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How neighbours influence trade: Evidence from Bangladesh

International trade involves forming and sustaining relationships between buyers and sellers across borders. Previous research has established that such relationships may be enhanced by neighbourhood 'spillover' effects: having relatively close neighbours who already export to a certain country can help a new firm break into that market.

Using innovative data and methods, researchers have now zoomed in from country-level spillover effects to firm-level spillovers, focusing on Bangladesh.*

The study sheds light on the costs that individual exporting and importing firms face in making a match with a counterparty in any deal. These costs can represent a significant obstacle, particularly if one or both parties are in developing countries, where reliable information is harder to come by.

Using confidential US customs data on trade between US importers and Bangladeshi exporters, the researchers studied textile exports from one Bangladeshi city between 2003 and 2009. Fully 17,695 first-time matches were found, between some 2,100 importers and 7,300 exporters. A neighbouring firm was defined as one from the same city.

The findings showed that, for a firm already engaged in trade between the two countries, the more its neighbours were trading with a particular US firm, the more likely it was to strike a first-time match with that US importer. More specifically, a 1% increase in the number of neighbouring exporters that previously matched with a particular US importer is associated with a 0.15% increase in the likelihood of the firm matching with the same importer for the first time.

The researchers cautiously inferred two causal channels: learning and cost-sharing. Neighbours can share, and thus lower, the informational and other 'fixed costs' of matching – the initial investment of effort and resources required, regardless of how much trade follows.

Importantly, neighbours can lower search costs by making a would-be partner more visible. Neighbouring exporters also get to learn of the current importer's specific needs, such as product specifications, custom packaging and client preferences, while the importer can check out a new potential exporter's strengths, reliability and reputation more easily if it is in the same physical business network as an existing supplier.

The researchers tested for alternative explanations, such as a possible importer strategy of gradual expansion or possible US preferences for certain cities, and found they were unlikely.

Neighbour effects were much stronger for bigger exporters, perhaps meaning these can better translate gains from neighbours into actual matches. In contrast, effects were weaker in more competitive cities, where exporters possibly guard information more jealously. As expected, if each extra neighbour adds a little less extra knowledge, effects also tapered off with higher numbers.

All these firm-level spillover effects were teased out from documented country-level spillovers, which might include learning about foreign business norms, culture and customs procedures, and setting up foreign exchange accounts.

The results contribute to the literature on matching costs, spillovers, drivers of exporter success and networks in international trade. They also show the value of disaggregated trade datasets.

*The full study results are available in an article by Fariha Kamal and Asha Sundaram: "Buyer–seller relationships in international trade: Do your neighbors matter?" Journal of International Economics 102, 128–140 (2016).

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