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Tariff Preference and Trade Cost as Determinants of Export: The Case of Bangladesh

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Abstract

Bangladesh's export trend has been robust throughout the last couple of decades, but her exports have been limited to a number of products and product-destinations are restricted to only a certain developed regions. The current study examines whether tariff preferences impacts Bangladesh's export. Additionally, the paper also examines whether trade cost impacts Bangladesh's exports. In the above context, the study evaluates performance of export of the Bangladesh economy together with an analysis based on the relative preferential margin (RPM). The paper highlights that Bangladesh could make only a small progress towards diversifying her exports during last ten years (2003-2013). The RPM estimations for Bangladesh further reveals that tariff preferences for most of the export flows from Bangladesh faced unfavourable tariff preferences in 2013. As regards trade cost and its components, it is found that Bangladesh's exports are influenced by the economic condition of partner countries and GSP facilities. Since the trade cost variable incorporates a number of components including tariff, transport cost, cultural components and trade facilitation issues, future trade policies of Bangladesh will need to address these issues with utmost sincerity.

Keywords: Export, Bangladesh, Tariff Preferences, Trade Cost, Relative Preferential Margin (RPM), Gravity Model

JEL Classification: C10, C21, F14

I. Introduction

Exports originating from Bangladesh have been concentrated to a limited number of products. This has been the case historically with Bangladesh, from the spell when Bangladesh started to shift to an export-oriented economy since the early 1990s. What is more noteworthy is that exports are shipped to a limited number of destinations, mainly the developed US and Euro destinations. Bangladesh's exports grew by 7.8 per cent from 1980-1990. But the figure showed substantial increase in the subsequent decade of 1990-2000, taking a value of 15.7 (UNCTAD, 2014). The trend has continued in recent decades but has kept approximately to the same levels – 12.9 per cent growth between 2000 and 2010 and 13.6 per cent growth between 2010 and 2013. Lack of both product and geographic diversification of exports represent a grave concern for Bangladesh concerning the sustainability of export-led growth strategy, which has been a trending concept for Least Developed Countries (LDCs) (similar to Bangladesh[2]) for the past couple of decades.

The importance of higher survival rates of new export dimensions and trade at the extensive margin[3] is continually stressed for sustained economic growth of the poorer nations (Besedes and Prusa, 2006; Brenton, Pierola, and von Uexkull, 2009). While export diversification mitigates external volatility, but several constraints are faced by the developing countries in opting for export diversification. Some of the *el primo* factors would include transaction costs, weak infrastructure and rule of law, poor implementation of trade facilitation mechanisms and unbalanced national and regional trade policies. Another factor worth noting is that system of trade preference (e.g. most-favoured nation [MFN] tariff rate) determines exports of the developing countries. On the favourable side, there is preferential treatment by the developed trading partners, but on the other hand, sombre tariff and non-tariff barriers are encountered by these nations while venturing other developing and regional destinations.

The Doha Development Round (DDR) of the World Trade Organisation (WTO) was a major breakthrough in the sphere of tariffs. It was since assumed that tariffs would be a

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[2] Bangladesh is included in the list of LDCs. The LDC currently includes 49 countries.
[3] The extensive margin indicates new products at a later date as compared to a prior reference period

thing of the past and would be “relatively irrelevant” as a trade barrier. But the case has been essentially different in the face of the deadlock of the WTO. Even today, after more than one decade of the DDR, tariffs continue to be a solemn deterrent of trade for the developing countries. One can argue that there are trade facilitation instruments and there are Aid for Trade measures, but the question remains as to whether tariffs are still relevant and whether there is tariff erosion? We would like to put forward the hypothesis that tariffs are very relevant in today’s world. The “trade agreement shopping” that is evident between each and every nation further supports the hypothesis. “Trade agreement shopping” essentially refers to the notion that each country is opting for bilateral, multilateral, plurilateral or regional trade agreements, irrespective of their developmental state.

While it can be argued that overall tariffs are on the decline pertaining to both developed and developing countries and is receiving lesser and lesser attention as compared to other non-tariff measures, however, what appears to be disquieting is that tariffs still have a role to play in the determination of exports, especially that of the developing hosts. The first part of the study aims to identify determinants of exports from Bangladesh by focusing on the role of market access, specifically tariffs. The research question involves around the identification of the trend of whether the export-led growth of Bangladesh has been due to the increase in value and/or volume of existing trade flows or new trade flows. Together with examination of Bangladesh’s overall export trends, the paper identifies the relative market access of Bangladesh’s exports. This has been examined with the estimation of the relative preferential margin for Bangladeshi exports at the Harmonised System (HS) 6-digit level.

With tariffs falling under the broad category of trade costs, the second part of the paper aims to examine whether trade costs affect Bangladesh’s exports. This is important from the point of view that Bangladesh has very meagre amounts of trade with her developing partners, specifically the South Asian counterparts. The destination of the majority of the exports has been the Euro zone (EU 27) and the US. In this connection, 55.13 per cent[4] of Bangladesh’s export in 2012 accounted for the Euro zone and 19.28

[4] According to data from Trade Map data, International Trade Centre, 2013

per cent went to the US; while in contrast, only a meager 1.22 per cent of Bangladesh's exports catered to the ASEAN (Association of Southeast Asian Nations) region in the same timeframe (Bangladesh's imports from ASEAN stood at 18.8 per cent in the same year) and 2.47 per cent for the South Asian counterpart. It can be observed that more than four-fifths of the export of Bangladesh is diverted to the distant US and Euro zone, while very minimal trade occurs with its neighboring Asian counterparts. Hence, it can be made out that trade costs, including tariffs have a role to play in the lack of export diversification that is evident from the export basket of Bangladesh. With Arvis, Duval, Shepherd and Utoktham (2013) stamping the fact that trade costs are a major hindrance for trade in the developing countries, trade cost have also been determined to be a dynamic foray in Bangladesh's trade. The current study employs gravity modeling to identify the brunt of trade cost on Bangladesh's exports.

The paper has been purposely divided into separate sections to keep tariff preference analysis, dealing with individual export products of the Bangladesh economy, separate from trade cost analysis, which examines Bangladesh's export on an aggregate level. In this respect, the rest of the paper is organised as follows. Section II discusses relevant literature as regards tariff preferences and trade cost in connection to the Bangladesh economy. Section III presents export performance trend of Bangladesh. Section IV discusses the methodology of both RPM and trade cost pertaining to the current analysis while Section V presents the empirical results. Section VI concludes with recommendations and way forward.

II. Review of Relevant Literature

Tariff Preferences

The theory put forward by Smith (1776) and Ricardo (1817) in favour of comparative advantage and specialisation does not hold appear to be relevant in the twenty-first century. In fact, it was after the Second World War that Prebish (1950) and Singer (1950) argued that export diversification is necessary to stabilise export earnings and enhance economic growth. Given the former agenda, the developing countries would only be exporting primary commodities. In this regard, export diversification seems to contradict with theories of specialisation and comparative advantage. While some proponents argue that specialisation permits better international competitiveness, others believe that constricted number of export flows increase volatility in export earnings and consequently, leading to declining terms of trade. Trade diversification, essentially, trade involving export of a variety of commodities with different price tendencies can help achieve sustainable stability in overall export performance.

Export diversification can be defined as “the change in the composition of a country’s existing export product mix or export destination” (Ali, Alwang and Siegel, 1991). Thinking otherwise, export diversification can also be defined as the evolution from traditional to non-traditional sectors. In this connection, there can be different dimensions of export diversification. The two common prevalent forms of export diversification include horizontal diversification and vertical diversification (Diagonal diversification refers to a change from importer input into secondary and tertiary sectors). Horizontal diversification refers to diversification “within the same sector (primary, secondary or tertiary), and entails adjustment in the country’s export mix by adding new products on existing export baskets within the same sector, with the hope to mitigate adverse economic (to counter international price instability or decline) and political risks” (Samen, 2010). Vertical diversification refers to a move from the primary sector to secondary and tertiary sectors. The latter category of diversification can develop prospects for raw materials together with greater price stability as compared to raw commodities.

The role of export diversification’s contribution in growth of the developing countries have been stressed for quite a number of decades now. During the 1950s to the 1970s, development strategies in the developing world and specifically countries in South Asia, Africa and Latin America was in support of import-substituting strategies and installation of restrictive trade policies. However, this view was altered towards export promotion and outward orientation in the 1980s, 1990s and 2000s with the observable accomplishments of India, China and the East Asian countries (Samen, 2010). Bangladesh, too, residing in the South Asian counterpart, initiated the process of globalisation in early 1990s.

Exports play a major role in contributing to the long-run growth of economies. This is achieved through "supporting a virtuous cycle of investment, innovation and poverty reduction" (UNCTAD, 2008). In this connection, Bangladesh has predominantly transformed her economy from an exporter of primary products to a manufactured goods one. And accordingly, the associated externalities with such structural transformation has benefited the country with all merits. Export-oriented economies are generally prone to external economic shocks, with the scale impact depending on the degree of concentration of a country's export basket. External shocks pertain to the developing economies more as such economies are heavily dependent on commodity exports. "The ability of LDCs to expand export earnings depends on growing world trade, market access and the ability to diversify export products" (Edo and Heal, 2013). Market access and diversification of products are hence crucial from the viewpoint of enhanced global and regional participation of trade as propos LDCs like Bangladesh.

Generally, LDCs have comparatively weaker bargaining capacities. Therefore, the WTO is a more preferred option for the LDCs because the WTO represents stands a multilateral trading system. Several multilateral trading systems are existent to cater to improved market access of the developing countries and the LDCs in particular. The majority of such trading arrangements focus on reducing tariffs to fashion favourable preferential margins for the underdeveloped nations. The European Union (EU) together with other developed countries offers preferential market access for the developing countries and LDCs. With the Generalised System of Preferences (GSP) already in effect from 1995, Everything but Arms (EBA) initiative (introduced in 2005) provides duty free and quota free (DFQF) access for all products from the LDCs (but arms).

India and China, developing country themselves, provides DFQF access to the LDCs. India's Duty Free Tariff Preference (DFTPI-LDC) arrangement was effective from 2008. While at the outset it preferential arrangements might seem lucrative, but Engel (2009) argues that "potential welfare benefits are mitigated both through limitations in the product coverage and administrative specifications, as well as through the uncertainty of their sustained access".

The apparently dismal state of the WTO agreements and regional and bilateral trade arrangements taking preference over WTO agreements has become a common practice. In this respect, the Ninth Ministerial Conference of the WTO in 2013 installed a new ray of hope for the LDCs. While multilateral trading arrangements benefit LDCs with "a rule-based policy platform to negotiate flexibilities, waivers and special and differential treatment" (Rahman, 2014) this agenda was rather unobtainable due to non-reciprocatory practice of existing bilateral or plurilateral trade negotiations. It should be noted that broadening of the export base is a very challenging assignment for the LDCs. While the WTO trade negotiations were meant to cater to the LDCs by means of better integration into world markets, but the case appears to be driven by political decisions of key players of the advanced economies. In this connection, it should be stressed that structural transformation of the developing economies will require firm commitment from the international community, together with efforts from the developing country themselves.

Trade cost

Trade cost, amongst other determinants of the volume of trade, plays a significant role in determining the amount of trade of a nation. Components of trade cost would include "transportation costs (both freight costs and time costs), policy barriers (tariffs and non-tariff barriers), information costs, contract enforcement costs, costs associated with the use of different currencies, legal and regulatory costs and local distribution costs" (De, 2007). Arvis, Duval, Shepherd and Utoktham (2013) calculated trade costs of agriculture and manufactured goods in 178 countries to show that "trade costs are strongly declining in per capita income". However, the authors make a distinct observation that the rate of decline of trade costs is far quicker in the developed