

Why do some countries trade more than others?

SELIM RAIHAN

THEORETICALLY, trade liberalisation results in productivity gains through increased competition, efficiency, innovation and acquisition of new technology. In particular, the changing relative prices induced by trade liberalisation cause a re-allocation of resources from less efficient to more efficient uses. Trade liberalisation is also thought to expand the set of economic opportunities by enlarging the market size and increasing knowledge spillover effects. Empirical research on international trade also shows that, in general, larger trade-orientation and freer trade, with supporting policies and institutions, can lead to higher welfare for a country than otherwise.

However, a major question remains some way unclear – why do some countries trade more than others? More specifically, does country size matter? How does difference in per capita income affect trade-orientation among countries? Does human capital make any difference? How does tariff liberalisation promote trade-orientation? Moreover, does foreign direct investment (FDI) affect trade performance? Furthermore, does geographical location have a bearing, i.e., being an island country or a landlocked country? Also, does membership of the GATT/WTO raise trade-orientation? Finally, does institution matter in trade-orientation?

In order to answer these questions, fixed effect panel regressions using a database covering the period between 1981 and 2014 for 128 countries were conducted. We have defined the country's trade to GDP ratio as the country's trade-orientation. We want to explain why some countries have higher trade-GDP ratio than others. The explanatory variables are the size of population (to represent country size), per capita real GDP, an index of human capital, domestic average applied tariff rate, and FDI to GDP ratio. Data for all these variables, except human capital, are taken from the World Bank's WDI, and the data of the human capital is taken from the PWT-8.1. All variables are

expressed in natural logarithm. The regression results show that all explanatory variables are statistically significant.

The negative coefficient estimate of the size of population reveals that larger countries tend to be less trade-oriented than their counterparts, as 1 percent rise in the size of the population is associated with 0.2 percent fall in the trade-GDP ratio. The reason is that countries with a large population find a ready domestic market and can substitute imports by producing for the internal market. The positive coefficient of the per capita GDP

percent.

The positive coefficient of the FDI-GDP ratio suggests that greater FDI orientation is positively associated with greater trade orientation, and a rise in the FDI-GDP ratio by 10 percent is positively associated with a rise in the trade-GDP ratio by 0.3 percent. FDI is assumed to have a positive impact on the export-orientation of any economy, as much of FDI is directed towards the export-oriented sectors. The success stories of East and South East Asian countries have suggested that FDI is a powerful tool of export promotion because multinational

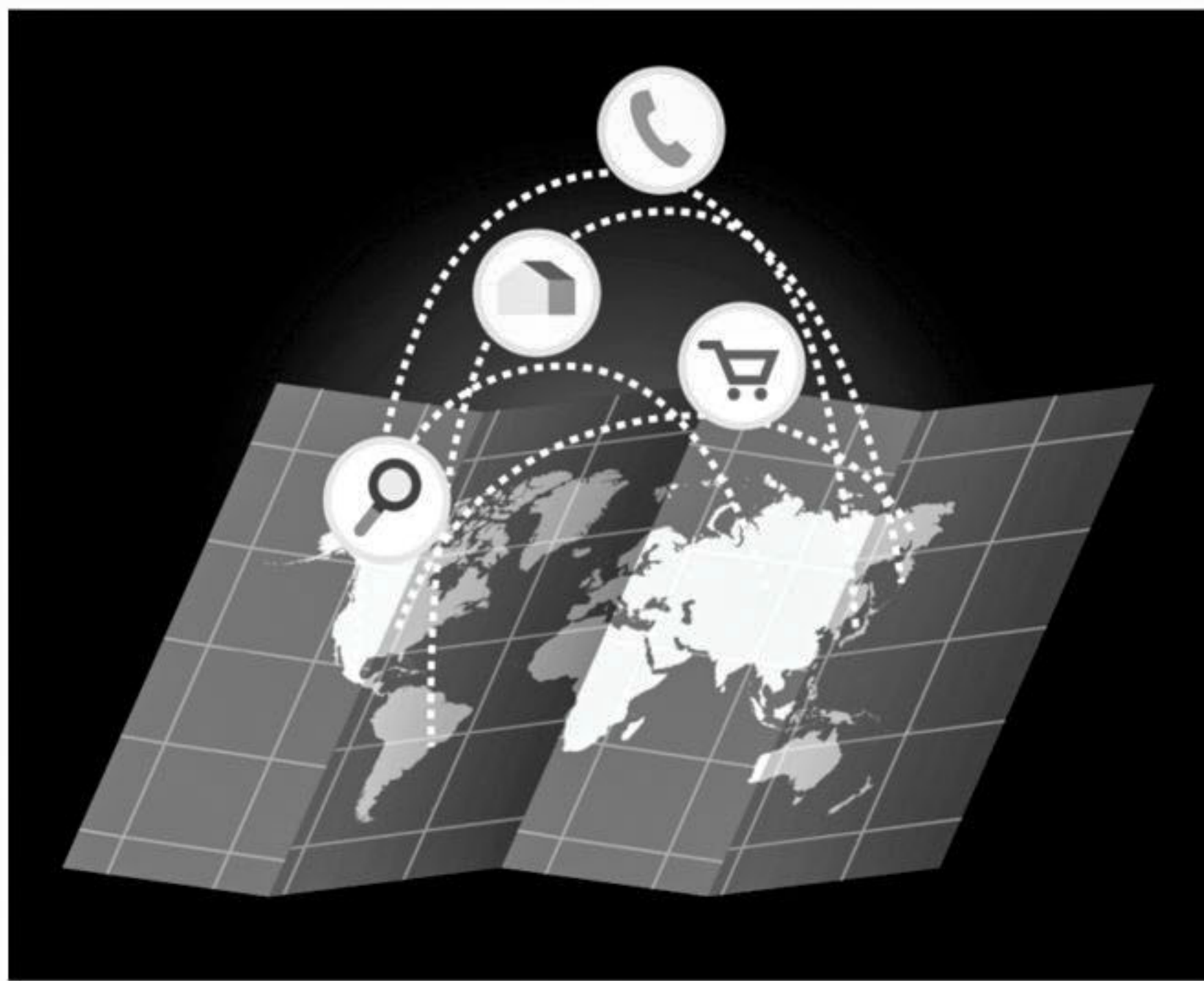
human capital is likely to have a positive impact on the perception of the people, as well as on the policy making of the government, in integrating their economy with the world market.

The findings of the LSDV models show that landlocked countries and island countries are 194 percent and 284 percent respectively more trade oriented than their counterparts. Both for island and landlocked countries, international trade plays a crucial role in their economic lives as most of these countries are dependent to an unusual degree, on imported goods and services, including foodstuffs, fuel, equipment and industrial material as well as a wide range of manufactured products. However, interestingly, being a member of the GATT/WTO doesn't make any difference in terms of trade-orientation.

We have also explored the association between trade-orientation and different institutional variables. The data of these institutional variables are derived from the ICRG database. The fixed effect regression results suggest that countries with better bureaucracy quality, larger democratic accountability, and sounder investment profile are associated with higher trade-orientation. These results are also consistent with findings from studies on the determinants of trade flows which argue distortions or costs placed on firms under inefficient institutions and poor governance can negatively affect trade flows.

Bangladesh's trade-GDP ratio was only 19.2 percent in 1981, which increased to 44.5 percent by 2014. Despite the fact that Bangladesh has been able to raise its trade-GDP ratio by more than two-folds during this period, in 2014, out of the 166 countries, Bangladesh ranked 150th in terms of higher trade-GDP ratio. This suggests that greater trade-orientation in Bangladesh would require further cut in tariff rates, larger FDI-orientation, investment in human capital and improvement in institutional quality.

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shows that a rise in the real GDP per capita by 10 percent is associated with a rise in the trade-GDP ratio by 2.2 percent. The reason behind such an association could be related to domestic producers, with the rise in per capita GDP, becoming more efficient in competing and integrating with their foreign counterparts in the world market. As expected, domestic tariff liberalisation is positively associated with higher trade-GDP ratio, as a cut in tariff rate by 10 percent is associated with a rise in trade-GDP ratio by 0.7

companies, through which most FDI is undertaken, have established-contacts and up-to-date information about foreign markets. FDI may also lead to increasing imports in the recipient country as foreign owners tend to have a higher propensity to obtain their inputs from abroad than do their domestically owned counterparts.

Finally, in the case of human capital variable, a rise in the index of human capital by 10 percent is associated with a rise in the trade-GDP ratio by 9 percent. This is not surprising! A higher level of

Ending child labour

Everyone has a role to play

BANGLADESH has made encouraging progress in increasing the number of enrollment in schools and yet 1.7 million children find themselves toiling in the informal sector of the economy, a majority of them involved in various forms of hazardous jobs. To end this scourge, there has to be proper coordination among ministries and between the government and the NGOs, experts observed at a recently held workshop. The government should, therefore, implement the National Child Labour Elimination Policy-2010, allocate sufficient funding for children and establish a child directorate.

Causes behind child labour are real and so should be our response to address them. It is often argued that children's wages are essential to the survival of poor families. But this flies in the face of overwhelming evidence that children who are forced to sacrifice education for work are doomed to a lifetime of low-wage jobs, perpetuating the cycle of poverty. The International Labour Organization estimates that economies reap a sevenfold return on every dollar spent on eradicating child labour and investing in education and social services for children. If the choice is some incentives in education, then impoverished families are more willing to send their children to school, studies show.

And yet all these measures, even when implemented, may fall short. The biggest challenge perhaps lies in the dualistic mindset of society. We raise our biological children to conquer the world but when it comes to other children, we tend to think that it's alright for them to work. If we cannot begin to consider all children our own, then we are not ready to end this social evil.

SD on telecom services

Scrap it

WE fully endorse the state minister for telecommunication's call to do away with the supplementary duties (SD) on telecom services, particularly on voice and data. The users, and there are more than 132 million of them in this country, are already paying 15 percent value added tax and a 1 percent surcharge. And the SD has been upped from 3 percent to 5 by the NBR on June 3.

We feel the proposed SD will hit the lower and middle income and poorer groups hardest in the long run; for these people, who are not in the personal income paying tax bracket, mobile phone is no longer a luxury.

While one understands the finance minister's compulsion to finance a highly ambitious budget, the consequences of a rise in taxes and duties in this sector will be quite far reaching. A three percent increase on the face of it might not appear too big but when contextualised, in terms of services gained for every taka spent, for example, in refilling one's mobile phone, a user will get only 80 paisa worth of services. The increase will also adversely impact the government's effort of digitisation.

What is also surprising in this context is the implementation of the proposal by the NBR through its order of June 3 even before the budget has been passed. The proposal is still to be thrashed out, as are all other tax proposals, before being approved by the parliament and the rush on the part of the board of revenue is not understood. What if the proposal is altered or indeed scrapped altogether come June 30 2016?

Rise of regional political parties in India



MAHMOOD HASAN

FROM A BYSTANDER
THE recent States Assembly Elections in five states of India indicate that Indian voters are becoming more region-centric. In three states - West Bengal, Tamil Nadu, Kerala -

people have rejected national level parties, opting instead for regional ones. The BJP-led alliance succeeded in Assam while the Congress-led coalition won in Puducherry.

Today, out of India's 29 states, the Indian National Congress (INC) led alliances have six states and BJP led coalitions are in nine states. The rest 14 are ruled by regional parties. As of 2015, the Election Commission of India recognises only six national parties, 62 state parties and 1,737 registered but unrecognised parties in federal India. Among the six national parties, only two have presence all over India – the Congress and BJP. The four other national parties are basically state parties – the CPI, CPI(M), Bahujan Samaj Party (BSP) and National Congress Party (NCP), although they have contested national elections from more than one state.

Since the Partition of 1947, Congress has had total sway over the political scenario of India until 1996. There were of course two brief interruptions – once from 1977-79 by Janata Party (Morarji Desai) and again from 1989-90 by the Janata Dal (V.P. Singh). The turning point in Indian election politics came in 1996.

The 1996 general election produced a fractured verdict for the 11th Lok Sabha, when for the first time BJP dethroned Congress and A.B. Vajpayee became the prime minister for 13 days. After BJP failed to pass a confidence motion, 13 regional parties formed the United Front that lasted two years. Since 1996, all

central governments in Delhi have been coalition governments, either led by Congress or by BJP. Clearly, the days of a single party forming the government at the centre was over, and coalition governments became the order of the day.

INC's struggle for independence, its socialistic economic orientation, secularism and its non-aligned foreign policy had lasted in people's mind for the first three decades after independence. As India consolidated its place in the comity of nations, people's aspirations for development overtook the sense of nationalism and gave into

provincial aspirations. And as the Cold War receded in the early 1990s and globalisation undermined India's socialistic policies, Congress started to lose its appeal among the vast population of India. Besides, the litany of scandals and allegations of corruption also played a role in people's disenchantment with Congress. Currently, the party is in doldrums, continuing to carry the baggage of the Nehru dynasty.

The conservative right-wing BJP came into being in 1980 with close ideological and organisational links to the Hindu nationalist Rashtriya Swayamsevak Sangh (RSS) and the Bajrang Dal. BJP has since used the "Hindutva" (Hindu nationalism) ideal to capture the imagination of India's 80

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percent Hindu population. Since the 1984 national election, BJP enlarged its vote share and also increased its number of seats in the Lok Sabha and made inroads at the state level. In 1998, it finally rode to power at the centre, riding piggyback on several regional parties. What is revealing is that both BJP and Congress have not contested the recent State Assembly Elections on their own. They have invariably tied up with one or more state level parties. It reflects that these two national parties do not have enough vote-share in those states to go alone. Congress once did have enough

Delhi's policies towards India's neighbours.

The rise of powerful regional parties, demanding more and more autonomy, has undoubtedly made democracy more palpable to the Indian mass. The process has definitely decentralised power from the centre to the states and has improved governance. But stiff competition among the parties and unholy alliances among parties which are ideologically opposed sometimes bewilder voters. The other point to note is that many of the regional parties revolve around a single politician. Once that politician retires or dies, the party loses its bearing. The death of Jyoti Basu has left the CPI(M) in West Bengal in a quandary. Analysts say that the inevitable rise of regional parties in politically fractured India is ominous to India's territorial integrity. However, after BJP's debacle in Delhi and Bihar in 2015, there were talks among Bihar Chief Minister Nitish Kumar (Janata Dal United), Delhi's Arvind Kejriwal (AAP) and other leaders to form a third front. Now that two popular ladies - West Bengal's Mamata Banerjee (TMC) and Tamil Nadu's J. Jayalalitha (AIADMK) - have returned to their states, there is a chance that a new front may emerge before the next Lok Sabha elections.

Regional politics will be important in the state elections in Goa, Punjab, Manipur, Uttarakhand and Uttar Pradesh, due in 2017. The roles of Mulayam Singh's Samajwadi Party, which is currently in power, and Mayawati's Bahujan Samaj Party in Uttar Pradesh will determine the move towards the third front. Given the rising vote-share of regional parties and BJP's intolerance towards anti-Hindutva ideology, a third front is viable. In any case, the rise of regional parties has fundamentally changed the election politics of diverse India.

The writer is a former Ambassador and Secretary.

COMMENTS

"Income tax looms for farmers"
(June 12, 2016)

Nazmul Hossain

This is not the right decision, Mr. Finance Minister. I don't understand how farmers, who struggle to sustain as it is, can pay this tax!

Jahangir Jan Alam

Farmer should pay taxes for what? If it's money the government is worried about, they should take actions against the bank heist thieves, and retrieve the stolen money from them first.

"MPs can't head school bodies: SC"
(June 12, 2016)

Shafiqul Islam Piash

The politicians who still hold posts in school bodies will finally be uprooted.

Nabid S. Salman

This is a very good decision. This may help reduce corruption in the education sector.

LETTERS TO THE EDITOR

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Withdrawing source tax on small fixed deposit income

A democratic government must work for the welfare of its citizens. It must formulate policies to reduce the burden on its countrymen. Source tax provision of the government on fixed deposit incomes should be amended to follow this welfare philosophy. The government imposed a 10 percent tax at source on interest income for twelve digit TIN holders and 15 percent tax at source for non-TIN holders from FY2013-14. Before that, a 10 percent tax at source was imposed on interest income. Bank and other financial

institutions have drastically reduced interest on deposits in recent years. In most cases, the rate of interest has come down to 6 to 7 percent on fixed deposit, which was above 10 percent three years back. In Bangladesh, we have been experiencing 6 to 7 percent inflation in recent years. That is, when the rate of inflation is deducted from interest income, in real terms depositors get no income at all from fixed deposits. In Bangladesh there are a good number of small depositors who live on their

small fixed deposits in bank or financial institutions. In such a low interest bearing situation, it becomes difficult to live on deposit bearing incomes, and if depositors have to pay tax at source on the interest income, they will lose out on the principal amount. The government can help them by withdrawing tax at source on deposit of money from up to three million fixed deposits.

Mohd. Ashraf Ramna, Dhaka

