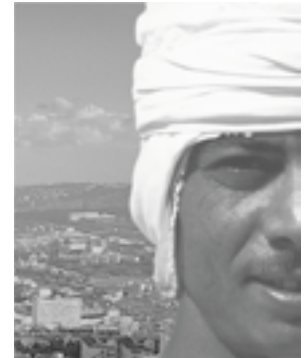


Overview



After fifty years progress, the future of the multilateral system of trade negotiations is surrounded by uncertainty. The collapse of the Cancun World Trade Organization (WTO) Ministerial Meeting in 2003 has put pressure on the Organization of Economic Co-operation and Development (OECD) countries to reduce agricultural subsidies and other domestic support measures that distort global trade and contribute to the marginalization of Africa in the international trading system.

The *Economic Report on Africa (ERA) 2004* takes the view that OECD trade policies are a serious constraint to Africa's integration into the global economy. African exports have been handicapped by industrial country policies such as tariff escalation, tariff peaks and agricultural protectionism. The industrialized countries must commit themselves to the development principles of the WTO's Doha Round, by widening market access for developing country exports and providing more trade-related assistance to poor countries. Such assistance is necessary, both to bear the heavy costs associated with trade liberalization and to help countries exploit the opportunities arising from a more integrated global economy.

“ OECD trade policies are a serious constraint to Africa's integration into the global economy ”

But the Report also argues that strengthening Africa's supply side capacity is essential to more successful integration into the global economy. Weak infrastructure, poor trade facilitation services, and inadequate physical and human capital are impediments to the development of Africa's export sectors. *ERA 2004* takes an introspective look at what Africa needs to do to put its house in order so as to benefit from existing and future opportunities in the global trading system.

Firstly, Africa needs to more quickly diversify its production structures. Secondly, countries must be more proactive in bringing about integration of their economies regionally and into the global economy. *ERA 2004* therefore makes specific recommendations to help African countries improve their competitiveness, including in the areas of energy policy for trade and trade facilitation.

Economic performance is improving, but not by enough to reduce poverty

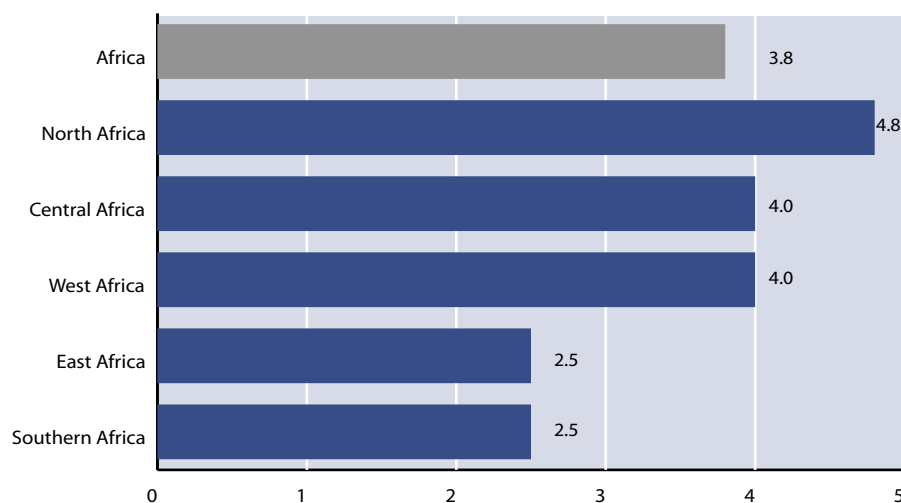
Despite Africa's slow progress towards the Millennium Development Goals (MDGs), the overall message of the Report is optimistic. In recent years, the continent has begun to recover from the “lost decades” of the 1980s and 1990s. In 2003, Africa was the second

“Africa was the second fastest growing region in the developing world”

fastest growing region in the developing world, behind Eastern and Southern Asia. Real Gross Development Product (GDP) grew by 3.8% in 2003 compared to 3.2% in 2002. This encouraging performance was driven by higher oil prices and production, rising commodity prices, increased foreign direct investment (FDI), better macroeconomic management, and good weather conditions. North Africa, with 4.8% growth was the continent's fastest growing subregion. West and Central Africa also achieved respectable growth rates of 4%. East and Southern Africa, in contrast, registered growth of only 2.5% (see figure 1).

Figure 1

North Africa tops subregional economic performance, 2003 (real GDP growth rates)



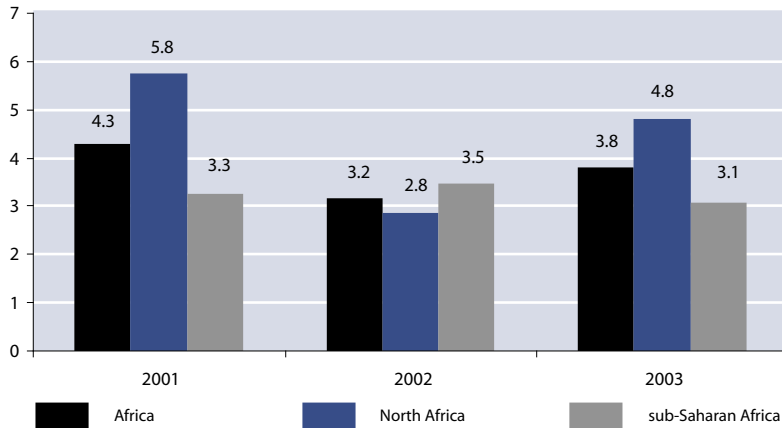
Source: ECA, from official sources

Apart from a few countries, the continent did well on other macroeconomic fundamentals. Fiscal deficits were largely kept under control despite the challenge faced by many countries of balancing increased spending for poverty reduction with the requirements of macroeconomic stability. Inflation rose slightly to 10.6% from 9.3% in 2002, reflecting higher food prices caused by poor weather conditions in some parts of the continent, increased oil-import prices, and currency depreciation in several countries. The regional current account deficit fell from 1.6% of GDP in 2002 to 0.7% of GDP in 2003 because of robust oil and commodity prices and high worker remittances.

On the downside, seven economies had negative growth rates, compared to one in 2000 and none in 1999. Compared to 2002, there was a slight deterioration in overall growth performance in sub-Saharan Africa (SSA), with a rate of expansion of 3.1% in 2003, down from 3.5% the previous year (see figure 2). Furthermore, rapid population increase meant that SSA's per capita growth was only 1.7% in 2003, much too low to achieve the MDG for poverty reduction.

Figure 2

Rates of economic growth – Africa, North Africa and sub-Saharan Africa, 2001-2003



Source: ECA, from official sources

The recent establishment of a new Commission for Africa, launched by the British Prime Minister, Tony Blair, in March 2004, represents an important acknowledgement of the need to address Africa's underperformance. This should provide support for the principles and actions of the New Partnership for Africa's Development (NEPAD). The Executive Secretary of ECA, K.Y. Amoako, recently commented:

"The international community and Africa have agreed on the central importance of a partnership to achieve NEPAD's goals but we must now focus on implementation and action... We must agree on what we can really deliver for Africa's people."

The continent still awaits the "peace dividend"

One of the main reasons for Africa's poor economic performance has been the continuation of military conflicts. In the early 1990s, in the aftermath of the Cold War, there were expectations of a "peace dividend" through the resolution of long-running wars. But this never materialized: the 1990s was the most conflict-ridden decade since independence, and economic growth was sluggish. Without peace, there is little hope for social and economic progress in Africa.

In 2003, signs of a peace dividend finally appeared in some of Africa's most troubled countries. Peaceful political transitions in Angola and the Democratic Republic of Congo (DRC) began to produce economic benefits. Angola attracted substantial FDI during the year and GDP grew at over 7.5%. The DRC saw growth of over 5%. The country also made gains in macroeconomic stability, registering single-digit inflation in 2003 – remarkable progress given inflation of over 500% as recently as 2000. Since the departure from Liberia of ex-president, Charles Taylor, there is hope that civil wars in

neighbouring countries will abate. In November 2003, the Government of Burundi signed a peace agreement with the main rebel group to end the country's civil war and took steps to integrate former rebels into the political process.

“
Without peace,
there is little hope for
social and economic
progress in Africa
”

Continuing political instability in Côte d'Ivoire and Zimbabwe is cause for concern. In Zimbabwe, macroeconomic indicators deteriorated sharply in 2003: inflation rose to 420%, the fiscal deficit widened to 7.1% of GDP and the economy contracted for the fifth consecutive year. In other countries, such as Uganda, the persistence of low-intensity conflicts has hampered growth and poverty reduction.

Insufficient and inconsistent external support hinders progress

Central to NEPAD is the idea that a future African renaissance requires substantial external support as well as internal reforms. It is estimated that there is an annual shortfall of \$US 20-25 billion of resources needed for African countries to achieve the MDGs. Official development assistance (ODA) flows, at \$19.4 billion in 2001, are well below their 1990 peak (ECA, 2003). At the International Conference on Financing Development held at Monterrey, Mexico in 2002, the industrialized countries made a pledge to increase the quantity and quality of ODA flows to Africa.

The Report highlights inconsistencies in donor approaches. For instance, despite donor acknowledgement of the importance of the role of women in development, gender-related projects for the whole of Africa receive a mere \$81 million of ODA. Similarly, although there has been a welcome increase in ODA for tackling the HIV/AIDS epidemic, minimal support is given to the fight against malaria, one of the biggest killers in SSA.

Another concern is the continuation of tied aid linking ODA with the purchase of goods and services from the donor country. This reduces the value of aid to recipients by 25-40%¹, because countries are obliged to buy uncompetitively priced imports. Some donors have reduced tied aid: Denmark, the Netherlands, Norway, and the United Kingdom provided over 90% of aid untied in 2001. But many countries continue to tie aid flows to export purchases.

The challenges of trade liberalization for North and South

There have been various initiatives to improve market access for the poorest developing countries. The European Union (EU)'s "Everything but Arms" (EBA) agreement, and the United States' African Growth and Opportunity Act (AGOA) are two examples (see box 1). Preliminary evaluations of these initiatives show modest but important gains

for some sub-Saharan countries (UNCTAD, 2003b). In this sense, the initiatives set encouraging precedents for future liberalization of industrial and agricultural markets in OECD countries. However, because neither initiative involves the reduction of agricultural subsidies in rich countries, they fall short of fulfilling Africa's needs for fully developing its export potential. For example, Mali lost \$43 million in 2001 as a result of large subsidies to US and EU producers, which lowered the price of cotton, one of Mali's main exports.

Box 1

AGOA has had some encouraging results and should be extended

The United States' African Growth and Opportunity Act (AGOA) was signed into law on 18 May 2000. According to AGOA's webpage (www.agoa.gov), "the Act offers tangible incentives for African countries to continue their efforts to open their economies and build free markets". However, because most African countries already enjoyed preferential treatment due to their status as least developed countries, the preferences offered are not a major improvement over the existing general system of preference agreements. But for some products such as textiles and apparel, where tariffs and quotas are higher, there are significant advantages in belonging to the scheme.

Circumstantial evidence suggests that some African countries have benefited from the access agreement. For instance, South African exports to the USA under AGOA were 45% higher in 2002 than in the preceding year. Nigeria, too, has gained, and accounts for more than 60% of all AGOA exports to the US (although the bulk of this trade is related to the oil industry). Countries have also seen an increase in FDI as a result of AGOA. For example, companies from the Taiwan Province of China are the main investors in Lesotho's garment industry.

Nonetheless, this evidence has to be set against the backdrop of a 15% fall in total SSA exports to the US in 2002. The benefits from AGOA are limited because only "non-sensitive" products are included in the agreement. In addition, excessively tight rules of origin and the restricted list of countries admitted to benefits from the special textile preferences regime reduce the usefulness of the scheme for African textile producers. Moreover, the scheme expires in 2008, and this has dampened the reaction of potential investors. Finally, there is concern that AGOA's benefits will be diluted as the US Government seeks to negotiate free trade agreements with other regions such as the Middle East and Central America.

Africa would benefit if the US administration took on board some of the recommendations of the US Commission on Capital Flows, such as an extension of AGOA until 2018, and extended the preferences to include all products coming from Africa.

Sources: *Mattoo et al., 2003; UNCTAD, 2002 and 2003b; US Department of Commerce, 2003; US Commission on Capital Flows to Africa, 2003*

“Initiatives such as AGOA and “Everything but arms” set encouraging precedents for future liberalization of industrial and agricultural markets in OECD countries”

The pros and cons of further liberalization for Africa...

A forthcoming study by ECA, “Trade Liberalization under the Doha Development Agenda: Options and Consequences for Africa”, reveals the gains that might be realized by

“Africa’s high share of primary commodities in exports has been costly”

African countries under liberalization of OECD agriculture. The study analyses three types of trade liberalization: “little”, “modest” and “full”², using the Global Trade Analysis Project (GTAP) model, a multisector and multi-region framework. In the static version of the model, full liberalization of trade would increase global welfare (income) by 0.3%, and would add 0.7% to income in Africa. While the absolute gains for SSA are quite modest – some \$704 million – when compared with the \$15.9 billion gain for the EU15, the study shows larger gains from deeper liberalization. While North Africa benefits under all liberalization scenarios, SSA loses from partial liberalization. This is because of preference erosion as many African countries are beneficiaries of preferential trading arrangements. Partial market access (the “little” and “modest” scenarios) would thus increase the degree of competition they face in export markets.

Allowing for dynamic effects such as capital accumulation increases, the estimate of the gains to SSA from full liberalization rise to \$4.3 billion, six times as large as in the simple static version. This underlines the importance of complementing trade liberalization with policies to enhance investment volumes.

There is, however, a potential downside from further agricultural liberalization. The findings of the simulation exercise suggest that liberalization may cause contraction of industrial activities and force further specialization in agricultural commodities in African countries. Although this is dictated by comparative advantage, it raises the risk of continued excessive dependence on commodities and vulnerability due to fluctuations in their prices. These findings drive home the urgency of adopting policies to promote export diversification towards higher value-added industrial and service sectors.

Africa must move beyond primary commodity production

Africa’s high share of primary commodities in exports has been costly: terms-of-trade losses because of declining real commodity prices have had negative impacts on external indebtedness and investment, hampering income growth and poverty reduction (UNCTAD, 2003a). According to one study, non-oil-exporting African countries suffered cumulative terms of trade losses between 1970 and 1997 of almost 120% of GDP, offsetting the benefits of increased aid flows after 1973 (World Bank, 2000). Even oil producers such as Angola, Gabon and Nigeria have seen few developmental gains despite terms of trade increases; oil income has not brought economic diversification and these countries have therefore failed to achieve sustained growth.

There is an urgent need for a coherent strategy to promote diversification, particularly given the current deadlock in the WTO negotiations. Not only are OECD countries reluctant to reduce domestic export subsidies, the dismantling of domestic farm support measures (e.g. the EU’s Common Agricultural Policy) is also politically unfeasible.

Promoting domestic industries...

Over the last two decades African countries have reduced state support for domestic industries. But such support, aimed at bringing about diversification, need not be controversial:

- There is a strong theoretical and empirical case for selective interventions to overcome market and institutional failures in order to build the capabilities required for export sector development (Lall, 2003).
- Critics argue that the State is not capable of “picking winners”. This has often been true in the past. But there could be a case for industrial policy targeted at general activities such as investment, research and development (R&D) and training instead of selective support to particular industries or firms. This has been the approach of many industrialized countries that have employed systems of incentives to encourage R&D and infrastructure development.
- Industrial policies have often failed because of poor coordination between different government bodies. Coherent interventions must be based on an integrated approach spanning key line ministries as well as trade and business organizations.

Such policies take time to implement. For this reason, the principle of “special and differential treatment” (SDT) continues to be of importance to African countries. Liberalization by African countries needs to be sequenced over time in order to strengthen supply-side capacities so that the continent can compete in global markets.

There are positive lessons from Asia...

High growth in many Asian economies was driven by dynamic trade policies that were based on a combination of liberalization and State control. Early explanations of the “Asian miracle” cited the apparent openness of the Asian economies to external markets. This contrasted with the failed import-substitution approach pursued in Africa. The root of Asia’s success was thought to lie in State neutrality towards economic sectors, allowing existing comparative advantage to determine the composition of production and exports. State neutrality could take the form of equal exchange rates for exports and imports and equality between domestic and world market prices.

Later it began to be recognized that Asia’s success did not lie in State neutrality and that the State played an important role in fostering export competitiveness by maintaining export-friendly effective exchange rates and granting large subsidies to exporters. Trade policies were part and parcel of broader national development strategies. There are important lessons to be learned here for Africa, although this goes against free trade arguments many of which focus on the need to remove import barriers without considering how to strengthen export capacity and promote diversification. The Mauritius experience suggests that *laissez faire* policy is not the route to export diversification (see box 2).

“ Selective interventions to overcome market and institutional failures in order to build the capabilities required for export sector development ”

Box 2

The recipe for success in Mauritius

The Mauritian economy has been a success story over the last two decades as indicated by its high ranking in ECA's Trade Competitiveness Index, Institutional Sustainability Index and the Economic Sustainability Index. Its economy is dominated by the sugar and tourism sectors and its export-processing zone (EPZ). Contrary to popular belief, the country has maintained a highly restrictive trade regime, with the market being relatively closed to imports. But its export sector has been kept open by segregating the sector from the import sector. Duty-free access was provided to all imported inputs, resulting in competitive exports. Tax incentives were given to firms operating in the EPZ, and the labour market for EPZ exporters has been made more flexible in areas such as overtime payments and laying off workers. The country's ethnic diversity has attracted investment from Asia. In addition, political and macroeconomic stability has enhanced the trade environment.

Sources: ECA, 2003; Subramanian and Roy, 2003

“Asia's success did not lie in State neutrality”

In this vein, the report of the High-Level Panel on Financing for Development (the Zedillo Report) argued that WTO negotiations need to consider how to legitimize time-bound protection of certain industries, by country, in the early stages of industrialization:

“However misguided the old model of blanket protection intended to nurture import substitute industries, it would be a mistake to go to the other extreme and deny developing countries the opportunity of actively nurturing the development of an industrial sector” (UN, 2000).

Focusing on export diversification....

During the 1990s, it was often argued that trade drove economic growth and development.³ Structural adjustment policies were aimed at increasing the “openness” of African economies to trade. African economies are now surprisingly open: SSA's share of trade in GDP is 62.2%, compared to a world average of 57% and 35.9% for Latin America and the Caribbean. Given Africa's falling terms of trade and the high level of unregistered informal trade, the continent's degree of integration into the world economy is higher than commonly thought.

Africa's performance in world trade reflects the continent's small GDP rather than a lack of openness per se. While the volume of trade is important, the share of manufactured goods in total exports is a more important determinant of economic success (Fosu, 2002a). Manufacturing is one of the main vehicles for technological development and innovation. Economies with higher shares of manufacturing in total value-added are less vulnerable to price and climatic shocks.

Over the last two decades Africa has made gradual but insufficient progress in export diversification (see Table 1). A few African countries, such as Kenya and Uganda, have moved into non-traditional exports, typically, vegetables, fruits, and flowers. Even more encouraging are the few countries that have successfully promoted manufacturing exports, such as Mauritius and Tunisia. These experiences can provide lessons for other African countries.⁴

Table 1**Manufactures as % of export trade, selected African countries, 1980-2001**

	1980	1990	2001
Algeria	0.3	2.6	2.3
Angola	12.9	0.1	..
Benin	3.4	..	6.2
Cameroon	3.8	8.5	4.7
Comoros	23.8	..	8.2 ^a
Côte d'Ivoire	4.7	..	14.5 ^a
Egypt	10.9	42.5	32.7
Ghana	0.9	..	15.8
Kenya	12.1	29.2	20.8 ^a
Mauritius	27.4	65.8	74.2
Morocco	23.5	52.3	64.1 ^a
Nigeria	0.3	..	0.2 ^a
Senegal	15.1	22.5	28.8
South Africa	18.2	21.9	59.4
Togo	10.6	9.1	49.7
Tunisia	35.7	69.1	77.0 ^a
Uganda	0.7	..	6.9
Zambia	16.0	..	12.7
Zimbabwe	35.8	30.9	28.1 ^a

Note: ^a Refers to data for 2000.**Sources:** World Bank, 2003; UNCTAD 2003

Trade liberalization alone is unlikely to lead to manufacturing export capacity. A stronger supply-side is also required. Policies to improve infrastructure and the trading environment are critical. *ERA 2004* provides policy recommendations in these and other areas.

Policy actions needed to strengthen trade performance – lessons from ECA's Trade Competitiveness Index

This year's *ERA* presents a Trade Competitiveness Index (TCI). The TCI allows comparisons between African countries in different areas of trade competitiveness, and identifies bottlenecks to improved trade performance. It is calculated for a sample of 30 African countries. It also includes four Asian countries (India, Indonesia, Malaysia and Thailand) and four Latin American countries (Argentina, Bolivia, Brazil and Chile) – developing countries that had GDP per capita levels similar to today's African level in the 1960s, but have since followed a different development path.

“Trade liberalization alone is unlikely to lead to manufacturing export capacity”

“ Competitive countries also have higher shares of manufactured exports ”

The TCI is divided into three components, each capturing a different dimension of trade competitiveness: a *Trade-enabling Environment Index (TEI)*, reflecting the overall economic and political environment's conduciveness to trade; a *Productive Resource Index (PRI)*, capturing the availability of direct inputs to production, such as land and the labour force; and an *Infrastructure Index (II)*, measuring indirect inputs such as physical infrastructure and energy that enable the movement of goods and services. The results reveal a number of findings:

- There is a positive relationship between the TCI and the degree of export diversification: competitive countries export a broader range of products. Competitive countries also have higher shares of manufactured exports. The challenge for African policy makers is to encourage competitiveness and diversification towards higher value-added goods and services with a greater technological content.
- Variations in competitiveness within Africa are driven by factors captured in the TEI including the macroeconomic and political environment as well as policies that affect the ease of trade. The top-scoring African countries in the TEI also do best in overall trade competitiveness. These countries have managed to diversify the most and have the highest exports of manufactured goods in GDP.
- The PRI reveals that labour-force indicators are key determinants of trade competitiveness on a global scale. Non-African countries dominate the overall TCI because of their high-quality labour forces. More successful integration by Africa into the world economy will require better educated and healthier workforces.
- Africa's trade with itself and with the rest of the world is hampered by inadequate infrastructure. These weaknesses lead to high transaction costs on the continent, a major cause of comparative disadvantage and limited diversification. Improved infrastructure is critical to better trade performance.

An active employment policy is vital...

Job creation is essential to Africa's future. Investments in human capital will have little return in the absence of job opportunities. In many African countries trade liberalization has been associated with a sharp fall in employment as consumers have switched from non-traded goods to imports. Policies are urgently needed to boost employment. One option, recently recommended by the US Commission on Capital Flows to Africa, is to provide more active support to small- and medium-sized enterprises (SMEs). Reflecting their importance as creators of employment and as seedbeds for technology acquisition and innovation, industrialized countries offer financial and technical support to their own SMEs. Africa needs to create similar small business institutions to coordinate comprehensive programmes of SME support. These institutions could strengthen technical and managerial capacities of SMEs; provide loan guarantees, and equipment and export financing; build links with multinational corporations; provide information on market and export opportunities; and facilitate "one-stop-shopping" on licensing, taxation, and other regulatory matters.

Box 3

Tackling unemployment in Tunisia

The Tunisian Government has taken measures to tackle unemployment, which stood at 15% of the economically active population in 2001. In January 2000, the National Employment Fund, popularly known as the “21-21 Fund”, was launched. Its aim is to help find employment for job seekers, particularly the young.

The 21-21 Fund includes an internship programme for disadvantaged youths under 20. These individuals are placed in companies where they receive training to enhance their employability. University graduates can participate in advanced training programmes in computing and telecommunications. Those with liberal arts backgrounds are trained in fields such as pre-school teaching and participate in the national adult literacy programme. The 21-21 Fund provides financial assistance to 35 public and private training centres.

The most successful of the Fund’s initiatives is an aid programme to help potential entrepreneurs establish small businesses, in collaboration with the Tunisian Solidarity Bank. Emphasis has been put on enterprise creation in poor areas. Approximately 204,000 people benefited from the Fund between January 2000 and November 2002. Most of the beneficiaries have since established their own businesses or have found stable employment. The Fund provides credit lines to guarantee commercial bank loans for those enlisted in its programmes who eventually start their own projects.

Source: ECA, from official sources

“ Africa needs to create small business institutions to coordinate comprehensive programmes of SME support ”

To help the poorest segments of the population, State financing could be provided for public works projects such as road building and irrigation, especially during economic downturns (see box 3). In Ghana, for instance, youth are employed in forestry and urban sanitation programmes (Nwuke, 2002). Some countries such as Kenya and Ethiopia have tried “food for work” programmes; these have had varying degrees of success. Such schemes need to be improved upon and should be extended as far as financial resources allow.⁵

The key importance of energy

Firm-level surveys in countries such as Ghana, Kenya, Senegal and Uganda have identified infrastructure weaknesses as major constraints to export development and international competitiveness (Reinikka and Svensson, 1999).

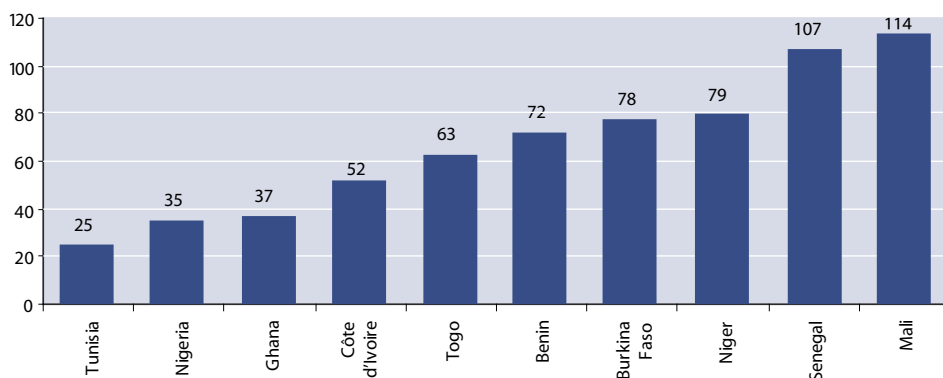
In particular, Africa’s poorly developed energy infrastructure hampers export diversification. Despite the continent’s enormous potential for energy production, its energy-generating capacity is small relative to its geographic size and population. Electricity supply is prone to rationing, “brownouts” and blackouts. The sector is inefficient because of system losses in transmission and distribution, poor pricing policies, limited managerial capacities and ineffective government intervention. West African countries such as Mali

and Senegal have energy unit costs as high as four times that of Tunisia, a country with an efficient state-owned energy sector and a well-diversified economy (see figure 3).

“Africa’s poorly-developed energy infrastructure hampers export diversification”

Figure 3

Cost of 1 kWh in Tunisia compared to selected ECOWAS countries (in CFA francs)



Source: ECA, from official sources

Africa has not attracted the levels of FDI needed to upgrade the continent’s power network. FDI in the power sector in SSA between 1990 and 1998 represented only 6% of infrastructure-related FDI flows to the region. Energy schemes involving foreign private investors have sometimes had poor results, providing services at an excessively high cost, which hurts the poor.⁶ On the other hand, privatized utilities have proved more efficient in extending service coverage (Ford, 2002).

But least developed countries (LDCs) may be less able to attract external flows to their power sectors. A recent UN report reminds us that “*the growing tendency to leave even LDCs to the mercies of the capital market to build power plants and upgrade their telecommunications facilities has led to growing under-provisioning of investments in this sector in the LDCs... Not all LDCs can access FDI in these areas or access it with sufficient urgency to meet their immediate demand for power or water*” (UN, 2000).

Reforming the electricity sector...

ERA 2004 makes a number of recommendations for power sector reform to help export diversification:

- Direct government control of the electric power sector has often had disappointing results, although this has not always been the case, as the case of Tunisia shows. However, a significant step is to transform power companies that are under government ownership into independent and self-reliant corporations, where feasible, operating on the basis of modern economic and business principles.

- African countries should promote energy efficiency. This reduces operating costs, enhances economic efficiency, and improves the productivity and international competitiveness of energy-consuming companies. An energy efficiency programme should include information dissemination activities to increase awareness of the issue, and incentives for energy conservation.
- Rural electrification programmes develop the energy sector and help export diversification by aiding structural transformation of the rural economy. African governments should promote rural electrification by facilitating the establishment of village-based energy systems.
- Increased private sector involvement in the energy sector brings the need for good regulation. Effective regulation prevents abuses of monopoly power and limits price increases to those compatible with appropriate profit margins. Regulatory bodies need to be independent, and distanced from political and corporate pressures.
- Regional integration in energy services could bring efficiency gains. A study by the Southern African Development Community (SADC) and the World Bank estimated a saving of \$1.6 billion over ten years through the optimal use of regional electricity resources in Southern Africa.

“Direct government control of the electric power sector has often had disappointing results”

Effective strategies for trade facilitation

Trade facilitation includes the ease of moving goods through ports and the speed of processing documents associated with cross-border trade. *ERA 2004* also considers broader aspects such as the transparency and professionalism of customs and regulatory institutions, and the harmonization of standards and regulations.

Greater efforts are needed to facilitate trade in the African continent. As well as strengthening Africa’s infrastructure network, this requires harmonizing customs and administrative procedures.

African countries must remove their own trade impediments...

Trading more effectively requires a comprehensive approach by African countries. This should include improvements in infrastructure; the provision of good information and communications technology services; the removal of check points that constitute a *de facto* tax on trade; the simplification and harmonization of customs and border procedures; the promotion of new technology in customs agencies; and the strengthening of regional trade facilitation initiatives. Existing efforts through national, bilateral and subregional initiatives need to be better harmonized. Efficiency can be improved through the adoption of recognized trade facilitation mechanisms like the Automated System for Customs

Data (ASYCUDA) introduced by UNCTAD. A good example of a national-level facilitation initiative is the Tunisia TradeNet, an automated system designed to reduce shipment clearance delays.

“*African capital markets remain marginal in the global and emerging markets*”

At the multilateral level, trade facilitation is one of the four “Singapore Issues”. This was introduced into trade negotiations at the First WTO Ministerial Conference held in Singapore in December 1996, despite strong opposition from developing countries, including those from Africa. Concerns surrounding the creation of a “multilateral framework” on trade facilitation centred on the limited human, financial and technical capacities to address the issue at the multilateral level.

Mobilizing domestic resources

African governments must promote domestic resource mobilization. The shares of savings and investment in GDP remained low during 2001 (the latest year for which data are available), and well under the levels needed to achieve the MDGs on growth and poverty reduction. In the region, 27 countries had savings below 10% of GDP in 2001, indicating a huge shortfall in resources needed to catalyze development. Rising private investment has been insufficient to offset the sharp drop in public investment seen during structural adjustment. Given complementarities between public and private investment, more public investment in infrastructure, health and education is required.

The Report also discusses the role of Africa’s capital markets in resource mobilization. Amid the poor performance of developed country stocks over the last two years, many African stock markets have performed relatively well. This reflects Africa’s partial insulation from global financial shocks due to the continent’s low level of integration into the international financial system. Large increases in the value of stocks traded have occurred primarily in the regional powerhouses of Egypt, Morocco and South Africa. Overall, however, African capital markets remain marginal in the global and emerging markets: their share of world market capitalization fell from 1% in 1992 to 0.7% in 2001. External and institutional constraints limit the growth of African stock markets. Political instability and patchy macroeconomic performance hamper their performance, while settlement and trading mechanisms are often poorly developed.

Given the small size of African stock markets, the domestic banking system must play a central role in the provision of finance to businesses. Financial liberalization over the last two decades has not led to better banking sector performance: portfolios continue to be dominated by non-performing loans and excess liquidity. This contrasts with the relatively dynamic performance of the informal financial system. Africa has a “missing middle” in the provision of financial services: many potential borrowers are too large for the informal lenders but too small to access banks (Nissanke and Aryeetey, 1998). Reform of the banking system is critical in order to help firms break into the international market.

Challenges of fiscal reform in the face of trade liberalization

African governments' financial dependence on trade taxes raises the problem of how to maintain the fiscal base and preserve macroeconomic stability in the face of trade liberalization. In other regions, this issue is receiving increasing attention from policy makers. For example, all countries in Latin America, except for El Salvador, have either passed tax reforms or are in the process of so doing. In Africa, the domestic tax base is limited and tax administration inefficient. Taxes on international trade therefore make up a large share of fiscal revenue. In Africa as a whole, international trade taxes generated on average 28.2% of total current fiscal revenues over the last decade; for SSA the share rises to 30.5%. This contrasts with 0.8% for high-income OECD countries, 11.5% for upper-medium income countries, 18.42% for lower medium-income countries, and 22.5% for low-income countries. While the data shows a decreasing dependence on trade taxes worldwide, in Africa the share has fluctuated around a flat or slightly increasing trend.

“ In Africa, the domestic tax base is limited and tax administration inefficient ”

Trade liberalization is therefore a potential source of fiscal instability for African economies. Revenue-related concerns are often mentioned as a reason for resistance to trade policy reform in low-income countries. In fact, some components of trade liberalization packages are likely to have a positive impact on revenues. These include the replacement of non-tariff barriers by lower tariff equivalents and the elimination of tariff exemptions and trade-related subsidies. Moreover, tariff cuts can increase total revenues if they generate a sufficiently large increase in trade flows. Trade liberalization measures can also be combined with tax and fiscal reforms to help buffer the revenue impact of trade liberalization.

The effects of trade liberalization on revenues and fiscal deficits depend on the existing level of trade restrictions. When trade restrictions are high, trade liberalization increases trade tax revenues and reduces the deficit. When, instead, trade restrictions are already low, further liberalization results in smaller revenues and a larger deficit unless appropriate policy responses are implemented. Liberalization is therefore more likely to lead to fiscal problems at later stages. Most African countries have already carried out trade liberalization over the 1990s. They are therefore likely to face revenue reductions as a result of further liberalization, such as that set out under the Economic Partnership Agreements (EPAs) between the EU and African subregions (see box 4).

Most of the African countries that made the fastest progress on trade liberalization over the last ten years saw a significant decrease in revenues from international trade taxes. But in some, such as Ghana, Morocco, Senegal, and Tunisia, this did not translate into higher deficits. Their experience suggests policy responses to buffer the negative fiscal impacts of trade policy reforms. Trade liberalization should be co-ordinated with measures on the revenue and spending side of the budget including raising domestic indirect and direct taxes, strengthening tax administration and collection and improving the effectiveness of public spending. In addition, a sound macroeconomic environment helps prevent fiscal distress during trade liberalization.

Box 4

EPAs and their fiscal implications

“
Trade liberalization
should be coordinated
with measures on the
revenue and spending
side of the budget
”

The Economic Partnership Agreements (EPAs) between the European Union and individual subregions in sub-Saharan Africa are an extension of the Cotonou Agreement with the African, Caribbean and Pacific (ACP) countries. Despite new initiatives on the part of the EU (such as the “Everything but Arms” agreement), the results from preferential agreements have been disappointing. For instance, over the first two decades of preferential access to the EU market under the Lomé accords, the exports of the ACP countries to the EU market fell from 6.7% of world exports in 1975 to 2.7% in 1995. This was partly due to ACP countries’ dependence on primary commodities whose share in world trade had declined. Clearly, however, the concessions for the ACP countries did not offset this structural imbalance. The EPA initiative was a reaction to these poor results, and is part of a new approach by the EU on trade policy towards the poorest developing countries.

The planned establishment of free trade agreements with the EU under the EPAs represents an enormous challenge to African countries. They will have to completely liberalize their trade with the EU and carry out a range of institutional and regulatory reforms. One of the benefits of the EPAs is locking African countries into a reform programme, with the aim of making their economies more competitive internationally.

However, one concern is the impact of the EPAs on government revenues. Revenues from tariffs still amount to 2% of GDP in the median SSA country, reaching 4-6% of GDP in some cases (Hinkle et. al., 2003). For the countries most dependent on trade with the EU, such as the Central African Republic or Uganda, the loss of tariff revenue on imports could be a significant percentage of total government revenue, as high as 20%.

The EU has promised financial support for industrial restructuring and to compensate for lost tariff revenues. However, the EU may not be able to meet all its commitments in this area, given its overstretched budget as a result of EU enlargement. There are also concerns that financial help could come with new conditionalities.

Sources: Guggenbuhl and Theelen, 2001; Morrisey et al., 2003

Conclusions

Good progress, but continuing risks...

ERA 2004 stresses the progress that Africa has made in the last few years. After the disappointing economic performance of the 1980s and 1990s, there has been a return to positive rates of per capita economic growth across most of the continent. However, growth is still well below the annual average of 7% needed to attain the MDGs. Moreover, the economic recovery is fragile and in some parts of Africa has been overly dependent on favourable climate, something that cannot be counted on with certainty in the future. In addition, political instability and military conflict threaten the achievements of recent years.

Africa must focus on becoming more competitive...

In order to build on improved economic performance Africa must save and invest more, enhance its human capital, and achieve more dynamic export performance. *ERA 2004* tries to signpost the way towards a more competitive African economy. Greater efforts by African policy makers are needed to promote export capacity and diversification. This requires reconsideration of the way in which Africa has up until now attempted to achieve integration into the world economy. Although this is implicit in such initiatives as NEPAD, it is something that needs to be spelt out more explicitly in the future.

New initiatives are needed to help the continent diversify its exports...

Successful export diversification is dependent upon action by African governments themselves. But for most African countries the resource requirements for diversification are beyond what could possibly be mobilized at the domestic level. The United Nations Conference on Trade and Development (UNCTAD) has stressed the need to work out a financing mechanism at the international level to help these countries develop a system of supply rationalization and to diversify into other products. According to it, this may provide a rationale for a “diversification fund” for African countries (UNCTAD, 2003b).

And trade liberalization must be more equitable...

Helping African exporters through the removal of trade impediments by industrialized countries is essential. At the same time, the continent must focus on enhancing its ability to compete. African countries must be allowed to make use of special and differential treatments in order to build supply-side capacities. Over the long term, if the multilateral system does not produce the desired results, there is a possibility of a backlash against trade liberalization and the multilateral institutions. This should be avoided by ensuring now that the multilateral trading system is equitable.

Notes

¹ More than \$12 billion of total aid (including most technical and emergency assistance) to developing countries is tied (or partially tied) to exports from the supplying country, which reduces its value to the recipient country by 25-40%. For a discussion on tied aid and its relationship with trade flows in an African context, see Lloyd et al., 2000. For a discussion on how tied food aid can negatively impact on aggregate welfare, see Osakwe, 1998.

² Policy changes envisaged in the “little” scenario are tariff reductions (agricultural goods by 36%, all other goods by 20%); reduction in export subsidies by 20%; reduction in domestic support by 20%; and trade facilitation by 1%. The “modest” scenario envisages tariff reduction of all goods by 50%; reduction of exports subsidies by 50%, and trade

facilitation by 1.5%. The “full” scenario encompasses 100% reduction in tariff, export subsidies, and domestic support, and trade facilitation by 3%.

³ The classic reference to the importance of trade in development strategies has become Sachs and Warner, 1995.

⁴ The case of Togo also stands out as a country which has apparently achieved a higher level of manufactured exports than the norm for Africa. However, this high figure is principally the result of transshipment, rather than the diversification of the economic structure towards manufacturing.

⁵ See the recent study by Barrett et al., 2004. A good example of this kind of model is the Maharashtra Employment Guarantee Scheme, in India, which provides a minimum basic wage for rural workers during periods of economic hardship, and is financed by a consumption tax on urban areas.

⁶ For a discussion on this, see Ford (2002) and Globalization Challenge Initiative (2002). On more than one occasion, the World Bank has questioned deals reached between multinationals and African governments. Such was the case of Enron’s \$800 million deal with the Nigerian Government. The World Bank and other foreign consultants were widely reported to have objected to the terms of the agreement, saying that in haste to solve the electricity supply problem the Nigerian Government had offered terms that were excessively favourable to Enron (Economist Intelligence Unit, 2000).

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