Leverhulme Centre for Research on Globalisation and Economic Policy

The University of Nottingham

Research briefing

Trade costs differences there to be exploited

Country Trade Costs, Comparative Advantage and the Composition of Trade

By Chris Milner, David Greenaway and Danny McGowan

Economists have shed new light on how trade costs shape a country's export patterns, highlighting opportunities for governments to help boost exports.

Trade costs represent all the costs involved in delivering a traded good from its producer to its final user overseas, excluding the cost of producing the good itself.

Most commonly when thinking of trade costs, people tend to focus on costs like trade barriers, which are induced by public policy.

This study concentrates more on costs arising out of, for example, transport infrastructure, distribution, contract enforcement and legal and regulatory requirements.

The study examined how trade costs affected exports in more than 70 countries and almost 160 industries over two decades.

It showed that counties with lower trade costs exported more of those products for which trade costs are more important.

Researchers concluded there was support for the theory that lower trade costs offer a country a source of comparative advantage, in the same way that lower labour or raw material costs do.

Where these costs are comparatively low they should be regarded as an endowment that a nation can exploit for competitive advantage within the global economy.

The research concludes that it should be possible to enhance this endowment and that this is an area worthy of considerably more research.

Key findings

- Non-policy-induced trade costs such as transport infrastructure, distribution and contract enforcement are more significant than previously thought.
- Trade costs should be seen as an endowment, and one that can be exploited to competitive advantage.
- More research is needed to highlight ways to enhance trade cost endowments.

Research basis

Researchers studied the export performance of up to 71 countries and 158 industries for five-year periods from 1972 to 1992.

The data were assembled from various sources. These included the National Bureau of Economic Research's World Import and Export dataset; the Manufacturing Industry Database produced by the NBER and the US Census Bureau's Centre for Economic Studies; and the Bureau of Economic Analysis's Input-Output table.

This and other GEP research can be found at http://www.gep.org.uk/leverhulme/publications/research_papers.php

Comments and implications

Study co-author Professor Chris Milner said: "Considerable research has been done in the past on trade volumes and the impact of costs induced by government policy – for instance, trade barriers.

"But increasingly economists are realising that issues like poor transport infrastructure, language issues and the quality of institutions play a much more important role in encouraging or discouraging international trade and that these costs are greater than was previously thought.

"Differences in trade costs capture the differences in the overall quality of countries' infrastructure and institutions and in the competitiveness and effectiveness of their business and policy environments.

"We concentrated on how those differences matter empirically to patterns of trade.

"We found trade costs are actually an 'endowment' that affects the pattern of comparative advantage and export composition – and we consider our findings robust.

"This fresh way of looking at trade costs opens up new avenues of research. It should be possible for governments to help enhance trade cost endowments and therefore boost comparative competitive advantage and ultimately exports of a country's goods and services.

"Effective research in this area could uncover useful insights to help shape government policy and generate significant economic impact."

About GEP

Based at the University of Nottingham and substantially funded by grants from the Leverhulme Trust, GEP is the major centre in Europe studying the impacts of globalisation and economic policy.

In January 2008 it opened GEP in Malaysia at the University of Nottingham's purpose-built Semenyih campus, 30km from Kuala Lumpur. In November 2008 it launched GEP in China at the University of Nottingham, Ningbo, China.

GEP is keen to promote its research work and is committed to communicating its expertise. Its academics have advised the Treasury, the OECD, the World Bank and the WTO.

Website: www.gep.org.uk

Study authors

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Professor Chris Milner is a Professor of International Economics. His areas of specialisation include trade and trade policy, particularly in developing countries. Chris joined the Nottingham School of Economics as a Professor in 1995 and served as Head from 1995 to 2002 and from 2004 to 2008. He has acted as an adviser to international organisations including the World Bank, UNCTAD and the Commonwealth Secretariat, as well as several governments in Africa and the Caribbean.

David Greenaway

Professor David Greenaway is Vice-Chancellor of the University of Nottingham, a Professor of Economics and the founder and former Director of GEP. His research interests lie primarily in the fields of exporting and productivity, cross-border investment, international trade and economic development. David has been Chair of the Armed Forces Pay Review Body since 2004 and is also a member of the Senior Salaries Review Body, a governor of the National Institute of Economic and Social Research, Chair of the Scientific Advisory Council at the Institut für Weltwirtschaft, University of Kiel, and a member of the Scientific Committee of the European Trade Study Group. He has been a consultant to the World Bank, UNIDO, UNCTAD, the European Commission, GATT, UNECE and the Treasury.

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