OBSERVATORI DE LA GLOBALITZACIÓ

(Parc Científic de Barcelona – Universitat de Barcelona)

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COMERÇ I DESENVOLUPAMENT:
LA PERSPECTIVA D'UN PAÍS MOLT POBRE

Per: Sheila Page (*Overseas Development Institute of London - ODI*)

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Les *Notes Informatives* de l'Observatori de la Globalització tenen com a objectiu oferir un seguiment continuat dels principals instruments internacionals que emmarquen el procés de globalització de l'economia. Es publicaran en diferents "Sèries" amb una numeració pròpia per a cadascuna.

L'Observatori de la Globalització reuneix especialistes que no necessàriament comparteixen el mateix enfocament metodològic i polític. Les opinions expressades en les diferents *Notes* reflecteixen únicament el punt de vista del seu autor. Les Notes es publicaran en versió original, en català, castellà, francès o anglès. Amb l'excepció de totes les *Notes* relatives a Mercosur, que seran publicades en castellà.

Totes les activitats de l'Observatori de la Globalització són finançades amb càrrec al conveni de col·laboració subscrit entre el Departament d'Economia, Finances i Planificació de la Generalitat de Catalunya i la Universitat de Barcelona, sense perjudici de l'existència d'altres fonts de finançament.

1. INTRODUCTION

The 4th of October of 2001, the **Observatory of Globalisation** invited **Sheila Page**, senior researcher of the **Overseas Development Institute of London** (ODI) and president of the **European Association of Development Research and Training Institutes** (EADI) to introduce the Association and to give a lecture on "**Trade and development: The perspective of a very poor country**".

The event was held at the "Aula Master" of the Faculty of Law, University of Barcelona.

This is the briefing of her lecture.

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The central problem in analysing the effects of trade on development is that we do not really understand what it is that promotes development.

I shall look at different analyses of the relationship between trade and development, identifying variants, which show an interesting progression: from policy-based, to market-based, to various combinations, to a renewed interest in policies, but now no longer very targeted industrial or sectoral policies, but rather the general 'governance' of a country (and potentially of the international system). But without knowing what is missing in countries which have not developed, it is difficult to know whether trade can provide 'it', whatever 'it' is, and how it should do so.

Reducing dependence on commodities has proved to be not merely the best, but the only successful strategy for countries which have developed rapidly in the last 50 years, while the still-commodity-dependent countries are among the most slow growing, and remain concentrated among the least developed. Diversification has involved a set of general economic measures including high saving and investment, public investment in infrastructure and in education, and in some cases specific trade promotion. An essential element is finding the capital to invest to establish new types of production and trade. As external assistance is unlikely to be sufficient, and is now often targeted at income and social goals, not productive capacity and sustainable development, this requires using income from existing exports, either directly (the exporters themselves diversifying into new products) or indirectly (taxation and then assistance to different entrepreneurs). Where there are extra non-economic profits, for example from quotas, such transfers to new activities are particularly appropriate. But the countries which have not done this are in many cases those where the formula is difficult to apply.

2. MALAWI'S TRADE

Malawi's principal sources of external revenue are oda and exports of goods, at about the same level; exports of services are very low. Malawi is much more dependent on aid to finance its trade even than the average for other African or other least developed countries. Tourism, a major earner for other countries in the region, is only 1% of export revenue, and declining. Its imports are typically 30-50% greater than its exports, so that a policy operating on them would, arithmetically, have a larger impact on the economy.

The concentration of its exports remains among the highest in the world, so that although it shows relatively good performance by value, it is very vulnerable to price movements by a single commodity, tobacco. About 60% of exports are tobacco, and tobacco, tea and sugar make up three quarters of the total. Malawi is an important supplier of tobacco in world terms, about 4% of total world exports, but this is still only half the share of Zimbabwe, for example. An important difference is that for Zimbabwe and the other major suppliers of tobacco it is a much smaller share in their total exports (about a quarter for Zimbabwe, substantially less for the others). This high dependence on a single commodity, without being the major supplier, is not unique for a least developed country in Africa (coffee in Uganda, copper in Zambia), but it is a very vulnerable position, particularly when the commodity is one subject to health concerns. It would make it difficult to use that export as a basis for expanding exports or for financing investment.

The costs of trading, both exporting and importing, are increased by the natural conditions of Malawi: landlocked, with limited transport routes to all external markets and a complex and highly intermediated system of transport; by inadequate physical infrastructure: in Malawi and in the neighbours on whose transport it depends; and by inadequate institutional arrangements at the borders. One trader estimated that the total cost of taxes, transport, and other additional costs added 80% to the original cost of imports, and a study of transport costs found that they accounted for up to 28% of the retail price, for maize. This is in line with estimates which have been made for Uganda, with similar constraints, that non-tariff costs effectively double those from tariffs. The result is that the price responsiveness of both exports and imports will be attenuated (a 10% change in the price of the good will be only about 6-7% to the final supplier). This means that market responses will be relatively weak, unless there are countervailing characteristics of suppliers or policies by the government.

In both goods and services, the policies are principally permissive, with general protection for domestic providers, and no special promotion for exports. This suggests a trade policy more directed towards imports than exports, and, in combination with the high non-tariff barriers to trade, gives a bias against trade, compared to other countries.

3. ANALYSING THE EFFECTS FROM TRADE

In the last 50 years: trade policy has been liberalised; trade has grown; output has grown. But many other policies have changed; attitudes to policy and to intervention in economies have changed; technology has changed; the non-trade, non-economic contacts among countries have changed. It is not difficult to find simple correlations among all these variables, but before attempting to identifying causation, it is necessary to analyse what type of effects could be explained by generally accepted economic relationships. Without this, it is difficult to distinguish directions of causation (expansion in output may lead to expansion in output of tradable goods and therefore in trade) or to discard correlations which merely reflect variables which have both moved because of an omitted variable, for which trade or some measure of **openness** may be acting as a proxy.

Econometric techniques can supplement theory in identifying relationships, and can draw attention to potential relationships, but they should not be used without theory. Cross-country and time series analysis have different advantages for this, and both are used.

What are the direct effects from trade which may affect development?. It can improve the allocation of domestic resources, increase the efficiency with which these are used, bring new technology, bring knowledge of markets and marketing techniques, increase stability of income, and increase investment.

The first effect, **allocation efficiency,** is that trade raises a country's potential income (or welfare) by permitting it to change the composition of its output to a more efficient structure, that is, permitting it to specialise according to comparative advantage. A country which is producing efficiently in a closed economy can move to a higher level in the open (or at least less closed) situation, although there is no change in the macroeconomic balance. The increase is only potential, however, not inevitable. If it is not producing efficiently at the initial stage, then whatever prevents it from doing so may also prevent it from benefiting, in full or indeed at all, from the new opportunity. If the problem in the initial situation is unemployment of some resource, for example labour, which cannot be transferred from one type of production to another, and opening to trade allows the country instead to export more of that good, importing the alternative, then the gain from trade may be even greater than the static efficiency gain. But if the failure arises from more structural reasons: lack of sufficient incentive in the market to improve efficiency (see below), deliberate (or unintentional) distortion of prices because of other policies, or lack of information or infrastructure linkages which permit efficient transmission of price and demand information to producers, as in Malawi, this may prevent any response to trade. Under this effect, therefore, trade may raise total income by more than or by less than the **allocation effect**; it will not lower it, although it may have no effect; the direct effect is one-off.

The allocation effect may not work, because it depends on the response to impulses and assumes that sectors and firms are operating efficiently in their own terms within the closed economy. It is this efficiency which allows them then to respond efficiently to the new signals, and obtain the allocative gains. If they cannot respond efficiently to market incentives, they will not be able to respond to the new trade environment.

The **X-efficiency effect** of trade appears if what is holding output below potential output before trade is opened is lack of suf-

ficient stimulus to adopt new methods or technologies because of lack of competition and if trade provides that stimulus. How does competition work? If losses are weighted more heavily than (equal) gains, the incentive from the risk of losing profits (to competitors) is greater than that from potentially gaining more. (This can be contradicted by the equally prevalent view that encouraging policies works better than punishment; does the cold north wind or the mild south wind make you remove your coat?)

Two reasons can impede the effect from competition. If market prices do not reach producers: if the infrastructure makes mobility among sectors or regions difficult or failures in credit markets impede investment, then the country is at its current potential output. To raise this, it requires appropriate investment in physical and perhaps social infrastructure. If the response to stimuli seems weak, it is difficult to know whether economic or policy changes can tackle it: does it need appropriate education, or training, or stronger stimuli? Or necessary infrastructure? The lack of understanding of this is reflected in old concepts like 'take off' or new ones like openness or readiness.

As well as stimulating its application, trading is one way of obtaining **access to technology,** and to familiarity with world markets; through observing traded goods, through the stimulus to efficiency (increasing the application of, not the access to technology), or even simply through greater contact between economies. Through **technology**, trade can raise income, and, in a relatively technology-poor country, this can be a continuing stimulus.

Stability has attracted attention for developing countries since the analysis of the effects of commodity price fluctuations. Concern has been intensified by the apparent increase in the frequency and intensity of financial crises. Although the steps in the argument that stability improves income or growth are uncertain theoretically and empirically, if there is an effect, then any impact from trade to stability becomes important. Liberalising increases the number of potential shocks that could affect an economy, but a large number itself ensures some offsetting effects, including on the shocks that come from within the economy (trade plus capital movements allow 'transfer' of production from one year to another). If, however, a country has become more specialised because of trade, and if trade is a high share of total output, the whole economy may be more concentrated and therefore more exposed to specific risks. Trade may increase or reduce instability, and we still do not know which would help or harm growth. Malawi's dependence on a single export to very limited markets makes trade more likely to concentrate shocks than to spread them.

Any increase in income may stimulate increased **investment**, so that all these initially 'one-off' effects can have second round effects, and if a country is very closed and pursues a policy of continuous opening, then the observed growth rate will increase, although it could be decomposed into the same trend plus a series of shocks. Therefore under any of these effects if they do increase income, trade may lead to a continuing higher growth over an adjustment period.

Protection by developed trading partners is now concentrated on labour- or labour- and land- intensive sectors (clothing, other light manufactures, agriculture), so that the reductions in these distortions may improve the advantage of labour intensive sectors in developing countries.

4.- HYPOTHESES ABOUT TRADE AND DEVELOPMENT

Trade was first considered a central element in a country's development path in the 1950s and 1960s; at the same time, planning was becoming the 'normal' way of development. Both these owed their new significance partly to the experience of the developed countries in the 1930s and then in World War II: the breakdown of the trading system in the 1930s and the further disruption by war had had a serious effect on many of them, and the need to mobilise all national resources in the war had underlined the importance and demonstrated the feasibility of planning. All the countries at war had used active government intervention to direct production sectors to maximise performance during the war. There was also the tradition of public works from the depression of the 1930s.

For the developing countries, development was seen as a stage, in which there would be rapid transition to a more stable state of growth, and therefore a stage where different policies from those suitable for equilibrium countries were likely to be appropriate. There were no examples of countries that were still clearly 'developing', but competing against 'industrial countries' in some industries. Analysts and policy makers thus saw a discontinuity, but also a potentially successful strategy: a planned economy.

4a) Import substitution

Much of the literature on the role of trade in the 1960s, which followed the observation of the success of countries which industrialised and increased their income (and growth rates) by means of increasing internal consumption and production, attributed this to import substituting trade policy. Empirical observation, and the history of primary product consumption within countries, had suggested that demand for their primary exports would grow less rapidly than average demand in the developed countries, and much less rapidly than their objectives for their own growth. Therefore, it seemed that the only path open to them was to continue to specialise in primary products for export, but concentrate on increasing production of other goods for home consumption. Because of the constraint from the expected limited growth in demand for their exports, they would have to substitute an increasing proportion of their imports with home production to avoid having foreign exchange as a constraint on their growth. In terms of trade policy, as export promotion was (by assumption) not likely to be successful, this meant a concentration on policies to control imports, not only their quantity but their composition, to concentrate limited resour-ces on the goods least replaceable by local production. Following the policy precedents of the 1940s, they would do this by active intervention on trade and production. The objective was that the country would be 'developed' in the sense of at a comparable income to the North American and European countries, but even that did not then imply the high degree of trade dependence seen now.

The closed economy model assumed that the allocation and efficiency effects were either unobtainable because of structural defects in the economy (which had to be corrected before any trade effects could be achieved) or that there were alternative ways of changing the way resources were allocated among sectors. Countries had to plan and restructure their own economies, with trade

necessary to provide certain inputs. Therefore exports were necessary to permit these imports, but they had no special advantages in themselves. But if we go back to Malawi, with too small an economy to develop on the basis of national demand, and little hope of extracting an investible surplus form its exports, this strategy offers no answer.

4b) Export-led growth

The export led model went to the opposite extreme: trade in itself would bring development: all the potential effects listed here would happen automatically if trade flowed.

The literature of the 1980s and early 1990s observed the success of the Asian NICs, and attributed the association between high and rapidly growing exports and rapid growth of manufacturing and total output to a policy of 'export-led growth'. What are the steps in this argument? Three possible cases where exports can be exceptionally useful to development have been considered: that there is unemployed capacity, X-inefficiency, or a technology gap. The step from this to advocating exports as the best strategy is to assume that, for each of these, exports are the only solution: to providing demand, to stimulating efficiency, or to acquiring technology, rather than one possible means, to be considered along with others.

The importance of the experience of the NICs was that they showed that it was not necessary for a country to develop an integrated national industry before competing with developed countries in manufactures. It was possible to specialise in exports of one or a few manufactured goods, and therefore secure a better export market prospect than from primary goods. There seemed to be an alternative strategy, and a very successful one. Their exports grew substantially faster than those of the industrial countries; while this seemed 'normal' by the 1980s, it had not been true before the early 1970s (and started to cease to be true again in the 1990s).

This interpretation of the trade led model was thus that the principal effect of trade on the economy was not in the conventional economic forms (higher demand, changes in composition), but partly in the extended economic (technology transfer), and more in the changes in the way in which economic decision-makers responded to incentives. For Malawi, handicapped by high trading costs, achieving competitiveness in exports would be difficult.

Later analysis emphasised that in most cases the successful exporters had first had a period of import substitution. There remains disagreement about whether this is because they were mistaken, and then found the better solution, or because the import substituting period was necessary as a preparation. This, however, extended the interpretation, by suggesting that it is necessary to develop the efficiency of firms through appropriate stimuli, in other words, through the use of incentives which fall outside economic analysis, whether government or market stimuli. For the sequence analysis, the argument was that it was necessary to start in a market that was 'easier': the home market offered less competition and was familiar. When a company was ready and when the country needed more complex integration into the world economy, the protection could be removed, and the opposite incentive, the threat from competition, would be effective.

But there are unspoken assumptions in the theory. The economic size of a country will influence the length of time an import substitution strategy may be viable; for some small countries this may be a negligible period, while large ones can have a

long period. A small country, like Malawi, may need to move to exporting before its efficiency or responsiveness is 'ready', and therefore may be unlikely to succeed without special measures to help exports.

If there is a sequence of correct policies, which must be followed, and if some policies require specific conditions, whether of size of country, good national characteristics, or good luck in external circumstances, it becomes questionable whether there are general rules about the role of trade in development, or whether the particular characteristics of the country or the nature of the external environment are the dominant influences.

Although these trade-based views of the policies which have been followed are common, an alternative view of the successful countries, both Latin American and Asian, is that they followed policies with national objectives, in particular of **industrialisation**, and that they used the **trade instruments** as one element, but not the only one, in this. The effects of trade on development are therefore of interest in analysing their success, but not necessarily central to all countries at all times.

Development and industrialisation had been regarded as synonymous for the present industrial countries (the most common term for what are now called 'developed' until at least the 1980s). Industrialisation had traditionally been argued to have the effects of improving efficiency and technology that are attributed to trade in the analysis above. The process requires a shift in production, and therefore productivity gains through reallocation of resources and specialisation. Industry produces high-income elasticity goods. If industry may have these effects, it has the same claim to be an instrument of development as exports.

Even the more sophisticated trade-based interpretation suggested that some identifiable minimum level of policy was necessary: efficient investment, labour mobility, training. And in addition to the traditional list, there has been increasing emphasis on 'good macroeconomic policy' and 'good governance'. These do not have formal definitions, so their correlation with improved output growth or development is (at least) as difficult to test as that of 'openness'. They seem to have emerged not, like the analysis of export-led growth from observing success and looking for its explanation, but from observing failure (in particular, the debt crises). This origin also makes them more difficult to test as conditions for success. And these policies require resources, so for a poor country like Malawi they require external commitment as well as 'good' national policy.

At the same time as this changed interpretation of the role of national policies emphasised the need for a broad range of good policies, rather than the role of individual policies, understanding of international economic policy was increasingly recognising that the role of organisations like the WTO and other international institutions was at least as much to provide regulatory certainty as to 'liberalise'. This led to an emphasis, at the national level as well, on the need for strong institutions as a tool for development.

5. CONCLUSION

If a country is at its productive potential, and has the means to stay there, and if it has followed advice on its non-trade policies and received assistance to remove distortions and improve the transmission of effects, or to put in place the institutions which will achieve this, and if it either has a comparative advantage in what it considers the 'right' products or does not take a view on the appropriate pattern of development, then the traditional recommendations of trade policy come into play and trade will have only its traditional, limited development effects.

It is perhaps puzzling that there has been such strong emphasis on trade in the analysis of development, whether as an obstacle or as an advantage. In particular, for each successive 'constraint' on development which has been identified (market demand, investment, technology, efficiency, finance) trade has been identified as the best or only means of supplying it to developing countries. Theory confirms that it is one way of supplying each of these (with the possible exception of **X efficiency** where economics has little to say), but not, for any of them, that it is the only way. If, however, there is a preference not to use government intervention (whether because of political choice or because of concern about the competence of the government sector in developing countries), then the only available exogenous agent may seem to be the external sector, so it may seem necessary either to assume that trade can provide whatever is needed to develop or to conclude that we do not know how to stimulate development. As one of the oldest and best developed branches of economics, international economics has been well placed to find possible development roles for trade. In contrast, analysis of the formulation of government policy is principally outside economics, so that it is not as well understood (and the bias may be against relying on it). But in practice, the exogenous agent in some successful countries in the past has been either the government or the emergence of a new type of private sector, so the external sector is not the only possible agent. But this implies that prescribing a guaranteed path for development to a country like Malawi where the external sector seems likely to have at best a weak role becomes very uncertain.

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Adreça: Edifici Florensa, c/ Adolf Florensa, 8
08028 Barcelona
E-mail: obsglob@pcb.ub.es
Http://www.ub.es/obsglob