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Trade and Logistics: A "Bali Package" for the EU

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Traditionally, the concept of trade costs for shipping goods has been centred on tariffs, quotas and other policies inhibiting exporting firms from entering foreign markets. Now that the nature of trade is changing from shipping final goods to the transport of a myriad of inputs through global supply chains, the concept of trade costs is altering too. Rather than policy barriers "at" the border policy measures "before" and "behind" the border have become increasingly important. One of them is logistical barriers and the importance of them for trade is of course reflected in the new agreement on Trade Facilitation, part of the World Trade Organisation's Bali package. However, renewed attention should also be given to trade and logistics policy in the EU, as it will significantly impact its competitiveness in the future.

During the second wave of globalization the world has seen a massive reduction in trade barriers ranging from conventional tariff cuts in goods to the development of technology in ICT facilitating the exchange of products previously considered non-tradable. Yet, a third factor which has tremendously affected the growth of trade is often put in the background, namely transportation, varying from cargo handling in ports to the ability to trace and track a package from producer to consumer or the movement of managers from A to B. Even though the importance of these logistics services has been recognized on the international trade agenda, they merit far more attention and action. Next to cost competitiveness, linking international markets and improving the business climate domestically for the transhipments of goods are major determinants for the quantity and quality of a country's role in global supply chains.

Typically trade is thought of as a final product travelling from one country to another where the good is consumed. Although this still holds true for some products, in many sectors this is not the case anymore: input goods cross borders many times before they become a final good. This is the world of global supply chains or, as more recently called, global value chains. Each time an input is being exported after processing, some "net" added value is created, which in turn contributes to the national economy. Some sectors, of course, have higher value added than others. For instance, in the European Union the chemical sector, and the machinery and equipment sector, generally creates higher value added than textiles or food production. Therefore, if the EU's economy is more concentrated towards the production of these so-called sophisticated sectors it will collect higher value added surpluses and eventually greater welfare gains.

Importantly, specializing in these advanced sectors creating higher value added implies the transhipment of many more inputs than sectors with lower value added. In other words, these sectors use a higher amount of related inputs during their production process. Dealing with the imports, delivery and usage of all these interrelated inputs can become such a complicated task that strong coordination on the side of the firm is required. This of course affects the costs of managing the global supply chain. As a result, on the one hand there are sectors adding relatively little value to the EU's economy. These sectors require less coordination as they use fewer interrelated inputs. On the other hand, there are sectors in the EU such as electrical equipment or mineral production which generate higher value added yet require strong coordination management through the use of many interconnected inputs in the global value chain.

As the pattern of trade is changing, the concept of trade costs is altering too. Moreover, the essence of trade policy also needs to be redefined. "Old" trade policy is still important: even low applied MFN tariffs in the EU (around 2%) have a considerable effect in a world organized around global supply chains as tiny mark-ups can have tremendous effect on goods crossing numerous amounts of borders every day. Still, what is of greater importance for Europe's global competitiveness now is the cost of managing the international segmentation of production, linking its own internal productions processes to global markets. What can the EU do to facilitate this development?

First, the EU could improve its logistics performance, involving concerns such as the international shipments of goods to the timeliness of delivering products. Comparing the EU with the best performer on facilitating transport, it scores particularly low on the efficiency of clearance processes by border control agencies and customs. This process includes the speed, simplicity and predictability of formalities of trade. Moreover, the EU could further develop the quality of trade and transport related infrastructure such as ports, railroads, roads and information technology. On other "behind-the-border" issues the EU is performing relatively well, such as the timeliness of delivering products according to schedule, the ease of arranging competitively priced shipments or the ability to trace and track consignments. But there is still some room for improvement.

Second, although many countries in Europe have a good reputation for the ease of doing business, Europe's costs of doing trade are still relatively fragmented. For instance, the costs of exporting a container in Czech Republic are 1.5 times more expensive than in Denmark. Similarly, the unit price of importing in France is more than 2 times more expensive than in Finland. These differences are stark for an internal market based on common transport policies and do not seem to follow the general cost structure of EU countries. Most likely, the varying quality of infrastructure, the number of checkpoints and the operation of administrative procedures cause these diverging costs across the EU. In addition to these costs, exporting in and out the EU is a lengthy process: on average it takes the EU five days more than the US to export and import a good. An order may be delivered according to schedule, but longer transnational shipment increases the price of coordination. As a result, trading faster increases the competitiveness in the global value chain.

Third, other measures "before-the-border" matter too. Overall connectivity of the transport network could further decrease trade costs in the EU. This includes the frequency of shipments, its reliability or the diversity of destinations. In a world where parts and components come in from multiple destinations, connectivity becomes an increasingly important concept. Specifically, the Air Connectivity Index developed by the World Bank shows that the US is best connected with the rest of the world. Second come EU members such as Germany, the Netherlands and France, albeit with much lower scores. On the other end, there are economies such as Latvia, Finland or Bulgaria which could improve their position. Although part of the explanation has to do with geography, policy can certainly play a significant role in improving these linkages. Research illustrates that a more liberal policy regime in air transport much explains increasing levels of connectivity. Commitments in the air transport services sector are, to a large extent, still low or non-existent in the General Agreements of Trade in Services (GATS) whereas the passenger transport sector remains highly regulated.

Global value chains form a central part of trading patterns in today's world and the competitiveness of production. Consequently, the notion of trade policy has changed too – and that change needs to be better reflected in actual trade policy. The question is not what comes into or leaves the domestic market, but how goods and inputs are imported and exported. More attention to policies around transport and logistics services is urgently needed.