Policy brief

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Who's Getting Globalized?

Intra-National Trade Costs and World Price Pass-Through in South Asia and Sub-Saharan Africa

In brief

- Many consumers in developing countries continue to face significant trade barriers within the country that may neutralize some benefits of globalization. Thus, this policy brief addresses the question: how integrated with the global economy are households in developing countries?

- This question will help us understand where the gains from trade accrue in developing nations, how these gains are distributed and what factors facilitate or impede the integration of a country within the global economy.

- This is a preliminary policy brief as not all the data from this project has been analyzed, thus the following policy implications are preliminary and should be treated as such.

- **Key policy implications:**
    - There are significant intra-national trade costs in developing countries that substantially raise the prices paid by inland customers. This is particularly in the case of heavy or bulky commodities. Trade costs are higher between locations separated by poor infrastructure.
    - When the port price of imported goods falls due to sudden changes in the exchange rates, only a portion of this saving is passed onto consumers in the interior. This suggests a portion of consumer gains that should come from reduced trade are captured by intermediaries.
    - Policy-makers must tackle both physical barriers to trade (poor roads, long border delays etc.) and a lack of competitiveness in the distribution sector if consumers throughout the country are to reap the full benefits of trade liberalization.

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Policy Motivation

Over the past few decades, the process commonly referred to as "globalization" has resulted in substantial reductions in international trade barriers. However, many consumers, particularly those in developing countries continue to face significant trade barriers within the country that may neutralize significant portions of the effects of globalization. The empirical question motivating our research is thus: how integrated with the global economy are households in developing countries?

Policy Impact

The answers to this question could be of potential significance in assessing the gains from trade accruing to countries, the distribution of these gains and, ultimately, a better understanding of the factors that facilitate or impede the integration of a country with the global economy. This will help us to identify the manner in which the functioning of intra-country trade networks can be improved to maximize consumer welfare.

"Significant investment in transportation infrastructure is needed if households residing in remote areas of the country are to face similar prices to those in the rest of the country"

Audience

Given the relevance of the policy and research questions contained within this research agenda, we anticipate this project being of interest to academics concerned with both International Trade and Development Economics, as well as policymakers involved in planning infrastructure and regulating the various actors involved in moving goods within countries.

Policy Implications and Implementation

Note: Unfortunately at this time we have not yet been able to analyse all the data that we have collected in a satisfactory manner and the draft is incomplete. For this reason the following section should be taken as exceedingly preliminary. We are more than happy to update it when we have finalized our empirical results and can make more clear-cut policy recommendations.

There are significant intra-national trade costs in developing countries that substantially raise the prices paid by inland customers

Our findings suggest that these intra-national trade costs are large, especially in the case of commodities that are heavier and bulky. Trade costs are higher between locations that are separated by poor roads, and in areas with especially poor infrastructure.

Implementation: This finding would suggest that significant investment in transportation infrastructure is needed if the households residing in remote areas of the country are to face similar prices to those in the rest of the country.

Constraints: Clearly, as with any large infrastructure projects, corruption and or low quality construction are major worries. The question of how best to deliver these projects is an area of active research.

"The extent to which consumers gain from trade reforms is likely to be smallest in the most remote locations since few middlemen serve these areas and accordingly charge very high mark-ups."

When the port price of imported goods falls due to sudden changes in the exchange rates, only a portion of this saving is passed onto consumers in the interior

This portion is even lower for particularly remote consumers. This suggests that a portion of the consumer gains that should come from reduced trade barriers are captured by intermediaries, as well as deadweight loss. The extent to which consumers gain from trade reforms is likely to be smallest in the most remote locations since few middlemen serve these areas and accordingly charge very high mark-ups.

Policy-makers must tackle both physical barriers to trade (poor roads, long border delays etc.) and a lack of competitiveness in the distribution sector if consumers throughout the country are to reap the full benefits of trade liberalization

Implementation: One way in which consumers will gain more from trade reforms is to enact policies that would encourage the expansion of intermediary trade networks. For example, reducing regulations that inhibit entry into the intermediary sector could go some distance towards making the market for intermediaries more competitive, driving down mark-ups, reducing deadweight loss and benefiting poor inland consumers.

Constraints: Middlemen often form powerful interest groups, and this may face substantial political opposition.

Further Reading

Anderson, James E. and Eric van Wincoop (2004): "Trade Costs," Journal of Economic Literature, 42(3), 691-751.

World Bank (2009): World Development Report 2009: Reshaping Economic Geography.

World Bank (2009): "Transport Prices and Costs in Africa: A Review of the International Corridors"

About the authors

David Atkin is currently an Assistant Professor at UCLA. He was previously an Assistant Professor at Yale University after receiving his PhD from Princeton University. His primary fields are trade and development. David's research focuses on evaluating the impacts of trade liberalization on the poor in the developing world by using the microeconometric tools and the large household datasets common in applied economics to analyze trade and development issues. His recent work has studied the role of regional taste differences in altering the impacts of trade reforms in India, and educational responses to the rise of export oriented manufacturing in Mexico.

Dave Donaldson is the Gary Loveman Career Development Associate Professor, Department of Economics at the Massachusetts Institute of Technology. He is also an Associate Professor (with tenure) in the Department of Economics at Stanford University. His research concerns topics at the intersection of international trade and development economics. He has studied at Oxford University and the London School of Economics.

The International Growth Centre (IGC) aims to promote sustainable growth in developing countries by providing demand-led policy advice based on frontier research.

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