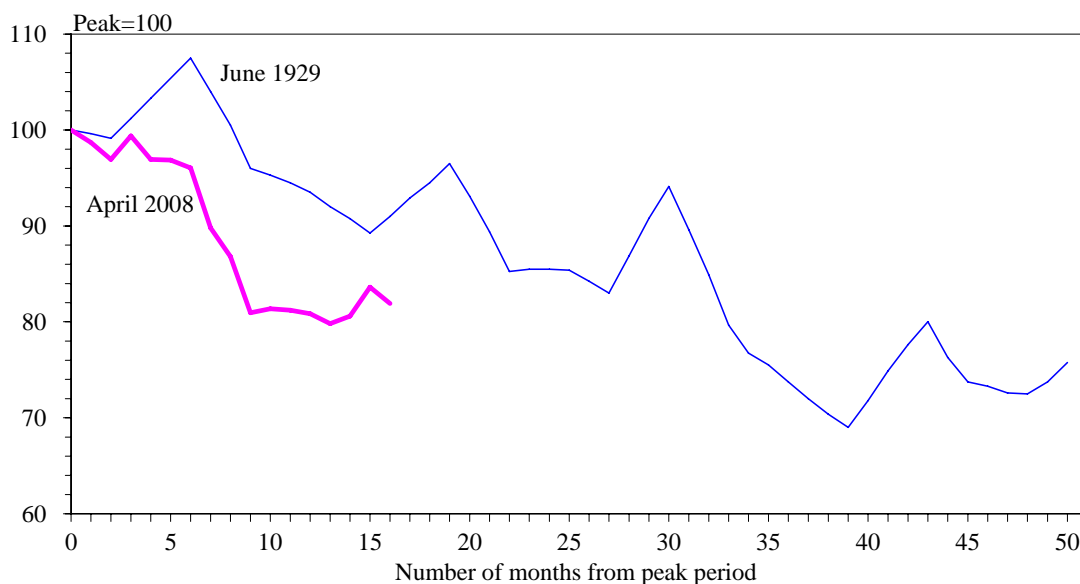


Box 1.1**The performance of world trade during the Great Depression and the current crisis**

The global economy slid into the deepest recession in more than 60 years after the outbreak of the financial tsunami. The collapse in global demand led to drastic declines in world merchandise trade in the final quarter of 2008 and the beginning months of 2009. While global economic activities in terms of industrial production showed signs of gradual recovery in recent months, along with improving consumer and business sentiments in many major economies, world trade remained notably lower than the pre-crisis levels.

In a study by Eichengreen and O'Rourke (2009)⁽¹⁾, a comparison was made between the performance of world trade during the current crisis and that during the Great Depression in the 1930s. It was noted that during the current crisis the volume of world trade slumped by around 20% in June 2009 from its pre-crisis peak in April 2008. By comparison, during the Great Depression the volume of world trade fell by around 10% over the same 14-month span from its pre-crisis peak in June 1929 (*Chart 1*). Thus the severity of the contracting impact on world trade is even more pronounced in the current crisis than that in the comparable stage of the Great Depression. While the more recent data showed that global trade stabilized somewhat in July and August, the total trade volume remained around 17% below its peak in April 2008.

Chart 1: Performance of world trade volume during the current crisis and the Great Depression



Source: Eichengreen and O'Rourke (2009). Data for the current crisis extended to August 2009.

(1) (<http://www.voxeu.org/index.php?q=node/3421>)

Box 1.1 (Cont'd)

The plunge in world trade during the current episode can be attributable to the rapid inventory drawn-down due to the loss of business confidence, extremely tight credit conditions in the advanced economies, as well as the extensive use of global supply chain as a result of trade liberalization and technology advancement over the decades. Compared to the 1930s, the use of global supply chain is much more widespread, giving rise to increased trade involving intermediate goods through exports and imports and to closer trade links among economies. Thus the impact of the collapse in import demand in advanced economies on world trade had been amplified by these trade links during the current crisis.

In the recent months, many major economies saw nascent recovery thanks to the strong policy actions by the respective governments in shoring up aggregate demand and credit supply. Nevertheless, their unemployment situation continued to deteriorate and this trend is widely expected to remain well into next year. These would easily trigger protectionist sentiments, which many major economies had pledged to fight against in many multilateral arenas. According to a report jointly prepared by the World Trade Organization, the Organization for Economic Cooperation and Development, and the United Nations Conference on Trade and Development⁽²⁾ for the G-20 Leaders' Meeting in Pittsburgh in September, there was no indication of a descent into high-intensity protectionism. Yet the report noted "policy slippage" since the beginning of the current round of global recession. It also highlighted the possibility of the governments of major economies to continue to cede ground to protectionist pressures as the main risk to world trade and thus global economic activity.

As *Chart 1* indicates, during the Great Depression the volume of world trade fell for several years, with a peak-to-trough decline of over 30%. An important reason was the enactment of the Smoot-Hawley Tariff Act in 1930 in the United States and the subsequent retaliatory actions taken by its trading partners. The rise in protectionism that exacerbated the global downturn during the Great Depression was a grave mistake that the world today needs to avoid. In this regard, the recent increased incidences of trade disputes among the world's major trading entities are a concern.

For an economy as externally-oriented as Hong Kong, the revival in world merchandise trade is critical to Hong Kong's economic recovery process. This in turn hinges on the sustainability and strength of economic rebound in the major advanced economies after public policy support is withdrawn. On this, it is of utmost importance that governments will continue to guard against the rise in protectionism, to ensure that the conditions for a sustainable recovery remain in place.

(2) Report on G20 Trade and Investment Measures
(<http://www.pittsburghsummit.gov/documents/organization/129863.pdf>)