

newsletter

Leverhulme Centre for Research on Globalisation and Economic Policy

Issue 18 Summer 2006

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Leverhulme Centre
for Research on Globalisation and Economic Policy

Conference Report: GEP fifth Post-Graduate Conference

In April GEP hosted its fifth Post-Graduate Conference. It attracted young post-graduate students from Europe, America, Asia and Australia. In this Conference report the organiser Sara Maioli comments on the themes of the papers presented and their main findings. Sara is a Research Fellow at GEP.

This year the Annual GEP Post-Graduate Conference, which is open to PhD students addressing topics related to globalisation, reached its fifth edition (and the fourth open to PhD students outside Nottingham). Over time the event has grown steadily in number of applications and this year we decided to extend it to a second half day in order to accommodate as many presentations as possible (but still, the selection was quite tough). With a total of 27 delegates, we had 20 universities representing four continents! The quality of the papers was also very impressive, reflecting the growing interest in globalisation topics and the intensity of research. This year all the participants were given a dis-

cluding the poster session presentations, to maximise the opportunities for feedback. This stimulated an even more intensive exchange of ideas and opinions. I report on some selected papers, one from each of the six sessions, to give a flavour of the vibrancy of research being pursued across the globe by these young academics.

In the session 'Globalisation and Technological Transfer in India and China' **Veerle Slootmackers from the Catholic University of Leuven** presented the



Robin Hood stealing ideas from some of the speakers

Post-Graduate conference report, contd...

paper 'FDI Spillovers, Firm Heterogeneity and Degree of Ownership: Evidence From Chinese Manufacturing' (joint with F. Abraham and J. Konings). She recalled how the empirical literature on productivity spillovers in transition economies finds no evidence of positive spillovers on domestic firms from foreign investors, or it even finds negative spillovers. Her paper thus studies the direct and indirect effects of foreign direct investment in the Chinese manufacturing industry, using firm-level panel data, taking into account the degree of foreign ownership. It is the first paper that analyses FDI spillovers in China using micro data. She finds that the degree of ownership matters for spillovers: foreign multinationals that own a majority stake in the affiliate reduce the risk of undesired knowledge spillovers to a minimum compared to foreign firms that hold only a minority stake. Hence, when multinationals can deploy their most advanced production techniques without fear of spillovers, a negative competition effect on the local market is observed. In addition, the importance of absorptive capacity is stressed since firms that are far away from the technological frontier do not benefit from the presence of foreign firms, while firms operating close to the technological frontier enjoy positive spillovers.

In the session 'The Gains from Inward Foreign Direct Investment' **Sam Hill from the Australian National University** presented the paper 'Growth effects of foreign direct investment: What role for liberalisation and absorptive capacity?'. It aimed to contribute to the ongoing debate over the role of host country factors in conditioning the growth effects of foreign direct investment. Within a general cross-country growth empirics framework, he used a newly compiled dataset to test the hypothesis that countries which adopt a liberal approach to the regulation of FDI benefit more from a given flow of foreign investment. As an extension, he also considered the relevance of trade policies and investments in human capital in conjunction with investment policies. His results

suggest that investment policies are directly relevant with a stronger relationship between FDI and growth observed for countries that adopt more liberal FDI policies. He also found some evidence of complementarity between liberal investment policies and openness to trade in enhancing the growth effects of FDI. However, the impact of the interaction between investment policies and human capital is less clear.



Participants of the 5th GEP Post-Graduate Conference

Charles Ackah from University of Nottingham and CREDIT presented the paper 'Is Trade Policy Openness Good for Growth?' in the session 'Trade And Developing Countries' where he investigated the effects of trade policy on the rate of economic growth and poverty in developing countries. The relationship between trade barriers and growth is estimated using a dynamic panel regression model for data on 48 developing countries over 1980-1999. Trade barriers are captured by measures of tariffs, import and export taxes. He paid particular attention to simultaneity, country-specific effects and the potential contingency of this relation on income. The results highlight the non-linearity in the relationship between trade barriers and economic growth, with the marginal impact of tariffs on growth rising in initial income. In particular, the relationship between tariffs and growth is negative and significant across all alternative policy measures, but is not uniform

Post-Graduate conference report, contd...

across income groups. The richer the country, the smaller are the growth-reducing effects of trade protection and the poorer the country the more likelihood that trade protection will affect growth negatively. This finding is particularly interesting for Sub-Saharan Africa (the world's poorest continent) where trade restrictions are still pervasive and where poverty is widespread.

A window on the research presented in the session 'Institutions and Contracts as Determinants of Globalisation Outcomes' has been offered by **Marcella Nicolini from University of Milan** with the paper 'Institutional Quality and Comparative Advantage: An Empirical Assessment'. Her paper is part of an important recent strand of literature underlying the relationship between institutional quality and international trade. The idea beneath this is that institutions are in charge of the enforcement of contracts: good institutions are those which punish the party that breaks the contract, and implement this activity with a high probability of success. Goods can be more or less complex, according to the number of intermediate inputs needed for the implementation. Complex goods require a large number of contracts to be produced, and therefore rely more on the level of contract enforcement of their country. This implies that good contract enforcement, and thus high institutional quality, is a source of comparative advantage in the production of more complex goods. Several theoretical models have declined this idea and her paper tests empirically the different predictions of these models following Romalis (2004) specification. She indeed finds strong support to the predictions of the different models, employing new measures of complexity of goods and of institutional quality as robustness check.

Luca David Opmolla from New York University contributed to the session titled 'What Drives a Firm's Decision to Export or Invest Abroad?' with the paper 'Hysteresis in Export Markets' (joint with Alfonso A. Irarrazabal) which develops a dynamic monopolistic competition model with heterogeneous firms to analyze the effects of uncertainty on international trade. A stationary equilibrium with N symmetric countries and where firms' productivities evolve stochastically over time is characterised. This model retains the main results of previous recent papers like Melitz (2003), Bernard, Eaton, Jensen and Kortum (2003) and Luttmer (2004), and provides additional new predictions. Re-entry export costs generate hysteresis in export participation creating a band of co-

existence within the stationary distribution of firms' productivities. The decision to export becomes history-dependent and new entrants and incumbent firms might sustain temporary negative profits before becoming profitable. Most importantly, the model is very amenable to estimation and simulation, therefore representing a useful tool for analyzing the effects of trade policies. Several moments, like average age, size and productivity of different categories of firms (exporters, entrants, exiters, incumbents), the hazard rate of exiting or of becoming an exporter as a function of age and others have closed-form solutions that are crucial for matching static and dynamic features of the data. Evidence from Chile was shown to provide support for the findings.

Finally, the session on 'Financial Interdependencies in a Globalised World' closed the conference with the paper 'Exchange Rates and Exports: Evidences from Manufacturing Firms in the UK' presented by **Xufei Zhang from University of Nottingham and GEP** (joint with David Greenaway and Richard Kneller). This work is the first to look empirically at the role of exchange rate movements and exchange rate uncertainty in affecting UK firms' decisions on export participation and export share. The analysis distinguishes export adjustments due to changes in export share by existing exporters from the movements due to changes of entry into export markets. Using data on a representative sample of UK manufacturing firms, the paper finds sunk costs hysteresis to be an important factor in determining export market participation. The firm's export participation decision does not appear to be related to movements of exchange rate faced by the exporter. Instead, exchange rates have a significant and negative impact on the export share of the firms after entering export markets. The responsiveness of the export share to exchange rate changes is not quantitatively small: one index point depreciation in REER index will increase export share by about 1.28 percent. Also, the export behaviour of multinational firms is less likely to be affected by exchange rate changes.

In addition to the highlighted six sessions, there were three poster sessions: 'Labour Market Adjustments to Globalisation', 'Topics in International Trade' and 'What does attract FDI?' each containing four or five papers.

Interested readers are referred to the conference website (<http://www.gep.org.uk/conferences>) from where the papers are downloadable.



The World Economy Annual Lecture 2006

Professor Richard Baldwin

*Professor of International Economics,
Graduate Institute of International Studies,
Geneva*

on “Asian Regionalism”

*Thursday 22nd June 2006,
A48, Sir Clive Granger Building, University Park,
University of Nottingham*

For further details contact sue.berry@nottingham.ac.uk

Life after Longbridge: How much do displaced workers lose?

*The globalisation process is likely to make both winners and losers. Surely, among the latter are the workers who lose their jobs because of the closure of firm where they used to work. However, until recently it has been virtually impossible to measure precisely the earning loss caused by plant closures because of lack of data. In this article, **Richard Upward** provides an overview on some new results on this issue, obtained by investigating a recently matched employer-employee data set. They point to sizeable loss in earnings because of plants shutting down. Richard is Senior Lecturer in the School of Economics of the University of Nottingham and a Senior Research Fellow at GEP.*

The closure of the MG Rover car plant at Longbridge in April last year, and the threatened closure of the Peugeot plant at Ryton, have served to highlight again how precarious manufacturing jobs can be. Car manufacturing is, of course, a *prima facie* example of a highly globalised industry, both in terms of the cars that are produced, and the process of production itself.

John Martin’s article in the previous *Newsletter* (Spring 2006) reminds us that globalisation has “winners” and “losers”, and few of the workers at Longbridge and Ryton would disagree that they are among the losers.

But how much do displaced workers actually lose? How long does it take them to return to work, and are their wages much lower when they do re-enter the labour market? Recent research in GEP has utilised a new source of data which allows us to answer this question more precisely than previously.

The key problem in measuring the costs of worker displacement is the “what if” conundrum. *What if* a worker whose factory shuts down had in fact not been laid-off? The problem is that we do not observe this alternative outcome: a given worker is either displaced, or not. We must therefore make a comparison between workers whose factory closes with comparable workers whose factory does not close.

To illustrate this, let’s look at some data. We have a sample of approximately 1% of all UK employees whose employer is part of the PAYE income tax

scheme. Information on these workers is collected from their employer every April. Information collected includes the worker’s usual earnings. The data we use cover the period 1994–2003.

For each of these workers we can search a database of firms to find information on their employer. Crucially, we can determine when a worker’s employer disappears from the data-

base of firms. If this happens, we label the worker as being “displaced” because of firm closure. We then compute the average earnings of those workers who are dis-

placed with the average wage of those who are not.

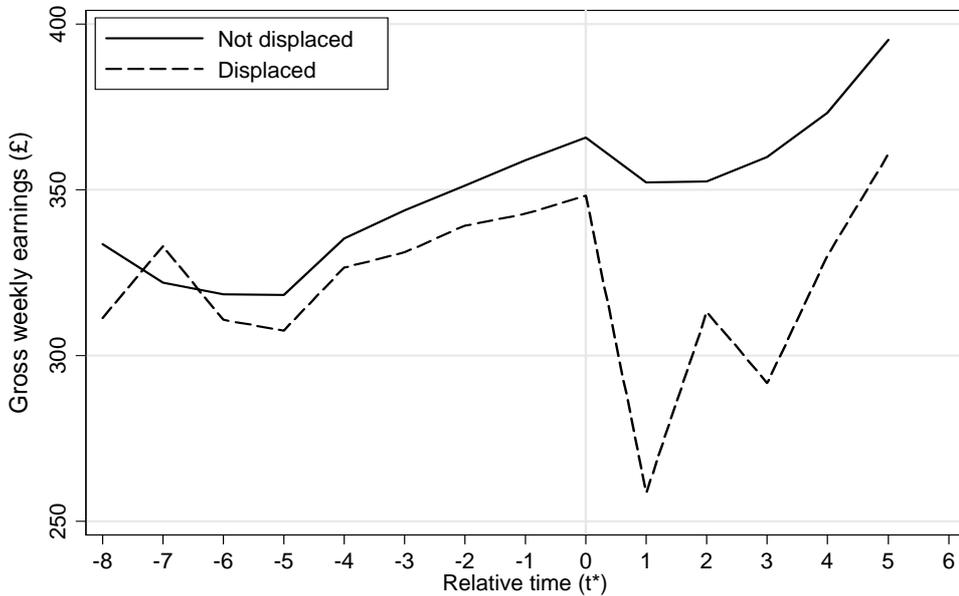
Figure 1 shows how earnings evolve for these two groups of workers. The horizontal axis represents time relative to the

“...the large fall in earnings for displaced workers is driven mainly by workers who do not have a job.”



Good old times at Ryton

Life after Longbridge, contd...



some of these workers have become self-employed, or have left the labour market and are not looking for work.

To examine this issue further, we link in data relating to claims for Job-Seekers' Allowance (JSA).

Figure 2 shows that workers who are displaced are indeed far more likely to be unemployed and claiming JSA than those who were not displaced. This supports the idea that the large fall in earnings observed in Figure 1 is a genuine loss, rather than a problem of missing data.

displacement: a firm which closes disappears from the database at some point between $t^*=0$ and $t^*=1$. Unsurprisingly, we see that workers who are displaced experience a dramatic fall in earnings in the years following their firm's closure. It takes five years before their earnings catch up with their pre-displacement earnings.

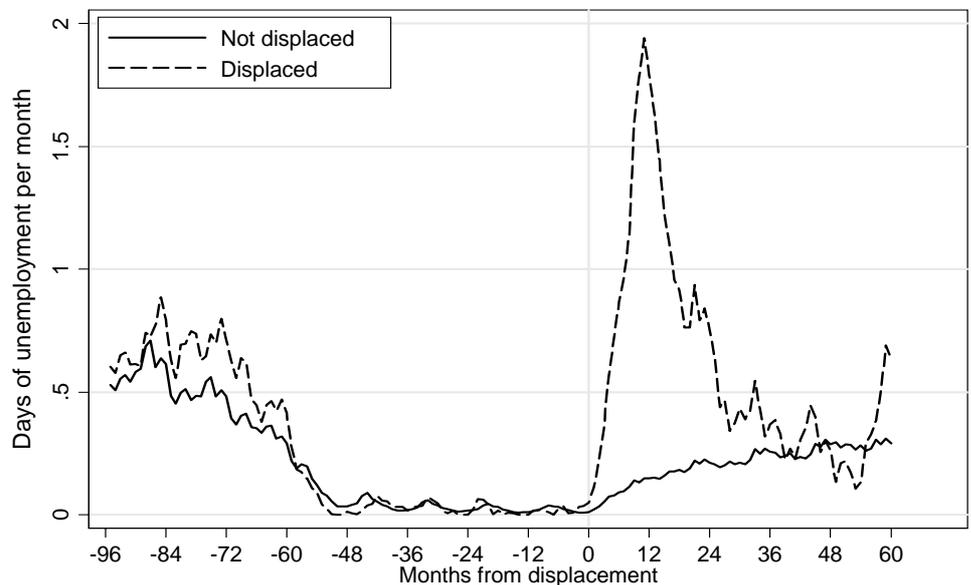
“...displaced workers suffer earnings losses of about 50% in the first year, 15% in the second and 10% in the third.”

The solid line shows average earnings for the comparison group of workers whose factory does not close. Note that their earnings also dip after $t^*=0$. This is because at $t^*=0$ the comparison group are all employed, but they themselves may leave employment in the following years.

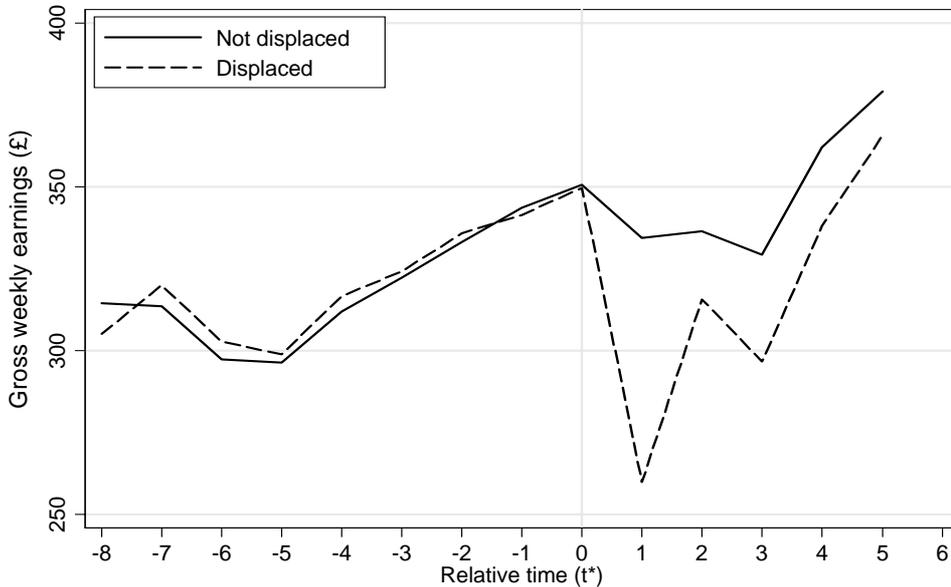
It turns out that the large fall in earnings for displaced workers is driven mainly by workers who do not have a job. More than 30% of workers whose employer closes are not in the sample in the following year. Unfortunately, our data do not tell us whether they are actually unemployed or not. It is possible that

displaced workers claim, on average, only two days of benefit per month in the April following displacement. If all

displaced workers were unemployed, this figure would be nearer to 30 days. This result is entirely sensible if one considers that the great majority of individuals who do not have a job do not claim JSA: in 2003 the claimant count was under one million, compared to over



Life after Longbridge, contd...



seven million people of working age defined as “inactive”.

Returning to Figure 1, we can also see that displaced workers’ earnings are actually lower than non-displaced workers *before* as well as after the closure of their firm. It is possible that this is a genuine pre-displacement effect: it might be that firms which are about to close pay their workers a lower wage, perhaps because they are in financial difficulty. However, it is also possible that workers whose factories close might, on average, be different from workers whose factories do not close. That is, our control group of workers are not truly comparable to those whose firms close. For example, displaced workers might be older, or they might have different skills to those who are not displaced.

To deal with this problem, we “match” each displaced worker with a non-displaced worker who is observably very similar. For example, if the displaced worker was aged 50 and worked in the car industry in the West Midlands we draw a comparison from non-displaced workers of the same age in the same industry and region.

Figure 3 shows the result of this matching procedure. Notice that now there is almost no difference in earnings before dis-

placement, suggesting that the difference observed in Figure 1 was caused by differences in the characteristics of the two samples. But the pattern of earnings loss following firm closure remains very similar.

How large are these wage losses? We find that displaced workers suffer earnings losses of about 50% in the first year, 15% in the second and 10% in the third. After five years displaced workers still have lower earnings (as can be seen in Figure 3). However, we find that these losses are small (about 3%) and not statistically significant. In other

words, it is likely that if we were to look at another sample of workers we would not find any difference in earnings between the two groups.

In contrast, estimates from the United States suggest that, even in the long-run, wage losses are large. Displaced workers in the US appear to suffer “permanent” wage losses.

We finish with a note of caution. It is possible that, as time passes, our sample becomes less representative of all workers whose firm shuts down. If those workers whose chances of finding a decent job are lowest withdraw from the labour market altogether, we will tend to underestimate the full, long-run impact.

Note

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Further readings:

Kuhn, P. (2002) *Losing Work, Moving On: International Perspectives on Worker Turnover* W.E. Upjohn Institute for Employment Research.

Hijzen, A., Upward, R. and Wright, P. (2005) “The Earnings cost of business closure in the UK” *GEP Working Paper 2005/31*.



Leverhulme Globalisation Lecture 2006

Will Hutton

Chief Executive

The Work Foundation

9th November 2006

5 pm, University of Nottingham

For further information contact sue.berry@nottingham.ac.uk

Tariffs and Growth: Evidence from German Cotton Textiles, 1857-1913

*The relationship between tariffs and growth is one of the most debated issue in economics. Proponents of the view that low tariffs are bad for growth argue that to be successful in the international markets a country must have reached a certain degree of development to be able to catch up with the most advanced economies. In this article **John Brown** analyses this problem from an historical perspective looking at the German cotton textile industry. His results suggests that protection slowed total factor productivity growth. John is Professor of Economics at Clark University and a GEP External Research Fellow.*

The backlash that has developed in opposition to liberal trade policies in developing countries offers several lines of argumentation. Countries relying upon exports of raw materials face concerns about the volatility of primary product prices and the resistance of many developed countries to lowering barriers to trade in many agricultural commodities. An alternative, exploiting a comparative advantage in the export of manufactures based upon cheap labor, faces another set of objections. This argument draws on assertions first offered by List, which were given credence by Gerschenkron and more recently by some development economists. To be successful, a late-comer to markets for manufactures requires a “developmental state” to initiate the catching-up process prior to being open to international trade.

Proponents of this view draw on two historical episodes. The first is the industrial development of Germany and the United States (and also Meiji Japan) during the late-nineteenth and early twentieth centuries. The histories of these countries are used to argue that only strongly interventionist—and protectionist policy—permitted them (and, by extension, most of Europe and its offshoots) to develop independent industrial capacity and successfully challenge the leadership of Great Britain. The microeconomic story behind these interpretations leans heavily on appeals to learning, capturing scale economies and creating stable environments for high-risk investments in new technologies. The second episode is the rapid growth of several East Asian economies during the post-World War II era. There, behind judicious protective barriers, the developmental state was able to target industrial policy, credit and subsidies in ways that eventually led to successful export promotion. Even as the sources of East Asian success are debated, the popular reading of the evidence of the nineteenth century

has received quantitative support in the work of several economic historians.

Papers by O’Rourke (2000) and Clemens and Williamson (2004) offer hard evidence that buttresses a correlation first advanced in the 1970s only for Europe: protectionist countries grew more rapidly than open countries prior to 1914. These studies estimate versions of a growth convergence model that use panels of countries and measures of average—or bilateral—tariff levels. They find that a positive relationship between tariffs and economic growth prevails through 1940 and even during the 1870 to 1914 period of the first globalization. The post-World War II inverse correlation between tariffs and growth results from a new environment in which mutual tariff reductions on trade in manufactures facilitated outward-oriented strategies for growth based upon export expansion. In the face of the positive static gains to welfare from the unilateral abandonment of autarky documented by Brown and Bernhofen (2005) for Japan—also during the nineteenth century—the results based upon a growth-tariff correlation pose an interesting puzzle.

This paper takes up this puzzle with a case study of the German cotton textile industry over the period 1857 to 1913. It examines the inter-relationship between protection and other influences on the development of total factor productivity for a period that includes both heavily protectionist and liberal trade policy. As the third largest cotton industry in the world in 1913, the German industry is of interest for several reasons. Cotton textiles is the classic import substitution industry of the nineteenth century; the industry would be expected to contribute to a positive relationship between protection and growth prior to World War I. By 1850, German firms

“To be successful, a late-comer to markets for manufactures requires a “developmental state” to initiate the catching-up process prior to being open to international trade.”

Tariffs and growth, contd...

had ready access to both raw cotton and the most up-to-date machinery. A well-developed network of skilled British personnel was ready to assist with training. Manuals available in English and in German provided detailed information on mill management and on the technical side of production. On average, the industry also received moderate protection. It experienced rapid growth prior to 1914.

The German system of protection was transparent and varied a great deal across products of the cotton textile industry. First, protection relied solely upon specific import tariffs, which were well documented by contemporaries. The exchange rate was fixed relative to the exchange rates of leading competitors for the entire period. Second, protection varied substantially over time and across products. Fluctuations in the price of cotton because of the American Civil War led to widely-varying amounts of ad valorem protection (particularly with respect to other products such as iron or steel). Ad valorem protection across varieties of yarn and cloth varied because of differences in tariff levels and the kinds of cotton used in the products.

In this research project we develop indices of total factor productivity for the period of the study for six types of yarn and one type of cloth. The rich documentation of product prices, input prices and cost structures enables the calculation of indices of total factor productivity based upon the price dual. Defined according to two or three dimensions, the products are of constant quality over the entire period. Published monographs, archival sources and the publications of reports of Chambers of Commerce in the German textile districts all provide evi-

dence. Enough information is also available for calculation of similar indices for two leading products of the British industry.

The total factor productivity indices exhibit impressive annual rates of growth that ranged from 0.5 percent to 1.1 percent over the prior before 1914. With only one exception, productivity growth was most rapid during the period of lower protection (prior to 1880) than it was during the remainder of the period of study. Productivity growth in the German textile industry compares favourably with estimates for American steel or the products of European blast furnaces during the same period.

Germany's trading relationships with Great Britain offered two channels for productivity improvement. German firms installed primarily British machinery, and successive in-

“With only one exception, productivity growth was most rapid during the period of lower protection...”

vestment booms ensured that it was up-to-date. Frequent incursions of British imports kept up competitive pressure on the German industry. Estimation of a

panel model of the determinants of the growth of total factor productivity uses generalized least squares to test for the importance of these two influences. Additional controls include the average firm size (by product type) and the price of cotton. The results are striking. British productivity growth significantly increased the growth of German productivity. Protection retarded productivity growth. Most other variables were insignificant.

The results of this study argue for a closer look at the relationship between trade policy and productivity development in the United States and the protectionist countries of continental Europe prior to 1914. The historical lessons that are so frequently cited for the period remain open to interpretation.

Further readings:

Bernhofen, Daniel and John C. Brown (2005), “An Empirical Assessment of the Gains from Trade: Evidence from Japan”, *American Economic Review* 95 (1), pp. 208-225.

Clemens, Michael A. and Jeffrey G. Williamson (2004), “Why did the Tariff-Growth Correlation Change after 1950?”, *Journal of Economic Growth* 9(1), pages 5-46.

O'Rourke, Kevin H. (2000), “Tariffs and Growth in the Late Nineteenth Century,” *Economic Journal* 110, pages 456-483.



GEP November Workshop

The Impact of International Competition on Firms and Workers

9th November 2006

University of Nottingham

Speakers include:

Francis Kramarz

Centre de Recherche en Économie et Statistique, Paris

Ingo Geishecker

Free University of Berlin

Pedro Martins

Queen Mary, University of London

For further information contact sue.berry@nottingham.ac.uk

Tariff Reforms and Market Access

*The reduction of tariffs is one of the main policy reforms that the IMF and the World Bank require of countries asking for their help. One complication is that in many developing countries decreasing tariffs will drastically reduce tax revenues. The solution to this problem has been found in increasing consumption taxes, to leave consumer prices unaffected. However, another outcome which reduction in tariffs may impact upon is market access. **Pascal Raimondos Møller** (in new joint work with Udo Kreickemeier at GEP) argues that tariff-tax reforms as devised by the IMF and World Bank may actually decrease market access instead of increasing it. Pascal is Professor of Economics in the Copenhagen Business School and External Research Fellow at GEP.*

The literature of tariff reforms has by tradition been part of normative economics – the focus has always been on the welfare implications of tariff reforms. The lesson that we learned from that literature was that what appears to be a welfare improving reform in a partial equilibrium setting may not be so in a general equilibrium setting. To see this, consider first a tariff-ridden one good perfectly competitive economy. Clearly the reduction of that one tariff will increase the consumer surplus and will lead to welfare gains. Introduce now a second good that faces no tariffs. In a general equilibrium the goods will be either net complements or substitutes and changes in the one good will have repercussions in the other good. Are we sure then that the general equilibrium repercussions of changing this one tariff are always welfare improving? As we know the answer is “no”. In a world of second best, where a tariff-ridden economy reforms its tariffs in a piecemeal fashion, we are not sure whether the overall welfare effect is positive.

Confronting this general equilibrium reality, the literature developed tariff reform rules that by certainty this will lead to a welfare improvement (see Hatta, 1977). Two rules have been very popular: the proportionality rule, where all tariffs are reduced proportionally, and the concertina rule, where the highest tariff is reduced to the second highest level. The first delivers welfare improvement with no condition whatsoever, and is therefore quite an easy rule to implement.

The second delivers welfare improvement if the good whose tariff is reduced is a net substitute to all other goods in the economy. Since then, the literature on piecemeal tariff reform has been testing the robustness of these two rules by adding more realistic features into the general equilibrium models, e.g. intermediate products, non-tradable products, domestic taxes, etc. By and large, adding complications to the models weakens the welfare performance of these two rules.

“...a coordinated tariff-tax reform may easily reduce market access to the country that implements it.”

Still, in practice what seemed to worry more the IMF policy advisors was not the robustness of these two rules but rather the fact that tariff reductions seemed to remove the main source of tax revenue for most of the countries that they advised (as it is well known, less developed countries depend heavily on trade taxes in raising revenues as other kind of taxes are difficult to implement). Thus, the issue was whether there existed tariff reform rules that increased welfare without reducing (or, even better, that increase) government revenues. Recently, such a rule was indeed found: reduce tariffs and increase consumption taxes point-by-point so that consumer prices are left unaffected! This combination of tariff and tax reform will end up affecting only the production sector in the economy, which, facing smaller subsidies (remember that a tariff is equivalent to a tax on consumption and a subsidy on production) will allocate resources more efficiently and thus lead to a welfare gain. On top of that, the reduction of the production

Tariffs and market access, contd.

subsidies will benefit the government budget! Clearly, a “win-win” device that currently the IMF uses: reduce tariffs and increase consumption taxes (see Keen and Ligthart, 2002).

However, this new focus on more positive issues (government revenues) rather than pure normative issues (welfare) opens up a whole new research agenda. Government revenue is one possible target that tariff negotiators will need to take seriously, but there may be other targets as well. One such target is market access. Market access is defined as the change of the volume of trade evaluated at world prices (world prices are much more interesting than domestic prices since these are the prices that exporters are paid in (and thus on which market-access demands are made). It is definitely something that trade negotiators bargain about, and it is something that IMF advisers expect to happen when they require tariff reductions, viz. that the country in question will increase its trade with the rest of the world (the market access to this country will improve). But do we know anything about that? Well, in a partial equilibrium set-up it makes perfect sense that a tariff reduction increases the volume of imports but does it follow also in a general equilibrium set-up?

Two recent papers by Ju and Krishna (JIE, 2000) and Anderson and Neary (forthcoming, JIE) provide a careful analysis of this issue and come up with a surprising result: implementation of the two well-known tariff reforms rules (proportionality and concertina) may easily

reduce market access! Anderson and Neary (op.cit) also show that in general the tariff reforms that will lead to welfare improvements do not coincide with the tariff reforms that will lead to market access improvements.

In that sense, the situation is exactly as it was with the government revenues target when that was first introduced, viz. the credibility of the standard tariff reform rules is under attack. The solution then was the introduction of consumption tax reforms and thus the development of a new rule that both increases welfare and government revenues. But how does this rule cope with the market-access issue?

Well, it turns out that it is not coping so well (see Kreickemeier and Raimondos-Møller, 2006). As in the tariff reform literature, a coordinated tariff-tax reform may easily reduce market access to the country that implements it. Moreover, and assuming that we could implement a tariff-tax reform that was targeted to increase market access, that increase will be far smaller than a tariff reform alone. (A partial equilibrium intuition suffices here. A tariff reform reduces both the consumption tax and the production subsidy and thus increases imports. Clearly, a tariff reduction combined with a consumption tax increase that leaves consumer prices unaffected will increase imports by less.) That was not exactly what the IMF had in mind when it advises less-developed countries to reduce tariffs and increase consumption taxes.

Further readings:

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Keen, M. and J. Ligthart, 2002, Coordinating tariff reduction and domestic tax reform, *Journal of International Economics* 56, 489-507.

Kreickemeier, U. and P. Raimondos-Møller; 2006, Tariff-tax reforms and market access, *mimeo*.

Global Imbalances

*Every year GEP hosts in Nottingham a number Leverhulme Globalisation Lectures, for which distinguished speakers are invited to provide their views on public issues related to globalisation. In February, **Martin Wolf** (Associate Editor & Chief Economics Commentator of Financial Times) presented his opinion about the global imbalances facing the world economy and advanced possible solutions. In this article **Mauro Pisu** summarises the lecture Martin gave. Mauro is Research Fellow at GEP.*

Martin Wolf started the lecture quoting the present and previous FED Governors, Ben Bernanke and Alan Greenspan, asserting respectively that currently there is a global saving glut and that long-term rates are low everywhere. These are two of the basic facts of the conundrum that he then went on to analyse. The world economy is characterised by exceptionally loose monetary and fiscal policies, low real rates despite strong economic growth and an exploding current account deficit in the US.

Martin suggested that behind these phenomena lies a savings glut. In fact, many economies moved to surplus of savings over investment in the latest years.

These saving excesses have determined sizeable current account surplus in many countries. This is surely true for Japan, the EU area, the East Asia emerging economies and China. On the contrary, the US has experienced a deficit of savings over investment determining its huge current account deficit.

Therefore, the world seems to be awash with excess savings, except in the Anglosphere and central and eastern Europe. Martin singled out two broad sets of countries responsible for the excess savings. These are the mature high-income countries such as Europe and Japan featuring a slowly growing economy and chronic excess savings. This group of countries generated a current account surplus of \$336bn in 2004, up from \$189bn in 1996. The second group comprises the emerging market economies, which registered a current account surplus of \$323bn in 2004, up from minus \$99bn in 1996. This group of countries appears to be the major cause of the current savings glut. The speaker suggested that this is the result of the financial crises in the late 90s and the recent oil surge, which persuaded the Asian economies to stick to export-led growth strategies and generated windfall revenues for oil exporting countries.

Martin noted how these global imbalances are in fact balanced by the balance of payments. The rest of the world is generat-

ing large saving surpluses which find their way into the US. This, along with the fact that these countries (in particular China, Taiwan and South Korea) are also recycling capital inflows, supports the current valuation of the dollar against other currencies.

The US, in the end, seems to be accommodating the external imbalances created by the rest of the world. The US current account deficit has reached huge proportion measuring 7% of the GDP. The net liabilities of the US stand now at around 30% of the GDP. The speaker argued that to correct these trends would take large adjustment in the relative growth of exports and imports.

Then he asked the question of where the solution to these global imbalances might lie. Is it possible for the saving surpluses to shrink? He thinks this is unlikely in Japan and Western Europe given the fact that these are natural surplus regions. It is likely in oil exporting countries, although he admonished that it would be unwise to spend the windfall from the oil price surge all of a sudden.

The key players in the solution are the Asian emerging economies and in particular China. They can afford current account deficits, since they have accumulated, so far, large foreign reserves. In addition, subsidising exports through undervalued exchange rates is expensive. The role of China is important given its size, although, Martin noted, it is difficult to know how much its currency should appreciate and what the best exchange rate regime it should adopt.

At the end of his lecture Martin stressed that the fate of the world economy is not solely in US hands. The best solution involves adjusting exchange rates, coupled with fiscal tightening in the US, to reduce the public sector deficit, and expansionary policies in Asian emerging economies, to decrease their reliance on exports. In the end, global imbalances require a global solution or much severe adjustment lies ahead.



GEP Annual Conference

China and the World Economy

23rd and 24th June 2006

Arts Centre Lecture Theatre, University Park, University of Nottingham

Speakers include:

Mary Lovely (Syracuse)

Deborah Swenson (UC, Davis)

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Lina Song (Nottingham)

Holger Görg (GEP, Nottingham)

Will Martin (World Bank)

Barry Naughton (UC, San Diego)

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Xiaolan Fu (Cambridge)

Linda Yueh (London School of Economics)

Linda Yueh (Oxford)

Tain-jy Chen (China Institute of Economic

Research, Taiwan)

For further details see the GEP website at www.gep.org.uk or contact sue.berry@nottingham.ac.uk

Nottingham Lectures in International Economics

Carl Davidson

Professor of Economics, Michigan State University

on "Trade with Unemployment"

31st October, 1st and 2nd November 2006

University of Nottingham

James R. Markusen

Professor of International Economics, University of Colorado

Spring 2007

University of Nottingham

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April 2006	May 2006	2006
<p>Professor Jeff Bergstrand <i>University of Notre Dame</i></p>	<p>Professor Carl Davidson <i>Michigan State University</i></p> <p>Professor Peter Egger <i>Munich University</i></p> <p>Professor Richard Friberg <i>Stockholm School of Economics</i></p> <p>Professor Gary Jefferson <i>Brandeis University</i></p> <p>Neil Kenward <i>HM Treasury</i></p> <p>John Martin <i>OECD</i></p> <p>Professor Peter Neary <i>University College Dublin</i></p> <p>Professor Gianmarco Ottaviano <i>University of Bologna</i></p> <p>Professor Jim Tybout <i>Penn State University</i></p> <p>Professor Tony Venables <i>Department for International Development</i></p>	<p>Professor Richard Baldwin <i>Graduate Institute of International Studies, Geneva</i></p> <p>Professor Jurgen Meckl <i>University of Giessen</i></p>

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