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

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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 (e.g., 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 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 of international transport links
- Trade facilitation (customs, regulatory reforms) brings out large benefits only if co-ordinated internationally as benefits accrue also to trading partners