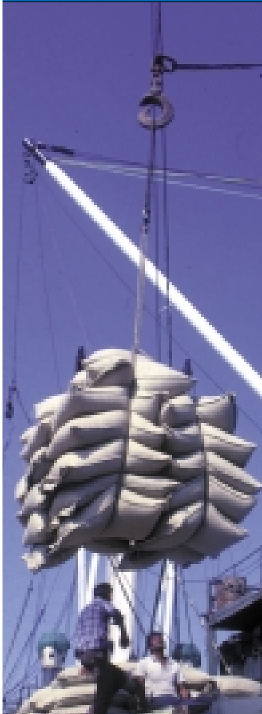


TRADE

An Engine of Growth for Africa

During the new round of trade talks, African countries should use their bargaining power to gain concessions in the areas of most interest to them—liberalization of world agricultural markets and increased access to industrial country markets. In exchange, they should further liberalize their own trade regimes.

Robert Sharer

MANY sub-Saharan African countries have made substantial progress with economic reforms in the 1990s. They have reduced fiscal and current account deficits, lowered inflation, and embarked on market-oriented structural reforms, including trade liberalization. From 1992 to 1997, average growth in the region accelerated to 5 percent from 1 percent, and 32 of the 47 sub-Saharan economies grew by more than 3 percent a year. Real per capita GDP is rising after five consecutive years of decline. But to raise living standards and lift their populations out of poverty, African countries will need to grow even faster.

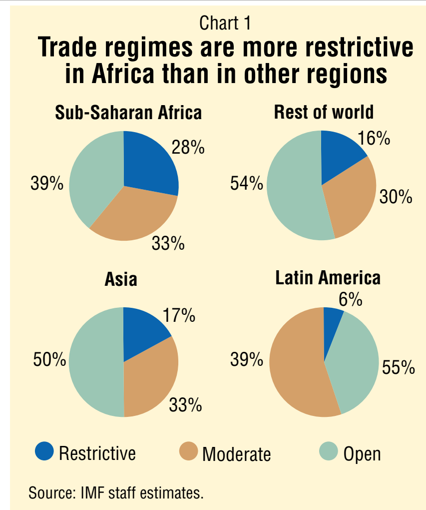
Empirical research has consistently shown close links between economic growth and export growth. Indeed, in recent history, no country with a closed economy and inward-looking policies has been able to achieve or sustain high growth rates. Empirical research also shows that economic growth is essential for the alleviation of poverty. Sub-Saharan Africa has lagged behind other developing regions in both export performance and economic growth over the past two decades. From 1975 to 1997, nominal exports and real GDP in sub-Saharan Africa grew annually by 4.7 percent and 2.2 percent, respectively, compared with 15.7 percent and 7.6 percent in six East Asian countries, and 9.6 percent and 3.0 percent in Latin America. Africa's share of world trade has fallen from about 4 percent in 1980 to less than 2 percent today.

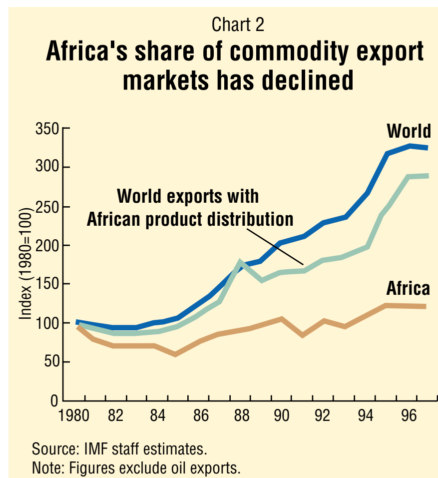
A country's export performance is influenced by its natural endowments, by exogenous factors, and by its macroeconomic and structural policy environment. Strong export performance requires an appropriate macroeconomic incentive environment, complemented by structural reforms—including liberal trade policies—that enhance the supply response. Africa's export and growth performance has been hobbled by the restrictiveness of its trade regimes, as well as by the slow growth of per capita income, the region's distance from major markets, and high transport costs.

On the domestic front, African countries should give priority to liberalizing trade and adopting complementary macroeconomic and structural reforms. On the international front, African countries—which account for 27 percent of the members of the World Trade Organization (WTO)—should use their influence in the WTO to effect changes in the global trading environment that would facilitate the integration of poor countries into the world trading system. During the round of trade talks launched in Seattle, African nations should join forces to persuade industrial countries to liberalize agriculture and open their markets to Africa's exports.

Trade policy in Africa

Despite substantial progress during the 1990s, Africa's trade policies remain, on average, more protectionist than those of its trading partners and competitors. In a recent study of trade liberalization in countries with IMF-supported programs, the IMF developed an index of trade restrictiveness with three categories—restrictive, moderate, and open—to facilitate cross-country comparisons and track the evolution of trade policy over time. The study showed that in the early 1990s more than 75 percent of African countries had restrictive trade regimes; none had a trade regime that could be classified as open. Many of the countries have since undertaken ambitious trade reforms; by the end of 1998, the proportion of countries with restrictive regimes had fallen to 28 percent, while nearly 40 percent had open trade regimes. Nevertheless, trade regimes in Africa remain more restrictive than those in other regions (Chart 1). Tariffs, the most widely used measure of trade restrictiveness, are higher—20 percent, on average—in Africa than elsewhere.





Transparent, liberal, outward-looking trade policies are critical in attracting foreign investment. Private capital flows to Africa have risen much less than those to other developing countries, and Africa has missed out on the benefits that often accompany such flows—the transfer of technologies and management and organizational skills, and the creation of jobs. Between 1980 and 1997, private capital flows to Africa rose only to $16 billion from $6 billion, while flows to developing countries as a group soared to $140 billion from $12 billion.

Africa's dependence on commodity exports is not, in itself, the major problem. The terms of trade for Africa's exports have deteriorated, by about 15 percent, over the past two decades. However, while world trade in the commodities Africa exports has grown more slowly than total world trade, it has still grown substantially. The problem is that Africa's market share is declining, and the region has been slow to move into new export markets (Chart 2). If its market share had remained at the 1980 level, by 1997 Africa's non-oil exports would have amounted to more than $150 billion, compared with the actual level of $62 billion.

Complementary policies

To improve their export performance, African countries will need to address numerous problems—such as inadequate health care and education, a lack of physical infrastructure, and a scarcity of capital. However, an appropriate macroeconomic incentive environment and complementary structural policies are fundamental. Fiscal and monetary policies that are conducive to price stability—and therefore encourage saving and investment—as well as a sustainable external current account position, are critical, as are structural policies that enhance economic efficiency. The credibility and perceived sustainability of reforms are equally essential. Thus, to promote trade and investment, policymakers need to focus on the following measures:

- removing subsidies and exemptions and simplifying the regulatory framework;
- shifting public spending to essential services, including health care and education;
- reforming the financial sector;
- privatizing state enterprises and economic assets;
- implementing institutional reforms to ensure that property rights are well defined and enforceable; and
- improving governance, transparency, and accountability.

It is also important to liberalize the services sector and to make it more efficient by reforming domestic regulations and opening the sector to foreign service providers. Services have been the fastest-growing area of world trade over the past two decades and are vital intermediate inputs in production. Freeing trade in services can facilitate the transfer of skills and new technologies. Technology and innovation, in turn, help make many services more tradable. As companies relocate their production processes around the globe, business success is becoming increasingly dependent on the efficient supply of such services as transport, communications, and finance. Moreover, services often account for more than half of the input costs of traded goods, so the price of services as inputs and the variety of services available strongly influence the export performance of manufactured goods.

The global trading environment

Africa's export performance will be determined primarily by domestic policies. However, enhanced access to industrial country markets is also important and would provide African countries with additional incentives to reform their domestic policies. Despite their generally open trade regimes, industrial countries tend to have restrictions on imports of agricultural products, where much of Africa's

export potential is concentrated. In 1997, for example, the European Union's average most-favored-nation (MFN) tariff was about 15 percent for imported unprocessed agricultural products and 25 percent for processed agricultural products, compared with 4 percent for other goods (excluding textiles).

Moreover, these figures understate the level of protection, because tariffs are generally low or zero on goods that the European Union does not produce, such as coffee and tea, and high on imports that compete with domestic products, including semiprocessed and processed agricultural products, which have higher value added. Equally important, nontariff barriers in the form of producer price supports, export subsidies, and marketing arrangements also keep out agricultural imports. These types of measures amount to agricultural subsidies estimated, on average, to be 1.5 percent of the GDP of the countries belonging to the Organization for Economic Cooperation and Development (OECD).

The existence of trade preferences for developing countries is the second area of the global trading environment with particular significance for Africa. The Lomé Convention, signed in 1975 and extended in 1980 and 1985, gives certain products originating in developing countries in Africa, Asia, the Caribbean, and the Pacific duty-free access to the EU market. In 1968, Australia, Canada, the European Community, Japan, and the United States accepted the generalized system of preferences (GSP), which stipulated that industrial countries would grant preferential tariff treatment to manufactures and semimanufactured products from developing countries.

Although the Lomé Convention is due to expire in 2000, there is no cause for alarm. Its impact, as well as that of the GSP, on the volume and pattern of trade flows has been small; in 1997, for example, only 17 percent of exports from developing countries to industrial countries benefited from the GSP. First, these agreements typically apply to goods with low value added for which the MFN tariff is already low or zero. Second, the application of preferences to exports of raw materials, combined with higher tariffs moving up the value-added chain, has discouraged countries from diversifying into higher value-added exports. Third, access to markets in industrial countries is often restricted by complex administrative requirements with which African exporters have difficulty complying—some 40 percent of goods eligible for preferential treatment under the GSP do not receive it because of such requirements. Fourth, preferences under the two systems apply only to particular products, are not legally bound, and may be removed at the discretion of authorities in the industrial countries. Market access is therefore uncertain, discouraging long-term investment in export industries. Finally, higher-income developing countries tend to reap greater benefits from preferential treatment than the poorest countries; for example, in 1996, Brazil, India, Indonesia, Malaysia, the Philippines, and Thailand accounted for 75 percent of all GSP imports into the United States.

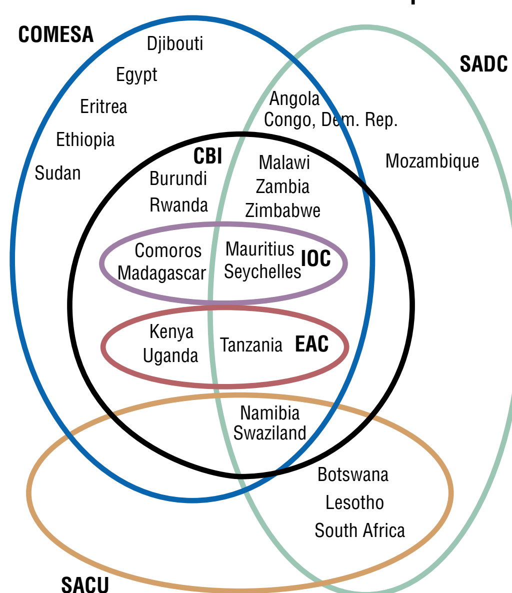
There are two ways sub-Saharan Africa can complement market-oriented domestic policies with an external environment that encourages trade and investment—first, through regional trading arrangements, and second, through more active participation in the multilateral trading system. These two paths are not mutually exclusive.

Regional trading arrangements. Regional trading arrangements can contribute to economic efficiency, trade, investment, and growth. In sub-Saharan Africa, such arrangements have contributed substantially to structural reform by creating incentives to eliminate restrictive trade practices and licensing procedures; streamline customs procedures and regulations; integrate financial markets; and simplify transfers and payments procedures and policies relating to transportation, infrastructure, labor, and immigration. A few countries have gone beyond this, harmonizing investment regulation incentives and tax treatment, as well as standards and technical regulations.

Regional trading arrangements may be beneficial if they result in a broadly similar degree of nondiscriminatory trade reform. Otherwise, they can lead to trade diversion, for which consumers—who will have no alternative but to buy expensive imports from a country's regional partners—will pay the price. However, African countries tend not to produce the goods that other African countries import. As a result, intraregional trade accounts for less than 10 percent of African

Chart 3

Regional trading arrangements in eastern and southern Africa overlap



Source: Author.

Note: CBI Cross-Border Initiative
COMESA Common Market for Eastern and Southern Africa
EAC Commission for East African Cooperation
IOC Indian Ocean Commission
SADC Southern African Development Community
SACU Southern African Customs Union

trade, compared with more than 60 percent for the EU, 45 percent for NAFTA, and almost 30 percent for Mercosur.

One problem with Africa's regional trading arrangements is the number of overlapping and internally inconsistent initiatives. The various regional groupings (including the Common Market for Eastern and Southern Africa, the Cross-Border Initiative for Eastern and Southern Africa, the Southern African Development Community, and the Southern African Customs Union), have overlapping memberships (Chart 3); conflicting obligations, rules, and administrative strategies; and different strategies and objectives. The complexity of Africa's arrangements reduces the potential trading gains from regionalism and undermines incentives for increased investment, because the internal inconsistencies and conflicting regulations hinder the creation of a larger market. Moreover, regional policies that are not effective may dissipate the political capital countries need to pursue outward-oriented reforms and may foster the very favoritism and special interests that trade liberalization is supposed to overcome.

The new trade round. The scope and comprehensiveness of the new round of negotiations are likely to be determined in the coming year. The best outcome would be comprehensive progress on a broad agenda, because this would facilitate the necessary trade-offs between competing interests, thereby increasing Africa's chances of achieving progress in all sectors, including those in which it has the greatest interest. The alternative may well be discussions of selected issues of interest only to groups of WTO members—sectoral discussions could eclipse the issues of greatest concern to Africa.

To ensure that their interests are adequately taken into account during the new round, African countries will need to focus on two goals—scaling back restrictive agricultural policies in OECD markets and revising preference systems, preferably by adopting the WTO Director-General's proposal that exports from the poorest countries, including the heavily indebted poor countries, be given across-the-board bound, duty-free access to markets in industrial countries. Such access would enhance African countries' incentives for export growth and diversification, and for expansion over the medium term of their trading relationships with industrial countries. Bound, duty-free access would lead to a more stable incentive environment and encourage domestic investment in export industries; countries would also be motivated to undertake reforms that make their export sectors more attractive to foreign investors.

Although duty-free access might lead to some trade diversion, concerns that it will be distortionary are unfounded. First, the volume of trade involved in relation to industrial country markets is very small. Second, for exporting countries, because bound, duty-free access would apply to all industries and all major markets, it would provide a uniform pattern of price incentives that would allow countries to exploit their comparative advantages. This is in contrast with the present system of preferences, which distorts incentives.

Robert Sharer is Chief of the Trade Policy Division in the IMF's Policy Development and Review Department.

A priority for Africa

Trade reform is an important priority for sub-Saharan Africa. Open trade regimes and strong export sectors are linked to economic growth, and trade barriers are being maintained at the expense of growth and the welfare of Africa's population. However, trade reform will not be effective without complementary domestic policy reforms geared toward establishing an outward-looking, market-oriented incentive environment.

The adoption of appropriate trade-oriented economic policies will not necessarily lead to an increased role for exports of manufactures or any other specific type of product. Rather, policies should emphasize economic efficiency and the pursuit of trade opportunities wherever they appear. Depending on where its comparative advantage lies, a country may focus on commodities, agricultural exports (including processed and other high-value products), textiles, manufactures, or services.

The new trade round provides an effective forum in which Africa can work for changes in the international trading environment that have the potential to improve the region's trade prospects. In return, however, sub-Saharan African countries should stand ready to liberalize their own trade policies. A more favorable external trading environment, combined with a sound macroeconomic and structural policy framework, including liberal trade policies, is the best route to stimulating export performance and reaping the benefits of fuller participation in the global trading system. F&D

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