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The trade reducing effects of restrictions on liner shipping

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ABSTRACT

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The costs of shipping containerized cargo on liner vessels play a pivotal role in determining a country's integration into international trade. We examine how policy governing the liner shipping sector affects maritime transport costs and seaborne trade flows. Using a novel dataset of services trade policy information, we find that restrictions, particularly on foreign investment, significantly increase maritime transport costs. The cost-inflating effect ranges from 26% to 68%, and the resultant reduction in trade flows from 48% to 77%, depending on the level of restrictiveness. We estimate the elasticity of seaborne trade flows with respect to distance to be nearly unity, and are able to disentangle the direct effect of distance from the one that is operating indirectly through higher maritime transport costs. Since the bulk of global merchandise goods trade is seaborne, the magnitude of frictions identified in this paper and their spatial distribution have ramifications for connectivity and growth. *Journal of Comparative Economics* 44 (2) (2016) 231–242. Treasury, Government of France, France; University of Sussex, Department of Economics, Brighton, BN1 9SL, UK; The World Bank, United States.

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1. Introduction

Since most manufactured and semi-manufactured goods are transported in liner vessels, access to efficient and competitive liner shipping is crucial for a country's engagement in international trade. In fact, for trade with developed economies, maritime transport costs (MTCs) today matter more than tariffs. *Ad valorem* MTCs of exports to the United States are on average more than three times higher than the average US tariff, and to New Zealand are more than twice as high.¹ The current perception is that the scope for lowering MTCs through policy reform is limited because the market for maritime liner shipping services is largely free of distortions. Governments now generally desist from both sins of commission, such as reserving cargo for national shipping lines, and sins of omission, such as exempting liner conferences from competition policy. However, a new services trade restrictions database reveals that protection persists. It now takes the form more

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E-mail addresses: fabien.bertho@sciences-po.org (F. Bertho), I.Borchert@sussex.ac.uk (I. Borchert), amattoo@worldbank.org (A. Mattoo).¹ The comparison is based on figures of average tariff rates, taken from WITS (2007), and maritime transport costs, taken from OECD (2007), respectively, both in *ad valorem* terms as of 2007.

often of restrictions on foreign investment in maritime transport services than of restrictions on cross-border trade or port services, which have been the focus of the existing literature.

This paper seeks to assess the impact on MTCs and seaborne trade flows of policy measures currently affecting trade in liner shipping services, with a focus on hitherto neglected restrictions on foreign investment or commercial presence – ‘mode 3’ in WTO parlance. There are two principal reasons for this focus. First, the most significant barriers to cross-border trade (i.e. ‘mode 1’ in WTO terms) have indeed diminished in significance. Cargo reservations only affect a few specific goods and cover a tiny share of total seaborne trade, and many countries have narrowed the scope of exemptions from competition law for liner transport. Therefore, the total impact of mode 1 measures on MTCs is likely to be small. Second, even though cross-border trade is the key mode of supply for international shipping services, the ability to establish a commercial presence is crucial for the efficient provision of liner shipping services. Thus, provisions governing mode 3 are likely to affect maritime transport costs and trade flows.

The focus on policy barriers to foreign investment in the shipping sector addresses a blind spot in the existing literature on the determinants of maritime transport costs. One strand of the literature has studied aspects revolving around infrastructure and connectivity. In their seminal paper, [Lima and Venables \(2001\)](#) look at the quality of transport infrastructure as a whole. Other papers take up specific aspects of infrastructure such as port efficiency ([Sanchez et al., 2003](#)), different port characteristics ([Wilmsmeier et al., 2006](#)), or port infrastructure endowments ([Wilmsmeier and Hoffmann, 2008](#)). The latter paper also addresses aspects of connectivity between ports,² as do [Marquez-Ramos et al. \(2011\)](#). In contrast, only few papers investigate public policy. For instance, [Wilmsmeier and Martinez-Zarzoso \(2010\)](#) focus on the impact of being an open registry country whereas [Clark et al. \(2004\)](#) study the impact of anti-competitive practices in the liner shipping sector. [Fink et al. \(2002\)](#) quantify the effect of certain policies relative to other determinants of trade costs and find that both public policy—in the form of mandatory port services—as well as private anti-competitive practices have a substantial effect on transport costs.

This paper makes two principal contributions: first, we estimate the impact of policy restrictions on maritime transport costs and hence on seaborne trade flows, highlighting in particular the role of investment barriers which have not been studied before. Second, we examine how distance affects maritime transport costs and seaborne trade flows, respectively, recognising that changes in transport costs have knock-on effects on trade flows. To the best of our knowledge, this is the first paper to focus attention on the cost-inflating effect of a comprehensive set of measures, and to disentangle the various channels linking policy, distance, transport costs and trade flows.

We find that more restrictive liner shipping policies are associated with appreciably higher shipping costs, and investment restrictions matter most. Specifically, maritime transport costs on routes with restrictions are between 26% and 68% higher than on ‘open’ routes, depending on the level of restrictiveness. The cost-inflating effect is therefore substantial in magnitude. In terms of the derived effect on seaborne trade, maritime transport costs are the most important determinant of seaborne trade flows by a wide margin. We estimate that policy barriers lower trade flows by 48–77% through higher transport costs, with the size of the effect depending in part on the destination country.

Turning to the effect of distance, we find that the elasticity of seaborne trade flows with respect to distance is nearly unity. We show that this number can be decomposed into a direct effect, which accounts for about three-quarters of the impact, and a smaller indirect effect of distance through higher maritime transport costs. Without properly accounting for transport costs, the estimated coefficients of conventional gravity variables such as distance represent a mixture of such direct and indirect effects.

While multilateral trade negotiations have been successful in many areas, efforts to open up maritime services during the Uruguay Round negotiations under the auspices of the GATT/WTO were a notable failure, and hardly any progress has been made in recent Doha negotiations. This paper’s findings suggest that the lack of progress in these negotiations leaves in place serious impediments to countries’ integration into global markets. Breaking the stalemate in regional and multilateral negotiating fora could lead to potentially large gains from policy reform.

The paper is organised as follows: [Section 2](#) describes policy barriers to trade and investment in the liner shipping sector. [Section 3](#) presents the data and estimation methodology. In [Section 4](#) we estimate the effect of policy measures in a maritime transport cost equation, and in [Section 5](#) we use those results to estimate the impact of transport costs on trade flows in a gravity framework. [Section 6](#) concludes and offers policy recommendations.

2. Policy barriers to trade in maritime shipping services

We consider four types of potentially cost-increasing policy measures: cargo reservations and the operation of liner conferences, both of which affect cross-border shipping services; port and terminal usage fees on both ends of a route; and policy restrictions on establishing commercial presence. Taking a comprehensive view on policy measures allows us to gauge the relative importance of each type of measure, whereas previous papers have mostly studied some of these types of measures in isolation. While port usage costs are measured in dollar terms and are readily available from the World Bank’s Doing Business database, the nature of other policy measures is less straightforward. This section therefore provides a brief background on such measures and how they interact.

² UNCTAD have pioneered the construction of composite indices summarizing the frequency, capacity and quality of services to and from countries, see UNCTAD’s ‘Liner Shipping Connectivity Index’ (LSCI).

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