THE IMPACT OF TRANSPORT LINKS ON TRADE, INVESTMENT AND ECONOMIC INTEGRATION

Preparatory Conference to the 14th OSCE Economic Forum "Transportation to enhance regional economic co-operation and stability"

Dushanbe, 7-8 November 2005

Robert Nowak
Economic Analysis Division
UN Economic Commission For Europe
Geneva

International trade and transport:

- Many believe international trade drives the world economy
- Trade (and openness to trade) - significant variables explaining the differences in economic growth
- High transport costs are an obstacle - discourage international trade

International trade - history:

- Before 1914: international trade driven by technological improvements in transport (railways, steamships, canals) and communication advances
- Between 1950 and 2003: the value of global exports increased 145 times, the volume of exports increased 25 times
- Did international transport costs play a role?
- Two-thirds due to higher incomes, one-quarter owing to tariff liberalization, lower transport costs account for 8 per cent

Trade policies and transport costs:

- Trade policy barriers (tariffs and NTBs) currently fairly low
- They appear much less important than other policies (transport infrastructure, law enforcement and property rights institutions)
- This implies potentially much larger (than historical) payoffs to be had by lowering transport costs and other institutional policies

Transport costs - location:

- Transportation costs matter and vary (eg., distance from major markets, geography, products, level of development, infrastructure)
- Landlocked countries face transport costs that are 50 per cent higher
- Transport costs are on average 70 per cent higher in developing countries

Transport costs -infrastructure:

- Poor physical infrastructure is reflected in higher transport costs
- Trade volumes go up by two-thirds if a country improves its infrastructure (incl. telephone lines) from a mid-point to top 25 per cent
- Improved infrastructure leads to higher trade (the greatest impact on trade has increasing port efficiency)

Transport costs - products:

- Transport costs vary not only across countries but also across products (high value to weight less penalized)
- Agricultural and mining products more expensive to ship than manufacturing goods

Shipping time:

- Doubling shipping time, decreases the volume of trade by about a third
- Loading, unloading time, administrative procedures take time
- Customs clearance up from 5 to 7 days, the volume of trade down by 40 per cent

Transport costs and trade:

- The higher the costs, the lower the volumes traded
- Transportation infrastructure affects a country's comparative advantage (fresh fish shipments, cut flowers
- The relative costs of different modes of transport affect the volume and composition of trade (production networks - vertical specialization)

Investment and economic growth:

- Economic growth drives exports and imports (reversed causality)
- Investment creates production capacities and enhances competitiveness
- Great shortages of domestic capital in many economies; crucial to attract foreign capital
- The availability of infrastructure and transport services (or distance) may be a factor in decisions where to invest

Foreign Direct Investment:

- FDI: a dominant type of capital flow into transition economies (the least volatile and most closely linked to improved economic performance)
- FDI flows also highly concentrated across the region and within sub-regions

Foreign Direct Investment (EU-8):

- The EU-8 countries received about two-thirds of cumulative total since 1996. Of which 80 per cent went to the Czech Republic, Hungary and Poland
- In general, FDI in the EU-8 countries is oriented towards exports
- Factors: geographical proximity, prospects for EU membership, well-educated, low cost labour, favourable investment climate (politics, macroeconomics, protection of property rights)

Foreign Direct Investment (CIS):

- About one-quarter went to CIS, of which Russia and Kazakhstan account for about 70 per cent
- CIS countries with natural resource have attracted inward investment. Other FDI tends to be import substituting (aims at domestic market).
- Factors: generally unfavourable investment climate, great distances from major markets, landlocked locations

What determines FDI?

- According to surveys of business executives:
- “Investor motives are driven … by the broad business climate of a country. Local market opportunities, overall policy toward free enterprise and competition and macroeconomic stability are considered the most important.” (The World Investor Prospects, EIU)

What determines FDI?

- According to World Bank's Investment Climate Surveys, about 10 per cent of respondent rate transport as a "major" or "severe" constraint to investing
- Small firms (< 20 employees) less than 10 per cent
- Very large firms (>250) about 15 per cent

Transport and investment:

- Many transition economies have not attracted investment despite favourable investment climate, but due to unfavourable location

- Is it possible to “reduce” the distance?

Infrastructure:

- Cost/benefit analysis (OECD 2002)
- Infrastructure requires better than “overall” investment climate (large financial outlays required, immobile and long-lived)

Good governance – institutions:

- Physical infrastructure to be complemented by market supporting “institutions” (law, customs, transit, security, competition)
- Domestic and international legal instruments – the role of UNECE
- Effective implementation

Transport and investment:

- Macroeconomic and political stability – necessary conditions
- Conflicts or a risk of violent conflict present in the OSCE region
- Capital will not flow in the presence of solid transport infrastructure and in the absence of stability

Economic integration:

- Work towards closer regional cooperation
- A positive impact on FDI by increasing the market size (reduction of transaction costs)
- A necessary condition for the development international transport links
- Trade facilitation (customs, regulatory reforms) brings out large benefits only if co-ordinated internationally as benefits accrue also to trading partners