The University of Nottingham

Leverhulme Centre for Research on Globalisation and Economic Policy

Newsletter

Issue 24 Spring 2008

In this issue:

GEP heads East with Malaysia branch launch

GEP Director David Greenaway

One often hears the statement 'This is Asia's Century', and when one looks at relative growth rates across continents, especially between actual and nascent superpowers, it is easy to see why.

So how is GEP responding? Well, in a very positive way. As the global centre of gravity shifts eastwards, so does GEP. In January 2008 our Centre launched its first branch, at the University of Nottingham Malaysia Campus, just outside Kuala Lumpur, with a conference on 'Asian Regionalism: Responding to Globalisation and China'.

The Conference attracted speakers from across the Asia region: China, Korea, Singapore, Japan and, of course, Malaysia. It also showcased two new public lectures that will run on an annual basis: *The World Economy Asia Lecture*, which was delivered by Kym Anderson, of Adelaide University, and the World Bank, and *The Boustead Annual Globalisation Lecture*, given by our very own Chris Milner.

A core team from GEP in Nottingham (David Greenaway, Daniel Bernhofen, Sue Berry, Chris Milner, Lina Song, Shujie Yao and Zhihong Yu), and GEP in Malaysia (Cassey Lee and Subra Pillay) ensured that this was a first-rate Conference that met the high-quality standards we take for granted at GEP events. We also enjoyed the splendid welcome offered by our Malaysia-based colleagues.

So what's next? A range of research and outreach activities will be initiated in the coming months. These will include reciprocal research visits from UK and Malaysia-based researchers, workshops and seminars in Malaysia and jointly-supervised PhD students. Moreover, another international conference, to be held in Kuala Lumpur in January 2009 is already in preparation.

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Of course, the University has also established the University of Nottingham, Ningbo, China! In March 2008 a GEP delegation (David Greenaway, Sue Berry, Shujie Yao and Zhihong Yu) visited Ningbo. Following discussions with the Provost, Professor Peter Buttery, and colleagues in the Business School, led by Head of School Professor Chris O'Brien, GEP is delighted to announce that it will also establish a branch at the University of Nottingham, Ningbo, China.

To launch this initiative, GEP is planning a high-profile international conference, to be held at Ningbo on 6th and 7th November 2008, on the theme of 'China and the World Economy'. We are delighted also that Wiley-Blackwell will sponsor an annual *The World Economy China Lecture*, the first of which will run alongside the November conference.

GEP has a number of key assets that have driven its creation ten years ago from a standing start to a world-class globalisation research centre. Those assets—in particular, of course, its people—will continue to drive GEP forward. The establishment of GEP in Malaysia and in China will help us 'push back the frontiers' geographically as well as metaphorically.

From left to right: Shujie Yao, Chris O'Brien (Head of Business School, UNNC); Zhihong Yu; Sue Berry; David Greenaway; Peter Buttery (Provost, UNNC).

GEP conference announcement

GEP is pleased to announce the following two conferences at the University of Nottingham's overseas campuses:

'China and the World Economy'
at the University of Nottingham, Ningbo, China
6th and 7th November 2008

'Globalisation and Development in Asia'
at the University of Nottingham, Malaysia
14th and 15th January 2009

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

Kym Anderson

Agricultural incentives and economic development

What is the relationship between an economy's agriculture protection policies and its own economic development? In the following article **Kym Anderson** summarises the key findings from his recent study on Japan, China and Korea, which draws on his 2008 *The World Economy Asia Lecture*, presented at the University of Nottingham, Malaysia, on 17th January 2008.

When Japan switched from being a small net exporter of food to becoming dependent on rice imports, farmers and their supporters called for rice import controls. Their calls were matched by equally vigorous calls from manufacturing and commercial groups for unrestricted food trade, since the price of rice at that time was a major determinant of real wages in the non-farm sector. These heated debates were not unlike those that led to the repeal of the Corn Laws in Britain six decades earlier. In Japan, however, the forces of protection triumphed, and a tariff was imposed on rice imports from 1904. That tariff then gradually rose over time, raising the domestic price of rice to more than 30 per cent above the import price during World War I. When there were food riots because of shortages and high rice prices just after that war, the Japanese government's response was not to reduce protection but instead to extend it to its colonies and to shift from a national to an imperial rice self-sufficiency policy. That involved accelerated investments in agricultural development in the colonies of Korea and Taiwan behind an ever-higher external tariff wall that by the latter 1930s had driven imperial rice prices to more than 60 per cent above those in international markets (Anderson and Tyers, 1992).

What emerges… is that the tendency to move gradually from taxing to protecting agriculture relative to manufacturing in the course of economic development is not confined to Northeast Asia.

After post-war reconstruction, Japan continued to raise its agricultural protection, just as had been happening in Western Europe, but to even higher levels. Domestic prices exceeded international market prices for grains and livestock products by around 40 per cent in the 1950s in both Japan and the European Community. By the 1980s the difference was 90 per cent for Japan and since the 1990s has been above 120 per cent. Meanwhile, in South Korea and Taiwan, an import-substituting industrialisation strategy was adopted in the 1950s. It harmed farmers for a few years but was replaced in the early 1960s with a more neutral trade policy, which stimulated very rapid export-oriented industrialisation in those densely-populated economies. That development strategy imposed competitive pressure on the farm sector, which, just as in Japan in earlier decades, prompted farmers to lobby (successfully, as it happened) for ever-higher levels of agricultural protection from import protection in those newly-industrialised economies.

The dramatic decline in the effective taxation of China's agricultural sector over the past 25 years helps to explain two apparent paradoxes.

A study two decades ago provided empirical estimates of the growth of nominal rates of protection to farmers in Japan, Korea and Taiwan from the early 20th century (Anderson et al, 1986).

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A new World Bank research project is revisiting this issue, extending those earlier estimates to the present decade and examining similar trends in other parts of Asia, as well as in Africa, the Americas and Europe (75 countries in all, comprising 90 percent of global agriculture). What emerges from the new results is that the tendency to move gradually from taxing to protecting agriculture relative to manufacturing in the course of economic development is not confined to Northeast Asia. On the contrary, it has emerged clearly in both China and Southeast Asia. In China the opening up of the economy from the late 1970s was accompanied by rapidly rising domestic prices for farm products – but from a very low base. The exchange rate was overvalued, too, in the 1980s. Together these policies meant that prices received by farmers were still well below prices at the border (while prices for non-farm tradables were above international levels) - that is, the nominal rate of assistance to farmers (NRA) was negative in the 1980s. Even in the 1990s China's estimated NRA was below zero and it became positive only in the present decade. For Southeast Asia the trend is less dramatic (Table 1), but so, too, was its rate of economic growth and structural change away from its earlier comparative advantage in farm products.

The dramatic decline in the effective taxation of China's agricultural sector over the past 25 years helps to explain two apparent paradoxes: why China has been able to remain food self-sufficient throughout most of that period despite rapid industrialization; and why rural poverty did not rise during the phase-in of China's commitments to WTO members to reduce some of its agricultural import tariffs.

A key question of interest to agricultural exporting countries is: will the newly-emerging economies of Asia and elsewhere follow the more advanced ones of Northeast Asia into an agricultural protection phase in the coming years? It was hoped that WTO commitments on agricultural tariffs and subsidies would limit that possibility, but, with the stalling of the Doha Round and the large gaps between earlier WTO legally-bound and actual applied tariff and subsidy rates, that is by no means certain to happen. When mapped against per capita income, it appears that China and Southeast Asia are on similar NRA trajectories as Northeast Asia (Figure 1).

Author's note:

Kym Anderson is the George Gollin Professor of Economics at the University of Adelaide in Australia. He recently returned from a leave of absence, spending 2004-07 in Washington DC as Lead Economist (Trade Policy) in the Development Research Group of the World Bank. *Financial assistance from The World Economy and World Bank Trust Funds, particularly from DfID and BNPP, are gratefully acknowledged, as are the contributions of the Asian country case study authors cited herein and research assistance from numerous colleagues based in Washington DC and Adelaide, especially Ernesto Valenzuela. Views expressed are the author's alone and not necessarily those of the World Bank or its Executive Directors.*

Research project details are at www.worldbank.org/agdistortions.

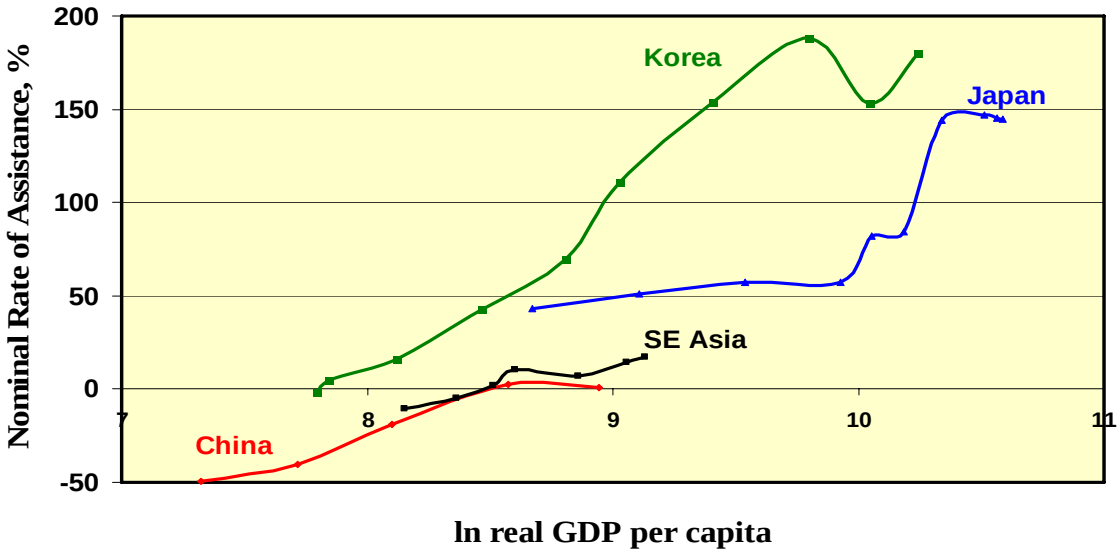
Table 1: Nominal rates of assistance to primary agriculture, East Asia, 1955 to 2004

	1955-59	1960-69	1970-79	1980-89	1990-99	2000-04
Japan	43	54	70	114	146	145
Korea	-2	11	56	132	171	180
China	na	na	na	-46	-8	1
SE Asia[a]	na	na	-8	6	11	16

[a] Weighted average for Indonesia, Malaysia, Philippines, Thailand and Vietnam, using the gross value of agricultural production at undistorted prices as weights.

Sources**:** Anderson, Martin and Warr (2008); Hayami and Honma (2008).

Figure 1: Nominal rates of assistance to primary agriculture and real per capita income, East Asia, 1955 to 2004



Source: Anderson, K. (ed.) (2008).

From left to right: Brian Atkin (Vice-President, University of Nottingham Malaysia), David Greenaway, Kym Anderson and Chris Milner

Martin Wolf

Why the sub-prime crisis is a turning point for the world economy

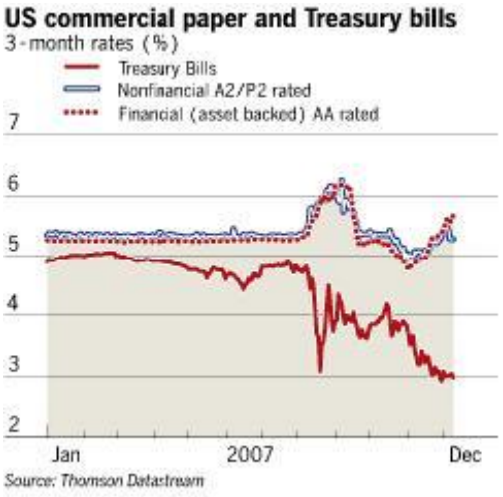
Is the current sub-prime crisis just a short-term shock to the US? Or will it have systematic consequences for the world economy in the long run? In a recent *Leverhulme Globalisation Lecture* **Martin Wolf**, Associate Editor and Chief Economics Commentator of the *Financial Times*, provided his insightful arguments on why he believes it more likely to be the latter.*

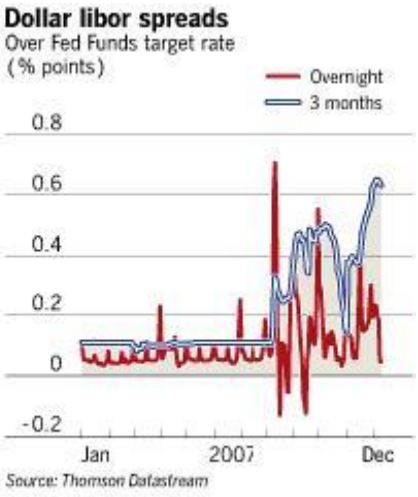
These are historic moments for the world economy. I felt the same during the emerging market financial crises of 1997 and 1998 and the bubble in technology stocks that burst in 2000. This "credit crunch" may, I believe, be an equally important turning point for financial markets and the world economy. Why do I believe this? Let me count the ways.

First and most important, what is happening in credit markets today is a huge blow to the credibility of the Anglo-Saxon model of transactions-orientated financial capitalism. A mixture of crony capitalism and gross incompetence has been on display in the core financial markets of New York and London. From the "ninja" (no-income, no-job, no-asset) sub-prime lending to the placing (and favourable rating) of assets that turn out to be almost impossible to understand, value or sell, these activities have been riddled with conflicts of interest and incompetence. In the subsequent era of "revulsion", core financial markets have seized up (see charts).

Second, these events have called into question the workability of securitised lending, at least in its current form. The argument for this change – one, I admit, I accepted – was that it would shift the risk of term-transformation (borrowing short to lend long) out of the fragile banking system on to the shoulders of those best able to bear it. What happened, instead, was the shifting of the risk on to the shoulders of those least able to understand it. What also occurred was a multiplication of leverage and term-transformation, not least through the banks' "special investment vehicles", which proved to be only notionally off balance sheet. What we see today, as a result, is a rapid shrinkage of markets in asset-backed paper (see chart).

Third, the crisis has opened up big questions about the roles of both central banks and regulators. How far, for example, do the responsibilities of central banks as "lender of last resort" during crises stretch? Should they, as some argue, be market-makers of last resort





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in credit markets? What, more precisely, should a central bank do when liquidity dries up in important markets? Equally, the crisis suggests that liquidity has been significantly underpriced. Does this mean that the regulatory framework for banks is fundamentally flawed? What is left of the idea that we can rely on financial institutions to manage risk through their own models? What, moreover, can reasonably be expected of the rating agencies? A market in US mortgages is hardly terra incognita. If banks and rating agencies got this wrong, what else must be brought into question?

What is happening in credit markets today is a huge blow to the credibility of the Anglo-Saxon model of transactions-orientated financial capitalism.

Fourth, do you remember the lecturing by US officials, not least to the Japanese, about the importance of letting asset prices reach equilibrium and transparency enter markets as soon as possible? That, however, was in a far-off country. Now we see Hank Paulson, US Treasury secretary, trying to organise a cartel of holders of toxic securitised assets in the "superSIV". More importantly, we see the US Treasury intervene directly in the rate-setting process on mortgages, in an attempt to shore up the housing market. Either, or both, of these ideas might be good ones (though I strongly doubt it). But they are at odds with what the US has historically recommended to other countries in a similar plight. Not for a long time will people listen to US officials lecture on the virtues of free financial markets with a straight face.

Fifth (and here we start to move from the questions about the workings of the financial system to global macro-economic implications), the crisis signals a necessary re-rating of risk. It turns out that it also represents a move towards holding more transparent and liquid assets, as one would expect. This correction is altogether desirable. It has, moreover, been selective. It is a striking feature of what has happened that emerging markets have emerged as a safe haven as investors run away from US households. For those in emerging economies, this must be sweet revenge. They should not cheer too soon. Today's favourites may be brutally discarded tomorrow.

Sixth, this event may well mark the limits to the US role as consumer of last resort in the world economy. As the Organisation for Economic Co-operation and Development notes in its latest Economic Outlook, the correction is well under way. In 2007, it forecasts, US final domestic demand will grow by just 1.9 per cent, down from 2.9 per cent in 2006. It forecasts a further decline, to growth of 1.4 per cent, next year. In both years, net exports will make a positive contribution to growth: 0.5 percentage points in 2007 and 0.4 percentage points in 2008, as the trade deficit shrinks in real terms. In this way, the US is re-importing the stimulus it exported to the rest of the world in previous years. The credit crunch is quite likely to accelerate this process. So the US needs strong growth of net exports. For this reason, policymakers are relaxed about the dollar's fall, provided it does not awaken fears of rapidly rising inflation.

Seventh, a US recession is possible. Whether it happens depends overwhelmingly on consumers. The principal counterpart of the external deficits has been the excess of spending over income by households. That has meant negligible savings and a big jump in household debt: mortgage debt jumped from 63 per cent of disposable incomes in 1995 to 98 per cent in 2005. This rising trend is unlikely to continue in a falling housing market. Unwillingness (or inability) to borrow on such a scale will, in turn, hamper the effectiveness of US monetary policy. That, in turn, makes a weak dollar and strong export growth yet more important.

Last but not least, this event also has big significance for the game of "pass the external deficits" that has characterised the world economy for several decades. It has proved virtually impossible for emerging market economies to run large deficits, without running into crises. Over the past decade, the US filled the (growing) gap as ever-larger borrower of last resort. This epoch has probably now ended. But the surpluses being run by China and Japan, by oil exporters and, within the European Union, by Germany continue to grow. If we are to enjoy global macro-economic stability, a creditworthy set of countervailing borrowers must emerge. If the US ceases to increase its absorption of the growing savings surpluses being generated elsewhere, which countries will be able and willing to do so?

Experience teaches that big financial shocks affect patterns of lending and spending across the world. Originating, as it does, at the core of the world economy, this one will do so, too. The question is how stable and dynamic the world economy that emerges will be.

** This is a reprint of Martin Wolf's article "Why the credit squeeze is a turning point for the world", published in the* Financial Times *in December 2007. For further details of his Nottingham talk , including more data and charts, please visit http://www.gep.org.uk/leverhulme/events/public_lectures.php.*

Spiros Bougheas

Moving up the technology chain

For many developing countries with limited government budgets, is it optimal to devote resources to shift production towards "moving up the value chain"? In the following article **Spiros Bougheas** summarises the key findings from his current research with Raymond Riezman and Richard Kneller, which argues that such a strategy may not always be right.

Reports by the World Economic Forum on the China Business Summit 2003 and the India Economic Summit 2004 reveal the strong desire pf the governments of these two countries to boost economic development by offering incentives to industries to "move up the value chain". The idea here is to shift specialisation from low-skill goods into high-tech commodities and in the process reverse the patterns of trade. During the second half of the past century this strategy has been successfully adopted by many East Asian countries. In order to achieve the above transformation they had to devote resources to education in order to equip workers with the new skills that were necessary for employment in the new high-tech sectors, as has been reflected by the steadily increasing flow of young persons to higher education.

However, intuition suggests that these policies cannot be globally optimal. As long as there is demand for low-skill intensive goods there will always be some countries with a comparative advantage in their production. For developing countries with limited government budgets that constrained their choices, understanding where their comparative advantage lies is important. Richard Kneller, Ray Riezman and I have recently developed a theoretical model that might improve our understanding of the conditions under which it is optimal for governments to encourage shifts in production that will eventually lead to a reversal in their patterns of trade.

In our model the government plays an important role. Its education policy influences both production and trade patterns by determining the distribution of skills in the economy. Our economy comprises two sectors: a low-skill sector that produces a primary commodity and a high-skill sector that produces high-tech products. The productivity of workers depends on both their sector of employment and their level of education. The economy is initially isolated and chooses its education policy accordingly. Then the economy begins to trade with the rest of the world. Finally, we allow the government to choose a new education policy and we compare the old patterns of trade with the new ones.

Whether a move up the skills chain is desirable depends on the country's long-term technological advantage. However, even when such a move is beneficial the budget might not allow the necessary change in education policy. This suggests that economies that move up the chain are more likely economies that grow fast. It is the combination of trade and economic development that can account for successful policy changes that move the economy up the skill chain.

We have also found that reversals in the opposite direction, namely moving down the chain, can also be optimal and that such reversals are not budget-restrained. Some preliminary work with data suggests that some East-European countries might have gone through this type of change after the collapse of Communism. As these economies opened up to trade, many heavy industries whose development had been encouraged in the past could no longer compete with superior Western technologies and became obsolete. Judging by the progress these countries have made, a move down the technological chain can be consistent with economic development.

We have also found that moving down the chain can also be optimal and that such reversals are not budget-restrained.

Our results also have some interesting policy implications for the provision of aid. Any economy with a tight government budget can benefit from aid. However, the size of the benefits can differ significantly. For those countries in which it is optimal to move up the chain, relaxing the budget constraint would allow them to switch their patterns of trade. The welfare improvement is such cases can be very high.

The World Economy Annual Lecture 2008

Professor Elhanan Helpman

Galen L Stone Professor of International Trade Harvard University

'Trade and Labour Market Outcomes

19th June 2008, 5pm

Elhanan Helpman

Lecture theatre A48
Sir Clive Granger Building
University Park
University of Nottingham

GEP Conference on Offshoring

20th and 21st June 2008, University of Nottingham

Speakers include:

- Mary Amiti, New York Federal Reserve Bank
- Giorgio Barba Navaretti, University of Milan
- Alan Blinder, Princeton University
- Claudia Buch, Tübingen University
- Karolina Eckholm, Stockholm University
- Peter Egger, University of Munich
- Joseph Francois/Julia Wörz, Vienna Institute for International Economic Studies
- Ingo Geishecker, Göttingen University
- Liza Jabbour, GEP, University of Nottingham
- Eiichi Tomiura, Yokohama National University
- Alex Hijzen/Richard Upward/Peter Wright, GEP, University of Nottingham
- Holger Görg/David Greenaway/Richard Kneller, GEP, University of Nottingham

Conference Organisers:

Holger Görg, David Greenaway and Richard Kneller

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

Liza Jabbour

Tom Ivlevs

Conference report: GEP's Seventh Postgraduate Conference

GEP hosted its Seventh Annual Postgraduate Conference on 10th and 11th April. The event was an opportunity for postgraduate students from Europe, America and Asia to present and discuss their work. In this conference report the organisers, **Tom Ivlevs** and **Liza Jabbour**, comment on the themes of the papers presented and their main findings. Tom Ivlevs and Liza Jabbour are GEP Research Fellows.

In April GEP hosted the seventh Annual GEP Postgraduate Conference. This Conference targets PhD students working on issues related to foreign direct investment, international trade, migration and labour markets. Some 27 presenters, representing 18 universities and 10 countries, participated in this year's event.

A large number of high-quality papers were submitted to the Conference, leading us to expand the programme. This year the programme comprised six sessions with stand-up presentations and two poster sessions, all spread over two days. Two innovations from the Sixth Postgraduate Conference were retained: the keynote speech by a leading scholar in the field and the Best Paper prize. **Professor Chris Milner** (GEP), Head of the School of Economics at the University of Nottingham, gave a keynote lecture entitled *Factor Endowments, Factor Content and Intra-Industry Trade*. The winner of the Best Paper prize was selected by a committee comprising Professor David Greenaway (GEP Director), Professor Daniel Bernhofen (GEP) and the conference organisers. Given the high quality of the presented papers, we decided to award the prize to two participants: **Benjamin Jung** (Eberhard Karls University), for his paper *Sorting It Out: Technical Barriers to Trade and Industry Productivity,* and **Mario Piacentini** (University of Geneva), for his paper *Migration Enclaves, Schooling Choice and Social Mobility*.

To give a flavour of the high-quality work that is being undertaken by these young researchers, we report on some selected papers, one from each of the six sessions.

Benjamin Jung presented his prize-winning paper in the session **Technical Barriers to Trade**. Benjamin focuses on the interaction between technical barriers to trade (TBTs) and aggregated productivity from a theoretical point of view. TBTs are significant and increasing, yet the theoretical literature has generally focused on variable trade costs. Benjamin's paper seeks to fill this gap in the literature. The model is one of international trade in differentiated goods with heterogeneous firms where TBTs are modelled as fixed costs. In this framework the reform of TBTs influences aggregate productivity, on one hand through its impact on input diversity—and thus on the productivity of final good producers—and on the other through its impact on the productivity distribution of input producers. The results tend to suggest positive effects of TBTs reform and shed new lights on the relationship between openness and growth.

The second prize-winning paper was presented by Mario Piacentini in the session **Migration**. The paper investigates the presence of a network externality that might explain the persistence of low schooling achievements among internal migrants. Mario presents a simple analytical framework showing how an initial human capital disparity between migrants and non-migrants can translate into persistent skill inequality if origin shapes the composition of social networks. His empirical analysis is based on data on life-time histories of migration and education choices from a rural region of Thailand. The size of the migrant network is found to affect negatively the propensity of young migrants to pursue schooling while in the city.

In the session **Foreign Direct Investment (I)**", **Forfinn Harding** (Norwegian University of Science and Technology) presented a paper that explores the role of investment promotion

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agencies in bringing international investors to developing economies. He uses newly collected data on national IPAs in 109 countries to examine the effects of investment promotion on FDI inflows. The results suggest investment promotion efforts appear to increase FDI inflows to developing countries. Moreover, agency characteristics, such as legal status and reporting structure, affect the effectiveness of investment promotion. There is also evidence of FDI diversion due to investment incentives offered by other countries in the same geographic region.

Priydarshini Mahabir (GEP, University of Nottingham) presented her paper analyzing the effect of Chinese openness to international trade on exports by Asian countries in the session **International Trade Theory and Methods**. The paper applies a gravity model to disaggregate trade data to explore the differential impact of China's exports displacement on product categories, classified by technology intensity and stages of production, over the period 1992-2006. She shows that displacement due to China's export surge occurs more in medium-tech and high-tech sectors than in low-tech manufactures—initially perceived as the most vulnerable. Crowding-out is more noticeable in developed country markets and the second half of the period. At a disaggregated level of stages of production, displacement occurs in semi-finished goods and there is little discernable effect on capital and consumption goods.

The second session on foreign direct investment, **Foreign Direct Investment (II)**, included a paper by **Juan Carluccio** (Paris School of Economics) in which he investigates, theoretically, the link between inward FDI, technological incompatibilities and technology spillovers toward domestic firms in host countries. The paper seeks to provide a theoretical explanation for the empirical evidence showing negative intra-industry spillovers and positive inter-industry spillovers. When foreign affiliates and domestic firms use different technologies, the technological incompatibility will lead upstream suppliers to specialise in one of the two technologies and will create a technologically segmented market. Most productive input producers will self-select into supplying foreign affiliates, which amplifies the productivity advantage of foreign firms and restricts backward and forward linkages towards domestic firms. In the long run, technological adaptation by domestic firms may reduce

technological segmentation and offset the negative spillover effect.

In the last session, **Globalisation and Labour Markets**, **Daniel Horgos** (Helmut Schmidt University) analysed the labour market effects of international outsourcing. Daniel argues that, at a disaggregated industrial level and from a theoretical point a view, a sector bias effect can take place and low-skilled workers may benefit from international outsourcing by receiving a wage premium. The main contribution of the paper is to provide evidence on the sector bias effect using disaggregated panel data for Germany. The paper shows that the wage gap between high-skilled and low-skilled workers is reduced when international outsourcing takes place in low-skill-intensive industries and concludes that negative implications of international outsourcing may be exaggerated.

GEP Schools Conference 2008

GEP to host two conferences for schools on 23rd and 25th June 2008

Speakers are:

- Professor Daniel Bernhofen
- Professor David Greenaway
- Dr Alessandra Guariglia
- Dr Richard Kneller
- Dr Tim Lloyd
- Professor Chris Milner
- Dr Wyn Morgan
- Dr Richard Upward
- Dr Peter Wright

For further details contact jo.morgan@nottingham.ac.uk

Leverhulme Globalisation Lectures

Andrew Witty
Chief Executive Officer
GlaxoSmithKline plc

16th October 2008

Nicholas Crafts
Professor of Economic History
University of Warwick

19th November 2008

David Blanchflower
Bank of England Monetary Policy Committee
and Dartmouth College

' Fear, Unemployment and Migration'

29th January 2009

The World Economy Asia Lecture 2009

Professor Danny Quah
London School of Economics

14th January 2009

at the University of Nottingham, Malaysia

Nottingham Lectures in International Economics 2009

Professor John Sutton
London School of Economics

9th, 10th and 11th February 2009

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

Benjamin Jung

Sorting It Out: Technical Barriers to Trade and Industrial Productivity

The importance of technical barriers to international trade has been rising significantly over the past decade. But how could industry productivity be affected? In a recent prize-winning paper presented at the Seventh GEP Postgraduate Conference, **Benjamin Jung** from Eberhard Karls University, Tübingen, with the help of co-author Gabriel J. Felbermayr, offers theoretical insights to addressing this question.

According to Pascal Lamy, Director-General of the WTO, harmonising standards and rules rather than abolishing tariffs and quotas is 'the real 21st-century trade issue'. Viewing technical barriers to trade (TBT) as fixed regulatory costs related to the entry into export markets, we use a model with heterogeneous firms, trade in differentiated goods and variable external economies of scale to sort out the rich interactions between TBT reform, input diversity, firm-level productivity and industry productivity. We calibrate the model for 14 industries in order to clarify the theoretical ambiguities. Overall, our results tend to suggest beneficial effects of TBT reform but also reveal interesting sectoral variation.

Even within the European Union (EU) only about 10% of total spending falls on products from other EU15 countries (Delgado, 2006). Chen (2004) explains this striking fact by the existence of TBTs that impose additional costs on exporters. They have to customise their goods to meet the import country's technical regulations, its health, safety or environmental norms and are forced to undergo costly product labelling and conformity assessment procedures. Both the EU and the WTO acknowledge that TBTs may serve a multitude of legitimate goals. However, regulation which effectively protects incumbent domestic firms against foreign competition is deemed discriminatory and therefore illegal.

Overall, our results tend to suggest beneficial effects of TBT reform but also reveal interesting sectoral variation.

The set-up in which we study the effect of TBT reform is akin to Melitz (2003), with the difference that we focus on aggregate industry productivity (not welfare) and allow for *variable* degrees of external scale economies in the final goods production function. Incremental mutual recognition – defined as a reduction of foreign regulatory fixed costs – affects industry productivity through two channels, namely average productivity of input producers and input diversity. First, it affects selection of input producers into exporting (extensive margin) and competitive pressure (intensive margin). This leads to reallocation of resources away from inefficient firms and from efficient firms to new exporters. The net reallocation effect that drives average productivity of input producers depends on the relative importance of these two countervailing effects. Second, the effect on input diversity is theoretically ambiguous. It depends, inter alia, on the degree of productivity dispersion. Both effects potentially work in opposite directions, with their relative importance given by the external scale elasticity. Consequently, the total effect of TBT reform on industry productivity turns out to be ambiguous as well.

It may be striking that TBT reform potentially deteriorates industry productivity. Still, this can be rationalised by second-best considerations. Standard models implicitly fix the external scale elasticity by the elasticity of substitution. The decentralised equilibrium is then efficient, in the sense that input diversity is constrained Pareto-optimal. In the empirically relevant cases, however, there is oversupply of inputs, with the scale of operating firms being too small. Technical barriers may be used as a second-best instrument to mitigate excess entry; the first-best instrument, however, is to tax monopolists adequately.

We use estimates of the key parameters of our model from the literature to calibrate them according to the model. Since there is substantial cross-industry variation, we do a separate analysis for 14 industries. The numerical exercise serves several purposes. It allows us to empirically sort out the ambiguous effects of TBT reform industry by industry. Moreover, we compute the productivity gains (or losses) relative to the status quo achieved by a situation where technical

Continued on next page

requirements are harmonised.

Mostly, TBT reform reduces average productivity. However, these losses are overcompensated by input diversity gains, such that industry productivity improves.

Further reading

Chen, N. (2004), *Intra-national versus International Trade in the European Union: Why do National Borders Matter?*, *Journal of International Economics* 63: 93-118

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Mario Piacentini

Migration Enclaves, Schooling Choices and Social Mobility

In his prize-winning paper presented at the Seventh GEP Postgraduate Conference, **Mario Piacentini** from the University of Geneva argues, theoretically and empirically, why network externalities are an important determinant of the inequality between human capital investments of native and migrant families.

'People in the city and people in the village aren't the same. Bangkok people, you can't trust them… I've lived in this room for many months now and I still don't know the neighbours. In the village I know everyone. We grow up together, we're all relatives and friends together. I know where they come from, their background. I can trust them." These words come from an interview with Daeng, a 20-year-old rural migrant to Bangkok (Mills, 1997).

As with Daeng, increasing numbers of rural-born try their chance in the cities while keeping strong links with their communities of origin. This paper takes a close look at the experience of these young people, trying to find out more about the mechanisms leading to—and the economic implications of—'enclaving'. Enclaving is a process of spatial and social concentration by which differences between migrants and the urban-born can fail to smooth out in time.

In this paper I focus on how schooling decisions of young internal migrants, as human capital investments at the destination, approximate to the capacity to assimilate. I advance the hypothesis that migrant networks can represent a determinant of the observed low educational attainments. A simple theoretical model - with overlapping generations and two groups diverging in their initial level of human capital - is presented to show how a migrant family can invest less in schooling compared to a similar 'native' family when network externalities are in place. This inequality in attainments is shown to persist across generations if segregation or preference for association with one's origin group is sufficiently high. I identify two mechanisms through which segregation can endogenously emerge. The first argues that social segregation can be generated by the housing market, through residential neighbourhood locations. Migrants, starting from a lower level of human capital, have on average less to bid in the trade-off between community quality and rents and end up disproportionately in neighbourhoods less favourable to human capital investments. The second channel introduces heterogeneity in migrants' social type, defined as their value to the community or their compatibility with the group's values and rules. Social types are only privately observed and the community interprets enrolments in higher education as a signal of low compatibility. As a result, migrant families might want to signal their social attachment by reducing their investment in higher schooling at destination.

I test the relevance of network externalities on schooling using unique data from Thailand, the Nang Rong Project database. This dataset provides direct information on both migrants and stayers

Continued next page

through longitudinal surveys in the villages and migrant follow-ups. I have built, using reliable life histories of migration and education decisions, a panel of individual location decisions and schooling outcomes, from multiple communities and to multiple destinations, over a long period of time. The migrant network is measured by counting, for each migrant and each year, the number of sampled co-villagers who are located at the chosen destination. Controlling for relevant characteristics (including origin, destination and time fixed effects) and correcting for selection into migration through first-stage modelling of the migration choice, a larger network of co-villagers at destination is found to lower the probability that a young migrant is enrolled in higher schooling.

Summing up, this paper shows that network effects can act as a driving mechanism of low-mobility traps among migrants.

The important role networks play in facilitating migration and easing life at destination might come at a cost, slowing down the convergence of people with rural origins to the average level of skills of the urban-born.

The important role networks play in facilitating migration and easing life at destination might come at a cost, slowing down the convergence of people with rural origin to the average level of skills of the urban born. Considering the strong links migrants keep with their villages of origin (through remittances, return and as role models), it cannot be excluded that this network effect might reinforce persistence in inequality between backward rural areas and dynamic urban poles of developing countries.

What is valid for internal migration is potentially even more valid for international migration: as the cost of migration and assimilation rise, so the value attached by the individual to his community group rises. Policy-makers should consider policies facilitating young migrants' access to higher education, also by reducing the dependency of young individuals on support from their own community of origin.

Further reading

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GEP WORKSHOP

Openness, FDI and Economic Development

Hosted by the Leverhulme Centre for Research on Globalisation and Economic Policy (GEP)

At the University of Nottingham, Malaysia

Wednesday 21st May, 2008

Speakers are:

Wyn Morgan, University of Nottingham - 'Trade Liberalisation and Economic Growth'

Wai-Hang Loke, University of Malaysia - 'Assessing Malaysia's and China's Comparative Advantages in Selected Manufacturing Goods'

Albert Hu, National University of Singapore - 'Economic Reform and Liberalization and Small and Medium Size Enterprises in Chinese Manufacturing Industries'

Richard Kneller, University of Nottingham - 'The returns to exporting at the firm level'

New GEP Research Papers

2008/16 **Agelos Delis:** *The Casual Effect of Exporting and Multinational Acquisition on TFP in UK: An Evaluation Method Approach*

Summary: This paper assesses the effect on TFP growth of a change in the status of a firm from domestic producer to either exporter or subsidiary of a multinational.

2008/15 **Sugata Marjit and Biswajit Mandal:** *Corruption and Trade in General Equilibrium*

Summary: This paper shows that greater corruption in labour-abundant countries will restrict the volume of world trade but they still may gain, while corrupt capital-abundant countries will promote trade and be worse off with increasing degree of corruption.

2008/14 **Rod Falvey, Neil Foster and David Greenaway:** *Trade Liberalisation, Economic Crises and Growth*

Summary: This paper employs threshold regression techniques on five crisis indicators to identify "crisis values" and to investigate whether an economic crisis at the time of trade liberalisation affects subsequent growth performance.

2008/13 **Matthew Cole, Robert J.R. Elliott and Supreeya Virakul:** *Firm Heterogenity and Export Participation: A New Asian Tiger Perspective*

Summary: This paper investigates the relationship between firm heterogeneity and a firm's decision to export for Thai manufacturing firms. The paper breaks down FDI by country and region of origin to observe whether the behavior of MNEs differs.

2008/12 **Robert J.R. Elliott and Supreeya Virakul:** *Multi-Product Firms and Exporting: A Developing Country Perspective*

Summary: This paper sheds additional light on the complex relationship between multinational enterprises, exporting and economic development in Thailand by making a distinction between single and multi-product firms.

2008/11 **Artjoms Ivlevs:** *Are Ethnic Minorities More Likely to Emigrate? Evidence from Latvia*

Summary: Using survey data on emigration intentions in Latvia, this paper shows that Russian-speaking minority individuals are more likely to go working abroad than ethnic Latvians.

2008/10 **Rod Falvey, David Greenaway and Joana Silva:** *International Competition, Returns to Skill and Labor Market Adjustment*

Summary: This paper uses a large matched employer-employee dataset to show that increased international competition increases the returns to skill and worker skill upgrading at the industry level.

New GEP Research Papers (continued)
www.gep.org.uk/research_papers

2008/09 **David Greenaway, Richard Kneller and Xufei Zhang:** *Exchange Rates, Exports and FDI: A Micro-Econometric Analysis*

Summary: Using data on UK manufacturing firms, this paper finds that exchange-rate movements have little effect on firm export participation but have a significant impact on export shares. The paper also investigates the effects of exchange-rate movements on the export behaviour of multinationals and finds important differences according to country of origin. Multinational firms originating from outside the European Union are less affected by changes in the exchange rate compared to those inside, whose reactions are similar to domestic firms.

2008/08 **Marius Brülhart:** *An Account of Global Intra-industry Trade, 1962-2006*

Summary: This paper describes global intra-industry trade using data on some 39-million bilateral trade flows over the 1962-2006 period. The share of intra-industry trade has been gradually increasing, accounting for 27 per cent of global trade in 2006 (measured at the five-digit level).

2008/07 **Shujie Yao and Xiuyun Tang:** *Airport Development and Regional Economic Growth in China*

Summary: Based on an augmented production function and a panel dataset covering all the provinces in China during 1995-2006, this paper finds that airport development is positively related with economic growth, industrial structure, population density and openness but negatively related with ground transportation. The results have important policy implications on regional airport development in China.

2008/06 **Spiros Bougheas, David Greenaway, Kittipong Jangkamolkulchai and Richard Kneller:** *Technology Gap, Foreign Direct Investment and Market Structure*

This paper develops and analyses an entry model that predicts that the likelihood that foreign firms enter a country increases with the productivity gap between foreign and domestic firms. The model is tested using firm-level data on acquisitions of British firms by foreign firms.

2008/05 **Alexander Hijzen and Paul Swaim:** *Offshoring, Labour Market Institutions and the Elasticity of Labour Demand*

This paper analyses the evolution of the elasticity of labour demand and the role of offshoring therein, using industry-level data for a large number of OECD countries.

2008/04 **Jun Du and Sourafel Girma:** *The Effects of Foreign Acquisition on Domestic and Export Markets Dynamics in China*

This paper establishes economically significant causal relationships between foreign acquisition and domestic and export markets dynamics in China.

2008/03 **Jun Du and Sourafel Girma:** *Multinationals, Access to Finance and the Exports of Private Firms in China*

This paper examines the relationship between access to finance, FDI and firm exports in China and shows that access to finance is much more important for exports, especially for politically-unaffiliated firms.

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