Trade Policy Development in a Coherent Macroeconomic Framework

Xavier Carim
Chief Director: Multilateral Trade – Department of Trade and Industry

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1. Introduction

The overriding objectives of the Nepad[1] programme are economic growth and sustainable development. If it is accepted that trade contributes positively to these objectives, the next question that arises is how to improve African countries' export performance.

The ability to improve export performance requires a broader discussion of trade, industrial and agricultural policies, and in particular how to enhance African economies' supply capacity and competitiveness by increasing production and investment. To understand the determinants of investment, it is vital that the appropriate regulatory environment and reform programme, along with a macroeconomic framework and policy, are determined. In this light, trade policy must be understood as only one element of a wider development strategy to promote sustainable economic development.

The key foci of trade policy are to advance the reform and restructuring of the economy, to enhance economic competitiveness, and to increase the capacity of firms to compete in an increasingly integrated world economy, thereby creating sustainable economic growth and employment opportunities.

Sustainable trade policy reform requires a political and institutional framework to ensure that key constituencies and stakeholders – bearing the burden of adjustment – actively participate in the evolution of economic policy so there is ownership around its vision and objective. As the outcome of adjustments invariably produces winners and losers, a sustainable development strategy must include measures that provide for safety nets and the ability to re-skill labour appropriately to shift into sectors of the economy that are growing. In this sense, trade policy reform is a political process that needs to be managed carefully.

Such a complex set of factors requires appropriate expertise, training and institutional development. At the same time, it is important to that we take into account changed and changing global economic dynamics, such as globalisation, liberalisation and regionalism that underlie growing competitive pressures in the world economy and the changed basis for competing in the global market.

[1] New Partnership for Africa's Development

This paper focuses mainly on globalisation's economic policy dimensions to identify:

i) The key features of globalisation; and
ii) Some aspects of a strategic policy response for development in the globalising world economy.

2. Features of Globalisation

Deepening interdependence

The most significant development of the last two and a half decades has been the massive global extension and deepening of markets to encompass previously excluded regions and nations. The global integration of production – largely through the activities of transnational corporations (TNCs) – and the increasing integration of markets for goods, finance, investment, services and technology are forging a truly global economy. Intensifying economic linkages are underpinned by both national economic policies that are more open and outward-oriented, and rapid advances in global communication and transport. These processes are binding national economic destinies ever more closely.

The lifting of various trade barriers has resulted in a twelve-fold increase in global trade since 1945, to over US$4-trillion by 2000. By 2000, worldwide FDI[2] flows reached $1.3-trillion, an increase of $1-trillion since 1995. Between the mid-1970s and 1996, the daily turnover in world foreign exchange markets increased from around $1-billion to $1.2-trillion. These changes have increased the impact of global markets on national economies, with profound implications for the financial stability of economies, the location of investment, and the dynamic competitiveness of manufacturing. The speed of transactions demands that countries and firms respond rapidly to be competitive.

Further, the basis for competitiveness has changed. Countries can no longer sustain global competitiveness on the basis of traditional comparative advantages in cheap labour or primary exports. The ability to compete increasingly turns on technological and innovation capacity. Industrial countries, where most innovation takes place, therefore retain a strategic advantage that is consolidated by more stringent levels of multilateral protection over intellectual property rights.

Overall growth in the global economy masks a complex balance sheet of winners and losers. There is growing evidence that many countries are being marginalised from the increased flows of investment, finance, technology and trade. This is leading to growing inequality and poverty among, and within, economies. The challenge is particularly acute for least developed countries (LDCs) and countries in sub-Saharan Africa (SSA). LDCs' share of world trade has shrunk by 50% from the mid-70s to 0.3%. Since the 1970s, LDCs have suffered a cumulative decline of 50% in their terms of trade. For developing countries as a whole, the losses from declining trade amount to almost $300bn.

Most developing countries have been bypassed by finance, with 90% of global FDI flowing to North America, Europe, Japan, China, Mexico and Brazil. At the same time, developing countries pay interest rates that are up to four times higher than industrialised countries because of inferior credit ratings and expectations of national currency depreciation. The loss

[2] Foreign Direct Investment

to developing countries from unequal access to trade and finance is estimated at $500bn a year, 10 times the amount they receive in aid.

A particularly worrying feature is recurrent financial instability and its contagion effects, which constitute the single most important obstacle to growth. Modern financial markets are organised less to create wealth and employment than to extract rent by buying and selling second-hand assets. The 'discipline' these markets exert on policymakers reinforces the advantages of existing wealthholders. Each financial crisis arrives with greater force and inflicts greater damage on the real economy, with the contagion effects particularly being felt in emerging economies.

A significant feature of the current era has been a narrowing and shifting of government discretion over public policy. Structural adjustment programmes under the International Monetary Fund (IMF) and World Bank, and firmer multilateral rules in the World Trade Organisation (WTO) combine to set priorities and define the parameters of government intervention in social, industrial, investment and technology policy. In these terms, the investment decisions of TNCs may, for example, be inconsistent with government objectives.

3. Strategic Responses for Development

National

Notwithstanding a <u>relative</u> loss of sovereignty over policymaking, governments – within certain parameters – retain considerable scope to intervene in the national economy to mediate the impact of the global economy and to promote development. A key issue is the appropriate role of the state in a profoundly changed global environment. A simple retreat by the state, leaving development to market forces, is an inadequate response to globalisation. Governments around the world play important roles in promoting the competitiveness of their economies.

However the policies pursued must take into account an increasingly integrated global economy, and the controls imposed by global markets and global rules. Financial markets inflict harsh discipline on countries perceived to be pursuing unfavourable monetary, fiscal or trade policies. The reaction of international markets is to impose a higher risk assessment, leading to financial outflows and denial of access to new finance on which developing countries are highly dependent.

In this light a coherent macroeconomic policy becomes vital to pre-empt the potentially destabilising effect of global financial markets, to improve investor confidence, and to sustain the trade reform process. Price stability through controlled inflation rates, an appropriately valued and stable exchange rate, fiscal discipline, managed deficit spending and consistent predictable monetary policy is necessary (although not sufficient) for investment.

Policy interventions need to recognise and respond to the changing basis for international competitiveness. Policy should be geared to encouraging the development of competitive markets under a clear set of consistent, predictable and transparent rules. These rules should be designed to ensure competition, innovation and entry into markets, that markets function effectively, and are not dominated by the powerful to the detriment of the weak. These rules will encompass provisions designed to secure broader public-interest objectives. Policy should also be designed to address market failures through the provision of key capacities that are not provided by the operation of the market alone.

At the core of the economic strategy is industrial policy, which aims to shift the dependence on raw material exports to increasingly higher value-added manufacturing exports. The reduction

of tariffs to reduce cost structures and enhance competitiveness may be accompanied by market-led, supply-side support measures to promote industrial restructuring; technology upgrading; investment and export promotion; and small, medium and micro-enterprise development.

The industrial policy may have a sectoral focus aimed at encouraging the exports of – and attracting investment and technology to – sectors that will drive industrial development. The strategy should also integrate backward and forward linkages with production. Of particular importance is the development and enhancement of existing capacity in knowledge-driven activities.

Regional

A key feature of the current global environment is the proliferation of regional trading arrangements (RTAs). RTAs can contribute significantly to the economic growth and development of participating economies. Such arrangements provide a platform for enhancing regional production and efficiency, as well as the capacity of regional firms to compete in the global economy.

Despite attempts at forging its own regional integration programmes, Africa's performance in this regard has lagged. Only around 9% of Africa's total trade is bound for the continent (*according to 1999 figures*). So regional integration remains a largely untested instrument for Africa's economic recovery and development. The lack of effective regional arrangements perpetuates a situation where Africa exports its commodities to the North in exchange for higher value-added manufactured imports. Being locked into this pattern results in declining relative per-capita income for Africa.

It is vital to consolidate continental trading arrangements in Africa in the light of recent initiatives to establish Free Trade Agreements (FTAs) with African countries and regions. (The African Growth and Opportunity Act, or AGOA, may be transformed into fully-fledged FTAs and trade arrangements similar to the Cotonou Agreement). Without an effective response, African producers and exporters will increasingly find themselves at a disadvantage in continental markets compared to European and American competitors.

Addressing this danger also requires taking lessons from the past to overcome the key impediments for regional trade growth in Africa. Regional economic integration is beneficial when trade creation outweighs trade diversion. Trade diversion may foster inefficiencies, misallocation of resources, decline in imports, and expansion of domestic production at relatively high costs, resulting in a reduction in real income and welfare in the region over the short term. However the reduction in income and welfare can be offset if longer-term dynamic influences of regional production, consumption and investment are realised. Overall increases in intra-regional trade may encourage regional production and place members of the regional arrangement on a higher growth path.

Experience in Africa suggests that intra-regional trade receives an initial boost following the launch of the arrangement which continues for several years, then reaches a peak and either stabilises or decline. There appears to be no internal sustained momentum towards trade growth. The reasons behind this experience need careful analysis, particularly as to why a peak is reached in intra-group trade growth.

Although regional integration can overcome constraints imposed by small individual markets, we need to understand and work towards reducing the highly dispersed trade regimes of

individual African countries. The complexities and degrees of protection of the trade regimes among individual African economies constrain the formation of integrated regional markets.

Linked to this is the question of whether tariffs should be lowered from bound or applied rates, and/or what formula should be used. Liberalisation from applied rates appears more effective in boosting intra-African trade. On product coverage, the exceptions lists should be limited and time-bound; that is, they should be integrated gradually into the regional programme. Governments also need to anticipate measures to be put in place to offset budget deficits and fiscal revenue shortfalls resulting from tariff reductions.

Developing services trade should become of major importance in intra-African trade, as the opportunities are vast. Regional co-operation in trade remedy legislation (such as anti-dumping, countervailing duties and safeguards) should also be evaluated. Low growth rates, low per-capita income and insufficient product diversification reduce the trade complementarities and inhibit regional trade growth.

While trade can be a catalyst, the key to resolving the problem is to increase investment, particularly in export diversification activities. Because it provides a larger market, regional arrangements can encourage inward investment. The link between trade liberalisation and investment must be strongly emphasised in intra-African economic integration processes. Investment has often been treated as a residual activity to increase production and improve competitiveness. Experience in Africa shows that despite trade liberalisation, investment – domestic and foreign – has not followed to take advantage of the regional market. The link between the development of trade and the promotion of investment to take advantage of the liberalised regional economy must therefore be clearly articulated and practically promoted.

High transaction costs for trade among countries on the continent, as compared to trade between African countries and traditional Northern markets, are also an impediment to regional trade growth. This suggests the need to complement regional integration efforts with programmes to enhance trade facilitation. Implementation is key to the intra-Africa trade liberalisation programmes – many programmes have been adopted but implementation has been weak or has lagged for various reasons. These reasons should be identified and measures and actions taken to counter them.

A key question for African economies concerns the nature of the regional arrangements and how they are to be constructed to take into account varying levels of development. It is necessary to address the respective participation of more and least advanced members of the grouping. Experience suggests that the integration of more and less dynamic economies could offer important prospects for trade and investment growth. Serving as the engine of growth for smaller economies, larger economies also benefit from increased trade flows and investment into the regional market and returns from such investment.

At the same time, however, the capacity of smaller countries to access the liberalised markets of larger economies and benefit from investment must be developed in terms of expanding production and competitiveness. If this is not addressed, economic imbalances between small and big economies will manifest acutely in trade imbalances, destabilising the integration process. Development support to small countries is therefore imperative and in the interest of the bigger economies, which will gain economically dynamic partners for trade and investment.

It is necessary to approach these questions practically and to develop flexible mechanisms that will advance the regional integration objectives. Relationships may be structured asymmetrically to accommodate the diversity and sensitivities of African economies. In this

regard, the notion of variable-speed geometry is useful. In the discussion, all parties should be involved so that their respective interests are taken into account even if not all parties are making commitments. This ensures that when such parties are in a position to adhere to the arrangements, they are already considered – and see themselves as – part owners of the programme.

The following alternatives and/or combinations of alternatives that embody the above-mentioned principles could be applied for the exchange of regional preferences:

- Extension of bilateral preferences with agreement that recipients reciprocate after a given transitional period;
- Individual country accessions to existing regional arrangements;
- Pursuing bilateral preferential/free trade agreements among key countries;
- Reciprocal exchanges of preferences on a trade bloc-to-bloc basis;
- An all-Africa free trade area, as envisaged in the Abuja treaty and carried over into the African Union.

Such arrangements should be complemented by programmes that aim to reduce the highly dispersed trade regimes among countries, enhance trade facilitation and develop regional investment platforms. In addition, regional cross-border investment in infrastructure such as road, rail, ports, energy and telecommunications could significantly reduce input costs, enhance competitiveness and facilitate exports. Private-sector investment could be leveraged through public-private partnerships (PPPs).

4. The Challenge of Global Rule-Making

In forging a strategic response to globalisation, it is important to address the challenge of global rule-making. Appropriately constructed multilateral rules that are coherent, inclusive and non-discriminatory can enhance access to markets, finance and technology for developing countries. However structural imbalances in the global economy, measured in trade, finance, investment and technology flows, are perpetuated and reinforced by inequities and deficiencies in the systemic 'rules of the game'. Such imbalances are a reflection of an uneven distribution of political and economic power across the globe. The weak institutional and human capacity in many developing countries undermines their ability to participate in establishing rules. And in some cases, a lack of transparency in rule- and decision-making in the most important international institutions exacerbates such countries' marginalisation. The implication is clear: it is imperative to review and reform multilateral governance structures to ensure greater equity.

In addition, development must be understood not as an adjunct to the main business of the world economy, nor as a matter for developing countries alone. Development lies at the heart of the future prosperity and stability of the world economy and society; indeed, of the future of globalisation. The key is to participate actively in shaping the evolution of rules in a manner that sustainably supports development.

Multilateral trade rules exhibit a range of imbalances and deficiencies that prejudice the trade and development interests of developing countries. Developing countries, accounting for three-quarters of the world's population, receive only a quarter to a third of income gains resulting from the Uruguay Round (UR). Goods from industrial countries enjoy greater tariff reductions in the UR compared to those from developing countries (45% compared to 25%). While developing countries face tariffs 10% higher than the global average, LDCs face tariffs 30%

higher. For both groups, tariffs remain high on goods that have the greatest potential for increasing production, exports and development in developing countries.

Tariff escalation in industrialised countries (higher tariffs by degree of processing) locks developing countries into volatile, primary-commodity production in which the terms of trade are in decline. Non-tariff barriers, including increasingly stringent standards, and trade remedies (anti-dumping and countervailing measures), are applied to the exports of developing countries. Further, massive subsidies for agriculture in the developed world stifle the development potential of developing countries.

Multilateral negotiations launched at Doha opened up the possibility of ensuring that issues of development are addressed in a decisive manner. Strategically, the key to sustained global economic growth lies in unlocking the growth and development potential of developing countries. To achieve this, developing countries must pursue industrialisation by processing their natural resources where they possess a comparative advantage. However realising the full potential of these advantages has been frustrated by protectionist interests in the North under various national policy regimes and by multilaterally negotiated disciplines in the WTO.

Therefore, the strategic objective in the new negotiations is for developed countries to undergo far-reaching structural adjustment in their economies. This requires reducing a range of protective and supportive measures to inefficient 'grandfather' industries and sectors to allow a relocation of production and investment to developing countries that possess comparative advantages in these areas. Such structural adjustment would boost investment, production and trade in developing countries, promote industrialisation and development, enhance North-South and South-South trade, and provide an impetus to renewed global economic growth.

5. Summary

Globalisation involves deeper integration of national markets with quantum growth in trade, investment and financial flows on a world-wide scale. While greater openness provides new opportunities for growth and development, the impact of these processes on national economies are not necessarily benign. National economies must confront greater competitive pressures, risks of financial instability, and polarising forces towards marginalisation. At the same time, government policy discretion has, in several ways, narrowed.

Nevertheless, the state's role in the economy and in promoting development remains vital. In a developmental situation such as that confronting South Africa (SA), the state will play a leading role. The elements of its response include the need for an industrial strategy, located within a stable macroeconomic framework that requires a range of fiscal and financial reforms. The industrial strategy should be supported by an international and regional economic strategy, and complemented by a socio-economic empowerment strategy to counter the powerful tendencies toward inequality, uneven development and marginalisation that characterise the globalisation process. Such a response is only effective within the context of a democratic state.

Together with other members of the international community, SA has reasserted the need to forge an integrated understanding of the constituent elements of sustainable development to form an appropriate response to the challenges posed by globalisation. Integrative programmes of action aimed at strengthening synergies among actors in their various locations are a prerequisite to address the related challenges of poverty eradication and sustainable development effectively. This requires that multilateral and national policies be aligned

through broad consultative processes that bring together, in an increasingly coherent manner, the relevant institutions, governments and civil society.

A strengthened multilateralism appears as the only practical response to managing globalisation and interdependence. The nature, complexity and inter-connectedness of the challenges confronting the international community again confirm the validity of the original tenets of multilateralism, particularly the principle that development is a shared global responsibility. This requires enhanced coherence in global governance to reform and strengthen global rules for sustainable development.

Acronyms

AGOA	African Growth and Opportunity Act
FTA	Free Trade Agreement
IMF	International Monetary Fund
LDC	Least Developed Country
PPP	Public-Private Partnership
RTA	Regional Trading Arrangements
SA	South Africa
SSA	Sub-Saharan Africa
TNC	Transnational Corporation
UR	Uruguay Round
WTO	World Trade Organisation