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Trade Liberalization and Export Growth: an Institutional Perspective[B]

Fundamentally, a country's trade policy is very much an institutional matter, since it concerns the rules and arrangements that influence what foreign trade can occur, and with what partners. However, simply adjusting a few tariffs here and there would count merely as a (minor) policy change, not as a change in the underlying institutional framework for trade. On the other hand, a comprehensive liberalization that not only simplified and reduced most tariffs, but also removed many of the regulatory barriers to trade, would count as an institutional change; for it should start to shape the behaviour of private sector agents, encouraging more to engage in trade, and providing them with greater security in doing so. At the same time, issues of credibility and consistency are bound to crop up – can private agents be sure that, if they engage in trade, their gains will not be swallowed up by a subsequent change of trading regime? And is the new trading environment consistent with other elements of the country's economic institutional set-up?

The institutional framework for trade is especially important, since in this globalizing age developing countries are often advised to liberalize their trade, to open themselves up much more to the world economy, in order to reap the full benefits of globalization. Mostly this is sound advice, since a good deal of empirical evidence supports the view that an open, liberal trading environment tends – on average – to have a positive impact upon a country's economic growth rate. However, this is not always so, and two recent working papers produced by staff of the African Development Bank examine this question for the countries of sub-Saharan Africa; these papers are reviewed below.

Ackah and Morrissey (2005) find that for a number of sub-Saharan African countries, trade liberalization was followed quite quickly by increases in imports, but that these increases were not accompanied by a corresponding expansion of exports; rather, exports stagnated and trade deficits rose, raising uncomfortable questions about the sustainability of the original liberalization. The second paper, Iyoha (2005), focuses on the exporting issues, emphasising that successful development in much of Africa is likely to be export-led. Taken together, the two papers can therefore be read as favouring trade liberalization for sub-Saharan Africa, but most especially in a context where export expansion is taking place.

Two important questions therefore arise: (a) what are the constraints that block export expansion in some countries? (b) What policies can be put in place to overcome the constraints and foster export expansion? We examine these questions in turn.

Constraints

These can take several forms, as we shall discuss below. Some, such as infrastructural constraints, are linked to physical deficiencies of particular goods and services and are not directly institutional; however, a country's institutional environment does influence the attention paid to

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infrastructure, its priority, and the mobilization of resources to ameliorate infrastructural deficiencies. Other constraints, though, are more immediately institutional. These would include the choices that countries make regarding the trade agreements they wish to adhere to, and their approach to customs rules and other formalities associated with foreign trade.

It is important to point out that trade liberalization *per se* – usually involving a mix of tariff reductions, and lifting of quantitative restrictions on imports – does little directly to stimulate exports. Indirectly it might help to a limited extent, since some of the inputs used to produce exports might be imported, and might have been subject to higher rates of import duty before trade liberalization occurred. To this extent, trade liberalization can make some existing export products more competitive in the world market, but that is usually quite a small effect. In principle, too, since import restrictions stimulate the production of import substitutes, the lifting of restrictions ought to encourage some shift of domestic production towards exportables. But this effect is also small in economies with few exportables, and facing difficult external market conditions.

If trade liberalization boosts imports much more than exports, however, one would expect the country's equilibrium exchange rate to fall, in other words it is likely to devalue. This makes imports relatively more expensive in the domestic market, and exports relatively cheaper in foreign markets. The result should be some stimulation of export growth, and some discouragement of imports growth, tending to bring the balance of payments back into a sustainable equilibrium.

These points do assume, though, that the country concerned already produces sufficient goods and services that are potentially exportable, and can do so in significantly larger volumes than when the whole liberalization process started. Given the huge decline over recent decades in Africa's share of world trade, for some countries this basic assumption must be questionable. The relatively easy cases are those countries with substantial natural resources – such as oil and some minerals – where the world market demand is extremely strong and where, although there have been some price fluctuations, prices have tended to be stable or even rising in real terms. A little harder are the countries producing agricultural products under conditions where international competition – mostly between developing countries – keeps earnings extremely low; items that come to mind here are coffee, tea, tropical crops such as bananas, and so on. Markets for these items are difficult and relatively unrewarding, with returns subject to massive fluctuations, and little or no capacity in the world market for poor countries (or their farmers) to insure against the associated income risks. One implication of this could be the suggestion that countries might be better advised to defer significant trade liberalization until a strong growth of exports is already taking place. However, I would not accept that view since it runs the risk of leaving countries locked into a low trade, low income equilibrium, whereas the whole point is to find ways to break away from such a position; trade liberalization may, in that context, be a useful first step.

Iyoha (2005) discusses a number of constraints that are argued to have limited exports from sub-Saharan Africa (these are worth discussing here, since while some are certainly valid and important points, others are, in my view, somewhat questionable and misleading).

First, high transport costs are commonly cited as an impediment to exports from Africa, both due to poor infrastructure (bad roads, few functioning railways, inadequate ports, erratic electricity supply, and so on) and to the fact that many African countries are landlocked. However, the same problems apply to imports, surely, so it remains unclear why these costs should affect exports markedly more than imports. Moreover, these costs should also make it profitable to produce domestically a wider range of goods and services than would be the case if transport costs were much lower.

Despite much liberalization, and an ever more complex network of regional free trade agreements, only a very small fraction of sub-Saharan African trade is with neighbouring countries. Intra-African transport links remain poor, and the trade agreements are often both too complex, too numerous and too poorly implemented, thus having little or no practical impact on trade flows. Iyoha (2005) suggests that one reason for this lack of export response might be doubts about various governments' commitment to the liberalized trade regimes formally in place, in other words concerns about the credibility of the trade agreements – this is possible, but in my view it can at most form a modest part of a convincing story.

Similarly unconvincing are the claims that the implementation of WTO agreements has been especially damaging to the interests of sub-Saharan African countries. It is perfectly true that developed countries (notably the EU, the USA, Japan) operate complex and costly (and inefficient) support schemes for their agricultural sectors, and it is claimed that these are extremely damaging to developing countries; but as Panagariya (2005) has argued, many of the poorest countries are net food importers – including many in sub-Saharan Africa – and so benefit from rich-country agricultural support which lowers the world market prices of their food imports. Likewise, the developed countries have generally offered good market access for developing country exports in most sectors, the effectiveness of which is shown by the huge increases in exports from South and East Asia in the past two decades, both of agricultural and non-agricultural goods. The fact that sub-Saharan Africa has little to show for this favourable market access is, as Michalopoulos (2001) emphasises, due to 'weaknesses in institutional capacity and other supply-side factors' (pp. 120). This point is also conceded by Iyoha (2005), though unfortunately it is then undermined by repeated proposals that rich countries both must improve market access for Africa and cut back their agricultural subsidies. These are problems, for sure, but they are not the most critical ones.

One of the few areas where rich-country agricultural support really is damaging to developing countries is the case of cotton; notably US subsidies to its own producers, associated with extremely restrictive rules of origin that prevent cotton from, say, Mali from being incorporated into clothing sold in the US market (for a general discussion, see Rivoli, 2005); and on rules of origin see Krishna, 2005). Hence it would make sense for developing countries, in future trade negotiations, to demand both more transparent and less restrictive rule of origin.

Policies

So what can sub-Saharan African countries do, in terms of policies, to promote their exports? Iyoha (2005) notes the need for African countries to diversify their exports, and for active policies to promote both agricultural and manufactured exports. Among the latter is the idea of establishing export processing zones, an approach that has proved effective in other parts of the world. It is hard to disagree with this broad line of thinking, but it feels too broad and too unfocused to be sufficient. Let me therefore conclude by adding a few points that seem to me to merit further consideration.

- As regards agricultural exports, or exports of processed agricultural produce, probably only a handful of countries in Africa will be able to succeed in, say, the next five to ten years. To do so, the countries concerned need to modernise and upgrade production methods in order to meet world market conditions; which might well entail substantial foreign investment, or at least partnerships with foreign companies, to provide the needed skills and resources. To succeed, such an approach would also need to be highly selective – it would certainly fail, for instance, if twenty countries all decided to adopt this idea at the same time.
- In several African countries, manufactured goods that were formerly exported, with moderate success, to developed countries have often lost out to a mix of technological change and competition from Asian and other developing countries. To recover, African exporters need a more business-friendly environment, with policies in place that promote improved labour skills, innovation, and high product quality.
- Both of the above require significant new investment, a necessary (but far from sufficient) condition for growth in general; but in recent decades, rates of investment in Africa have mostly been low, and this is not surprising since there is evidence that investment returns have also tended to be low.
- The key to successful growth in sub-Saharan Africa, therefore, including that based on the rapid growth of exports as advocated in this note, is to create the conditions for a rapid rise in investment to reach levels of at least 20% of GDP, with the important caveat that such investment needs to be highly productive. This is partly a matter of adopting policies to improve the investment climate in general, and partly about convincing investors that their returns will be protected from government predation and civil conflict. Providing such guarantees, and making them credible, is no easy task given the history of many sub-Saharan African countries, but a few countries might be able to start the process, then encouraging their neighbours to learn from their success (rather than invading to steal the early proceeds of development).

From an institutional perspective, what comes out of this discussion is a focus on the business environment in general, and the investment climate in particular, rather than on export promotion *per se*. African (and other developing) countries need to find ways to raise the returns to private sector capital investment, and this means that we need to understand better than we do currently, why, in recent decades, the returns have usually remained too low to attract much investment. In my view, this has nothing whatsoever to do with a real 'lack of investment opportunities'; rather, it is about very basic issues like protection of property rights and business contracts; the credibility of government promises not to expropriate assets or the returns on them; and the maintenance of a 'level playing-field' for doing business, in which established firms are not protected, and investors are not encouraged to locate projects inappropriately as part of the patronage system. With tolerably sound institutional arrangements in place (by which I mean merely 'adequate' – there is no need to demand the 'best'), export expansion will then largely take care of itself.

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