TRADING FIRMS AND TRADING COSTS IN SERVICES

Presented by Francesca Spinelli
co-authors : Dorothée Rouzet and Sebastian Benz
OECD, SERVICES TRADE RESTRICTIVENESS INDEX (STRI)

REDLAS: 6th Annual Conference on Tendencies and Perspectives for the Production and Trade of Services in Latin America and the Caribbean

21-22 September 2017

BETTER POLICIES FOR BETTER LIVES

Background

- Main question : How are the **decisions of services exporters and investors influenced** by **policy conditions** in the host markets?

- Looking at:
  - The decision to enter a market (extensive margin) and the value of exports (intensive margin)
  - All modes of supply: cross-border trade and foreign affiliate sales
  - Heterogeneous impact of restrictions depending on firm size, productivity, experience, specialisation, etc.

The OECD Services Trade Restrictiveness Index

- Extensive coverage of global services:
  - **44 countries**: OECD + BRIICS + CRI, COL, LTU (+ South East Asia)
  - **22 sectors**: Audio-visual services, Computer services, Construction, Courier and Postal services, Distribution, Financial services, Logistics, Professional services, Telecommunication, and Transport
  - **3 years**: 2014, 2015, 2016 (2017 about to be finalised)

- Restrictions on multilateral basis - PTAs are not taken into account

- Standardised set of measures organised under five policy areas:
  - Restrictions on foreign entry
  - Restrictions to movement of people
  - Other discriminatory measures
  - Barriers to competition
  - Lack of regulatory transparency

- Indices vary from **0** (liberal) to **1** (restrictive)

Data

- Confidential **firm-level data** from *International Trade in Services Surveys* and *Foreign Affiliate Statistics (FATS)*:
  - <u>Both services trade and foreign investment</u> : Germany, Finland, Sweden, United States
  - <u>Only services trade</u> : Belgium, Italy, United Kingdom
  - <u>Only foreign investment</u> : Japan
- From these surveys : info on annual exports and foreign affiliate sales by firm, partner country and service type
- Data complemented with firms characteristics extracted from structural business surveys
- Datasets span an overlapping <u>period of time</u> (2008-2014) and more than one continent to reach a sufficient level of representativeness

Main findings: Descriptive analysis

- Foreign affiliates sales are several times larger than services exports but these services affiliates serve fewer markets.
- The volume of services exports is *highly concentrated* among the few firms that serve a large number of partner countries.
- **Manufacturing firms** account for a significant share of services exports, especially in professional and computer services.
- Only a minority of cross-border services providers manage to *keep exporting* to a given destination for a prolonged period of time.
- Foreign affiliates act to as **export platforms**, supplying financial, transport, computer and distribution services, not only to their local host market, but also to third countries.

Methodology

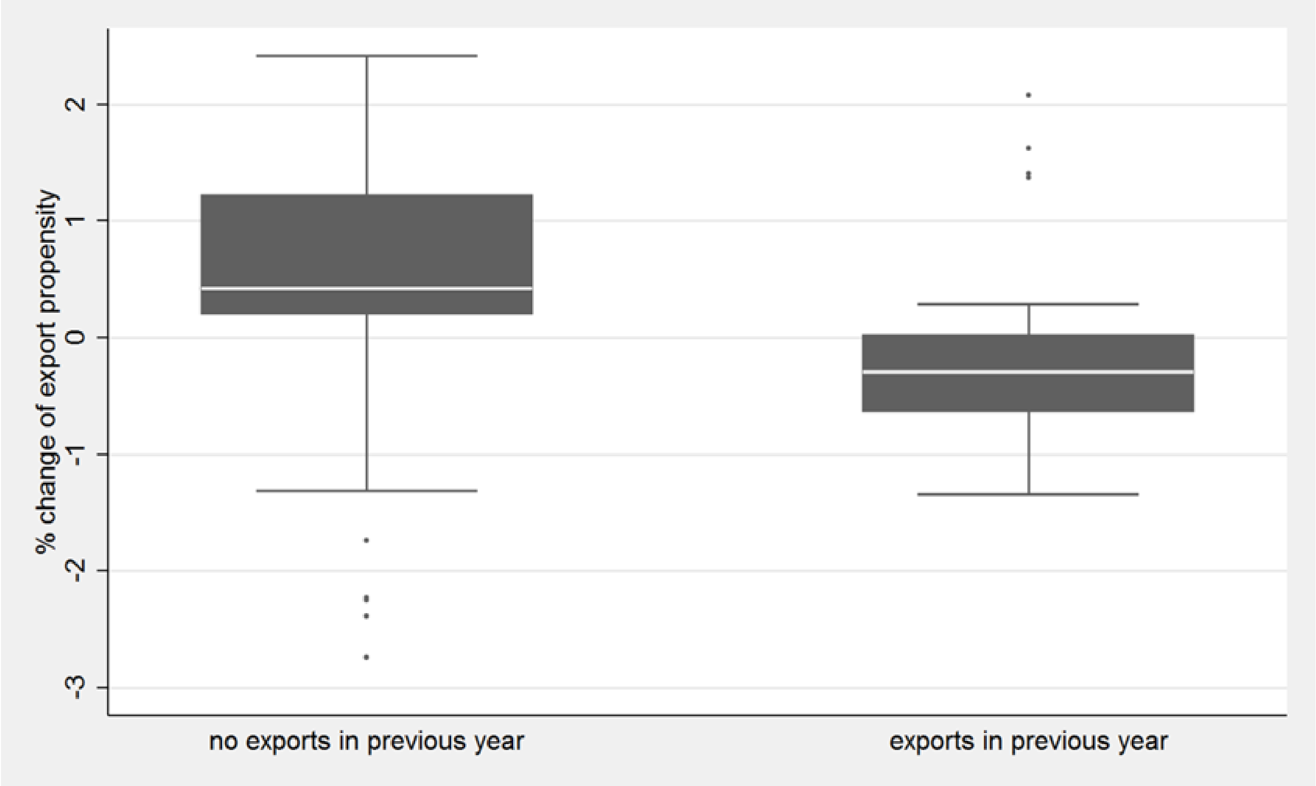
- Impact of services trade restrictions on:
  - the total value of international activity:
    $$X_{ict}^{s} = \exp(\alpha + \beta STRI_{c}^{s} + \gamma Z_{it} + \delta S_{ct} + \theta_{t} + \varepsilon_{ict}^{s})$$
  - the probability that such activity occurs:
    $$P(X_{ict}^{s*} > 0) = \Phi(a + bSTRI_{c}^{s} + cZ_{it} + dS_{ct} + \varphi_{t} + \omega_{ict}^{s})$$
- Analysis run on cross-border trade and foreign affiliate sales separately for each exporting country and each services sector
- Estimators used: PPML for the value of sales; Probit for probability of international activity.
- From the gravity regression coefficients on the STRI we estimate ad-valorem equivalents of services trade costs.

Main findings: Impact of services trade barriers

- Where the destination has a higher STRI score (= more restrictive market):
  - A smaller number of firms export
  - The volume of exports is lower
  - It attracts less FDI in services
  - Foreign affiliates realise lower sales
- The evidence suggests that restrictions create a combination of ad valorem trade costs and fixed costs
- The same regulations have a different impact on different firms

Trade liberalisation & export experience

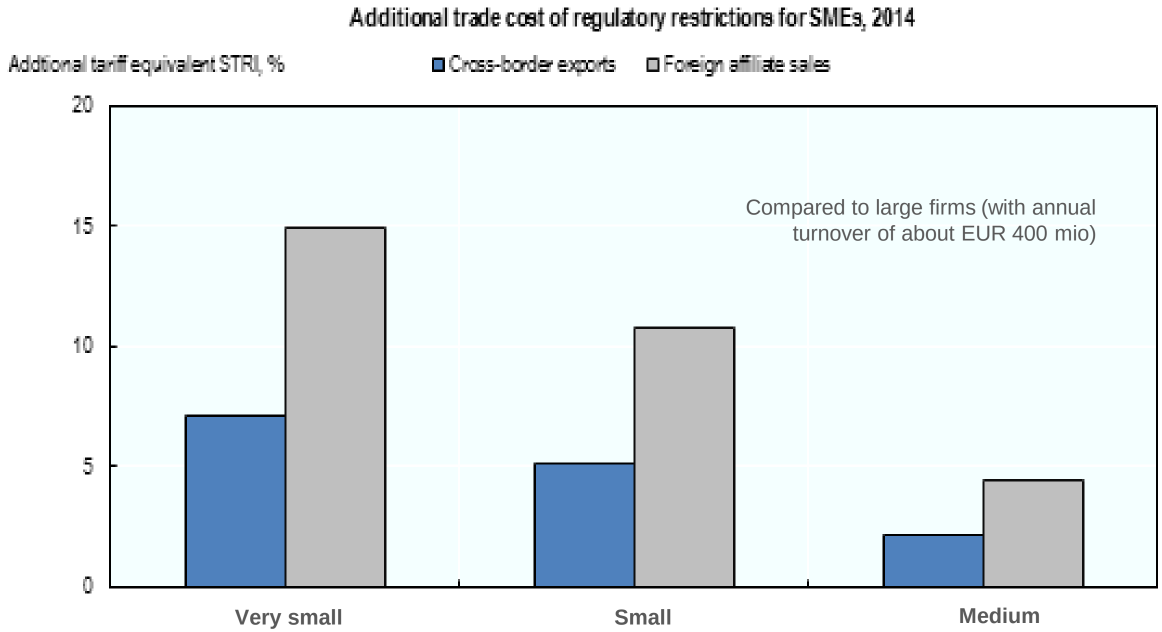
For a 0.01 global reduction in the STRI



Source: OECD calculations, based on estimates from Rouzet et al. (2017).

Notes: The numbers indicate the percentage change in the propensity to export of a given firm when reducing the STRI score by 0.01. Results based on sector-level probit regressions. Horizontal white line indicates the median of the marginal effects from all regressions. The black box represents the interquartile range, which corresponds to the intermediate 50% of the distribution of marginal effects.

SMEs bear the highest cost from restrictive trade policies

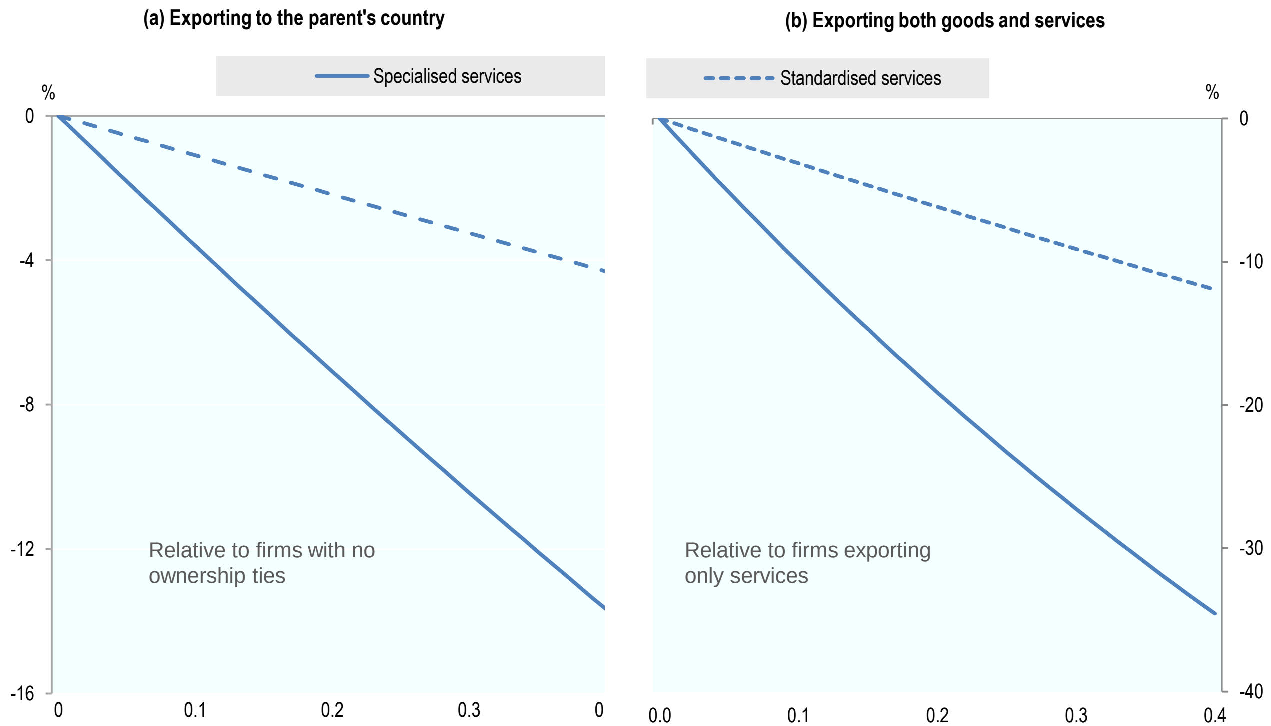


Source : OECD calculations, based on estimates from Rouzet et al. (2017).

Note: The numbers indicate the ad valorem tariff equivalent of an STRI score of 0.2 on top of what is paid by larger firms (with turnovers of EUR 400 million and above). Average turnover used for calculations is EUR 1 million for very small enterprises, EUR 5 million for small enterprises and EUR 25 million for medium-sized enterprises. Import demand elasticity is 2.5.

Firms with multiple ties to the host market do better

Estimated discount on the tariff equivalent of the STRI index on specific firms



Source: OECD calculations, based on Rouzet et al. (2017).

Note : The numbers indicate the amount by which the ad valorem tariff equivalent of the STRI is reduced for firms that have headquarters or ultimate owners in the destination markets, compared to firms with no ownership links in the country (left); and for firms also exporting goods to the same country, compared to pure services exporters (right). Specialised services correspond to an import demand elasticity of -1.5, and standardised services to an import demand elasticity of -5.

Thank you!

Contact us

We look forward to hearing from you!

Access all of the information from the Trade & Agriculture Directorate at:

www.oecd.org/tad

You can reach us via e-mail by sending your message to the following address:

tad.contact@oecd.org

We invite you to connect with us on Twitter by following:

@OECDtrade
@OECDagriculture