

Part I Trends

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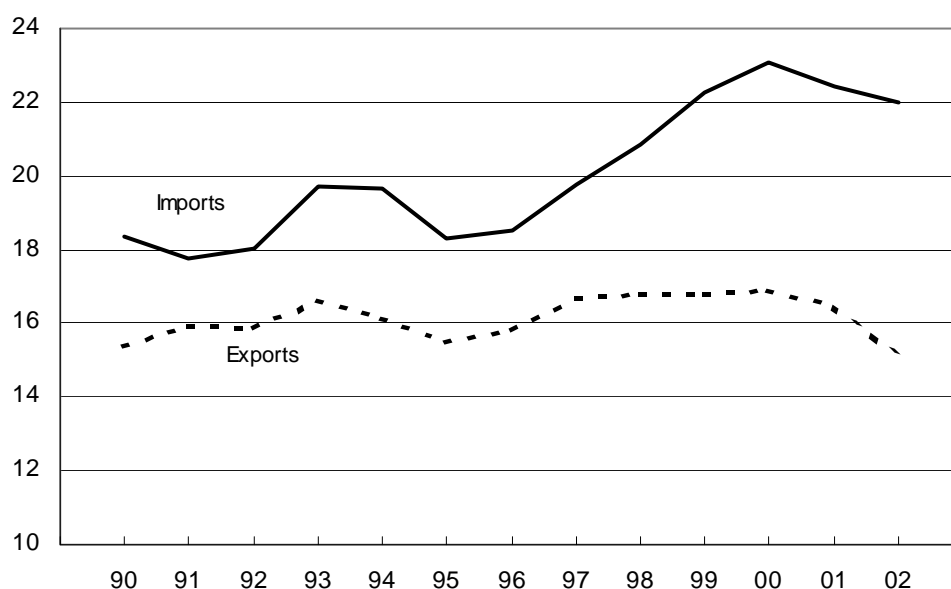
Part I Trends

1. Trends in global trade

World GDP and exports continue to grow: Around the end of 1990s, the average growth rate of world trade was; the fastest growth periods are the years of 1994、1995、1997 and 2000. The average growth rate of trade doubled that of GDP.

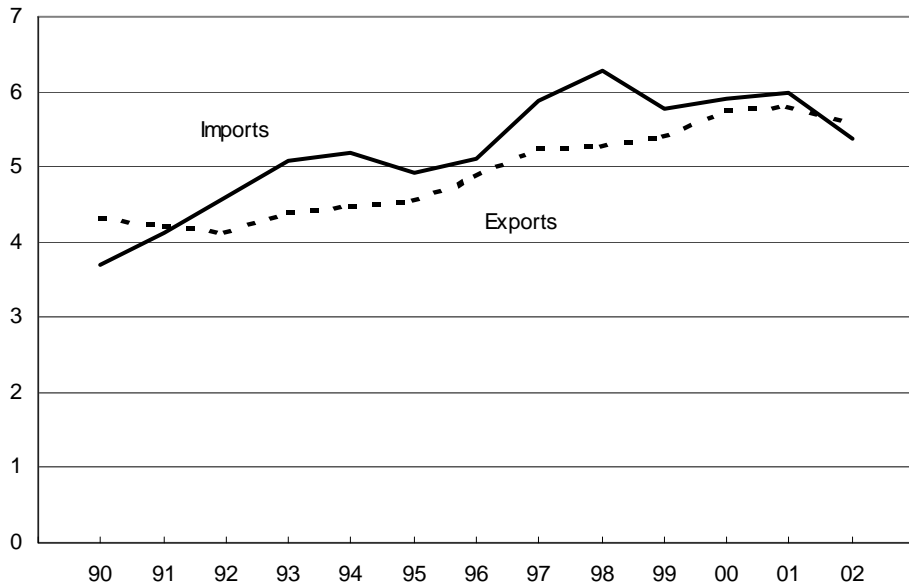
While the volume of world trade has expanded significantly, the distribution of trade and the balance of economic power is changing. We divide the world geographically into North America, Latin America, Western Europe, Central and Eastern Europe (transition economies), Africa, Middle East and Asia. It shows that North America Western Europe and Asia could dominate the global trade. North America's share of world exports dropped from 27.3% in 1948 to 15.1% in 2002;

North America's share in world trade (1990-2002)



Latin America's share also dropped. In 1948, the share was 12.3%, in 2002, it dropped to 5.6%;

Latin America's share in world trade (1999-2002)



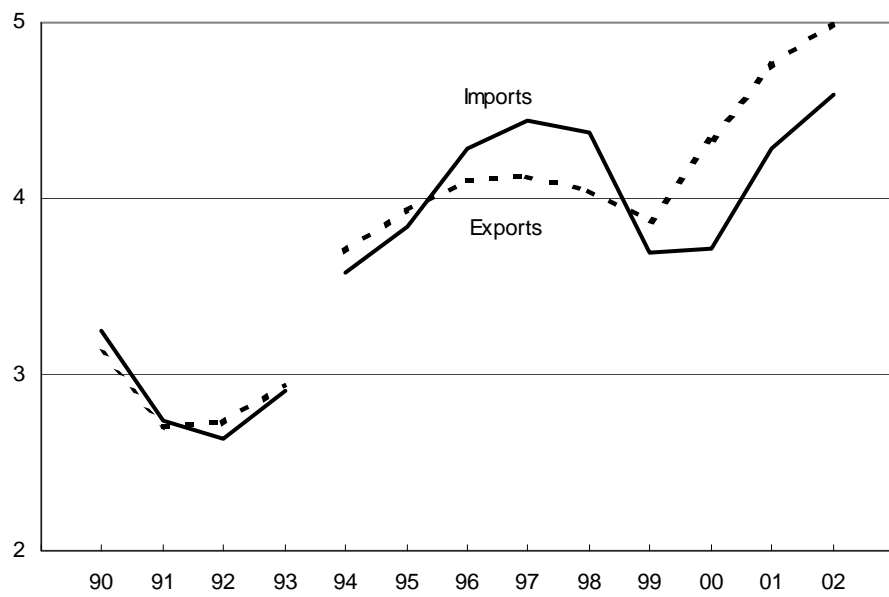
Western Europe's share in world exports had steadily increased from 31.5% in 1948 to 42.4% in 2002;

Western Europe's share in world trade (1999-2002)



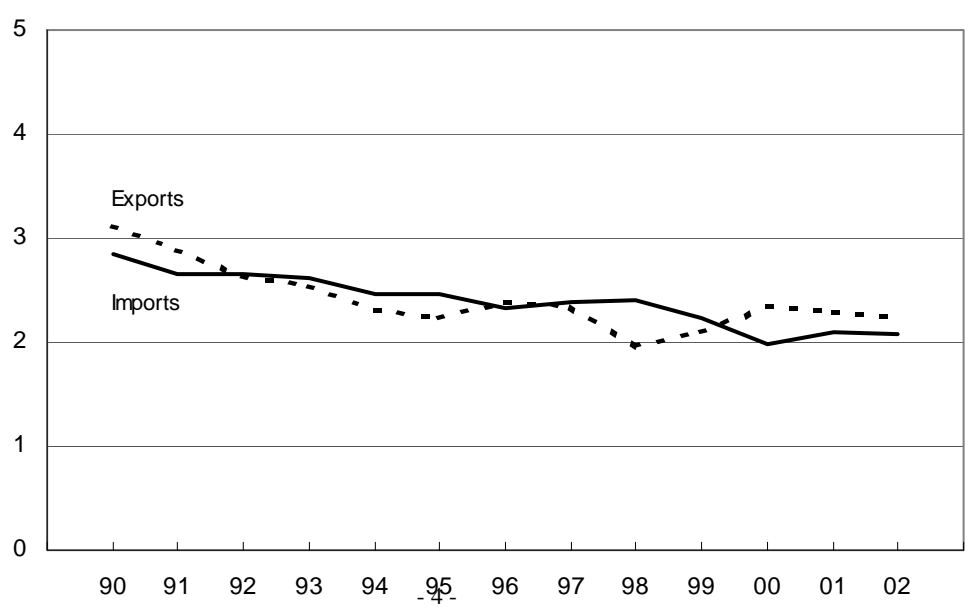
Central and Eastern Europe has stagnated between 2.9% and 11.0% range (1948-2002);

Central and Eastern Europe's share in world trade (1990-2002)



Africa's in global exports declined between 1948 and 2002 from 7.3% to 2.2%;

Africa's share in global trade (1990-2002)



Middle East had remained between 2.0% and 6.8% ;

Middle East's share in world trade (1990-2002)



Asia has the fastest penetration with the share in global exports rising from 13.6% in 1948 to 25.8%. (according to latest figure, China close to 10%).

Asia's share in world trade (1990-2002)



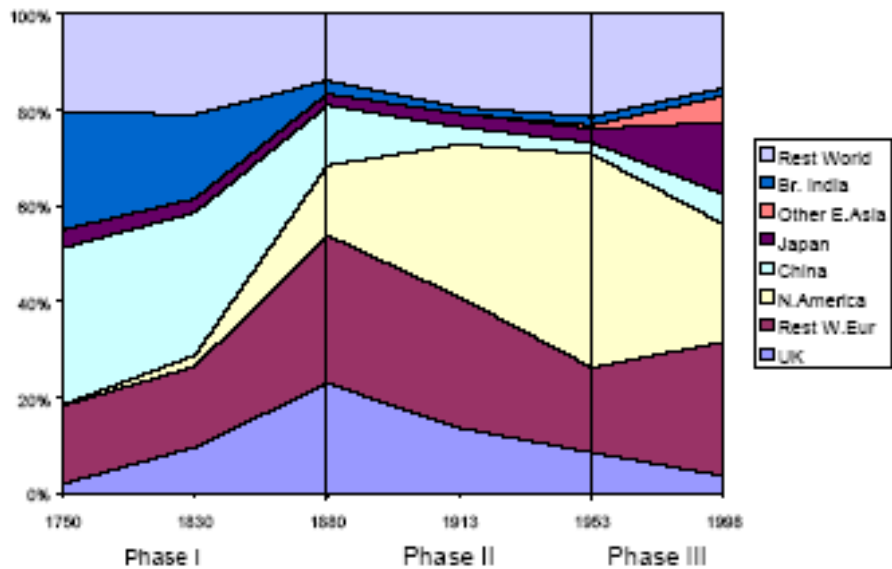
In 1750, China and India produced 50% of the world manufacturing output while Western Europe's share was only 18%. From the 19th century to the 20th, the pattern of global trade had gone through three major changes.

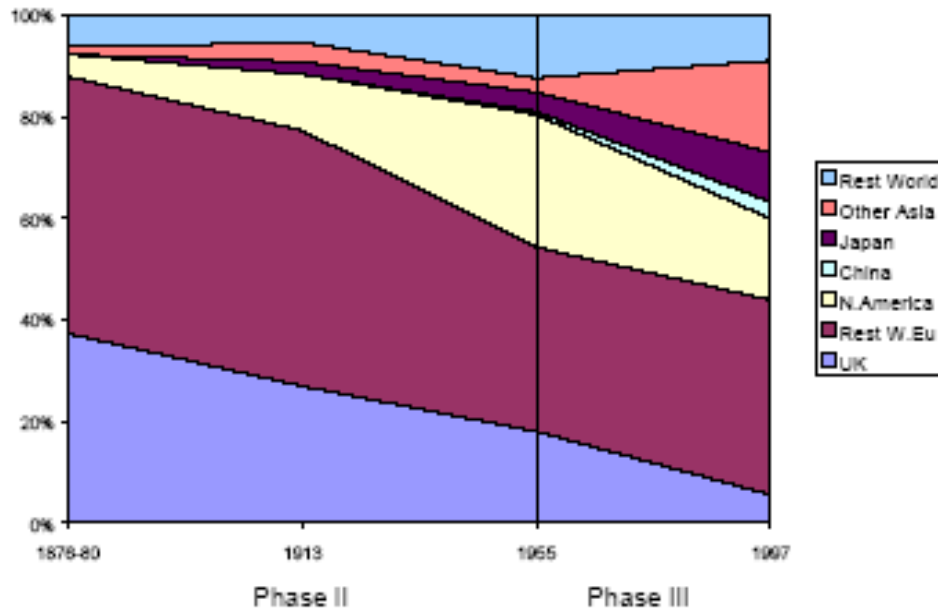
First, between 1820 and 1870, Western Europe, especially UK became dominated in the global trading system while the importance of China and India declined.

Second, between 1870 and 1950, the US replaced Western Europe UK as the most important trading nation.

Third, from 1950 to today, see Asia, especially Japan and China rose as important trading nations in the world.

Exports by regions





2. The rise of emerging economies

If measure at PPP, the emerging market economies now accounted for more than half of total world GDP measure at PPP. At market exchange rate, it is close to 30 percent. But even at the market exchange rate, they accounted for over half of the increase in global output in 2005. This is not just about China and India. These two made up less than one-quarter of the total increase in emerging economies in 2005. This means that rich countries no longer as dominate the global economy as before.

By most measures, emerging countries are more important in the global economy. Their share of world exports has jumped to 43 percent, from 20 percent in 1970. They consumed half of world's energy and have accounted for 4/5 of the growth in oil demand in the past five years. They also hold 70 percent of the world's foreign exchange reserves. Until the 19th century, China and India were the world's two biggest economies. Before the steam engine and power loom give Britain the lead, today's emerging economies dominated world output. Estimates by Angus Maddison, an economic historian, suggest that in the 18th centuries up to 1820, these economies produced, on average, 80 percent of world GDP. But they were left behind by

Europe's technological revolution and the first wave of globalization. By 1950 their share of world output had fallen to 40 percent.

Now they are on the rebound. During the five years before 2006, their annual growth has averaged 7 percent and above the 2.3 percent growth in rich economies. The International Monetary Fund forecasts that in the next five years emerging economies will grow at an average of 6.8 percent a year, whereas the developed economies will grow only at 2.7 percent. If both groups continue in this way, in 20 years' time, emerging economies would account for 2/3 of global output at purchasing power parity.

Since 2000, world GDP per head has grown by an average of 3.2 percent a year, thanks to the acceleration in emerging economies. That would beat the 2.9 percent annual growth during the golden age of 1950-73, when Germany and Japan were rebuilding their economies after the war and would certainly exceed the growth during Industrial revolution. That growth too was driven by technological change and by an explosion in trade and capital flows, but by today's standards it was nothing impressive. Between 1870 and 1913 world GDP per head increased by an average of only 1.3 percent a year. This means that the first decade of the 21st century could see the fastest growth in average world income in the whole history.

Because the developing countries started with much less capital per worker and than developed countries they have huge scope for boosting productivity by importing western machinery and know-how. Catching up is easier than being a leader. When America and Britain were industrializing in the 19th century, they took 50 years to double their real incomes per head; today China is achieving the same result in nine years.

China is having a bigger impact on the global economy than other emerging countries because of its vast size and its openness to trade and investment with the rest of the

world. The sum of China's total imports and exports amounts to about 70 percent of GDP, against only 25-30 percent in India and America. China now accounts for 10 percent of world trade, up from 4 percent in 2000.

With the internet, many once non-tradable services, such as accounting, can be provided from afar, exposing more sectors in the developed world to competition from India and elsewhere.

Workers share of the cake is the smallest it has been for at least three decades. In many rich countries average real wage are flat or even falling.

Meanwhile, capitalists have rarely had it so good. In America, Japan and euro area, profits as a share of GDP are at or near all-time highs. Corporate America has increased its share of national income from 7 percent in mid-2001 to 13 percent this year. The redistribution of income from labor to capital is explained by some people by the entry of China, India and other emerging economies into world markets. Globalization has lifted profits relative to wages in several ways.

First, offshoring to low wage countries has reduced firms' costs. Second, employers' ability to shift production, whether or not they take advantage of it, has curbed the bargaining power of workers. Third, increased immigration has depressed wages in sectors such as catering, farming and construction.

Traditional trade theory, based on the ideas of David Ricardo, a 19th century economist, argues that economies gain from trade by specializing in products where they have a comparative advantage. Developed countries have lots of skilled workers, whereas emerging economies have lots of low-skilled ones, so according to the theory of comparative advantage, advanced countries will specialize in capital intensive products requiring skilled labor and emerging economies in low-tech products. Competition from cheaper imports will reduce the wages of unskilled workers in developed economies, but workers as a whole will be better off.

Yet according to the evidence, the average worker does not seem to enjoy his fair share of the fruits of economic prosperity. Richard Freeman (Harvard) points out to several reasons why traditional theory may need modifying.

The first is the size of emerging economies' labor has shifted the global capital labor ratio (which determines the relative rewards of capital to workers) massively against workers as a group. With the entry of China, India and Russia into the global market, the labor supply has doubled from 1.5 billion to 3 billion. This has caused a drop in global capital-labor ratio. According to economic theory, it should reduce the relative price of labor and raise the global return of capital. Downward pressure on wages in rich countries may continue for some time. China still has about 200 million people underemployed in rural areas. It may take two decades to move these workers to factories. So wages for low-skilled workers may rise more slowly than productivity, reducing China's unit labor costs.

A second reason why traditional trade model needs modifying has to do with a rise in emerging countries' skill levels. It used to be thought that only rich countries had educated labor force able to produce skill-intensive goods, but poor countries have invested heavily in education in recent years, allowing them to start to compete in more sophisticated markets. Every year, 1.2 million engineers and scientists graduate from Chinese and Indian universities. This number is as many as in America, the European Union and Japan combined. In 1970, America accounted for 30 percent of all university enrollments worldwide; now its share is down to around 12 percent.

The third flaw in the traditional trade model is the assumption that rich countries would make high-tech ones. In fact, rich countries no longer have a monopoly on high-tech capital and know-how. The OECD says that in 2004 China overtook America as the world's leading exporter in information technology goods. This may exaggerate China's move up the ladder as laptop computers, mobile phones and DVD players are no longer cutting-edge technology and they are typically assembled in

China by foreign firms, with most of their high-value components being imported. According to Ferrantiao et al, most of the hi-tech exports have come from processing trade. Even so, the faster spread of technology to poor countries is weakening the rich world's comparative advantage in high-tech sectors. As emerging economies start to export high-tech goods and services this reduces the prices of such goods in world markets and hence reduce the wages of skilled workers in the developed world.

Emerging economies are driving the global growth and having a bigger impact on developed countries' inflation, interest rates, wages and profits. As these new comers to the global economic system become more integrated into the world economy, they will provide the biggest boost to the world economy since industrial revolution. Indeed, it is likely to be the biggest stimulus in history because industrial revolution fully involved only 1/3 of the world's population. By contrast, this revolution covers most of the globe. So the economic gains as well as adjustment pains will be far bigger.

While there are difficulties in the Douha Round negotiations, most governments would like to be identified as defendant of free trade or advocate of freer trade.

3. The trading blocs

Since 1990s Trading blocs are gaining momentum. In 2003, internal trade in EU, North America and ASEAN accounted for 36% of the world total.

4. Trade in intermediate inputs and vertical specialization with globalization

Countries' production are linked through the so called vertical specialization, with each country specializing its production at certain parts of the whole value chain.

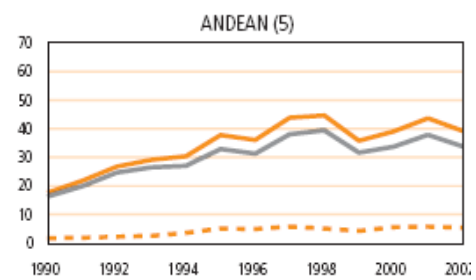
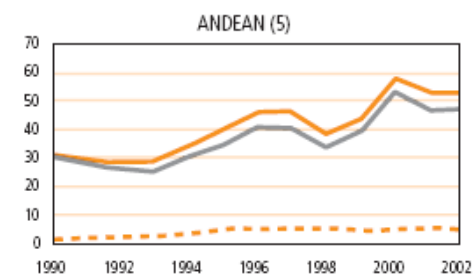
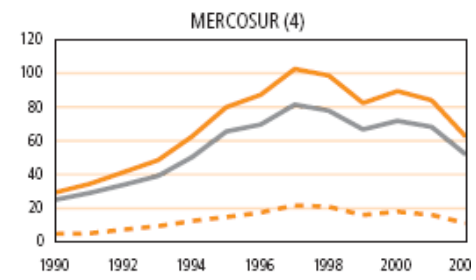
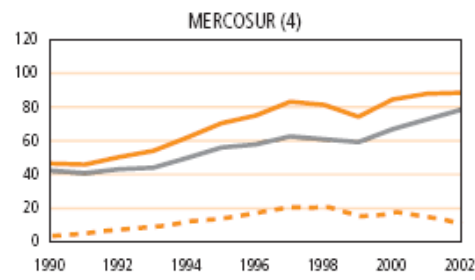
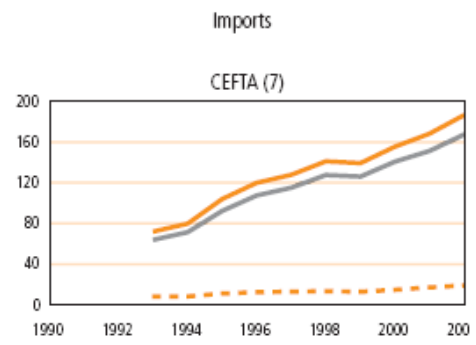
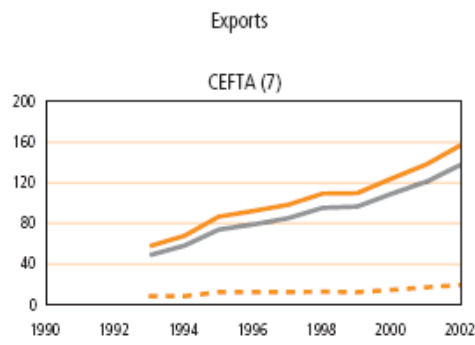
Barbie Doll (Tempest, 1996, Feestra 1998)

The product design was provided by the US and intermediate inputs were imported from Japan and Taiwan. The cloth was supplied by China while the final product was

assembled in China, or India or Malaysia. When the product was exported from Hong Kong to the US, the price was about 2 dollars. The Chinese labor cost to produce a Barbie doll was only 35 cents. The total raw materials cost was 65 cents, and the transport cost and profits to Hong Kong was about 1 dollar. The Barbie was sold at 10 dollars, in which Mattel could make 1 dollar profits and the remaining 7 dollars went to transportation and distribution.

5. Intra and extra trade in major trading blocs





Total exports ———

Intra-exports - - - -

Extra-exports ———

Total imports ———

Intra-imports - - - -

Extra-imports ———