DEVELOPMENT RESEARCH

Development Research Group
Monthly Research Highlights

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This month's theme: TRADE AND GLOBALIZATION

Trade, FDI and Global Value Chains

A populist backlash against globalization is prompting many to ask: What price might we pay for stepping back from a tightly integrated global economy? In this Policy Research Talk, Trade, FDI, and Global Value Chains, Senior Economist Hiau Looi Kee drew on a tool called the Overall Trade Restrictiveness Indices to explore a case study of the costs of withdrawal from a customs union. She found that while the costs to trade in the short run may be limited, such a step could threaten a country's long-run competitiveness depending on its impact on foreign direct investment flows.[1]

Revving the Engine of Services Trade

Trade fell dramatically during the 2008 financial crisis and has grown sluggishly since then. But this overall trend obscures an important fact: trade in services has been steadily growing since 2010. This expansion of services trade—from health and education to transport, telecommunications, and tourism—presents significant opportunities for developing countries. Until recently data on services trade policies was sparse. But in this Policy Research Talk, Research Manager Aaditya Mattoo unveiled new research and data, including the Services Trade Restrictions Database, that is advancing knowledge about services trade policies, and how best to reform them.[2]

As long as large income gaps exist, people will find a path to specific destinations via transit countries

Many migrants' paths involve multiple countries and are likely to be the outcome of complicated decision processes. For example, 9 percent of recent immigrants to the United States arrived from a transit country—a country *other* than their place of birth. This pattern is even more common for migrants with tertiary education: nearly 14 percent of such migrants did not come directly from their birth countries. Among those arriving in the United States from OECD countries, such as Canada and the United Kingdom, the transit migration ratio exceeds 30 percent. Historical evidence and current data provide ample evidence that many migrants live in a series of countries for different lengths of time, experience repeated migration episodes, or have circular migration paths. These decisions are based on current location-specific income levels, migration costs, as well as (expected) future opportunities that will become available only at a new location. Simulations of various policy scenarios highlight the spillovers of transit migration paths between alternative destinations. Governments need to incorporate the externalities created by their policy actions, especially on their neighbors, via direct and transit migration channels.[3]

The trade slowdown matters, but perhaps not as much as we fear

Since the Global Financial Crisis, world trade growth has lagged slightly behind growth of gross domestic product. Trade is growing more slowly not only because growth of global gross domestic product is lower, but also because trade itself has become less responsive to gross domestic product. There are reasons behind the changing trade-income relationship and its consequences for economic

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[1] September 2016: Event | Video | Presentation.

[2] April 2016: Event | Story | Presentation | Video.

[3] Transit Migration: All Roads Lead to America, **Erhan** Artuc and **Caglar Ozden**, World Bank Policy Research Working Paper 7880, November 2016 | Forthcoming in *Economic Journal*.

growth. On the demand side, sluggish world import growth may adversely affect individual countries' economic growth, as it limits opportunities for their exports. On the supply side, slower trade may diminish the scope for productivity growth through increasing specialization and diffusion of technologies. Although the changing trade-income relationship matters, the quantifiable effects do not appear to be large.[4]

A trade facilitation reform in Serbia reduced uncertainty about customs clearance times

The World Trade Organization's 2013 Trade Facilitation Agreement (TFA) included a host of operational reforms designed to increase the speed and reduce the cost of moving goods across international borders. One such reform, in-house clearance, allows qualified firms in Serbia to clear customs within their own warehouse rather than at the customs office. The estimated causal impacts on trade outcomes for 21 firms that adopted in-house clearance for import shipments showed the program compressed the distribution of clearance times for adopting firms, but median clearance times, inspection rates, and import value fell slightly. The most evident benefit of the program for participating firms is reduced uncertainty about customs clearance times.[5]

Domestic value added in exports is rising in China

Domestic content in exports is in decline in most countries, but not in China. The determinants of rising domestic content in Chinese exports is explored using firm- and customs transaction-level data merged with firm survey data to measure and analyze the ratio of domestic value added in exports to gross exports at the firm level. The approach embraces firm heterogeneity, which reduces aggregation bias. The analysis shows that, for China, the substitution of domestic for imported materials by individual processing exporters raised domestic content in exports from 65 to 70 percent during 2000–2007. Such substitution indicates that the country is relying less on imports and becoming more competitive in intermediate input sectors, presumably due to the country's trade and investment liberalization, which deepened its engagement in global value chains and led to a greater variety of domestic materials becoming available at lower prices.[6]

Exporting to high-income nations leads to quality upgrading

The destination of exports matters for the input prices paid by firms according to detailed customs and firm-product-level data from Portugal. Exchange rate movements when used as a source of variation in export destinations show that firms that export to richer countries charge more for outputs and pay higher prices for inputs, other things being equal. The results support the hypothesis that an external increase in average destination income leads firms to raise the average quality of goods they produce and to purchase higher-quality inputs. These findings have implications for our understanding of the upgrading process in developing countries. In particular, that raising the quality of outputs requires raising the quality of inputs, which in turn suggests that increasing exports to high-income destinations may require the upgrading of entire complexes of suppliers and downstream producers, not just of exporters.[7]

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[4] Does the Global Trade Slowdown Matter? Cristina Constantinescu, **Aaditya Mattoo**, and Michele Ruta, World Bank Policy Research Working Paper 7673, May 2016 | Audio interview with Aaditya Mattoo on how to confront protectionism and better manage globalization (Radio Sputnik, July 25, 2016).

[5] Expediting Trade: Impact Evaluation of an In-House Clearance Program, **Ana M. Fernandes**, **Russell Hillberry**, and Claudia Berg, World Bank Policy Research Working Paper 7708, June 2016.

[6] Domestic Value Added in Exports: Theory and Firm Evidence from China, **Hiau Looi Kee** and Heiwai Tang *American Economic Review* 106 (6): 1402–36, 2015. (Also available as Working Paper 7491).

[7] Export Destinations and Input Prices, **Paulo Bastos**, Joana Silva, and Eric Verhoogen, World Bank Policy Research Working Paper 6914, June 2014.