in brief...

Sharing the fruits of trade

One of CEP's core research themes is the impact of trade openness on countries, firms, regions, communities and sectors. Two recent studies confirm the gains from opening up trade – but recognise that addressing the uneven outcomes of globalisation is as big a challenge as pursuing liberalisation in the face of entrenched interests.

One of the defining features of globalisation is increasing openness to trade – the removal of a whole range of barriers to the free flow of people, goods, services and capital. Some of these trade barriers can take the form of duties and tariffs levied at national borders. Others are caused by standards – regulations covering labour, environmental issues and health and safety – which differ between countries and regions. Still others arise from geography, for example, inaccessibility or a lack of transport infrastructure.

As these barriers are dismantled by economic liberalisation, new transport networks and constant innovation in information and communications technologies, so the impact of trade openness on countries, firms, regions, communities and economic sectors is coming under closer scrutiny.

One CEP study of the effects of new transport infrastructure focuses on the US interstate highway system, spanning over 40,000 miles, and mostly constructed between 1956 and 1975. The highways had three goals: to improve the connection between major metropolitan areas in the United States; to serve US national defence; and to connect with major routes in Canada and Mexico. As an unintended consequence of meeting these goals, the highways crossed many rural areas, making it possible for researchers to examine their causal impact on the local economy.

The research by Guy Michaels finds dramatic effects. A country where distances were long, travel was slow and most economic activity was highly localised began to integrate across its land mass. It soon became apparent that the new highways had a big impact not on passenger vehicles but on the large trucks that have become the primary mode of cross-county commerce.

The highways increased trucking income and retail sales by 7-10% per capita in the rural counties they crossed, relative to other rural counties. This suggests that highway counties took advantage of the reduction

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Transport infrastructure like the US interstate highway system increases trade

in trade barriers to increase their trade with other counties.

More surprising perhaps are the findings on how the highways affected the demand for skills in rural areas. On average, the highways had no effect on the demand for high-skilled workers relative to low-skilled workers. But the highways increased the demand for high-skilled workers compared with low-skilled workers in counties where skills were abundant and reduced demand where skills were scarce.

In other words, by opening new markets, the highways disproportionately benefited high-skilled workers where skills were abundant and hurt them where skills were scarce. This finding is consistent with the view that trade increases the demand for the abundant factor.

Other CEP research on trade liberalisation – by Stephen Redding and colleagues – sheds more light on how the reduction in barriers to trade reallocates economic activity. Here too, the pattern that emerges is one of success reinforcing success.

At the most basic level, the researchers find that a reduction in trade barriers encourages simultaneous job creation and job destruction in all industries, but that gross and net job creation vary with country and industry characteristics.

Significantly, there is a net loss of jobs in industries with a comparative disadvantage (those where relative labour and non-labour costs are high), while industries with comparative advantage enjoy net job creation as job losses due to exiting firms are exceeded by jobs created by the entrance and expansion of high-productivity firms.

Likewise with productivity levels and average firm output: the gains from liberalisation are greatest in industries with comparative advantage. Interestingly, it is in these industries that the research finds the highest levels of 'creative destruction' of firms, which may explain why workers in these more dynamic sectors report higher levels of job insecurity.

That the overall effect of opening up trade is to increase aggregate welfare is not in doubt, as both studies make clear. As average productivity increases, so the price of goods is driven down, reinforcing the virtuous circle. But welfare gains are not experienced uniformly, and just as some regions or sectors have to grapple with the handicaps of a low skills base or high input costs, so too do developed and less developed economies.

Contrary to the anti-globalisers, success breeds success not just for the few but for the many – and often for the vast majority. But the fruits of commerce are not always enjoyed by all. Addressing those uneven outcomes is as big a challenge for politicians as pursuing liberalisation in the face of entrenched interests. Most agree on the need to 'manage' globalisation. That shouldn't mean reining it back, but helping everyone to jump on board.

This article draws on research described in 'The Effect of Trade on the Demand for Skill – Evidence from the Interstate Highway System' by Guy Michaels, CEP Discussion Paper No. 772 (http://cep.lse.ac.uk/pubs/download/dp0772.pdf) and 'Comparative Advantage and Heterogeneous Firms' by Andrew B Bernard, Stephen J Redding and Peter K Schott, *Review of Economic Studies* 73(1): 31-66, 2007.

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