Chapter 2
CANADA AND WORLD TRADE

Trends in world trade

In 1986 the volume of world merchandise trade was estimated to have grown at the same rate as in 1985, viz. 3.5 per cent, exceeding the growth of world merchandise output by .5 per cent (GATT estimates). The pace of expansion has been moderate by comparison with earlier cycles, and trade has played a less dynamic role. Nevertheless, despite disturbances in some commodities and considerable protectionist sentiment in many countries, the gains from international trade did continue to increase through 1986.

Significant structural changes continued to alter the international economic environment during 1986, as integrated financial markets, deregulation, and improved flows of information and technology became more widespread. These developments facilitated flows of capital and investments, with consequences for exchange rates, interest rates, international debt and commodity prices. Thus, trade became increasingly linked with other economic flows in a network of interdependence involving both developed and developing countries. As a consequence of this interdependence, there were renewed efforts in 1986 to co-ordinate macroeconomic policies affecting exchange rates and trade flows.

The US dollar value of world merchandise trade passed the two thousand billion mark for the first time, up 10 per cent over 1985 to an estimated $2 110 billion. This increase appears to have resulted from the above-noted increase in volume, combined with the valuation effect arising from the large depreciation of the US dollar during this period; inflationary effects were small.

The sharp drop in petroleum prices that occurred with the collapse of OPEC price support arrangements at the beginning of 1986 was a major factor behind a high growth in the volume of trade in mineral and energy products, which increased seven per cent, with higher consumption and stockbuilding. Crude petroleum trade flows grew nine per cent in volume, but declined in total value as a result of the price drop.

There was an increase of three per cent in output volume of agricultural products, and a one per cent increase in trade volume. This reflected a worldwide increase in productivity combined with the effects of domestic support programs. The prices of non-fuel primary products on world markets dropped in 1986 by an amount estimated between 6 and 16 per cent (in terms of SDRs)* although the value of world agricultural trade increased slightly in dollar terms, owing to the higher valuation of food movements within the European Community. There was a pronounced weakness in traditional import markets for many agricultural products, as exports from an augmented range of suppliers competed to meet import requirements that were often static or diminishing.

Trade in manufactures, traditionally the fastest growth area, expanded by only three per cent in volume in 1986, down from 5.5 per cent growth in 1985. Many factors contributed to the relatively weak performance of trade in manufactures including a slowdown in economic growth in the industrial countries, a fall in real income in OPEC countries and other developing countries, indebted countries' efforts to reduce imports and the failure of exports to respond proportionately to changes in effective exchange rates.

Developed countries and centrally-planned countries both increased their trading among themselves as a percentage of world trade, but developing countries did not. For developed countries, total exports and imports rose by 10-15 per cent, and about 10 per cent for centrally-planned East European economies. Much of these increases was due to the dollar revaluation effect. Developing country exports declined by about $41 billion, and their imports rose by $12 billion. The developing countries as a group swung from a surplus position in 1985 to a deficit position in 1986, owing mainly to the drop in oil and other commodity prices. For the first time, developing countries earned more foreign exchange in 1986 by exporting manufactures than by selling fuels and non-fuel commodities. Preliminary figures for the most heavily indebted countries show that their combined merchandise trade surplus fell from $29 billion in 1985 to an estimated $13 billion in 1986.

The problem of imbalances

The deficit of the United States on its global merchandise trade account continued to grow during 1986, reaching $169.8 billion (US), while the global trade surpluses of Japan and the Federal Republic of Germany also continued to grow, reaching the equivalent of $83.1 and $52.3 billion (US) respectively (IMF figures). The United States dollar depreciated against the yen and deutschmark, returning to its effective level of 1980, but the volume of US imports nevertheless continued to grow during the first three-quarters of 1986, while US export growth remained sluggish. There were some domestic US factors involved in this slow response of the adjustment process, including the high budget deficit, structural rigidities in the United States economy and a high income elasticity of demand for imports. These trade imbalances were part of a larger disequilibrium in international payments stemming from

* SDRs — Special Drawing Rights in the IMF are a unit of account derived from a weighted average of the five main world currencies.