

HIGHLIGHTS from Chapter 3:

High Trade Costs: Causes and Remedies

Key Points

- *The COVID-19 pandemic has triggered a steep slowdown of global trade. While the recovery was swift, especially for goods trade, prospects going forward remain weak. Lowering trade costs can help revive global trade.*
- *Despite a decline since 1995, trade costs remain high, doubling the cost of cross-border traded goods over domestic ones. Trade costs are about one-half higher in emerging market and developing economies (EMDEs) than in advanced economies. Tariffs account for a small fraction of trade costs. The bulk of trade costs are incurred in shipping and logistics as well as cumbersome trade processes at and behind the border.*
- *A comprehensive reforms package to streamline trade processes and customs clearance requirements, enhance domestic trade-supporting infrastructure, increase competition in the domestic logistics, retail, and wholesale trade industries; lower tariffs and reduce corruption could significantly lower trade costs.*

Prospects for global trade. COVID-19 triggered a sharp contraction of global trade in early 2020, which was followed by a rapid rebound. By November 2020 global goods trade had recovered to pre-pandemic levels (Figure 1). By March 2021, services trade, which had been hit harder in 2020, had also recovered to within 3 percent of pre-pandemic levels despite still-depressed travel and tourism. Beyond the immediate recovery, prospects for world trade remain subdued amid weak global output growth, maturing global supply chains, and trade tensions. A major policy push may help spur global trade such that it can once again become an engine of growth for many EMDEs.

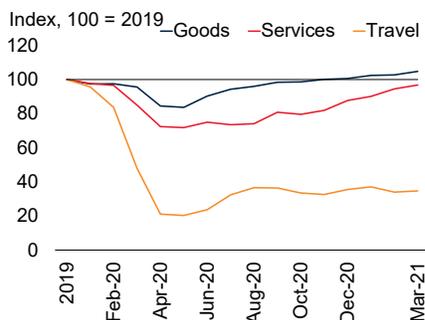
High trade costs. Trade costs capture the costs faced by countries when trading goods across borders, in excess of the costs of the same good traded domestically. Despite a decline since 1995, trade costs remain high, doubling the costs of internationally traded goods over domestically traded ones. Tariffs form a small part of trade costs; the bulk are incurred in shipping and logistics as well as cumbersome trade procedures and processes at and behind the border. Trade costs are about four-fifths higher in agricultural goods than in manufacturing goods. They are about one-half higher in EMDEs than in advanced economies; higher shipping costs and worse logistics performance account for around one-third of the differences and less favorable trade policy for another one-third. More cumbersome customs regulations and border processes in EMDEs and greater remoteness also contribute to the difference.

Remedies to lower trade costs. A menu of options is available to reduce trade costs. These include measures to streamline trade processes and customs clearance requirements; enhance domestic trade-supporting infrastructure; increase competition in the domestic logistics, retail, and wholesale trade industries; lower tariffs; lower compliance costs with standards; and reduce corruption. Trade agreements that deepen integration beyond tariff cuts can help lower non-tariff barriers. Some of these measures could yield large dividends: among the worst-performing EMDEs, a hypothetical reform package to improve logistics performance, maritime connectivity, and border processes to those of the best-performing EMDEs is estimated to halve trade costs.

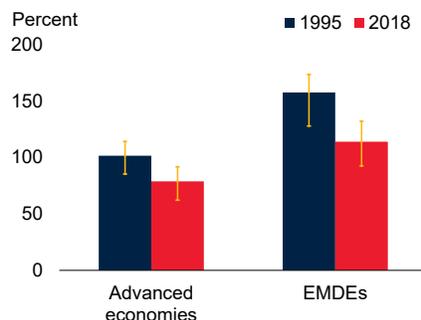
Figure 1. Global trade and trade costs

After falling sharply in 2020, global trade has rebounded fast, particularly goods trade. Despite a decline since 1995 trade costs remain high, particularly in EMDEs, where they are almost one-half higher than in advanced economies. Higher shipping and logistics costs, cumbersome border procedures and worse trade policies account for the gap to a large extent. Comprehensive reforms packages that streamline trade processes and customs clearance requirements and enhance logistic and shipping connectivity can halve trade costs in EMDEs.

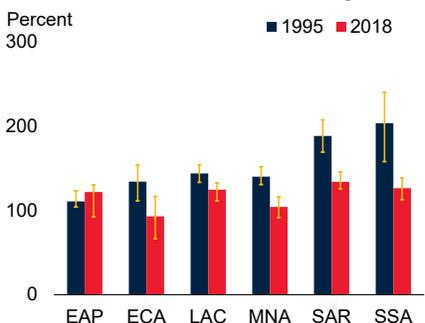
A. World trade



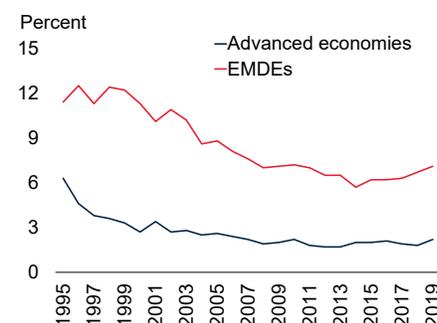
B. Trade costs in 1995 and 2018



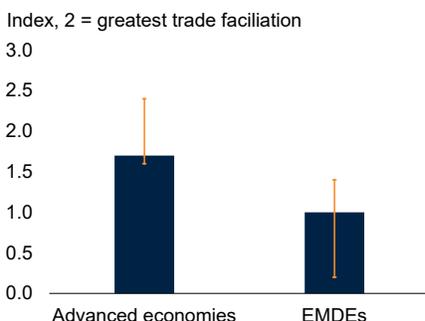
C. Trade costs in EMDE regions



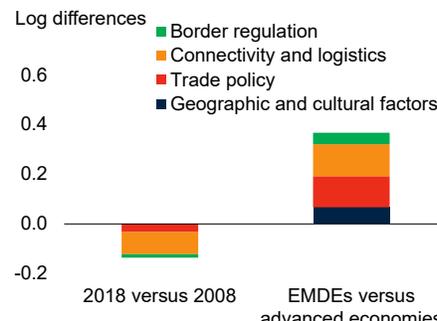
D. Tariff rates in AEs and EMDEs



E. Trade facilitation index



F. Contributions to differences in trade costs



Sources: Comtrade (database); Gurevich and Herman (2018); Organisation for Economic Co-operation and Development; World Bank; World Trade Organization.

Note: EMDEs = emerging market and developing economies; EAP = East Asia and Pacific, ECA = Europe and Central Asia, LAC = Latin America and the Caribbean, MNA = Middle East and North Africa, SAR = South Asia, SSA = Sub-Saharan Africa.

A. Goods trade is the average of import and exports volumes, services trade is the average of imports and exports values. Goods trade data in 2021 relative to average of 2019, services and travel trade data relative to corresponding month in 2019. Total goods trade volumes for 38 advanced economies and 43 EMDEs, as reported in the CPB World Trade Monitor. Services trade and travel data from WTO statistics. Sample for services trade and travel includes 13 advanced economies and 16 EMDEs. Last observation is March 2021.

B.C. Bilateral trade costs (as defined in the ESCAP database) measure the costs of a good traded internationally in excess of the same good traded domestically and are expressed as ad valorem (tariff) equivalent. Bilateral trade costs are aggregated into individual country measures using 2018 bilateral country exports shares from the Comtrade database. Bars show unweighted averages, whiskers show interquartile range. Sample in 1995 includes 33 advanced economies and 46 EMDEs, sample in 2018 includes 21 advanced economies and 57 EMDEs.

D. Regional aggregates are computed as unweighted averages of country weighted tariff rates.

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E. Unweighted average for 36 advanced economies and 122 EMDEs. Trade facilitation index is an unweighted average of 11 subindices, all scored on a scale of 0-2. The indices score countries on information availability, trade consultations, advance rulings, appeals procedures for administrative decisions by border agencies, fees and charges on imports and exports, simplicity of trade document requirements, automation of border procedures and documentation, simplicity of border procedures, cooperation between domestic agencies, cooperation with neighboring agencies, and governance and impartiality. The data is collected from publicly available sources, country submissions, and private sector feedback. Orange whiskers indicate minimum and maximum range.

F. Predicted ratios of overall trade costs between the two groups indicates the contributions to differences in logarithms of trade costs. Computed using coefficient estimates for each variable and the following realizations for each indicator included in the regression: trade-weighted averages for all countries in the sample in 2018 minus trade-weighted average for all countries in the sample for 2008 for the comparison over time and trade-weighted averages for EMDEs minus trade-weighted average for advanced economies in 2018. Trade policy includes tariffs and membership in regional trade agreements; geographic and cultural factors includes distance, common border, and common language; border regulation includes the ease of trading; and connectivity and logistics include liner shipping connectivity index and logistics performance index