-0.1
	2009	-4.2	0.9	-3.3	-2.2	-1.1
Western Asia	2008	3.4	7.7	11.1	4.9	6.2
	2009	-3.3	-8.8	-12.2	-2.3	-9.9
Latin America and the Caribbean	2008	-0.4	1.0	0.7	1.4	-0.7
	2009	-1.7	-0.6	-2.3	-4.1	1.8
Least developed countries	2008	1.4	-2.1	-0.7	3.6	-4.3
	2009	-1.6	1.3	-0.2	-2.2	1.9

Source: UN/DESA, World Economic Vulnerability Monitor, based on Comtrade and UNCTAD data.

exporters of food and agricultural materials fared better to the extent that the decline in agricultural commodity prices was (more than) offset by the lower prices of their energy imports. This was the case in many of the LDCs.

All regions have suffered adverse trade shocks ...

Each of the country groups in table II.1 suffered adverse total trade shocks in 2009. The total trade shock is the combined effect of the decline in export volume and the terms-of-trade effect. Relative to their GDP, the net energy exporters among the economies in transition and in Western Asia were the most severely hit. The cumulative trade shock over the period 2008-2009 was also negative for all regions. The developed-country regions had seen a negative total trade shock as early as 2008 as a consequence of the economic slowdown that had already started in the United States, and this deepened as the financial crisis unravelled. In contrast, all other regions still benefited from a buoyant demand for their exports throughout most of 2008. This was not the case for LDCs, however, which, on average, suffered most from the steep rise in oil and food prices in the first half of 2008.

The reaction of import volume to the total trade shocks outlined above varied by country. In most developed countries, import volumes fell by more than the combined loss in export volumes and terms-of-trade effect to yield an improvement in the merchandise trade balance. Import adjustments in Latin America and the Caribbean were also stronger than the adverse export shock. LDCs also saw a narrowing of merchandise trade deficits or larger surpluses as imports contracted by more than their relatively mild adverse trade shock, suggesting that limited access to external finance might have led to an overshooting of the impact of the trade shocks into the growth of domestic demand. In other regions, import adjustment has been weaker than the trade shock, in some cases on account of a lagging response to shocks or greater rigidity of spending patterns supported by the use of accumulated foreign-exchange reserves (or support of domestic demand through strong fiscal stimuli, as in the case of China and a number of other Asian countries in particular).

It is worth noting that “improvements” in the trade balances of particular regions or countries driven by strong import adjustments are not necessarily positive developments. Even though these shifts have helped reduce the global imbalances, the adjustment has been recessionary (see chapter I for further discussion). The impending recovery in parts of the world could lead to a resumption of those imbalances and the world may still be positioned for a continued “bumpy ride” in the period ahead.

## Regional trends

The steep decrease in merchandise imports by the *United States of America*, which started in August 2008, appears to have bottomed out over the second quarter of 2009. However, the first-semester level is more than 30 per cent lower year on year. The significant fall in oil prices accounted for about 40 per cent of the reduction in import expenditures. However, a further reason was the drop in demand from households and businesses. While exports had been declining since mid-2008, they picked up in the third quarter of 2009. Since the decline of imports moved significantly faster, the trade deficit was shrinking to about \$40 billion per month, down from about \$75 billion in early 2008. *Canada*, which was additionally hit as an exporter of energy and minerals, experienced a deterioration in its trade balance of about 2 per cent of GDP, although it managed to preserve a small trade surplus overall.

*Japanese* imports and exports picked up slightly in the second quarter of 2009, after collapsing by about 40 per cent in late 2008 and early 2009. Reflecting the pace of recovery among different regions of the world, exports to Asia led the rebound, followed by exports to the United States and the EU. Real exports, however, remain 30 per cent below last year. Japanese exports will likely continue to rise in 2010, albeit at a moderate pace, curbed by the appreciation of the yen and domestic deflation. The rebound in imports was driven by information technology (IT)-related and consumer goods, as well as by raw materials and foodstuffs, but capital goods continued to decline.

Trade flows in *Australia* and *New Zealand* have dropped from an annual growth of about 30-40 per cent in the first half of 2008 to a decline of about 25 per cent in early 2009, showing a gradual turnaround in the second half of 2009. A strong Australian dollar and a large drop in contracted prices for some categories will curb export revenues in the outlook.

Trade collapsed in *Western Europe* as world demand plummeted and is only recently showing tentative signs of stabilization. In the euro area, exports fell in real terms by 7 per cent (quarter over quarter) in the fourth quarter of 2008 and by 9.2 per cent in the

... but in some cases there was a greater contraction in imports, leading to improvements in the trade balance

Contractionary improvements in the trade balance during the crisis threaten the potential for global recovery

United States imports decreased, aided by low oil import values

After collapsing by about 40 per cent in late 2008 and early 2009, Japanese imports and exports started to improve slightly

Export volumes in Western Europe remain far below the previous year even though the pace of decline is moderating substantially

first quarter of 2009, and patterns were similar in the rest of the region. Even though the pace of decline moderated substantially in the second quarter, export volumes stood 17.7 per cent lower than the year before. Import volumes displayed similar behaviour, with a lag effect; in the second quarter of 2009, they stood 14.4 per cent lower than a year earlier, but more recent declines have been more substantial than those of exports. In United States dollar value terms, exports over the first six months of 2009 were 32 per cent lower than a year earlier, with energy, machinery and vehicles registering the largest declines. Imports declined by a similar amount, energy and crude materials being the most predominant. Going forward, trade is expected to pick up gradually through the rest of 2009 and into 2010, but not to robust levels, and in some cases will be held back by stronger exchange rates.

Merchandise export revenues of the new *EU member States* shrunk by 25 per cent in 2009 owing to weaker import demand from the EU-15. This was also the case for the Baltic States, who, in addition, saw weak demand from the Russian Federation. The automotive and capital goods industries experienced major shocks, partially mitigated by the car-scraping schemes in the EU-15. Depressed domestic demand, strong import content of exports and lower prices of energy have led to a fall of about 30 per cent in imports. In the outlook, exports from the region may recover slowly, but will perhaps lag behind a 3-4 per cent recovery of imports. However, in the Baltic States further economic contraction is projected.

In *South-eastern Europe*, export revenues declined by about 25 per cent in 2009 as industrial sales declined, prices and demand for minerals fell and competition by some Asian industries increased. Meanwhile, imports contracted by about 30 per cent owing to weaker demand and slower credit growth, along with falls in the price of energy. Going forward, a slight recovery of exports may be hindered by formal or informal pegs to an appreciating euro, undermining export competitiveness outside the euro area. Import growth is expected to resume, but at a slow pace.

Nominal exports and imports in the *Commonwealth of Independent States (CIS)* have contracted significantly in 2009, but are forecast to increase in 2010. Lower commodity prices and exchange-rate depreciations have contributed to a significant decline in the region's terms of trade. Export losses are likely to exceed \$250 billion in 2009 and will be only partially offset by lower imports. In the Russian Federation, the trade surplus will decline by more than 46 per cent to an estimated \$96 billion in 2009. It is expected to contract by 50 per cent to \$16.5 billion in Kazakhstan. Meanwhile, despite collapsing steel and manufacturing exports and relatively higher prices for gas imports, Ukraine's trade deficit will likely decline by 80 per cent in 2009, to \$3.4 billion, reflecting the impact that the deep contraction of the economy is having on import demand.

Exports of *East Asian* economies declined precipitously between October 2008 and January 2009, but started to recover in the second quarter of 2009 as demand for high- and medium-technology manufactured goods picked up. A likely improvement in access to trade finance may have played its part. Yet, export revenues have remained far below the levels reached a year ago. In most economies, except China, the decline in export earnings in 2009 will be more than offset by lower import bills. Trade balances will therefore improve markedly in many countries, including Indonesia and the Republic of Korea. In China, by contrast, the trade surplus declined by 20.3 per cent year on year during the first eight months of 2009. In 2010, import bills are forecast to rise considerably as domestic demand strengthens and energy prices move up. Thus, trade surpluses may shrink despite higher export earnings.

Trade in the Commonwealth of Independent States is likely to resume slowly in 2010

China's trade surplus declined by 20 per cent year on year during the first eight months of 2009

Export sectors across *South Asia* have also been hard hit. Indian export earnings fell by 26 per cent year on year during the first eight months of 2009. However, exports started to recover in several South Asian economies during the third quarter of 2009—a trend that is likely to continue in 2010. Overall, trade and current-account balances improved everywhere in 2009 except in the Islamic Republic of Iran, where oil revenues declined sharply. The decline in global energy and food prices, combined with the slowdown in domestic demand, led to sharply lower import bills, while remittance inflows to the region continued to increase substantially.

In *Western Asia*, oil exporters saw a pronounced drop in exports in 2009 owing to lower global demand and prices. Imports have been shrinking, partially offsetting the contractionary effect on trade balances. The expected sustained upward trend in oil prices will again underpin solid trade surpluses in 2010. In oil importing countries, the severe drop in global trade has hit the manufacturing sector especially hard. Meanwhile, imports have shown even more dramatic falls, resulting in improved trade balances in 2009.

While many *African* oil and mineral exporters were hit severely by the sharp drop in the value of their exports in late 2008 and early 2009, they experienced an export rebound in the second quarter of 2009. On aggregate, exports declined faster than imports. Hence, African trade and current accounts are expected to switch into deficit in 2009 and, conceivably, 2010. However, specific situations in some countries diverge from the regional patterns. For instance, South Africa switched from deficit to surplus between the first and second quarter, as merchandise imports declined sharply. Food-importing countries also experienced a reduction of their import expenditures as food prices declined by around 20 per cent from 2008.

Export earnings in *Latin America and the Caribbean* have suffered a severe downturn in 2009. The most affected are energy exporters such as Bolivia, Ecuador, Trinidad and Tobago and Venezuela (Bolivarian Republic of), with losses greater than 6 per cent of their GDP. Similar losses were experienced by Chile, and to a lesser degree Peru, both mineral exporters. Yet, other countries such as Colombia, Mexico and Suriname, which are more diversified towards manufactures, were hit due to their trade links with the United States and other developed economies. Trade deficits in goods are expected to narrow in the region as a whole, however. Imports decreased at a somewhat stronger pace than total shocks in Mexico, Brazil and a few South American countries which promptly adjusted expenditures, while for many other countries the improved trade balances were triggered by significantly lower prices for imports. For 2010, the expected global economic recovery and higher commodity prices will help increase export volumes and prices, in particular for commodity exporters.

## Trade in services

World trade in services more than tripled in value terms between 1990 and 2008, reaching \$3.7 trillion. In the years immediately prior to the crisis, services trade worldwide continued a fast pace of growth, rising sharply by 11 per cent in 2008, year on year. Exports of services from developing countries were up by 15 per cent and those from developed countries by 8.5 per cent. However, as shown in figure II.2 there was a clear turnaround in the third quarter of 2008 and a rather precipitous decline from the last quarter of 2008 onwards. Total services exports of developed countries dropped by 13 per cent in the fourth quarter of 2008 from their peak in the third quarter. The largest declines were in the euro area in the fourth quarter of 2008 (about 14 per cent) and Japan in the first

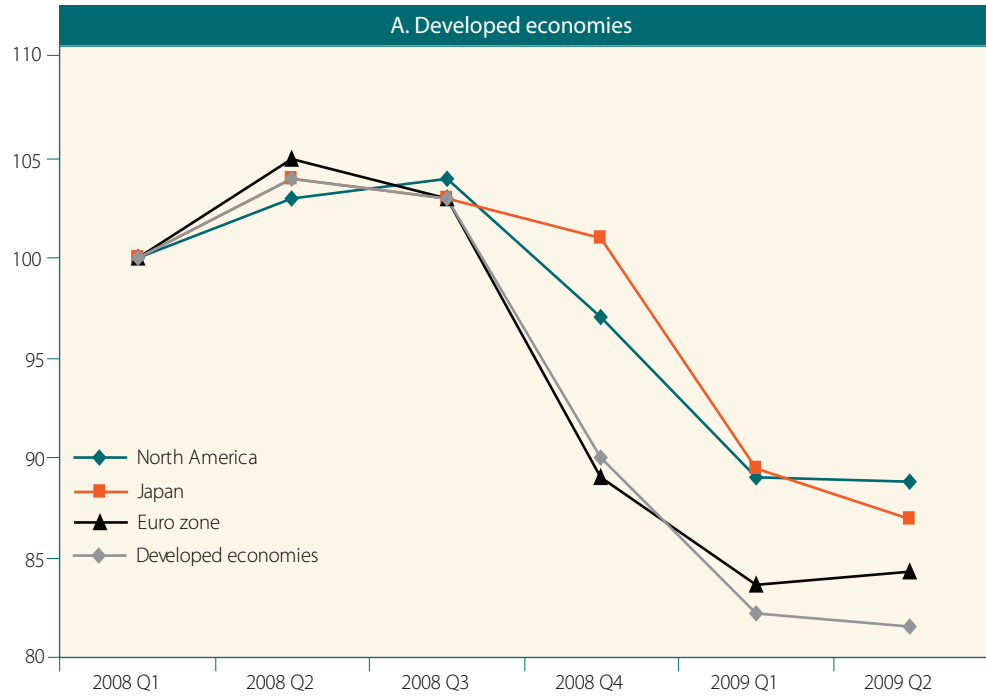
Oil exports from Western Asia will probably continue to increase

Trade accounts have narrowed in most of the larger African economies

Oil and mineral exporters in Latin America have experienced great adversity

Trade in services has bottomed out after declining sharply in late 2008

Figure II.2  
Service export performance, first quarter 2008–second quarter 2009



Source: OECD StatExtracts, Balance of Payments (Main Economic Indicators).  
Note: 2008Q1=100

quarter of 2009 (11 per cent). Services exports from several developing countries also fell notably during that time. For example, Brazil, Indonesia, Mexico and the Republic of Korea experienced declines of about 8 per cent in the last quarter of 2008, with all except Mexico falling by more than 16 per cent in the first quarter of 2009. Going beyond the first quarter of 2009, it appears that such dramatic declines in exports of services may have started to bottom out for developed countries and may have become smaller for selected developing countries.

The share of services in total world trade has fallen slightly since the growth of global trade in services in pre-crisis years had not risen nearly as fast as that of merchandise trade. Table II.2 shows that developing countries and economies in transition showed a more pronounced fall, whereas developed countries actually increased their share.

As suggested by table II.3, the geographic distribution of services trade among developing countries continues to remain quite concentrated, with the first five exporters representing 50 per cent of total trade and 60 per cent of trade for the 25 highest ranking countries. China and India have become the largest exporters of services in less than two decades, leaving behind the newly industrialized economies (NIE) of East Asia.

The decline in services trade during the crisis may be partly associated with the evolution of foreign direct investment (FDI). Worldwide, the services sector represents a larger and growing share of global FDI stocks and flows, while the share of manufacturing has continued to decline. As a consequence of the global economic crisis, FDI inflows to both developed and developing countries declined by 15 per cent in 2008, to about \$1.6 trillion (see chapter III). This sharp decrease marks the end of a growth cycle which lasted four years. Further decline of FDI in services is anticipated for 2009, especially for flows to developing countries.<sup>4</sup> Another affected subsector is that of financial services associated with utilities, such as telecommunications and energy. Similarly, IT-related services seem to have felt the impact of the virtual halt of construction activities in many countries.

The geographic distribution of services trade among developing countries continues to remain quite concentrated

The decline in services trade during the crisis may be partly associated with the evolution of foreign direct investment

**Table II.2**  
**Exports of services: share in total trade in goods and services, 2003-2008**

Percentage						
	2003	2004	2005	2006	2007	2008
<b>World</b>	<b>20.1</b>	<b>19.9</b>	<b>19.6</b>	<b>19.2</b>	<b>19.7</b>	<b>19.4</b>
Developed economies	22.5	22.7	22.8	22.6	23.2	23.3
Economies in transition	15.9	14.9	13.7	13.2	13.7	13.2
Developing economies	15.0	14.7	14.2	13.7	14.1	13.7
Africa	20.0	18.5	16.5	15.6	16.2	14.2
Latin America and the Caribbean	14.2	13.3	13.3	12.5	12.8	12.8
Asia	14.5	14.5	14.0	13.7	14.1	13.7
Oceania	35.2	34.2	33.0	29.8	27.9	29.0
<b>Memorandum items:</b>						
Least developed countries	16.0	14.9	12.5	11.6	11.1	9.7
Landlocked developing countries	17.5	15.9	14.1	12.0	12.0	9.6
Small island developing States	45.4	44.3	39.8	34.3	35.1	32.3

Source: UNCTAD GlobStat.

<sup>4</sup> See United Nations Conference on Trade and Development, "Assessing the impact of the current financial and economic crisis on global FDI flows", study prepared by UNCTAD, Division on Investment and Enterprise, UNCTAD/DIAE/IA/2009/3, April 2009.

Table II.3  
Top 25 exporters of services among developing countries, 1990, 2000, 2007 and 2008

	1990			2000			2007			2008		
	Value of exports (in billions of dollars)	Share (percentage)	Rank	Value of exports (in billions of dollars)	Share (percentage)	Rank	Value of exports (in billions of dollars)	Share (percentage)	Rank	Value of exports (in billions of dollars)	Share (percentage)	Rank
<b>Developing economies<sup>a</sup></b>	<b>150</b>	<b>18.1</b>		<b>348</b>	<b>22.8</b>		<b>865</b>	<b>25.3</b>		<b>981</b>	<b>25.4</b>	
China	5.9	0.7	9	30.4	2.0	3	122.2	3.6	1	129.5	3.4	1
India	4.6	0.6	10	16.7	1.1	7	89.7	2.6	2	104.0	2.7	2
Hong Kong SAR <sup>b</sup>	18.1	2.2	1	40.4	2.7	1	83.6	2.4	3	91.4	2.4	3
Singapore	12.8	1.5	2	28.2	1.8	4	69.8	2.0	4	83.1	2.2	4
Korea, Republic of	9.6	1.2	3	30.5	2.0	2	63.0	1.8	5	79.3	2.1	5
Taiwan Province of China	7.0	0.8	6	20.0	1.3	5	31.3	0.9	6	33.9	0.9	7
Thailand	6.4	0.8	7	13.9	0.9	9	30.4	0.9	7	33.7	0.9	8
Turkey	8.0	1.0	5	19.5	1.3	6	28.9	0.8	8	34.8	0.9	6
Malaysia	3.9	0.5	11	13.9	0.9	8	28.3	0.8	9	30.2	0.8	10
Brazil	3.8	0.5	12	9.5	0.6	12	24.0	0.7	10	30.4	0.8	9
Egypt	6.0	0.7	8	9.8	0.6	11	19.9	0.6	11	25.1	0.6	11
Mexico	8.1	1.0	4	13.8	0.9	10	17.7	0.5	12	18.2	0.5	12
Macao SAR <sup>b</sup>	1.5	0.2	23	3.6	0.2	18	14.4	0.4	13	17.4	0.5	13
South Africa	3.4	0.4	13	5.0	0.3	14	13.6	0.4	14	12.5	0.3	16
Lebanon	..	..	..	..	..	..	12.5	0.4	15	16.3	0.4	14
Indonesia	..	..	..	..	..	..	12.5	0.4	16	13.6	0.4	15
Morocco	2.0	0.2	18	3	0.2	22	12.2	0.4	17	12.5	0.3	17
Argentina	2.4	0.3	17	4.9	0.3	15	10.3	0.3	18	12.4	0.3	18
Kuwait	1.3	0.2	26	1.8	0.1	32	9.6	0.3	19	10.6	0.3	20
Chile	1.8	0.2	19	4.1	0.3	17	8.8	0.3	20	10.8	0.3	19
Philippines	3.2	0.4	14	3.4	0.2	19	8.4	0.2	21	10.2	0.3	21
Cuba	0.5	0.1	40	3.1	0.2	21	8.2	0.2	22	9.2	0.2	22
Saudi Arabia	3.0	0.4	15	4.8	0.3	16	7.9	0.2	23	8.2	0.2	23
Nigeria	1.0	0.1	33	1.8	0.1	31	7.3	0.2	24	na	na	na
United Arab Emirates	..	..	..	1.8	0.1	25	7.3	0.2	25	8.2	0.2	24

Source: UNCTAD GlobStat.

<sup>a</sup> In order of 2007 ranking.

<sup>b</sup> Special Administrative Region of China.

The decline in services trade is particularly visible in maritime transport and tourism

The decline in services trade is particularly visible in maritime transport and tourism. Data on port traffic provide additional information on the downturn in containerized trade. Activity in the world's largest container port, Singapore, was down by 19 per cent in January 2009 (year on year). In Hong Kong Special Administrative Region (SAR) of China, port traffic had fallen by 23 per cent, in Long Beach (United States) by 14 per cent and in Le Havre (France) by 25 per cent. These sharp declines tapered off later in the year, however, as is evident from annual data for other related indicators. These data show that, between July 2008 and July 2009, the number of vessels in operation had fallen by 10.1 per cent, the total twenty-foot equivalent unit (TEU) carrying capacity of ships by

3 per cent, and the number of shipping companies by 7.8 per cent. Only the maximum vessel size continued to increase (by 11.6 per cent), as new and larger vessels are being delivered by the world's shipyards. Many of these larger ships have replaced smaller vessels, leading to a significant reduction in the average number of vessels per country. For the first time since the United Nations Conference on Trade and Development (UNCTAD) has been recording these data, the average TEU container-carrying capacity assigned per country has fallen.<sup>5</sup> Meanwhile, the financial crisis and rising unemployment have had a toll on international tourism. World Tourism Organization (UNWTO) data show that statistics for international tourist arrivals flattened or exhibited negative growth in each of the last six months of 2008, and declined by 8 per cent between January and June 2009.<sup>6</sup> On the other hand, this trend appears to have been slowly bottoming out throughout July, August and September, so far showing a smaller decline of 3 per cent.

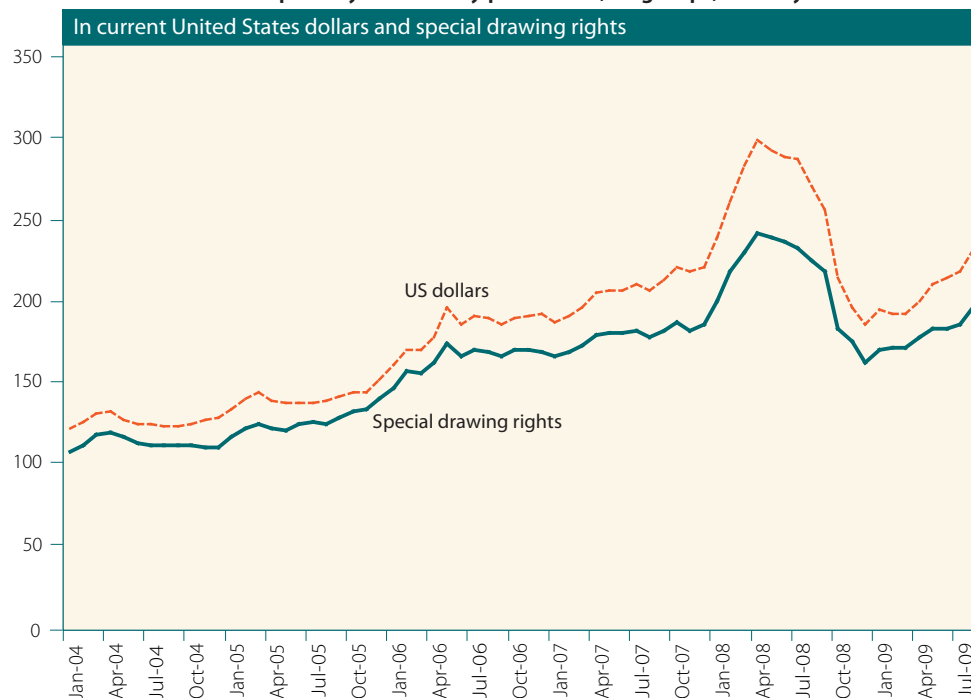
## Trends in primary commodity prices

### Non-oil primary commodities

The year 2008 marked one of the most dramatic episodes in the history of commodity-price cycles (figure II.3). After reaching an historic peak in mid-2008—in both nominal

The year 2008 marked one of the most dramatic episodes in the history of commodity-price cycles

Figure II.3  
Trend in the non-oil primary commodity price index, all groups, January 2004–June 2009



Source: UNCTAD Commodity Price Statistics.

- 5 United Nations Conference on Trade and Development connectivity database, derived from Containerisation International Online.
- 6 Various World Tourism Organization (UNWTO) press releases, and UNWTO *World Tourism Barometer*, vol. 7, No. 1 (January 2009); vol. 7, No. 2 (June 2009); vol. 7, No. 3 (October 2009), available at <http://www.unwto.org/facts/eng/barometer.htm>.

and in some cases real terms—commodity prices fell sharply as a consequence of the global economic and financial crisis, and hit a trough at the beginning of 2009. During the first quarter of 2009, prices of many commodities started to recover. The future dynamics of non-oil commodity prices remain highly uncertain.

The pre-crisis commodity boom was caused by a complex mix of demand, exchange-rate variations and speculative activity

The long-lasting commodity-price boom in the years prior to the crisis was due in part to the strong growth in demand for commodities worldwide, particularly to the demand in fast-growing emerging economies. Increased demand was met with a lag in supply response due to underinvestment in primary commodity production during the preceding two decades (which provides a further explanation of the strong price increases). Other factors also played a role, including the increased financialization of commodity markets and the depreciation of the United States dollar. There had been an extraordinary increase in speculative investments in commodity derivatives as financial asset classes, which attracted swings in short-term portfolio investments. The financial turmoil of 2007 and continued dollar depreciation led many investors to seek higher returns in commodity market derivatives, causing prices to deviate further from their trend levels. On the eve of the global financial crisis, from July 2008, financial investors started to pull out of commodity markets and prices started to fall sharply. The precipitous decrease in international commodity prices continued until the first quarter of 2009, as further reversals of portfolio investments in commodity markets took place in the process of deleveraging resulting from the global financial crisis, the related appreciation of the United States dollar and the fall in global demand.<sup>7</sup>

Non-oil primary commodity prices rebounded from the second quarter of 2009, showing a rise of 20 per cent in the composite index between April and August 2009. The recovery was stronger for minerals, ores and metals, whose price index rose by 38 per cent between March and August 2009, but weaker in the case of food and tropical beverages, which showed world price increases of 11 per cent and 15 per cent, respectively, in the same period. The “China factor” explains most of the influence on the recovery in global demand for commodities and the reversal of the downward trend in commodity prices. The resumption of the trend towards dollar depreciation and the slowdown of the deleveraging process in financial markets are likely to have strengthened the rebound in commodity prices.

### *Minerals and metals*

During the first quarter of 2009, the sharp contraction in industrial production and in the demand for metals in developed countries caused a further dramatic fall in the prices for most minerals, ores and metals. The steep price declines recorded since the second half of 2008 (figure II.4) have led to massive cutbacks in production and the closure of many mines and refineries, as well as postponement or cancellation of new investments in mining.

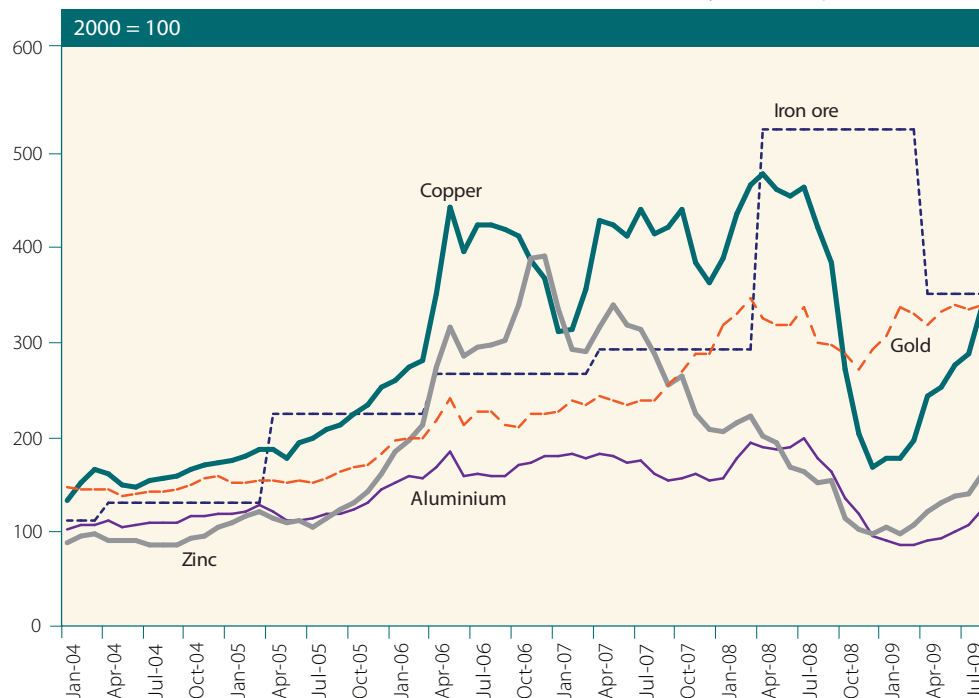
The drop in demand caused a stark rise in international stocks for most base metals. The first signs of an economic recovery in the second quarter of 2009 helped to reverse the downward trend in prices, possibly prompting investors who were left with large stocks to sell at positive profit margins. The prices of some metals, such as *copper* and *nickel*, almost doubled during the first eight months of 2009, while *lead* and *zinc* prices started to recover as early as February 2009, eventually showing increases of 72 and 64 per cent, respectively, between February and August of 2009. An additional factor for these

A sharp contraction of industrial demand contributed to severe setbacks for mineral and metal producers

The relatively early boost of China's demand for major base metals supported the significant rebound in the second quarter

<sup>7</sup> See *World Economic Situation and Prospects: Update as of mid-2009*, available from <http://www.un.org/esa/policy/wess/wesp.html>, and United Nations Conference on Trade and Development, *Trade and Development Report 2009* (United Nations publication, Sales No. E.09.II.D.16), chap. II.

Figure II.4  
Price indices for selected metals, United States dollars, January 2004–August 2009



**Source:** UNCTAD Commodity Price Statistics.

**Note:**

Iron ore: Australia to Japan, 64% Fe content, Hamersley, freight on board (FOB) (US cent/Fe unit)

Aluminium: High grade, London Metal Exchange (LME), cash (US dollar/ton)

Copper: Grade A, electrolytic wire bars/cathodes, LME, cash (US dollar/ton)

Zinc: Special high grade, virgin zinc, LME, cash settlement (US dollar/ton)

Gold: 99.5% fine, afternoon fixing London, average of daily rates (US dollar/troy ounce).

price increases was the relatively early boost of China's demand for major base metals, which had most likely acted upon the opportunity of securing good prices for inputs it expects to need as the policy stimuli work their way through. Between January and April 2009, Chinese imports increased by a staggering 641 per cent in the case of lead and 596 per cent in the case of zinc. Prices of *aluminium* recovered later in the year, but jumped by 16 per cent in July-August 2009.

While showing substantial volatility, the price of *gold* has remained at historic highs during the past three years, averaging \$921.82 per troy ounce. Gold prices tend to respond to two forces of opposite sign. On the one hand, demand for gold for industrial purposes reflects the general economic environment and thus prices follow the trends of other minerals. This may explain the decline through mid-2008. On the other hand, gold is seen as a safe haven for investors during times of crisis and financial uncertainty, thus explaining the upward trend in its price following the intensification of the financial crisis that began in late 2008.

The outlook for world prices of metals and minerals is uncertain. A gradual recovery of the world economy would support a continued upward trend, although it seems likely that prices will increase at a much slower pace. The initial upward trend of China's import demand will likely, if it continues, lead to a more gradual trend, and thus more moderate world prices in the near future.

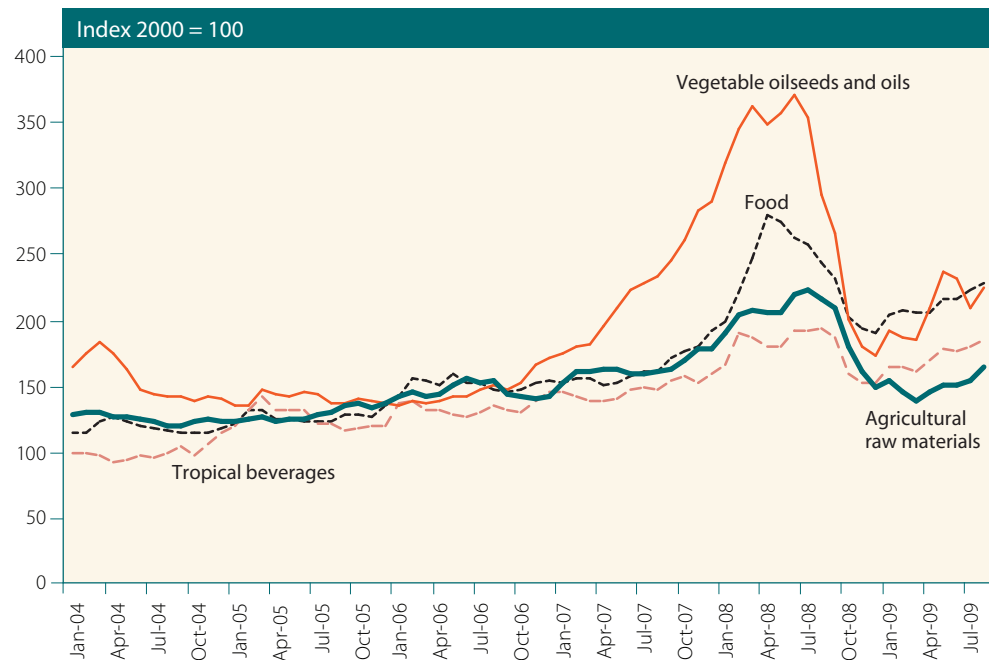
### Agricultural commodities

World prices of agricultural commodities also declined dramatically in the second half of 2008 (figure II.5). The downward trend came to a halt in the first quarter of 2009 and rebounded thereafter. By mid-2009, real agricultural commodity prices were still high compared with the low levels sustained during much of the 1980s and 1990s. This holds

In this period of uncertainty, the price of gold remains at historic highs

Despite the drastic fall in the second half of 2008, prices of agricultural commodities remain well above the levels of the 1980s and 1990s

Figure II.5  
Price indices of agricultural commodities, United States dollars,  
January 2004–August 2009



Source: UNCTAD Commodity Price Statistics.

true in particular for prices of *vegetable oilseeds and oils* and *food* commodities, which by mid-2009 were still 30 and 50 per cent above pre-boom levels. By contrast, prices of *agricultural raw materials* as a group have fallen below their pre-boom levels.

The decline in prices of food commodities during the first semester of 2009 is explained in part by the drop in crude oil prices and the related fall in demand for agricultural inputs for the production of *biofuels*. A large number of ethanol plants were closed in 2009. Biofuel production is exercising an increasing influence on fluctuations in world prices of food commodities. Wheat prices, for example, are set to continue their upward trend as a result of the expected increase in the demand for wheat used for ethanol production in the EU, China and India. Growing concerns over energy security and the climate change implications of rapidly rising fossil fuel utilization have led Governments to subsidize biofuel production, which, as a result, tripled worldwide between 2000 and 2007. Most available studies suggest that, with the exception of ethanol produced from sugar cane in Brazil, these subsidies are needed in order to make biofuels generated from food crops competitive.<sup>8</sup> Despite increasing doubts about the net contribution these biofuels make to climate change mitigation and concerns over their production's adverse impact on food security, the total utilization of coarse grains for the production of ethanol is estimated to increase from 110 million tons in 2007/08 to 119 million tons in 2009/10.

Prices of agricultural products remain vulnerable to weather changes and harvest cycles. In 2008/09, record harvests for some commodities in some regions were not fully offset by crop losses in other parts of the world suffering adverse weather conditions,

Weather conditions remain a factor in price volatility of agricultural exports ...

<sup>8</sup> For examples of ethanol studies, see <http://e85.whipnet.net/outlook/resource.html>; [http://www.pureenergysystems.com/news/2005/04/12/6900080\\_Acetone\\_and\\_Ester/Ethanol\\_Mandates\\_Subsidies.doc](http://www.pureenergysystems.com/news/2005/04/12/6900080_Acetone_and_Ester/Ethanol_Mandates_Subsidies.doc); and David Pimentel, "Ethanol fuels: Energy balance, economics, and environmental impacts are negative", *Natural Resources Research*, vol. 12, No. 2 (June 2003), pp. 127-134. It should be noted that other studies have suggested that ethanol production could be profitable where the price of oil is between \$40 and \$60 per barrel.

on balance putting downward pressure on world market prices. For example, despite dry conditions reducing crop prospects in China and Argentina, the Food and Agriculture Organization of the United Nations (FAO) forecasts that world production of coarse grains will reach 1,098 million tons by the end of the 2009 *maize* harvest season. After last year's record, this would constitute the second-largest crop in history. As a result, the price for United States corn fell by about 15 per cent through the summer, down from \$185 per ton in May-June. Similarly, despite unfavourable climatic conditions in some Asian countries, including India, Pakistan, the Republic of Korea, Taiwan Province of China and Thailand, FAO estimates that *rice* production in 2009 would be second only to the record level of about 668 million tons reached in 2008.<sup>9</sup>

*Tropical beverages* have also been affected by unstable weather conditions, with prices moving in various directions depending on the crop. The increase in *coffee* prices was exacerbated by stock shortages as opening stocks in exporting countries were at their lowest historical level in 2008/09 owing to crop failures the previous season. At the same time, coffee consumption continued its upward trend despite the economic meltdown. Weather-related supply shortages are also expected to influence prices in the *tea* and *cocoa* markets. Similarly, world *sugar* production had initially been anticipated to reach about 149 million metric tons in 2008/09 as a result of support measures (see discussion below), but successive projections have been revised downwards owing to weather factors affecting output in India and Brazil, the two largest sugar producers in the world. Sugar production is also expected to be down in China, Mexico and the Russian Federation. As a result, sugar prices have increased by about 90 per cent since December 2008, reaching \$22.4 per pound, the highest level since 1981, and making it the year's best performing soft commodity.

In summary, the supply of agricultural commodities seems to be vulnerable to increasingly unpredictable weather conditions such as droughts, floods and hurricanes. Although there is no conclusive evidence, the increased frequency and intensity of such weather shocks are generally seen to be associated with climate change caused by global warming.

Going forward, for some products and regions, positive supply effects are expected to result from government support measures for targeted commodities in developing countries. These support measures were introduced after decades of relative neglect of the agricultural sector. Sugar has been one of the most neglected sectors over the past 30 years, with underinvestment leading to low levels of supply as farmers have faced low prices. Renewed interest in the rice sector has led to the implementation of public support measures, including input subsidies, public investment programmes and producer price incentives in many countries in Africa, such as Madagascar, Mali, Mozambique and Nigeria. Although such measures have led to an expansion of cultivated areas and are expected to alleviate domestic demand constraints, they may not have immediately perceptible effects on world markets because of the low export volume of rice from these countries.

In the immediate future, the fragility of global economic activity is a stronger determinant for world markets of agricultural products than either weather or government support to increase supply, particularly with regard to agricultural raw materials. The drop in global demand has affected industrial production worldwide and with it also demand for and prices of agricultural inputs. World market prices for *cotton* experienced an initial sharp drop of 10.8 per cent between January and March of 2009 but have recovered somewhat since July, stabilizing at around 63 cents per pound. Despite the price rebound, the cotton sector has been hard hit, with global consumption declining by 10 per cent in

... but, at present, the fragility of world economic activity presents a greater factor of uncertainty

<sup>9</sup> United States Department of Agriculture estimates are lower, at 436 million tons.

2008/09 to an historic low of 23,015 million tons. *Rubber* prices have also suffered from the global recession, especially from the decline in automobile production, which generates two thirds of world demand for rubber.

## The oil market

### *Demand*

Oil demand declined in OECD countries, while it continues to rise in emerging economies

Global demand for crude oil is highly dependent upon overall economic activity. In view of the contraction of the global economy in 2009, global oil demand is expected to have decreased from 86.3 million barrels per day (mbd) in 2008 to 84.4 mbd in 2009.<sup>10</sup> This decline of 2.2 per cent follows the small drop of 0.2 per cent in 2008 and is associated with the dramatic collapse in trade and industrial production that occurred at the height of the crisis. This has also led to a reduction in transportation activity which in turn has a strong impact on energy demand: transportation fuels such as gasoline, kerosene and diesel constitute almost 60 per cent of total oil demand.

Reduced demand for energy in countries of the Organization for Economic Cooperation and Development (OECD) in particular has remained a drag on oil consumption. The corresponding data suggest that the slowdown was most severe in Japan, followed by the United States and Europe.

By contrast, the non-OECD economies have continued to see increases in the demand for oil, albeit at a more modest pace in 2009 than in preceding years. Oil demand in China and India increased by 4.6 per cent and 3.8 per cent, respectively, in 2009.

### *Supply*

In reaction to the drop in oil demand, OPEC has had several rounds of output cuts since September 2008 ...

The sharp drop in global oil demand in the light of the global economic and financial crisis left producers with the prospect of a growing excess supply. Among the Organization of the Petroleum Exporting Countries (OPEC), this has set off several rounds of agreed output cuts since September 2008, resulting in a target of cumulative output reduction of 4.2 mbd. In effect, by August 2009, OPEC had reduced production by 2.8 mbd, equivalent to a compliance rate of 67 per cent against agreed supply cuts.<sup>11</sup> However, the renewed run-up in crude prices gave individual members of OPEC the incentive to deviate from the agreed target for production cuts in order to capitalize on the potential for additional revenue, and total OPEC output amounted to 28.5 mbd in the second quarter of 2009.<sup>12</sup> As the mirror image of the tighter supply conditions among its members, spare capacity in OPEC stood as high as 6.5 mbd in August, of which 3.4 mbd belonged to Saudi Arabia alone. Non-OPEC supplies stood at 50.8 mbd in the second quarter of 2009 and are expected to reach 51.0 mbd in 2009 as a whole, up from 50.6 mbd in 2008.

... but crude stocks remain at elevated levels

In line with weaker global demand, crude stocks remain at elevated levels. Total OECD stocks amounted to 97 days of forward demand coverage in the second quarter of 2009, compared to 88 days the year before. Among the non-OECD countries, China has seen a significant build-up of inventories of crude oil since the beginning of 2008, to about 280 million barrels or 33 days of forward coverage in July.

<sup>10</sup> Data for both demand and supply are from the International Energy Agency and based on UN/DESA calculations.

<sup>11</sup> This refers to OPEC-11, which does not include Iraq.

<sup>12</sup> This refers to output in crude oil and excludes output in natural gas liquids equivalent to 5 million barrels of crude per day.

### Prices

After reaching a low of \$33.97 per barrel (pb) in 30 December 2008, Brent crude oil prices moved sideways to fluctuate between \$40 pb and \$50 pb until the second half of March. In early January 2009, crude prices rose to almost \$50 pb following a spell of cold weather, the gas dispute between the Russian Federation and Ukraine, and the conflict in the Gaza Strip. However, excess supply quickly pushed prices back to slightly more than \$40 pb towards the end of February. This increased the incentive among producers to hold back supplies. At the same time, refinery demand showed clear weakness as a result of contracting economic activity, especially in the United States. Crude prices subsequently remained rangebound, as lower OPEC output offset weaker demand.

In late March, crude prices broke out of their trading range by moving beyond the \$50 pb mark, as the announcement of a series of stimulus measures by individual Governments and central banks gave rise to more optimistic sentiment in financial markets regarding a recovery in global economic growth. Crude prices then continued on an upward trend, influenced by optimism driven by rebounding equity markets as well as by a depreciation of the United States dollar. The crude oil price temporarily peaked at \$71.55 pb in mid-June 2009. Market fundamentals also played a role in sustaining the upward trend in oil prices. These included a resumption in the demand from oil refineries after shutdowns in the second quarter of 2009, expectations of higher demand for gasoline during the summer holiday season in the northern hemisphere, as well as a decrease in floating stocks due to a narrower spread between futures prices and the spot crude price.

Yet, while continuing to be highly volatile, the oil price fell back to about \$59 pb in the first half of July resulting from an initial greater pessimism vis-à-vis the economic outlook, continued high inventories and overall weaker demand. Subsequently, however, the price reversed course again and increased by 25 per cent to about \$75 pb at the beginning of August, in view of renewed optimism over the recovery of the global economy. From August through October 2009, the offsetting effects of greater optimism about the economic outlook and continued high levels of inventories appear to have kept crude oil prices at about \$70 pb (figure II.6).

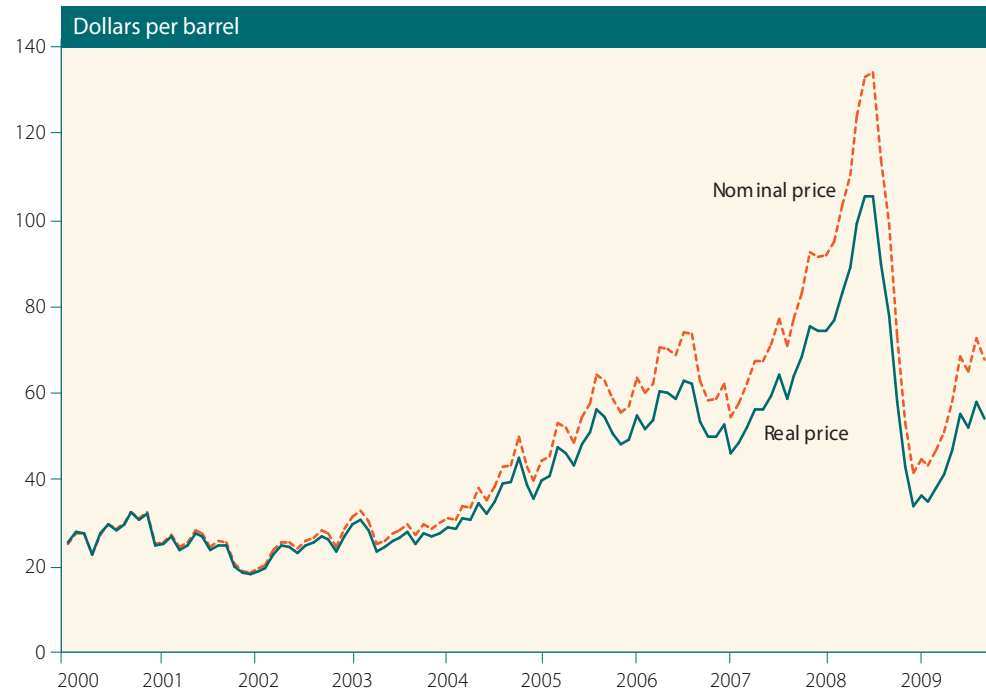
### The outlook for oil markets

The outlook for oil markets in 2010 will greatly depend on the timing and shape of any global economic recovery. Based on the baseline scenario of moderate global economic growth in 2010, global oil demand is expected to increase by 1.5 per cent in 2010, to 85.7 mbd. The stabilization of the OECD economies is forecast to result in unchanged oil demand from those countries, which will represent 53.0 per cent of global demand. By contrast, oil demand from non-OECD countries is expected to show an increase by 3.3 per cent in 2010 to 40.3 mbd, driven in particular by emerging economies such as China. Moreover, increases in regulated oil-product prices tend to cause a hoarding effect, making it difficult to ascertain whether any increase in demand in fact stems from stronger underlying economic activity.

Demand for crude is also expected to remain solid on the part of financial investors. The current global environment of low interest rates should sustain strong incentives to seek higher returns in a variety of asset classes, including crude oil. Moreover, expectations by some market participants of an uptick in inflation in the wake of the significant fiscal and monetary stimulus measures provide a motive for investing in oil as a hedge against inflation. This rationale acquires an even greater relevance in view of the

The outlook for oil markets in 2010 will greatly depend on the timing and shape of the economic recovery

Figure II.6  
Nominal and real Brent crude oil prices, January 2000–April 2009



Source: IMF, *International Financial Statistics*.

Note: The real price is deflated by the United States Consumer Price Index.

expected continued weakening of the dollar, which implies higher import prices for the United States and those economies with a currency pegged to the dollar.

On the supply side, non-OPEC production is forecast to increase to 51.5 mbd in 2010. At the height of the crisis, there were fears of a significant negative impact on non-OPEC supplies stemming from lower oil prices and tighter credit conditions, making oil exploration and production less profitable and more difficult to finance. However, with the recovery in oil prices and the expectation of a normalization in credit markets, these more pessimistic forecasts for non-OPEC supplies are slowly giving way to a more stable outlook supported by solid investment activity. In addition, significant new oil discoveries, for example in the Gulf of Mexico and off the coast of southern Brazil, have provided a vivid illustration of the continued potential for companies to achieve relatively high replacement ratios of production through successful exploration projects.

In the outlook, Brent crude prices are projected to average \$72 pb in 2010, underpinned by the recovery in global economic activity, falling inventories and continued efforts by OPEC to support prices. While the current crude supply of 84.3 mbd in the second quarter of 2009 remains sufficient to cover the current demand of 84.1 mbd, the market is expected to become increasingly tight moving into 2010. Demand will reach about 85.5 mbd at the beginning of 2010, based on a more positive outlook for economic growth as well as the seasonal winter effect in the northern hemisphere, leaving the market undersupplied at current output levels. Consequently, although stocks will provide some cushion against more abrupt upward price pressure from any uptick in demand, the demand-supply relationship points to the emergence of increased upward pressure on prices from the fundamental side starting in the first quarter of 2010. However, the actual price effect will then depend to a large extent on how OPEC will move, especially with respect to making use of its considerable spare capacity.

Oil prices may average \$72 per barrel in 2010

### Risks and uncertainties

The outlook for oil prices remains subject to a number of risks. For example, the combination of tighter-than-expected supply by OPEC and a stronger recovery in economic activity could lead to a more pronounced increase in crude prices. Another source of uncertainty relates to developments in currency markets. A more drastic fall in the value of the dollar would increase the upward pressure on oil prices by increasing the demand for oil as a hedge against inflation. With regard to geopolitical factors, the international dispute regarding the Islamic Republic of Iran's nuclear programme holds the potential to also affect the oil market. With an output level of 3.9 million barrels of crude per day in 2008, the Islamic Republic of Iran represents the second-largest producer within OPEC after Saudi Arabia, raising the spectre of unexpected supply disruptions in the case of escalating tensions. A resurgence of financial instability remains a further risk, although one with a potentially more ambiguous effect on oil prices. While this could increase the demand for oil as a real asset, it also has the potential to cause a sharp drop in oil demand through a renewed weakening in economic activity.

### Evolution of the terms of trade for developing countries<sup>13</sup>

The fall in global demand during the economic and financial crisis exerted deflationary pressures on all markets, with the prices of primary commodities experiencing their steepest falls from peak levels in 2008.<sup>14</sup> As noted above, after hitting bottom in the first quarter of 2009, prices for most primary commodities rebounded. These global price movements have led to huge shifts in terms of trade, strongly driven by the changes in the prices of primary commodities. By contrast, terms of trade faced by countries specializing in exports of manufactures either remained flat (those with a relatively even composition of exports and imports of manufactures and low dependency on energy or commodities) or improved. In the aggregate, exporters of manufactures witnessed relatively stable terms of trade.

As figure II.7 shows, even though primary commodity prices began to decline in the second half of 2008, the previous rally had been so impressive that annual averages generally remained well above 2007 levels. As a consequence, annualized data for the terms of trade in 2008 show a continuation of the trends since 2003, with all developing and transition economies, except those in East and South Asia, benefiting from improved terms of trade. Also when classified by trade specialization, a continuation of past trends can be observed in 2008, with clear gains for oil exporters and a deterioration for exporters of manufactures and (low-income) net food importers (except those countries that are also net fuel exporters). Mining and mineral exporters form the only cases in which a reversal in the terms of trade is already visible on average for 2008. Meanwhile, terms-of-trade reversals in 2009 are widespread compared with the trends experienced from 2002-2007.

Exporters of manufactures faced more stable terms of trade than commodity exporters

Terms of trade for oil exporters remained positive in 2008 despite declines in the second half of the year

<sup>13</sup> This section discusses the specific changes in net barter terms of trade per region according to trade structure, rather than in prices of individual commodities (as in the previous section) or in the effect of terms-of-trade shocks in the value of the trade balance of each region (as in the first section of this chapter).

<sup>14</sup> See United Nations Conference on Trade and Development, *Trade and Development Report 2009*, op. cit. The influence of the financialization of commodity markets and its unwinding as deleveraging was taking place was apparent in both the upward and downward movement of prices.

While prices of oil and commodities remain high compared with long-term trends, it is doubtful whether such gains can be sustained

The size of the terms-of-trade shocks strongly depends on the structure of commodity trade. Low-income countries that are net importers of food and energy experienced improved terms of trade in the second half of 2008 and in early 2009 as world market prices for these commodities fell steeply. Yet, those prices remain high compared with levels at the beginning of the decade, and the continued high volatility in food and energy prices is characteristic of the high vulnerability of these economies to swings in global markets. More generally, it remains unclear whether developing countries that have gained from improved terms of trade during the present decade, such as countries in Western Asia, parts of Africa, and Latin America and the Caribbean, as well as many of the economies in transition, will see benefits in the near future. The vulnerability of economies strongly dependent on exports of primary commodities has been repeatedly underscored in the economic development literature up until very recently, although the debate appears to have faded away with the substantial terms-of-trade gains during the present decade. The current global crisis should be a warning that commodity price booms tend to be temporary and that, in order to avoid the long-lasting negative consequences of severe trade shocks, countries should engage counter-cyclical macroeconomic policy rules to protect their domestic economy from such adversity and invest in greater economic diversification to reduce vulnerability over time.<sup>15</sup>

## Trade policy developments

### The Doha Round

A proven resistance to recur to beggar-thy-neighbour policies could be a positive stimulus for a return to negotiations on the Doha Round

The most recent major attempt to re-energize the Doha Round of multilateral trade negotiations was at an informal ministerial meeting of the World Trade Organization (WTO) in July 2008. This attempt failed over disagreements on various issues, but especially on the special safeguard mechanism (SSM) for agriculture in developing countries. Since then, the world has been severely hit by the global economic crisis. A natural, expected reaction to economic turmoil is the use of trade barriers to dampen the negative impact on domestic producers. During the Great Depression of the 1930s, protectionism spread rapidly and caused irreparable economic and political damage. As discussed below, there were wide concerns that a similar—albeit perhaps more timid—protectionist trend might emerge as the current crisis deepened. To counteract this, there have been numerous calls by world leaders, including at the G20 summits, to conclude the Doha Round before the end of 2010 as a credible multilateral policy response to the crisis. According to WTO estimates, the successful conclusion of the Round would provide a global stimulus and welfare gains of about \$150 billion. While small in relation to WGP and the fiscal stimulus measures, such gains would be an incentive not to recur to the beggar-thy-neighbour policies that characterized the initial responses during the Great Depression.<sup>16</sup>

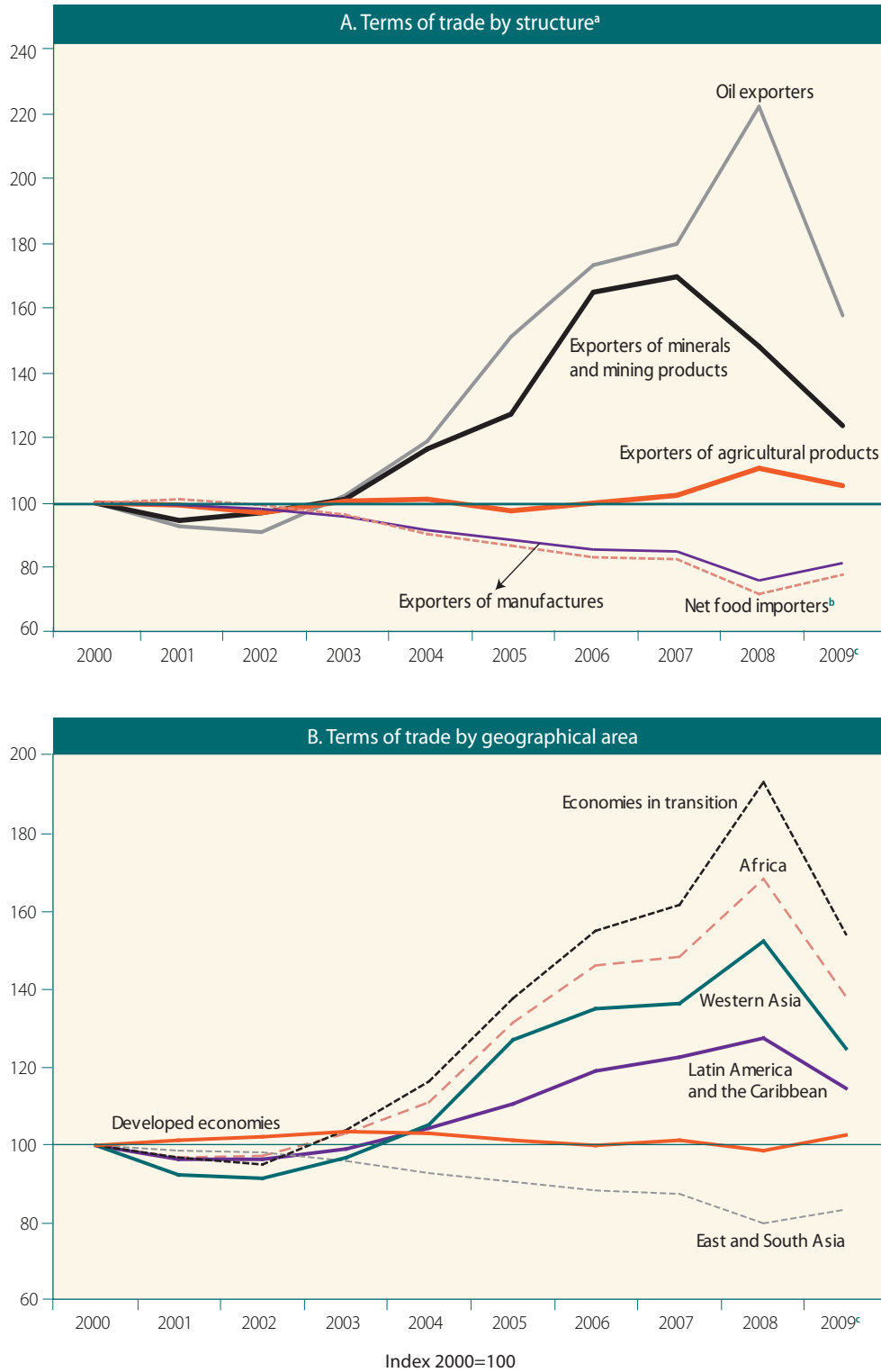
A meaningful development content of the Round's final package could make a significant contribution to a sustained recovery

The road towards a successful completion of the Doha Round is yet to be found. There is no doubt that the success of trade negotiations embracing the concerns of all countries would send a positive signal that countries were committed to multilateralism after

<sup>15</sup> See, for instance, *World Economic and Social Survey 2008: Overcoming Economic Insecurity* (United Nations publication, Sales No. E.08.II.C.1).

<sup>16</sup> See Report on G20 Trade and Investment Measures, issued on 14 September 2009 by the World Trade Organization, the Organization for Economic Cooperation and Development and the United Nations Conference on Trade and Development, available at [http://www.unctad.org/en/docs/wto\\_oecd\\_unctad2009\\_en.pdf](http://www.unctad.org/en/docs/wto_oecd_unctad2009_en.pdf).

Figure II.7  
Net barter terms of trade, selected countries, 2000–2009



**Sources:** UNCTAD Secretariat calculations, based on UNCTAD Handbook of Statistics Online; UNCTAD, *Commodity Prices Bulletin*; United Nations Commodity Trade Statistics Database; United States Department of Labor Statistics; Japan Customs; IMF, International Financial Statistics database; and ECLAC, Balance of Payments Statistics database.

- a** Selected developing economies and economies in transition.
- b** Net food importers are low-income food-deficit countries, excluding exporters of fuel, minerals and mining products.
- c** Partly estimated.

an economic and financial crisis that, in part, was precipitated by a lack of international regulatory coordination. More significantly, given that the crisis has also underscored the importance of proactive government policy action, a meaningful development content of the Round's final package would be seen as the key to maximizing the contribution of coordinated policy action for the recovery and post-crisis development, particularly for the LDCs.

It may be recalled that the Doha Round's original focus was on redressing development-related imbalances and asymmetries in the WTO agreements by placing development objectives at its centre. In practice, the protracted negotiations have gradually shifted away from a defined development agenda. In particular, the establishment of a strengthened and more operational special and differential treatment (SDT) in favour of developing countries and, more generally, the resolution of development-related issues which had been identified during the implementation of the Uruguay Round were essentially downgraded. The shift away from the development agenda was also manifest in the draft modalities on agriculture and non-agricultural market access (NAMA), by which the diverse capacities, needs and interests of developing countries were addressed through a de facto differentiation among developing countries, departing from the traditional approach to SDT based on non-discrimination among developing countries.

The crisis has also underscored the vital importance of strengthening countries' resilience to exogenous shocks, in particular through effective safeguard mechanisms. Therefore, development-related deliverables that were originally expected of the Round (such as the special safeguard mechanism (SSM) in agriculture which aims to preserve the necessary policy space against adverse external shocks) should logically be stressed in the negotiations.

While the above-mentioned developmental issues and safeguard mechanisms should not be disregarded, perceptions of poor prospects for a successful conclusion of the Doha Round in the foreseeable future seem to have provided incentives for establishing regional and bilateral preferential trade agreements. Nonetheless, the global economic crisis appears to have slowed the emergence of such trade arrangements outside WTO disciplines, but this may be temporary, and the trend could be revived after recovery.

Therefore, as the global recovery takes hold and the risks of proliferation of bilateral agreements re-emerge, the modus operandi of the multilateral trading system should stay firmly aligned with the development concerns that were at the centre of the conception of the Doha Round. A shift to place greater focus on implementation, policy review and the enhancement of trade-related capacities would perhaps be necessary to avoid the risk of non-implementation and disputes.

Consolidating enhanced and predictable Aid for Trade programmes, delivered both at the bilateral and multilateral levels, would form an indispensable ingredient to support such a process. Similarly, as part of broader national development strategies, consideration should be given to enhancing the space for developing countries to conduct development and industrial policies aimed at improving productivity, export competitiveness and diversification of trade and production. In order to strengthen the capacity of developing countries to cope with large adverse external shocks, certain use of legitimate trade defence instruments should be permitted, such as the (temporary) use of tariffs, safeguards, anti-dumping and other countervailing measures.

Finally, defining the future boundaries of the trading system is likely to be a formidable challenge, as the global economic and financial crisis has highlighted the weakness of having multilaterally agreed rules in one area (trade) even as another area (finance) is left largely unregulated.

It is critical that effective safeguard mechanisms in trade negotiations be strengthened

A shift towards greater focus on implementation could avoid obstacles to trade negotiations

Consolidation of Aid for Trade programmes remains indispensable

## Low-intensity protectionism in response to the crisis

In their response to the current global crisis, many Governments have been tempted by sentiments of economic nationalism and protectionism. Although the fiscal and financial packages that have been introduced are widely considered to be indispensable policy measures for economic stability and recovery, many contain elements—such as direct State support to industries, bailouts, other subsidies and “buy/lend/invest/hire local” conditions—that favour spending on domestic goods and services at the expense of imports and, hence, of global trade. In addition, several of those support measures may infringe upon fair trade practices, distort competitive conditions and influence decisions on the location of investment and production, with implications for many years to come. Developing countries that lack the capacity to engage such support measures may suffer undue loss in competitiveness as a consequence.

Increased trade protection in one country is likely to lead to retaliation by other countries in the presence of a global negative shock, which could lead to generalized beggar-thy-neighbour policies. The sum of these actions will likely have negative welfare implications for the world as a whole and most likely no country will stand to gain in the end. Bearing this in mind, at the latest G20 Summit in Pittsburgh, world leaders emphasized that “[i]t is imperative we stand together to fight against protectionism ... to refrain from raising barriers or imposing new barriers to investment or to trade in goods and services, imposing new export restrictions or implementing World Trade Organization (WTO) inconsistent measures to stimulate exports and commit to rectify such measures as they arise.”<sup>17</sup>

Nonetheless, trade defence or “contingency protection” measures are allowed under the current WTO agreements and need not be inconsistent with a feasible multilateral trading system. Their application would be regulated within an agreed multilateral framework. These contingency protection measures are designed to provide (temporary) relief for specific sectors of the domestic economy and are considered important elements of national policy space for all countries. Unfortunately, many of these measures (for example, safeguards, anti-dumping and other countervailing measures) are at present considered to be too murky and complex to implement in practice.

The poorer developing countries, and the LDCs in particular, could benefit from such measures in coping with adverse external shocks. Most of these economies have a weak capacity for implementing counter-cyclical policies. Their economies tend to be heavily dependent upon exports of a few commodities and they are bound to search for external financial sources to mitigate the consequences of adverse external shocks. Contingency protection measures could facilitate the continuation of diversification policies (as discussed above) during crises and severe adverse external shocks. It will be equally important, however, to ensure early implementation of the duty-free, quota-free treatment for the exports of LDCs, as agreed in Hong Kong SAR in 2005. This would be a tangible confidence-building measure demonstrating that the poorest countries are indeed supported directly by providing them full and duty-free market access for their exports. Another supporting policy could be an assurance by developed countries to keep their generalized system of preferences (GSP) schemes free of new restrictions and conditions. Such preferential schemes can provide an important stimulus for encouraging trade growth in developing countries, thus partially compensating for their limited ability to put in place policy stimuli on the scale of developed countries.

Policy responses to the crisis tend to favour spending on domestic goods and services

Outright trade protection in one country could lead to generalized beggar-thy-neighbour policies

“Contingency protection” measures are allowed under the current WTO agreements

The poorer developing countries could benefit from increased contingency protection in coping with adverse external shocks

<sup>17</sup> See Leaders’ Statement: The Pittsburgh Summit 2009, available at <http://www.pittsburghsummit.gov/mediacenter/129639.htm>.

## Headroom for tariff protection in developing countries

There is still room for tariff protection in developing countries as a part of national economic responses to the crisis

Since the existence of the WTO, its members, and especially developing countries, have reduced tariffs to well below the legally bound rates belonging to the most-favoured-nation (MFN) status. This has provided some space to increase applied tariffs, if necessary. The difference between applied and bound tariff rates is often called “tariff water”. Recent estimates show that the world’s tariff water amounts to 11 percentage points, while it is close to zero in the United States and China, and higher than 70 percentage points in many LDCs and small island developing States.<sup>18</sup> Further evidence indicates that there is also quite significant variance across commodities, with the world’s tariff water for agricultural products amounting to about 27 percentage points, while the tariff water for manufactures is about 9 percentage points. Countries with “positive water” (that is, with lower applied rates than the MFN-bound rates) could actually increase tariffs to protect domestic industries.

In response to the current crisis, large countries have been more inclined to increase tariffs than small countries. WTO studies report several instances in which developing countries and economies in transition have raised import tariffs well within their bound limits.<sup>19</sup> Developed countries, on the other hand, have closely approached their bound limits, but no instances have been reported so far of attempts to raise their tariffs above them, probably because this would require renegotiation of existing WTO rules. At the same time, several Governments have also decreased tariffs. Thus, there is no clear trend towards an increased use of import tariffs.

### Non-tariff measures

Equally, there is so far no evidence pointing to the widespread use or systematic increases in non-tariff barriers in the wake of the global crisis. Fragmentary data suggest more incidental use of such trade restrictions in a limited number of countries, including the introduction of stricter import licensing requirements for some sensitive goods like steel. Safeguards and anti-dumping measures have been applied by some developed and developing countries, but with no clear indication of any significantly increasing trend. Anti-dumping measures can be very disruptive to trade and the rise in the use of such measures remains an issue that Governments will watch keenly.

### Subsidies

Subsidies are actionable under WTO rules and can be countervailed

Governments of mostly developed and the larger developing countries have increased the use of subsidies as a part of national economic stimulus packages in response to the crisis. Subsidies can be highly distortive to trade. As is the case for tariffs, they can artificially improve the competitiveness of those producers receiving the subsidy not only domestically but also in international markets. By supporting companies that would have been unable to compete, the subsidies may put otherwise healthy companies in an uncompetitive position, forcing even more subsidies. Subsidies are actionable under WTO rules and can be countervailed. Furthermore, they may in turn generate a chain of retaliatory measures and increased protection.

<sup>18</sup> See Liliana Foletti, Marco Fugazza, Alessandro Nicita and Marcelo Olarreaga, “Smoke in the (Tariff) Water” in *The fateful allure of protectionism: Taking stock for the G8*, Simon J. Evenett, Bernard M. Hoekman and Olivier Cattaneo, eds. (London, United Kingdom, Centre for Economic Policy Research, 2009).

<sup>19</sup> See World Trade Organization, Report to the TPRB from the Director-General on the financial and economic crisis and trade-related developments, JOB(09)/30, 26 March 2009.

The recent joint WTO-OECD-UNCTAD report<sup>20</sup> indicates that a number of Governments have resorted to various policy measures in 2009 to protect domestic industries and employment affected by the global crisis.<sup>21</sup> It is perceived that by using their existing national policy space, countries can respond to the current economic crisis by increasing temporary protection against imports. Measures which are consistent with the multilateral trade rules may not warrant the label of “protectionism”. The concern should be with any excessive use or abuse of such measures by trading partners outside of the multilateral framework.<sup>22</sup> Thus far, however, it seems that despite some policy slippage, Governments have avoided resorting to widespread trade restrictions in their anti-crisis strategies. This desire to avoid beggar-thy-neighbour responses might also work as an incentive to conclude the Doha Round based on careful attention to development concerns that have strongly come to the fore during the current crisis.

The conclusion of the Doha Round should be debated on the basis of its merits for development and not as a means to avert protectionist measures

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<sup>20</sup> See Report on G20 Trade and Investment Measures, op. cit.

<sup>21</sup> There are also a number of initiatives by non-governmental organizations and the academic community which trace “protectionist signs” worldwide at various levels of detail (for example, see “Global trade alert” trade policy discussion at [www.voxeu.org](http://www.voxeu.org)). These studies and opinions are informative and also help maintain vigilance towards averting a rising tide of protectionism and retaliation. However, the approach of such studies may be too narrow in so far as most of them do not manage to distinguish between rescue measures that Governments undertake legitimately to support full employment in their own countries and measures of a beggar-thy-neighbour nature that are sanctioned by the existing international legal framework.

<sup>22</sup> See Jagdish Bhagwati and Arvind Panagariya, “Legal trade barriers must be kept in check”, *Financial Times*, 11 June 2009.