

# Trade Facilitation, Production Networks and Regional Integration: Precondition or simultaneity

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# Trade Facilitation and Production Network

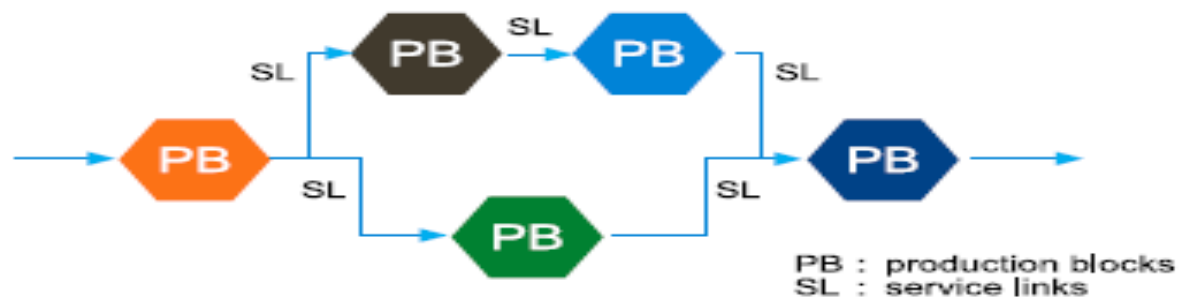
- Trade Facilitation is captured in terms of reduction of trade costs.
- Trade Facilitation is also one of the conditions for growth of production networks
- The concept of economic corridor is also dependent on trade facilitation

- ❑ Economic Corridor and production network is a concept where some regions across either two or more countries are identified whose infrastructure is specially promoted to strengthen trade and economic integration among the countries
- ❑ The main advantage of promoting economic corridors is realized when trade across such corridors is sufficiently liberalized and seamless, thus lowering the cost of trade across border.

Before fragmentation



After fragmentation



❑ Fragmentation of Production Process is a key for the development of economic corridors and Production Network along that Corridor

❑ Higher trade costs along Poor services links discourages fragmentation of production

❑ However, low trade costs do not necessarily promote production networks. One can say better infrastructure is necessary but not sufficient condition for the development of production networks

❑ Naturally, the question arises as to what items are included in the trade costs?

❑ They include transportation costs (both freight costs which is a direct cost and time costs which need to be imputed) and policy barriers (tariffs and non-tariff barriers, some of which again need imputations).

❑ Apart from these, there are costs associated with information gathering, contract enforcement costs, currency conversion costs, legal and regulatory costs, as well as local distribution costs (wholesale and retail).

❑ Costs are also decomposed into three elements: monetary cost, time cost, and reliability/credibility/stability. The last one seems to be particularly important in the case of developing country

❑ Broadly all the costs which may be non-monetary are part of logistics costs.

❑ Seamless movement of goods is a key to reduce trade costs. In fact, high transport and logistic costs impede competition, and Asia lags behind Europe and North America in reducing such costs

❑ Compared to about 45 percent intraregional trade among East Asian countries (excluding Japan), intraregional trade in South Asia had grown from a mere 3 percent in 1991 to around 5 percent in 2009

# Regional Integration Stages

- ❑ Free Trade Area- Eliminate Tariffs
- ❑ Customs Union- FTA plus common tariff against ROW
- ❑ Common Market – CU plus free movement of Factors of production
- ❑ Economic Union – CM plus unified fiscal, monetary and socioeconomic policies

## Condition for Success

- ❖ Competitive before Union but potentially Complementary after Union

- ❖ More competitive markets should allow scale economies to operate and investments to pick up

## Trade Facilitation and Regional Integration

- Trade Facilitation is not conditional upon the stage of regional integration but sustainable regional integration must have trade facilitation
- Successful Regional Integration did not wait for bilateral or multilateral treatise but had its seed in trade liberalisation, production network and fragmentation- clear example is ASEAN
- Thus, trade facilitation must be a continuous and autonomous process which creates the condition for various stages of regional integration
- Once snowballing starts, regional integration and trade facilitation strengthen each other



## **Prospect for South Asian Region**

- **South Asian countries have succeeded most in the Textiles and Clothing sector in a global perspective (ADB, 2009)**
- **In Textiles sector, less than 7 per cent is intra regional while for clothing it is less than 1 per cent**
- **India and Pakistan have comparative advantage in the textiles sector while Bangladesh and Sri Lanka have the same in clothing sector**
- **Apparently the Cut, Make and Trim model from orders placed from abroad is the cornerstone of clothing exports from both Bangladesh and Sri Lanka. They also contain foreign affiliate production**
- **ADB (2009) highlights the dependence of clothing sector in Sri Lanka as well as Bangladesh on East Asia for the 'quota hopping' nature of producers there**

## **Nature of ASEAN +3 Intra Regional Trade**

- **Intra Regional Exports of Parts and Components of ASEAN+3 countries touched 59.3 % in 2005. Thus there was stress on Intermediate goods trade intra regionally.**
- **Aminian, Fung and Ng (2008) showed that RCA reveals that ASEAN+3 have transcended to more export oriented 'Processing' stage compared to import based 'Assembling' stage.**
- **This has helped MNCs as well as smaller sized Local companies in this region to fragment their production process**
- **This Vertical specialisation across borders developed for economic needs. Thus this market driven integration preceded the rather slow moving and complicated agreement formulation stages.**

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Reporter	Partner	Indicator	1990	1995	2000	2005	2010
ASEAN	ASEAN	Export Growth (%)	N/A	23.5386554	25.8975996	16.57339467	35.1657862
ASEAN	ASEAN	Export Share (%)	18.9390582	24.4054322	22.9763892	25.32939078	24.5629882
ASEAN	ASEAN	Intra-regional Trade Share (%)	18.8423638	23.9481532	24.6891658	27.18072176	26.3743729
ASEAN+3	ASEAN+3	Export Growth (%)	N/A	27.7077895	28.7262061	14.80451247	35.7494649
ASEAN+3	ASEAN+3	Export Share (%)	26.7651311	34.844598	33.6338193	35.11707359	36.0704845
ASEAN+3	ASEAN+3	Intra-regional Trade Share (%)	29.4075959	37.524634	37.3222596	38.81824315	39.5574462
SAARC	SAARC	Export Growth (%)	N/A	39.3892831	23.5768986	32.07186538	33.498818
SAARC	SAARC	Export Share (%)	3.45183116	4.49622908	4.55155714	6.539049181	5.56965221
SAARC	SAARC	Intra-regional Trade Share (%)	2.90683225	3.97600326	4.28323	6.017785824	4.31204336

❑ South Asia is one of the least economically integrated Regions

❑ Most efforts for economic integration in this region is done through bilateral as well as multilateral agreements like SAFTA or Bilateral FTA like India-Sri Lanka FTA or Pakistan Sri-Lanka FTA

❑ Unfortunately, little effort is done to try integration through markets which creates true economic inter-dependence



Example of low trade  
facilitation and low  
regional integration- India  
Bangladesh trade in Yarns  
(Raychaudhuri and De,  
2011)

❖ We have selected textile yarn and fabric exports from India to Bangladesh in this study for further investigation on the links between economic corridor, trade cost and production network.

**India's Major Exports to Bangladesh (US\$ million)**

<b>HS code</b>	<b>Item</b>	<b>2008-09</b>
<b>70310</b>	<b>ONIONS &amp; SHALLOTS FRESH OR CHILLED</b>	<b>157.7</b>
<b>100630</b>	<b>SEMI/WHOLLY MILED RICE W/N POLISHED/GLAZED</b>	<b>229.33</b>
<b>170111</b>	<b>RAW CANE SUGR NT CONTNG FLVRNG/COLRNG</b>	<b>73.97</b>
<b>170199</b>	<b>SUGR REFIND NT CONTNG FLVRNG/COLRNG MATTER</b>	<b>82.82</b>
<b>230400</b>	<b>OIL-CAKE &amp; OTHR SOLID RESIDUE W/N GRND/IN PLLTS FORM OBTND FRM SOYA-BEAN OIL EXTRCTN</b>	<b>82.56</b>
<b>270119</b>	<b>OTHR COAL W/N PULVRSD BUT NT AGLOMRTD</b>	<b>59.61</b>
<b>520100</b>	<b>COTTON, NOT CARDED OR COMBED</b>	<b>78.71</b>
<b>520521</b>	<b>SNGL YRN OF CMBD FBRS MEASURNG 714.29 D CTX/MORE (NT EXCDNG 14 MTRC NO)</b>	<b>67.71</b>
<b>520522</b>	<b>SNGL YRN OF CMBD FBRS MEASURNG= 232.56 DCTX(&gt;14 BUT &lt;=43 MTRC NO)</b>	<b>24.07</b>
<b>520523</b>	<b>SNGL YRN OF CMBD FBRS MEASURNG&lt; 232.56 BUT &gt;=192.31 DCTX(&gt;43 BUT &lt;=52 MTRC NO)</b>	<b>51.21</b>
<b>520524</b>	<b>SNGL YRN OF CMBD FBRS MEASURNG=125 DCTX(&gt;52 BUT &lt;=80 MTRC NO)</b>	<b>21.19</b>
<b>520942</b>	<b>DENIM</b>	<b>50.55</b>

## Intra-Industry Trade Index in 2007: Common Set of Products at 6-digit HS

<b>HS Code</b>	<b>Product</b>	<b>IIT India</b>	<b>IIT Bangladesh</b>
<b>230220</b>	<b>RICE BRAN OIL</b>	<b>0.935</b>	<b>0.836</b>
<b>721550</b>	<b>BARS &amp; RODS OTHRTHN FREE-CUTNG STL NT FRTHR WRKD THN COLD</b>	<b>0.923</b>	<b>0.421</b>
<b>850720</b>	<b>OTHER LEAD-ACID ACCUMULATORS</b>	<b>0.922</b>	<b>0.557</b>
<b>600622</b>	<b>OTHR KNITED OR CROCHETD FBRCS OF COTTON , DYED</b>	<b>0.771</b>	<b>0.929</b>
<b>960719</b>	<b>OTHER SLIDE FASTENERS</b>	<b>0.770</b>	<b>0.719</b>
<b>610510</b>	<b>MEN'S/BOYS' SHIRTS OF COTTON</b>	<b>0.758</b>	<b>0.819</b>
<b>621790</b>	<b>PARTS OF GARMENTS/ CLOTHNG</b>	<b>0.729</b>	<b>0.463</b>
<b>848390</b>	<b>PARTS OF TRANSMISSION SHAFTS, CRANKS, BEARING HOUSINGS, GEARS</b>	<b>0.703</b>	<b>0.778</b>
<b>854419</b>	<b>WINDING WIRES OF OTHR METLS / SUBSTANCES</b>	<b>0.505</b>	<b>0.633</b>
<b>620319</b>	<b>SUITS OF OTHER TEXTILE MATERIALS</b>	<b>0.486</b>	<b>0.704</b>
<b>521211</b>	<b>OTHR UNBLCHED WOVEN FABRICS OF COTTON WEIGHING NOT MORE THAN 200 G/M2</b>	<b>0.417</b>	<b>0.770</b>



▪ Bangladesh and India do not allow trucks from one country to cross the border check posts

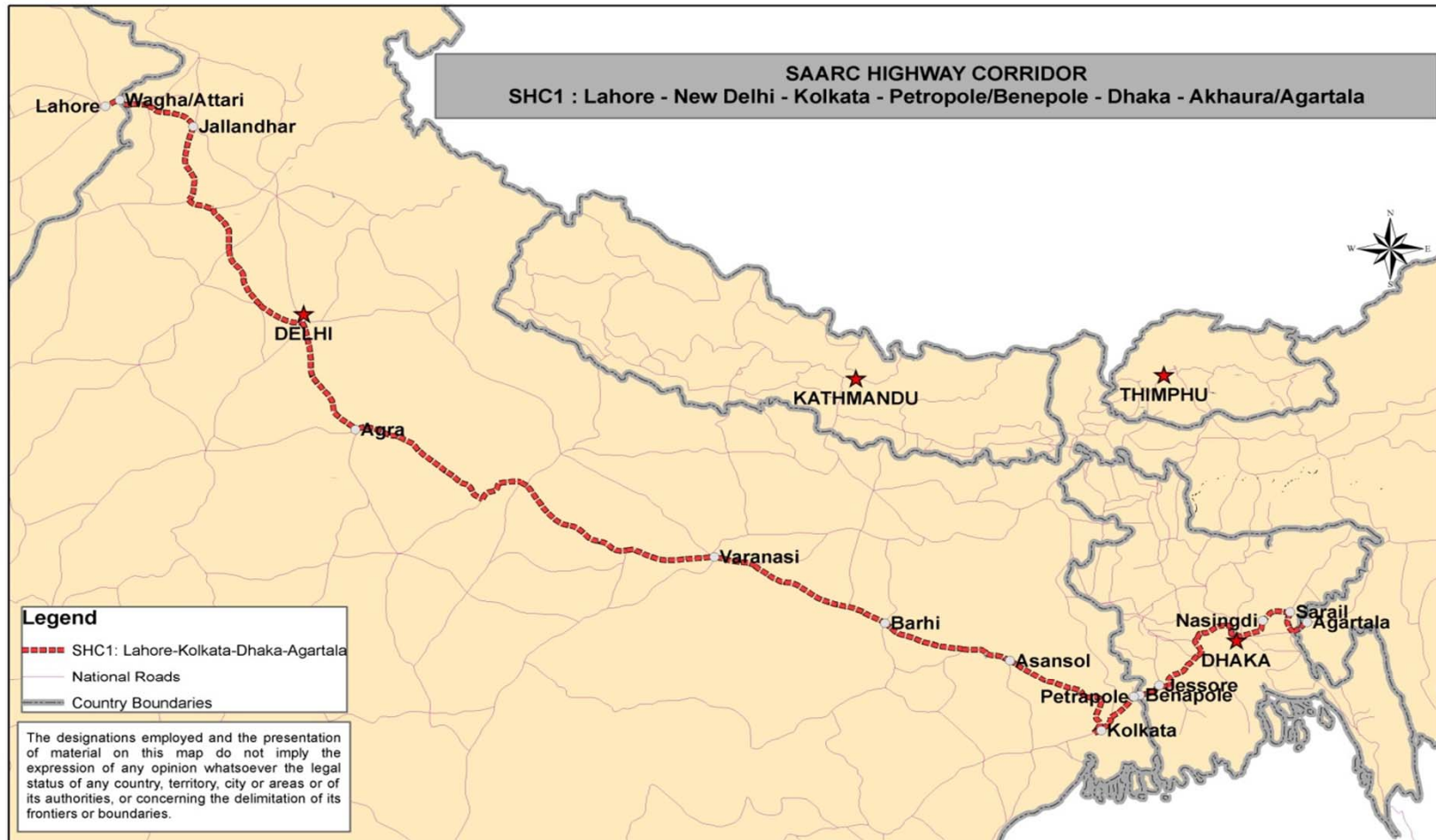
▪ Import of yarn from India met 75 percent of total demand while for fabric, more than 81 percent of exported finished garments used imported fabrics. All these shipments are made through roads by trucks


▪ Given the practice of letter of credit (LC) being exclusively issued by Bangladeshi Banks to Indian exporters, one can study the possible loss due to inefficiency of Bangladeshi banks in carrying out LC commitments in time. This a type of logistic cost.

## The Methodology and Estimation of partial trade costs

- The survey is conducted in two locations, namely, Ludhiana in Punjab state of India which is a major centre for yarn production and supplier to Bangladesh in general and Dhaka in particular
- At the border there is waiting, both on Indian as well as on Bangladesh side since Indian trucks could not cross to Bangladesh. Thus, the waiting time includes paper works by customs and border authorities on both sides of the border, which duplicates some of the requirements resulting in higher transaction time, hence higher trade costs.

## Road Transport Route from Punjab (marked as Jalandhar) to Dhaka



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- In this case, from the observed data, it is the Bangladesh transport operator who has cost advantage.
  - We adopt the costs incurred for the Bangladeshi segment for the entire route and reduce the border waiting time (part of trade cost) by 3 days.
  - So the estimate also presumes similar road tax structure in the two countries (not entirely unfounded since under true liberalisation, such taxes in neighbouring countries may tend to converge).

<b>Item</b>	<b>Pre-liberalization Trade Cost (as percent of export revenue earned for 1 kg of imported yarn from India)</b>	<b>Post-liberalization Trade Cost (as percent of export revenue earned for 1 kg of imported yarn from India)</b>	<b>Gain for Liberalized Trade Services (in percent of original)</b>
<b>T-shirt</b>	<b>Maximum: 1.72</b>	<b>Maximum: 0.81</b>	<b>64.53</b>
	<b>Minimum: 0.59</b>	<b>Minimum: 0.33</b>	<b>59.32</b>
<b>Polo-shirt</b>	<b>Maximum: 0.81</b>	<b>Maximum: 0.29</b>	<b>64.20</b>
	<b>Minimum: 0.33</b>	<b>Minimum: 0.13</b>	<b>66.61</b>

## Other Logistic costs- an example

- The survey conducted by us reveals that the end user in Bangladesh usually releases funds within 18 to 30 days, while the Indian supplier on the average reports that LC is honoured in 90 days time.
- How much does it cost the supplier in the process of delay in getting the LC? If one assumes an interest rate of 9 percent per annum on borrowed fund from banks in India, the supplier adds 60 days of opportunity cost at the rate of 9 percent per annum on the exported yarn value

➤ The extra 60 days delay may well be avoided.

Roughly this amounts to 1.5 percent of transportation costs per kg quoted earlier if exchange rate is assumed to be stable

➤ It will be more if Indian rupee appreciates against dollar.

❖ The Above case study is just an example of low level of trade facilitation creating market integration to precede a more lengthy process of treaty based regional integration

❖ This also shows that possibility of production network is also remote in any region which has low trade facilitation, since production fragmentation is difficult to take place under these circumstances. This may be illustrated with other sectors like machinery and consumer goods sectors.

❖ It is important that issues like trade facilitation, production networks and regional integration are not viewed as independent processes.

❖ However, the simultaneity and pre-condition of the processes need to be understood carefully. Trade facilitation comes first followed by fragmentation and production networks. This will bring increasing market integration which finally will be given official sanction through various degrees of regional integration





Thank You