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**Promoting and Sustaining Trade and Exchange Reform in Africa
An Analytical Framework**

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1. Introduction

Sub-Saharan Africa includes several of the world's fastest growing economies (Botswana, Equatorial Guinea, Lesotho, Mauritius, Mozambique, and Uganda) but many more where per capita income is not only low but also stagnant or falling (16 countries had lower per capita real income in 1994 than in 1960¹). Although war, disease, and drought have delayed economic progress in some areas, a large part of the blame lies with the economic policy decisions of governments in the region. Underlying every SSA success story are policies that foster integration into regional and global markets; most stagnating or shrinking economies are insulated by highly restrictive trade and exchange rate regimes or have a history of policy reversals that undermines the credibility of reforms. Increased openness is not an end in itself, however, and a few countries (Mali, the Gambia) have undertaken significant trade reforms without enjoying much improvement in growth.² Yet there is strong evidence in SSA and worldwide that an open economy is at least an important concomitant of sustained growth and development if not an immediate cause.³

This paper documents the extent of recent progress among SSA economies toward integration with international markets. Our purpose is to identify significant economic and political obstacles to sustaining trade liberalization as well as ways successful liberalizers in SSA and other developing regions have been able to overcome these obstacles. The focus of our analysis is on trade reform as an ongoing process, including the packaging of reform measures, their timing and sequencing, and the political-economy issues central to the viability of reforms in progress. In failed SSA reforms, we see a characteristic pattern in which exchange-rate and trade-policy reforms are set into motion, only to be undercut by real appreciation or even reversed outright. This pattern in turn damages the credibility of

¹ Rodrik (1998).

² While Rodrik (1998) attributes the slow growth in these liberalizing countries to "extremely poor human and physical resources," he also notes that Mali's economy did revive as soon as the CFA franc was devalued in 1994. As discussed below, changes in trade policy alone may have little effect without accompanying reforms in the foreign-exchange regime.

³ Harrison (1996) summarizes and evaluates several major econometric studies linking openness and growth.

any subsequent reforms. How can this cycle of failure be overcome? In addition to a range of policy choices at the national level, we look at the potential role of regional trade initiatives and aid conditionality in promoting the region's move to openness.

An underlying question is whether SSA leaders are simply reluctant reformers, looking for ways to meet aid conditions yet avoid real change, or whether, despite real commitment to change on the part of leaders, adverse political and economic conditions combine to sabotage their best efforts. In Asia and Latin America, ODA has supported market-oriented reforms and helped countries weather the difficulties of adjusting to a new policy regime. In Africa, however, the evidence for this kind of supportive role is so far less compelling. Indeed, the record in a number of countries shows decades of financial inflows with little or no net improvement in economic performance. This raises the possibility that, rather than facilitating reform (economic or political), funds may in some cases have allowed recipient countries to postpone needed change and even helped to maintain the viability of corrupt leaders in the interest of preserving political stability in a volatile region. The case of Mobutu Sese Seko in Zaire, while perhaps the most notorious example, is unfortunately not an anomaly in the context of SSA.

2. Trade and Exchange Reform: The Context

Over a period in which the key role of international trade in promoting economic growth and development has become increasingly manifest, SSA's share of global exports has fallen dramatically, shrinking from 3.8 percent in 1970 to 1.5 percent in 1995 (Table xx).⁴ In part this decline simply reflects the low GDP growth rates of most SSA countries relative to the average worldwide; SSA's share in world GDP fell from 1.6 percent in 1970 to 1.4 percent in 1995. Given the region's slower

⁴ Although they provide a convenient summary, regional averages can be misleading because of the disparate sizes of SSA economies. South Africa alone accounts for nearly half of total GDP in SSA but less than 10 percent of its population; South Africa plus Nigeria together account for about 60 per cent of the region's total income. Nigeria is also the most

overall growth, even maintained or increased openness could be consistent with some shrinkage in SSA's share of global exports. However, the degree of openness was not maintained, let alone increased. Of 33 SSA countries for which comparable data are available, 20 showed an actual drop even in real trade as a share of GDP between the early 1980s and the early 1990s (World Bank 1997b, Table 6.1).

Nor can the collapse of SSA trade be attributed to increased protection in the OECD market countries. Rather, the most important factor has been the countries' own policies, which have reduced domestic producers' ability to compete internationally and discouraged diversification out of traditional commodity exports (Yeats et al. 1997). The key factors retarding SSA exports are restrictive trade and exchange-rate regimes, together with slow growth of physical infrastructure to facilitate trade. The latter is especially important for the 14 landlocked countries in the region. Econometric studies (e.g. Sachs and Warner 1996) find that landlocked status has a statistically significant depressing effect on trade and growth—suggesting the importance of physical investments and institutional arrangements to overcome this disadvantage.

Moreover, while aid donors have increasingly linked grants and loans to policy reforms intended to promote openness, the marginalization of Africa in world trade has not been reversed even for some countries that have been relatively successful in meeting policy conditions imposed by donors. Zambia, cited as a successful liberalizer in Sharer et al. (1998) for achieving the trade policy reforms set forth in its agreements with the IMF and World Bank for the period 1990-1996, nonetheless had lower ratios of both exports to GDP and imports to GDP in 1995 than in 1980 (World Bank 1997b, Table 4.12). On the export side, this unfavorable trend reflects a major drop in the world price of Zambia's major export good, copper. Over the period from 1990 to 1995, export *volume* grew at an impressive annual rate of almost 27 percent, while export *value* grew by only 2 per cent per year

populous SSA country, with nearly 20 percent of the region's population. Ethiopia, in 1996 the world's second poorest country (after Mozambique), accounts for nearly 10 percent of SSA population.

(World Bank 1997b, Table 4.7). On the import side, however, volume actually shrank over the same period, so that price trends do not explain the reduced import penetration. Rather, the drop in imports may reflect compromises made in achieving the conflicting goals (and IMF conditions) of tariff reduction and revenue enhancement. The case of Zambia also illustrates another problem typical of SSA economies. Many depend on one or two primary commodities for the lion's share of foreign-exchange earnings, so that price swings in global markets are a major cause of fluctuations in prices, incomes, and government revenues. (Table xx--showing percent of foreign-exchange earnings accounted for by a single commodity for various countries).

Documenting progress toward liberalization in Sub-Saharan Africa

In an effort to cope with the world's highest debt burdens and to reverse unfavorable growth trends--and in response to strong encouragement from the World Bank, IMF, and bilateral aid agencies--many SSA countries agreed to undertake economic reforms that almost always included liberalization of trade and exchange-rate regimes. However, implementation of these reform programs has been halting, and policy reversals common. The outcome for SSA is a patchwork of experience: some countries have made important advances; others have advanced for a period, then regressed; still others have simply continued to regress.

To evaluate progress toward openness in the countries of SSA, an important first step is to consider the menu of policy changes potentially included under the general heading of trade liberalization. In the early 1980s, most SSA countries were insulated from world markets by relatively high tariffs, licensing requirements and a wealth of other nontariff barriers, as well as highly restrictive exchange-control regimes in the non-CFA countries. These multiple layers of distortion were not usually cumulative, however, in their effects on trade flows. Rather, the binding constraint on trade of non-CFA countries was typically quantitative restrictions or exchange controls. The region's high tariff rates were often redundant as a barrier to imports, although important as a source of government revenue (Nash 1993). Exports were likewise constrained by overlapping and often redundant policies including overvalued exchange rates, sub-market prices paid to suppliers, export bans or licensing, and required repatriation of foreign-exchange proceeds at the official rate.

This pattern of multiple and partially redundant trade disincentives has several important implications for the analysis of trade liberalization in SSA. First, the analysis cannot usefully concentrate on tariffs alone, nor even on tariffs and quantitative trade restrictions. Rather, the definition of liberalization must encompass exchange-rate policy and marketing arrangements as well as the narrower range of policies directly affecting trade. Second, tariff reductions in the absence of progress on exchange reform and elimination of quantitative restrictions would tend to worsen the country's budgetary problems without achieving a compensating boost to allocative efficiency (as discussed below, IMF advice has stressed a first stage of tariffication of nontariff measures, viewed as a revenue-enhancing step toward greater policy transparency). Third, seemingly gradual programs of policy reform may be associated with a pattern of little or no actual adjustment for some period, followed by a sharp drop in domestic industries' insulation from world market forces as the final redundant layer of protection is dismantled (Nash 1993). In this case, gradualism intended to reduce adjustment costs or ease political acceptance of reforms could be counterproductive. Finally, the intent of donor conditionality spelled out in terms of any subset of policy measures may be successfully evaded by substitution of other policies. This problem is hardly unique to Africa, but it is perhaps more significant there to the extent that the role of external pressure in shaping policy change is more important, either because of weaker domestic support for reforms or because of the relatively larger scale of ODA in the region.

Based on successful liberalization episodes in Asia and especially Latin America, analysts would be likely to characterize trade reform in terms of substantial across-the-board tariff cuts. However, tariffs are a major source of revenue in SSA, accounting for up to half of total revenue in some countries (see Table xx). It is not surprising, therefore, that average tariff rates have fallen relatively little in SSA, in comparison to the dramatic reductions achieved in a number of Latin American and East Asian countries. Yet Mauritius, despite an especially high dependence on trade taxes, has been one of SSA's most successful liberalizers.⁵

⁵ Current IMF advice counsels early introduction of a value-added tax (VAT) to offset revenue losses from tariff reductions (Sharer et al. 1998). In Mauritius, quantitative import restrictions were replaced by tariff equivalents in 1984-85, but progress toward rationalizing the complex tariff structure and reducing average rates was delayed until 1994, when a VAT was introduced.

Liberalization episodes in other developing regions have rarely involved increases in average tariff rates or even concertina-type increases in the lowest rates (Michaely, Papageorgiou, and Choksi 1991). In SSA, however, the importance of tariffs in generating government revenue and the large ex ante role of quantitative restrictions together imply that cuts in average tariffs would be neither necessary nor sufficient to signal reduced trade distortion. Moreover, in the presence of the pervasive exchange controls characteristic of SSA countries outside the CFA zone, even large across-the-board tariff cuts might in any case have had little or no effect on actual trade flows unless accompanied by liberalization of the exchange regime.

A further issue is that outward-oriented reforms in a number of Asian and Latin American countries have focused on creating new incentives for *exporting*, and especially for nontraditional export products and markets. Moreover, it has been far from unusual for a country to maintain import-substitution policies in some industries while offering export incentives in others, or even to tax traditional exports while promoting nontraditional exports. Most SSA countries have likewise implemented this approach, but with far less evidence of success in achieving the goal of export expansion and diversification. Mauritius, which developed an export-processing zone long before reducing protection of its import-competing industries, is a notable exception.

Export-enhancing policies successful in East Asia included keeping the real exchange rate at a level consistent with profitable exporting and allowing exporters relatively free access to imported inputs at world prices and without administrative delays (Thomas, Nash et al. 1991). In contrast, SSA currencies were notably overvalued until reforms in the mid- to late 1980s for non-CFA countries and the January 1994 devaluation of the CFA franc. Moreover, pressure toward real appreciation has continued to be a problem for many SSA countries (see Table xx). The use of tariff exemptions on imports to encourage export activity has been severely limited in SSA by fiscal problems, administrative delays, and corruption. Because of their poor track record of implementation, fiscal incentives lack credibility and thus have little if any impact on the behavior of potential exporters--including potential direct investors. Perhaps because tariff exemptions have proved to be ineffective in promoting SSA exports, IMF advisors have emphasized their elimination to maintain needed revenue while cutting tariff rates (Sharer et al. 1998).

Recent reform programs in SSA have been designed with multiple linked objectives, including macroeconomic stabilization (reducing domestic fiscal deficit and inflation), correcting domestic market distortions, and promoting openness to trade and inward direct investment. Because so many policy variables potentially affect a country's trade, even the direction of the net change in openness or outward-orientation can be less than obvious. The classic NBER study of trade reform in developing countries classifies as liberalization any policy change that reduces the traditional anti-export bias of a country's trade regime (Bhagwati 1978, Krueger 1978). By the Bhagwati-Krueger criterion, the explicitly targeted export incentives often used in East Asia qualify as liberalization.

Baldwin (1989) distinguishes between *incidence-based* measures of policies affecting trade, such as average tariff rates, and *outcome-based* measures, usually the relative size of trade flows. Because many factors apart from policies toward trade affect openness as measured by the relative importance of trade, outcome-based measures are useful in evaluating change in the openness of a single country rather than in making comparisons across countries. Moreover, a country may reduce its tariffs, thus appearing to liberalize according to one standard incidence-based measure, yet maintain import licensing arrangements or exchange controls that in effect nullify the reduced import barriers. In this case, an outcome measure such as the ratio of trade to gross domestic product (GDP) will show little progress. For most SSA countries, outcome measures may be the only practical means of evaluating changes in policy regimes in a timely manner. While most countries publish aggregate trade data on a reasonably current basis, meaningful incidence-based measures are unavailable or available only with a very long lag.

Malcolm: I'm not sure how much of this next bit is relevant, given the kinds of data we can expect to find. Cut and/or revise some or all as you see appropriate.

Pritchett (1996) proposes three concepts of trade liberalization or outward orientation. *Neutrality* refers to a reduced bias in favor of production of import-substitutes, *liberality* to a lower

degree of market intervention, and *openness* to an increase in trade intensity.⁶ Comparing alternative summary measures of outward orientation from the recent empirical literature on growth and openness, Pritchett shows the indicators to be almost completely unrelated in cross-country data for less-developed countries. This finding suggests that openness has several dimensions; countries making the best progress according to one measure will not necessarily look as good in terms of another.

Whereas broad reductions in tariffs and nontariff barriers qualify under all three of Pritchett's concepts, some export-promotion efforts in East Asia have improved neutrality and openness while increasing rather than reducing the extent of market intervention. As elsewhere, the move toward outward orientation in SSA has been far from synonymous with *laissez faire*. Although some SSA countries have liberalized trade and foreign-exchange restrictions while at the same time pursuing other market-oriented reforms, nowhere in SSA has trade reform been imbedded in an all-encompassing movement toward free-market policies such as that in Chile. However, tables [to be supplied—showing fx premium, extent of qr's, average tariff rates, range of tariff rates—if we have this stuff—there are tables for 13 SSA countries for mid-1980s and early 1990s in Dean et al. ; UNCTAD 1994 has tariffs and qrs for a different set of countries, but in most cases no values past 1990; individual country reports may give us better data for a small group of countries] suggest progress according to all three types of indicators for some countries.

Tables 1 and 2 display several indicators of import policy reform in SSA countries for which detailed information is available on a comparable basis. Table 1 shows both weighted⁷ mean tariff rates and weighted mean total import charges, the latter including a range of "paratariffs" that further

⁶ Broad reductions in import barriers, e.g., across-the-board tariff cuts, generally improve both neutrality and liberality. However, application of additional interventions may, for second-best reasons, improve neutrality while reducing liberality. Improvements in either neutrality or liberality may in turn raise openness as measured by trade flows. But standard openness measures such as exports as a share of GDP are also affected by changes in relative prices.

⁷ In UNCTAD data, sectoral rates are weighted by product shares in *world* trade. Compared to the usual practice of weighting by shares in the country's own imports, this procedure avoids a downward bias in the weight given to sectors with unusually high protection, i.e., ones more protected in a given country than the global average for the industry. However, there is still a downward bias for sectors highly protected on average, such as textiles and apparel.

raise the cost of imports. Between the mid-1980s and the early 1990s, mean tariff rates...(from tables).. Mean total charges⁸....

Table 2 shows that average minimum and average maximum tariff rates.... Because the inefficiency associated with protection comes in part from "chaotic" incentives (Bhagwati 1978), tariff reform is most beneficial when it is associated with a reduction in the dispersion of rates as well as in their average height. IMF and World Bank advisors have stressed the goals of reducing the number of tariff bands, reducing high tariffs while raising especially low ones, eliminating tariff exemptions, and substituting equivalent tariffs for nontariff distortions—the last three serving also as ways to maintain government revenue. In trade policy reviews of five SACU members, the World Trade Organization (WTO) Secretariat points out that SACU's external tariff, determined by South Africa, is both complex and subject to frequent changes. WTO officials judge that a simpler and more stable tariff structure would help SACU members attract more foreign investment (WTO 1998).

A flat tariff schedule such as Chile's gives most domestic production a uniform advantage over competing imports; a flat schedule implies that effective protection rates are the same as nominal rates. A formal commitment to maintaining a flat schedule should also reduce incentives for lobbying by producers seeking higher-than-average protection for their outputs or lower-than-average protection for their imported inputs. Where detailed rates are available, dispersion can be measured by the standard deviation. A cruder measure of deviation from a flat schedule is the ratio of the average maximum tariff rate to the average minimum rate. The higher the ratio, the greater is the possibility that effective protection rates have been maintained or even increased despite reductions in both averages. Table 2 shows that the ratio fell in The final ratios of average maximum to average minimum tariff rates range from⁹

⁸ Although cuts in tariffs are often regarded as an essential element in trade liberalization, less than half of the liberalization episodes in a major World Bank study included tariff reduction; in contrast, reduction in the severity of quantitative restrictions was almost always included (Michaely, Papageorgiou, and Choksi 1991).

⁹ In principle unification of tariff schedules can be accomplished by raising some especially low tariffs. However, actual tariff unifications in Latin America and East Asia have been achieved almost exclusively through tariff reductions (Michaely, Papageorgiou, and Choksi 1991).

In addition to direct restrictions on trade flows, the foreign-exchange regime is an important dimension of outward orientation broadly conceived. Devaluation of an overvalued currency fits the Bhagwati-Krueger definition of trade liberalization since it reduces the bias against exports across the board. Similarly, the composite binary measure of openness adopted by Sachs and Warner (1995a) classifies a country as closed if it meets even one of several criteria of significant insulation from global market forces, including a large differential between the official and black-market exchange rates (as well as the extent of policies directly limiting trade). In the Sachs-Warner scheme, removal of trade barriers alone is insufficient to qualify as opening if the real exchange rate remains so overvalued as to prevent development of export activities along lines of comparative advantage. Other analysts focus on changes in trade policies only and treat exchange-rate policy separately if at all.¹⁰

Of the 13 SSA countries studied by Dean, Desai, and Riedel (1994), four were CFA zone members with currencies already considered overvalued in 1985, the start of the study period. Moreover, these four countries experienced further real appreciation until the devaluation of the CFA franc by 50 percent¹¹ in January 1994. Of the nine non-CFA countries in the study, all but South Africa had double-digit or triple-digit black market premiums from 1980 until the reform year in the period 1986-89, reflecting highly distorted regimes. These eight all implemented varying degrees of exchange reforms, in some cases eliminating multiple exchange rates and abolishing most exchange controls; all had sharply reduced premiums in the post-reform period. Moreover, the countries with the highest black-market premiums prior to reform achieved the largest reductions in their premiums. In Ghana, with the largest average premium (984.6 percent) in the period prior to reform, the premium dropped to an average of 16.5 percent in the post-reform period through 1992. For the region as a whole, the average black-market premium fell from xx per cent in 1989 to xx per cent in the mid-

¹⁰ As in the NBER project, the binary Sachs-Warner openness measure relies on subjective evaluation of information from diverse sources. The IMF measures overall trade restrictiveness on a scale of 1 to 10 based on average tariff rates and incidence of NTBs, the latter given greater weight on grounds that NTBs are "inherently less transparent and more distortionary" (Sharer et al. 1998, 33). Other researchers attempting to establish statistical links between trade and growth have used a variety of statistical measures of openness. Harrison (1996) surveys recent contributions. Outcome measures based on export or import volume or on divergence between domestic and foreign prices implicitly consider effects of both trade and exchange-rate policies.

¹¹ For Comoros, the devaluation was 25 percent.

1990s (ref—Pick's?). Table xx (to be constructed) shows that the black-market premium fell, often dramatically, for all (?) countries for which 1995 data were available.

Exchange controls are almost always associated with maintenance of an overvalued official exchange rate, although the black-market premium is likely to overstate the extent of overvaluation. Liberalization of the exchange regime is therefore typically accompanied by a nominal devaluation of the currency. But while adoption of a more liberal exchange regime increases allocative efficiency in international transactions and reduces losses from rent-seeking, it does not ensure that an exchange rate consistent with purchasing power parity will be maintained over time. A market-based exchange rate will reflect capital- as well as current-account transactions. In some East Asian and Latin American countries, private capital inflows have produced a tendency to real appreciation and an accompanying tendency toward current-account deficit. In SSA, the large size of aid flows also tends to promote real appreciation, or at least to reduce downward pressure via market forces.

For World Bank-supported reform programs in the 1970s and 1980s, Michaely, Papageorgiou, and Choksi (1991) note that devaluation was a universal element in stabilization packages and a "common—sometimes crucial—instrument of trade liberalizations," even those not associated with stabilization programs." Among the nine non-CFA countries studied by Dean et al. (1994), six experienced a decline in the real exchange rate in conjunction with trade policy reforms, with further falls through 1992 [add table about this?]. Real devaluation should have helped to shift domestic production in favor of tradable goods, thus promoting export growth. But as these countries succeeded in implementing and sustaining market-oriented policy reforms, inflows of private capital and/or official development assistance may have contributed to real appreciation and thus slower export growth. Table xx shows that real effective exchange rates appreciated between 1990 and 1995 for

Table xx compares several outcome indicators of openness for xx SSA economies. Of the xx countries, xx experienced faster growth of export volume from 1990 to 1995 than in the preceding decade. Export growth slowed.... However, the share of exports in GDP rose in only xx of the xx countries, declining modestly for xx and dramatically for xx. The seeming paradox of a fall in export share over a period in which the average growth of exports is greater than that of GDP reflects differences in the two types of measures. The export share in GDP is calculated using current price

data, while growth rates are calculated using constant prices and thus measure changes in volume rather than value. Relative prices of most agricultural and mineral raw materials declined sharply between 1980 and the mid-1990s. With primary commodities accounting for up to xx percent of their exports, SSA countries experienced a large deterioration in its terms of trade over the period (as mentioned above for Zambia).

Because the ultimate goal of policy reform is to accelerate economic growth, the most important outcome measure is the rate of growth. Of course, many types of policy change as well as significant external shocks contributed to overall economic performance in SSA. Perhaps the most important domestic policy influence has been macroeconomic stabilization, including improvement in fiscal balance. Even within the category of efficiency-enhancing structural reforms, trade liberalization is only one of a broad spectrum of market-oriented policies implemented since the mid-1980s. However, the data confirm that the sustained trade reforms in some countries (Mauritius, Botswana, Uganda, Ghana) have at least been consistent with superior overall growth rates. xx of the yy SSA countries experienced higher average annual GDP growth in the period after 1990. For the region as a whole, the weighted average of the annual growth rates was 2.1 percent from 1991 to 1996, compared to 1.7 percent for the previous decade (World Bank 1997a, 1998). But higher economic growth in the 1990s has not translated into reduced unemployment even for some of the region's most successful countries, e.g., Botswana, where unemployment in 1998 is estimated at around 20 percent of the labor force (IMF 1998b). The region's average unemployment rate in the mid-1990s was in fact higher ??? than in the 1980s, reflecting sharply higher unemployment in ...(data if we can find some).

Table 5 (it's really there—but may be expanded to include membership in regional groups) dates the initiation of trade reforms in SSA countries as determined in several recent studies using alternative criteria. The table also indicates the influence of IMF and World Bank programs. A motivating role of World Bank conditionality is cited by Michaely, Papageorgiou, and Choksi (1991) for Thomas, Nash et al. (1991) cite external financing between 1979 and 1987 from the World Bank and the IMF as "intended to facilitate trade policy change" in 19 of 37 SSA countries. However, from the late 1980s onward, virtually all SSA reformers [any exceptions?] have benefited from after-the-fact external technical and financial support from the World Bank and IMF. By early 1996 xx

countries had joined the WTO (yy were already GATT members in 1994). By the mid-1990s, xx had also entered into at least one regional trade arrangement (see Table xx).

3. Liberalization as a Sequential Process

Why have some nations in SSA been able to achieve and sustain an open economy while others--often guided by the same received wisdom and even the same advice from foreign experts dispatched by the same agencies--failed to do so? And why has SSA as a whole lagged behind other developing regions in moving toward integration with international markets? The answer lies in the complex interplay of economics and politics that is central to the process of liberalization. Policies are inherently endogenous, shaped by underlying political as well as economic forces. The economic results of implementing each new policy alter the political balance within a country, thus strengthening or weakening the position of reformers.

To consider the underpinnings of successful and sustained trade reform, it is helpful to divide the process of liberalization into four sequential components: (1) the design of a policy package; (2) its acceptance and endorsement by top policy makers and later by the public; (3) its implementation in specific policy measures and their administration; and (4) the economy's response to changed incentives. The last component in turn influences the degree of support from the policy community and the public and thus the perceived need for modification of the package, completing the political-economic cycle. Correspondingly, a reform package may fail for several reasons. First, the policies themselves may be poorly conceived or inappropriate to the country's economic or political circumstances. Second, the package, though well designed and appropriate, may nonetheless fail to gain the support of a country's political leadership. Third, even an exemplary package that enjoys the support of top policy officials may be aborted if the relevant legislative and administrative bodies are unwilling to implement it. Finally, elements in the economic environment may prevent markets from responding appropriately to the changed incentives.

The record of SSA shows some progression over these stages. Until the 1980s, widespread doubt still remained concerning the best policies to follow; proposals for development through import substitution continued to enjoy wide support among SSA economists as well as policy makers. To

many, the domestic dislocations from the first oil shock, followed by steep declines in many primary export prices in the late 1970s, vividly demonstrated potential dangers of full integration into international markets. By the late 1970s the intellectual case for open markets was ascendant in multilateral agencies, but many SSA policy makers remained unconvinced. Further oil-price increases, together with the debt crisis that began in 1982, added further fuel to the fire. These external shocks increased policy makers' distrust of openness and foreign advice, but at the same time increased the leverage of multilateral agencies as the share of aid to GNP soared from a regional weighted average of 3.4 per cent in 1980 to 16.3 percent in 1994, about 5 times the figure for low and middle-income countries worldwide (World Bank 1997a).

By the late 1980s, some trade reforms once initiated began to stay in place in the subset of countries that had managed to achieve macroeconomic stability, including reduced fiscal deficits and an appropriately valued exchange rate (the last condition ruled out the CFA-franc group, where currencies remained overvalued until January 1994). But in the majority of non-CFA countries, policy makers reversed progress toward openness by restoring trade taxes to higher levels and devising new nontariff barriers, or undermined trade-policy reforms by allowing real appreciation and wage increases to undercut the competitiveness of fledgling export industries.

Getting reform started

In SSA, the fundamental ideas for reform have typically been imported. Reform programs are usually assembled and put forward by foreign experts or, more recently, by a new generation of domestic policy makers trained in Western Europe or the United States.¹² But to have a reasonable chance of being implemented, a reform initiative requires support from *some* of a country's top policy makers, what has come to be called "ownership." Williamson and Haggard (1994), summarizing views of several development experts, cite the need for visionary leadership and a "sense of history." In SSA, President Yoweri Museveni, who spearheaded Uganda's recent transformation from economic

¹² A feature peculiar to SSA and a few other less-developed countries (e.g., Cuba) is the role in the 1970s and 1980s of the USSR and China in providing policy advice and training abroad of future government officials. The result was a maintained voice for central planning and dirigiste policies long after their star had faded on other continents.

basket case to show case, is such a leader. In other SSA countries, however, the customary negotiations between national representatives and IMF teams have been inadequate to overcome the widespread perception in program countries that funding conditions and thus reform programs themselves are essentially imposed from outside, with even top officials having little or no effective control over the outcome (IMF 1998a).

Empirically, crisis conditions sometimes provide the spur needed for major reforms by destroying political support for current policies. In 1986, the failure of Nigeria's strict import and foreign-exchange licensing regimes to prevent a foreign-exchange crisis helped to undermine the rationale for these policies and weaken the coalition supporting them, in turn paving the way for wide-ranging reforms (Thomas, Nash et al. 1991). Rodrik (1994) argues that crisis conditions push distributional issues into the background and thus allow trade reforms to go forward. Yet even with per capita income falling, leaders often seem to view reform more in terms of the minimum quid pro quo for obtaining financial assistance rather than as an end in itself (possible reasons are discussed below).

Moreover, actions taken in response to a crisis do not necessarily represent a move toward greater openness. On the contrary, many developing countries worldwide rolled back fledgling trade reforms in response to the oil shocks of the early 1970s and again during the debt crisis of the early 1980s. Likewise, fiscal problems are most often cited in negotiations with the IMF as the justification for maintaining current trade barriers, and worsening budgetary problems as the justification for delaying or rolling back reforms (Sharer et al. 1998). In other cases, liberalizers have managed to initiate reforms without waiting for a full-blown crisis to materialize under old policies (Mauritius, Botswana, ???).

In addition to leadership, successful reform requires adequate support from legislators and/or administrators to ensure its effective implementation. To create the desired changes in economic behavior, the vision of a leader must first be translated into practical policies. However, even reform-minded SSA governments may lack the necessary technical expertise to implement new policies. While help is readily available from aid agencies in the OECD countries and from multilateral organizations such as the World Bank and IMF, the region's reliance on outside policy advice exacts a

significant price. The key role played by foreign experts often alienates local officials and erodes their sense of ownership of the new policies. Moreover, critics of reform usually take advantage of any prominent foreign role to marshal domestic support for their opposition. The persistent appeal of dirigiste economic programs in SSA stems partly from their rejection of neoclassical policy advice from foreign experts, and especially from the IMF. Moreover, the latter's traditional role in dealing with financial crises has contributed to the widespread perception in the developing world that IMF advice is the cause of economic woes rather than the solution to them.

A different type of problem related to policy implementation arises because the administrative burden of a laissez-faire approach is much lighter than that of a dirigiste economic regime. Much of the resistance to market-oriented reforms may come from government officials whose jobs, salaries, prestige, and often opportunities for graft are endangered, as well as from their opposite numbers in the private sector who have learned how to operate profitably under existing policies. Opposition to reform is thus likely to extend far beyond firms and workers in protected import-competing sectors. Indeed, the IMF's standard advice favoring tariffication of nontariff trade measures is sure to face an uphill battle politically. Pure tariffication eliminates rents formerly captured by those charged with administering NTMs (usually a group of powerful officials) and those accustomed to dealing with them. In the short run there may be no obvious winners from tariffication because one type of barrier has been substituted for another.¹³

Maintaining broad popular support

Support at the top is necessary but not always sufficient for political sustainability.¹⁴ However, the importance of broad political support depends, especially in the short term, on the form of

¹³ Tariffs are a more transparent form of protection than NTMs and are less likely to protect the domestic market power of import-competing producers. Moreover, tariffs entail less administrative discretion and thus less likelihood of rent-seeking activities that add to the cost of protection. In principle, tariffication is a first step in import liberalization, to be followed by staged reductions in tariff rates. However, revenue-constrained SSA countries often postpone these subsequent or reverse these reductions. As noted above, Mauritius replaced NTMs by tariffs in 1984-85, but progress on rationalizing tariff structure and reducing average rates was not undertaken until a decade later, after enactment of a VAT.

¹⁴ An external evaluation of the IMF's Enhanced Structural Adjustment Facility suggested that "ways should be found to better anchor these programs in national consensus and ownership as a way of ensuring the sustainability of these programs" (IMF 1998).

government. An authoritarian regime may be able to force the population to accept austere policies or to shape public opinion through control over the media. Some development specialists have even raised the controversial notion that early introduction of democratic institutions may doom the prospects for needed economic reforms.¹⁵ Indeed, authoritarian governments launched many of the successful reform efforts in both Latin America and East Asia, and in most cases these reforms have not been reversed by subsequent democratic regimes.¹⁶ In SSA, Uganda's model reforms have been carried out by a benevolent despot who came to power in 1986 through a coup. But any new government, whether authoritarian or democratic, may enjoy a kind of honeymoon period during which leaders benefit from greater freedom of maneuver as well as the luxury of blaming unsatisfactory economic conditions on the previous regime (Senegal in 1984, Nigeria in 1985-6, Uganda in 1986, Zaire/Congo in 1997—alas, an opportunity promptly squandered). Of course, sometimes the new leader is merely carrying out earlier promises regarding direction of policy change.

The need to maintain broad political support is one explanation for the popularity of reciprocal liberalization in general and of RTAs in particular. The public and even many policy makers take a largely mercantilist view of trade reforms, finding it easy to grasp the benefits from increased exports (typically seen as expanded sales and employment) and accordingly difficult to see the benefits from increased imports. In a reciprocal agreement, the increased imports can be justified as the price for increased exports. But, given this prevalent misunderstanding of the fundamental nature of gains from trade, belief in the benefits of unilateral liberalization requires a major leap of faith.

Factors associated with policy reversals

Many factors have either directly held up policy reform or undermined its effects. Circumstances that have been associated with policy reversals in SSA include (but are not limited to):

external shocks, especially commodity price collapse

¹⁵ For example, Senegal's stalled economic reform in the 1980s is commonly linked to political pluralism in one of the region's most democratic regimes (Ka and van de Walle 1994). Yet Mauritius, SSA's best example of successful export-led development, is also a pluralistic democracy governed by a coalition of parties.

over-expansion during booms

slower than expected debt relief

resistance by central banks in relinquishing exchange controls

delays in unwinding state-run trading monopolies

need for revenue holding up tariff reform

imposition of new non-tariff restrictions such as quality standards for imports

deterioration of physical infrastructure, especially that related to transport

exchange rate appreciation due to donor aid flows

activism by ministries of commerce to “promote industrialization”

unwillingness of government officials to eliminate special entitlements for the military

inability to control or reduce smuggling

inability to reduce unit labor costs so as to improve productivity

rising protectionism in developed countries (real or potential)

difficulties in penetrating regional markets

incoherence of donor conditions, so that government operates at cross purposes.

As these concomitants of policy reversal suggest, reversals arise for a wide variety of reasons that may be technical, bureaucratic, institutional, and often personal (to the leaders). However, the factors listed above can be viewed in terms of broad categories corresponding to the four sequential elements in the liberalization process: (1) defects of policy design, (2) lack of political support, (3) defects of implementation, (4) environmental problems that undermine policy effectiveness.

With respect to policy design, SSA countries have moved along the same trajectory as other developing regions, focusing their post-independence efforts first on import-substituting industrialization and only since the mid-1980s on market-oriented reforms and export promotion. One

¹⁶ If individual voters are unsure whether they will be winners or losers from liberalization, majority voting may reject even a trade reform that benefits the median voter (Rodrik 1996). Myopia and risk aversion exacerbate the problem of

implication is that reforming countries must contend with a legacy of highly protected, high-cost manufacturing, often including public enterprises. Likewise, the older top-down planning tradition put into place development finance agencies, export market boards, and other government-operated or government-sanctioned intermediaries that substituted for private market transactions between residents and foreign suppliers or buyers. In both cases, existing institutions provide profitable opportunities for those involved, and any reform effort must overcome the resistance of entrenched special interests. Reform plans are also restricted in scope because of concerns about fiscal or balance-of-payments considerations (Sharer et al. 1998). These concerns are sometimes no more than plausible excuses for maintaining a comfortable status quo, but they may also reflect a policy design that is too narrow to achieve its goals. In general, sustained reform requires a broader approach that includes privatization, fiscal measures such as implementation of a value-added tax, and a shift to a market-guided exchange regime, not merely reductions on direct barriers to trade.

In their efforts to chart appropriate policies, SSA leaders are hampered on one hand by lack of "in house" expertise within their own agencies (some countries have only a handful of trained professional economists) and on the other by conditions originating with the large number of donor organizations and international agencies actively engaged in the region. Most important among the latter are the IMF and World Bank; only recently have these major players begun to emphasize the need for an explicitly cooperative role in helping to shape policy (IMF 1998a). Indeed, protracted negotiations over policies and conditions further strain SSA's limited supply of skilled policy makers and administrators.

An additional problem in policy design and implementation is the lack of timely and reliable data on policy and performance. Because economic collapse and regional conflict in SSA have contributed to the degeneration of key data-gathering institutions such as central banks and budget offices, decisions regarding reform must often be taken before adequate data become available.

McPherson (1995) comments that Zambia's external debt was not fully documented until two years after the initiation of reforms. The situation is even more difficult in the area of trade policy because industry-level detail is essential for policy formation. Yet while UNCTAD (1994) provides detailed information on tariffs and nontariff barriers by sector through the early 1990s for many Asian and Latin American countries, the corresponding data for SSA countries are usually available only through the late 1980s or even the mid-1980s. In an assessment of trade reform under IMF and World Bank supported programs from 1990 to 1996, IMF analysts were restricted in their choice of case-study countries by availability of data needed to document the extent of reforms (Sharer et al. 1998). This is especially notable because progress toward trade liberalization goals was among the conditions of almost all of the programs.

However, even the best plan, i.e., one that reflects state-of-the-art analysis and reliable data, can still fail at the level of implementation. Such failures may reflect absence of adequate enforcement (e.g., inability or unwillingness to control smuggling) or backsliding through substitution of new barriers for ones that have been reduced (e.g., higher excise taxes or increased quality standards in place of import tariffs that have been cut). Another key problem is failure to implement or enforce complementary reforms, such as development of new revenue sources to replace tariffs, failure to remove exchange controls, delays in ending subsidies to high-cost import-competing manufactures, and postponements in the phaseout of state-run trading monopolies and privatization of public utilities. Moreover, officials looking for easier ways to meet the plan's overall budgetary goals may reduce social spending instead of enforcing more politically difficult cuts in industrial subsidies or civil service wages (IMF 1998a). This may shift the burden of adjustment primarily to those already disadvantaged by their lack of economic and political power.

A final set of barriers to sustained reform are those arising in the external environment, although in some cases these may reflect flawed plans, especially plans that are too narrow in their scope or based on unrealistic expectations. Such external influences include domestic shocks (war,

drought) as well as unfavorable changes in terms of trade and interest rates, delays in anticipated debt relief or other ODA, and increased trade barriers or recession in potential export markets. However, the most pervasive factor beyond the direct control of government officials and international agencies is lack of market response to new incentives, typically reflecting lack of confidence among businesses, consumers, and potential foreign investors.

Reform-minded governments face a classic "prisoner's dilemma." In light of past policy reversals, local and foreign businesses are hesitant to act immediately when the government announces and enacts specific reforms. They prefer to wait and see whether the government will maintain the reforms. However, perceiving little or no response from the private sector, government officials begin to believe they must step in to achieve the objectives of policy, such as increased manufacturing investment. To the extent that government officials overeager for immediate results backtrack or modify the reforms, the business sector's skepticism regarding government promises is reinforced. There is no effective way out of this downward spiral of adverse expectations without the government maintaining its commitment. This is especially difficult when key government officials (central bank exchange controllers, ministry of commerce regulators) are themselves not entirely convinced that liberalization and reform is the most effective route to industrial development and growth--and perhaps also have a financial interest in restoring controls on economic activity. But even the prospects of economies lead by committed reformers (e.g., Musaveni in Uganda) may be viewed with some skepticism in a region where abrupt changes of government and breakdown of rule of law have represented the norm.

4. Breaking the Cycle: Sustaining Trade and Exchange Reform

Trade liberalization is an intensely political subject for two related but distinct reasons. The first is that costs associated with new policies become quickly apparent while the gains usually lie farther in the future. Adjustment costs along the way can mean a period of lower average living

standard, even though there are always some who gain immediately from any change in policy. This is one reason why visionary leadership can be key to successful reform. A separate problem is that there are always *permanent* losers from any liberalization. Moreover, *trade* reform entails an especially high ratio of redistribution to total gains (Rodrik 1994). While there is no way to avoid transition costs or an uneven distribution of long-term costs and benefits, appropriate policies may reduce their extent and thus preserve the political viability of reform.

Commitment to an outward-oriented trade strategy requires complementary supporting policies including transportation and communications infrastructure; access to financial capital and to imported capital goods, raw materials, and intermediate inputs; a well functioning labor market, and, above all, maintenance of an appropriate real exchange rate. To the extent that potential exporters respond to the profit opportunities offered by the new policy environment, their political influence increases while that of import-competing producers wanes. The result is then to strengthen the political support for liberalization, allowing the reform process to go forward (Krueger 1993). But will potential exporters respond? As noted above, the key to the cycle lies in the credibility of the new policies, and this in turn rests on the ability of the government and of the economy to withstand the dislocations of the period of adjustment. The long record of policy reversals in SSA countries contributes to the continuing reluctance of private investors (and especially foreign investors) to commit their funds to new projects. Only if countries are able to maintain new policies even in the face of adjustment difficulties will investor skepticism be overcome, and then only gradually.¹⁷

Managing adjustment to new policies [cuts here?? maybe boil down to a couple of sentences]

Liberalizing countries necessarily experience dislocation costs during the period of adjustment to new policies. These dislocation costs are of two main forms: those associated with necessary changes in the composition of durable capital, and those associated with unemployment of labor or

¹⁷ The external review of the ESAF program (IMF 1998a, 18) points to the need for increased capital inflows into low-income SSA economies once they have achieved a satisfactory policy environment and proposes ways the IMF can "signal that a country has reached the phase in which the macroeconomic policy environment is satisfactory for private investment." This suggestion implies that private investors are currently passing up profitable opportunities because they lack information on recent policy improvements in SSA economies. However, investors may harbor doubts concerning the future of reforms, and such doubts will not necessarily be laid to rest by IMF certification.

other resources. In the normal case where change in policy has not been fully anticipated, the economy will begin from a given stock of durable sector-specific human and physical capital that is no longer optimal. In the new situation some types of capital will be worth more than their replacement cost, others will be worth less. In general, trade liberalization reduces the value of capital in import-competing industries and raises the value of capital in current or potential export sectors. To the extent that real factor rewards are flexible, all resources can continue to be fully employed as stocks adjust over time to suit new relative prices. Required changes in the returns to industry-specific factors are largest soon after the new policy comes into force; in the post-liberalization equilibrium following complete adjustment in the stock of sector-specific capital, the market value of any factor must again be equal to its replacement cost.

In the absence of factor-market distortions, the laissez-faire adjustment process will be socially optimal. In particular, there is no efficiency gain from speeding up or slowing down the process through government policy, although there may be political reasons to do so. But factor prices are rarely very flexible in the short run, and in SSA other factor-market distortions are likely to be present as well. Some resources will therefore become unemployed during the transition period, necessarily raising the social cost of adjustment and thus undermining political support for the liberalization program. This bolsters the case for some kind of government adjustment assistance program to speed the movement of resources into expanding sectors and to compensate those most affected by the change. Even if there is no efficiency justification for such efforts, providing special benefits may be good politics—allowing liberalization to go forward in the face of strong opposition from those adversely affected. A less benign type of adjustment assistance takes the form of subsidies, loans, or technical assistance for trade-impacted firms. These are measures that retain resources in declining sectors, thus tending to postpone rather than facilitate adjustment.

Development economists formerly counseled gradual change in policy as a means of reducing costs of adjustment (e.g., Little, Scitovsky, and Scott 1970). This is another area where the conventional wisdom has changed in the light of experience. In practice, gradual policy changes allow more time for opponents of liberalization to marshal their forces. Liberalization delayed can therefore mean liberalization cancelled. In Latin America and East Asia, rapid radical reform has had a better

overall record than gradualism. Based on evidence from trade reforms of developing countries in the 1980s, often with support from the IMF and World Bank, Thomas, Nash et al. (1991) conclude that "comprehensive, intense, and rapid" reform is usually preferable because its benefits are both larger and earlier than under a more gradual approach. To the extent that gradualism gives rise to uncertainty about full implementation, gradual policies may lack credibility. With domestic and foreign investors in doubt as to whether the announced program will ever be fully implemented, the new price signals may elicit little response.

Also undercutting the case for gradualism is recent evidence from Latin America that the aggregate effect of successful trade liberalization on employment can be relatively small even in the short run. Although workers will be displaced from contracting sectors, much of the resulting job loss can be offset by employment expansion in export industries (Edwards 1995). However, the popular mercantilist accounting of jobs created and jobs lost gives little indication of actual adjustment costs borne by displaced workers, which depend on gross rather than net changes and on worker characteristics. It also takes no account of the real gains from expanded trade--increased efficiency from replacing low-productivity import-competing output with regionally or globally efficient export production.

On the other hand, adjustment costs sometimes affect those already living on the economic margin. External evaluators of recent IMF-assisted reform programs (IMF 1998a) recommend greater efforts to identify in advance who is likely to lose from reforms, especially to the extent that losers are people who are already poor. This would allow public officials to put social safety nets into place before they are actually needed. The evaluators cited the cases of Zambia, where maize farmers remote from markets were suddenly cut off when agricultural marketing was liberalized, and Malawi, where real wages of estate workers were halved through very high inflation while owners reaped a corresponding windfall. Past SSA efforts to provide safety nets have been targeted primarily at politically powerful groups such as civil servants, rather than the very poor. Moreover, the effectiveness of social programs has typically been impaired by inadequate financing and delays in execution, the latter resulting at least in part from the former.

Malcolm et al.: Can we identify SSA countries with a good record on managing adjustment costs? Or an example of a situation handled well? What about the two-track system in Mauritius, which fostered exports in an enclave (using women, new entrants to the labor force) and left import-competing industry protected for a long time? Does any SSA country have a safety net worth mentioning?

Maintaining an appropriate real exchange rate

If promoting growth via an outward-oriented strategy is a matter of getting prices right, the most important price to get right is the exchange rate. Yet until the late 1980s, virtually all SSA currencies were overvalued, with nominal rates maintained through restrictive policies that exacerbated problems associated with overvaluation; in the franc zone, currencies were overvalued until 1994. An inappropriately strong real exchange rate undercuts the competitiveness of potential exports across the board and makes imports look cheap relative to their domestic counterparts, thus discouraging production of tradable goods. Increased unemployment and deterioration of the current account frequently accompany real appreciation. In economies with fixed nominal exchange rates, the common policy response is a resort to (further) protectionist measures. The reversal of past liberalization is typically billed as a temporary measure to protect jobs, revenue, or dwindling international reserves. On other continents successful trade reforms have typically begun with a large nominal devaluation (Thomas Nash et al. 1991; Edwards 1995), and the single economic factor most likely to sabotage a liberalization attempt once in progress is (a return to) overvaluation of the real exchange rate.

SSA's distorted foreign-exchange regimes may have been a legacy of the crisis-prone Bretton Woods system of pegged exchange rates. Although the system was designed by the United States and Britain to meet the needs of the industrial countries, almost all of these had moved to managed floating by 1973. However, the majority of developing countries in SSA (and elsewhere) continued to peg their exchange rates to a single major currency or to a basket of currencies, with the choice based on trading relationships. Like the industrial countries prior to 1973, non-CFA countries made occasional if sometimes inadequate parity revisions to accommodate changing circumstances. But the exchange

rates of franc-zone countries remained fixed from 1948 until 1994 despite steadily deteriorating economic conditions beginning in the 1980s. [or earlier?]

Most SSA countries in both groups resorted repeatedly to increased protection as a response to problems associated with overvaluation, but other policies varied according to the exchange-rate regime. In the franc zone, national currencies were kept freely convertible into French francs at a fixed rate, implying that members had to forego an independent monetary policy. Instead, monetary policy decisions were governed by two regional central banks [ref to be supplied]. Policy makers in some CFA countries also played by the traditional "gold standard" rules, tightening fiscal policy in an effort to restore balance-of-payments equilibrium without a parity change. In the years prior to the long-overdue devaluation of the CFA franc, restrictive macroeconomics policies and increased trade barriers combined to produce declining and even negative growth rates in the CFA countries (see Table xx). In the non-CFA countries, currencies were inconvertible until the late 1980s, with official rates up to 1000 times parallel rates (see Table xx) maintained through complex exchange controls. Rather than bringing their official rates into line with market conditions, countries with current-account deficits continued to pile on further restrictions on access to foreign exchange.¹⁸

The failure of most SSA countries to maintain appropriate real exchange rates has been a crucial element in the region's slow progress to openness, with complex exchange controls adding to the cost of overvaluation for the non-CFA countries. By the mid-1990s, however, a number of non-CFA countries had scrapped most exchange controls and brought official rates into line with market forces (see Table xx). Overvaluation of currencies in the franc zone had likewise been corrected through the large January 1994 devaluation relative to the French franc. These are significant steps in the right direction for SSA countries, although the problem of maintaining appropriate real rates under changing conditions remains a difficult challenge for all smaller countries, not just those in SSA.

In Latin America and Asia, real appreciation often occurs when the exchange rate is used as a nominal anchor in battling domestic inflation. The potential incompatibility of the nominal-anchor strategy with maintaining a desired real exchange rate gives rise to the judgment that macroeconomic

¹⁸ The motive for maintaining a clearly overvalued official rate comes from the associated benefit for those who control access to the limited supply at this rate. The opportunity for rent-seeking with licensing of foreign exchange is thus similar to that associated with import licensing and other discretionary nontariff barriers.

stabilization must be achieved before trade liberalization has a good chance at success. The repeated reversals of trade reform in Argentina and Brazil were linked to failed stabilization programs. Another threat to an appropriate real exchange rate comes from the capital account. The central objectives of SSA reforms almost always include ensuring continuation of aid flows, discouraging capital flight, and attracting foreign direct investment. Success in any combination of these objectives results in upward pressure on the real exchange rate, and thus an additional challenge for a country pursuing export-led growth. This is one reason for the conventional advice that trade reforms should precede capital-account liberalization. However, rather than limiting all capital inflows, developing countries often try to discourage only inflows of short-term liquid capital, thus offering exporters some protection from volatility of the real exchange rate without losing the potential benefits from longer term investments.

Until the 1980s, the credible fixed rates of franc-zone countries, along with the implied constraints on monetary expansion, helped keep inflation rates low without negative effects on growth. Overall economic performance for these countries was better than that of their non-CFA neighbors (ref to be supplied). But in the years leading up to 1994, the benefits of a "permanent" fixed rate began to be overshadowed by the costs of overvaluation. The increasingly apparent real overvaluation of national currencies discouraged exporting, generated pressure for new import barriers, and distorted financial flows as a devaluation of the CFA franc came to be widely anticipated. Although the devaluation of the CFA franc in 1994 made a change in regime less of an immediate issue than previously, many development advisors believe that a managed float rather than a fixed rate offers the best compromise between the goals of managing domestic macroeconomic performance and maintaining an appropriate real exchange rate (reference to exchange rate study—please supply details).

Macroeconomic discipline

Only in the past decade have SSA nations begun to achieve the degree of macroeconomic stability essential for good economic performance. Structural-adjustment policies including trade reform were previously held hostage by the need to reduce budget deficits and to curb inflation in many non-CFA countries. As noted above, battling inflation may produce an overly strong real

exchange rate that taxes potential exporters. Trade reform also poses a fiscal problem since SSA countries typically rely on trade taxes, especially taxes on traditional commodity exports, for a substantial share of revenue. Import tariffs have also been a significant source of government revenue for most SSA countries. However, Table 6 [it really exists] indicates that 5 of 8 SSA countries for which comparable data is available reduced their relative dependence on trade taxes as a source of revenue for the central government between the early 1980s and the mid-1990s.

In principle, a move to a simple trade regime with low uniform trade taxes and strong enforcement could raise rather than lower trade's contribution to government revenue, depending on the price elasticity of trade flows and the prior extent of smuggling to avoid high tariffs and burdensome nontariff barriers. Another potential offset is tariffication of quantitative restrictions, a policy change usually considered to be a move toward trade liberalization because it reduces the role of administrative discretion, boosts tariff revenues although it has the political disadvantage of creating losers (former license holders and administrators) without immediately obvious winners. In practice, these offsets are rarely sufficient to prevent total tariff collections from falling when trade is liberalized. For this reason World Bank analysts argue that the fiscal deficit should be reduced before trade is liberalized (Thomas, Nash et al. 1991).

Although tariffication of nontariff barriers, increases in the lowest tariffs, elimination of tariff exemptions, and better enforcement of existing tariffs are all recommended as ways to begin the process of trade liberalization while enhancing government revenue (Sharer et al. 1998), further progress on liberalization requires cuts in tariff rates and thus continued progress on developing other revenue sources (e.g., value-added taxes, income taxes) or reducing government expenditure. In Latin America, some temporary but significant budgetary relief on both the revenue and the expenditure side has come from privatization of government-owned companies. Privatization typically produces double fiscal benefits, first from the asset sale and then from avoidance of the budget-breaking operating subsidies often required to keep government enterprises in operation. In SSA ???

Increased inequality

Regardless of the political regime, the sustainability of any policy package eventually rests on its ability to raise, or at least not to reduce, the resources available to meet the needs of the population. It is obviously easier to sell a package that delivers a rising average living standard than a package that requires sacrifice. The yardstick most often used to compare economic success across countries is growth in per capita income.¹⁹ But the viability of reforms depends not only on aggregate or average gains but also on their distribution. For the region as a whole, World Bank (1997b) data show that the income share of the lowest quintile of the population improved significantly between the 1960s and the 1970s but has shown little further improvement subsequently. This is an especially grim statistic given that, as noted earlier, per capita income actually fell between 1960 and 1994 in 16 SSA countries. Although income inequality remains an important policy concern in SSA, a more pressing problem for the region is that some countries have undergone a process of "equalizing downward" as per capita income has fallen (United Nations 1997, 109). Nonetheless, there is scattered evidence that the benefits from market-oriented policies have been shared unevenly. In Uganda, government data indicate that urban workers reaped almost all the benefits of recent reforms, widening income inequality in an economy where, as is typical in Africa, urban incomes were already much higher than those in rural areas (IMF 1998, 85).

Saving and investment

A previous generation of development economists saw in Simon Kuznetz's inverted-U of temporarily increased income inequality the necessary price of future growth; concentration of income and wealth were assumed to promote essential capital formation by raising the aggregate saving rate. Today this rationalization seems less persuasive. The high saving rates of East Asia were achieved without increases in inequality. Moreover, in a world of internationally mobile capital, domestic

¹⁹ This standard is highly but not perfectly correlated with others that give a better picture of changes in the living conditions of the "typical" member of the population, such as infant mortality, longevity, access to clean water, and literacy. Another recent concern not captured by conventionally measured growth in PCI is degradation of the environment, including inefficiently rapid depletion of natural resources. This concern is addressed in the recent emphasis on *sustainable development*, i.e., development that doesn't mortgage the welfare of future generations.

saving and domestic capital formation are no longer required to move in lockstep. However, private investors have not yet shown the same kind of interest in Africa that they have demonstrated in other emerging markets with longer track records of sustained reform. [add something here on the very slow improvement in credit ratings and whether these involve a bias against SSA?]

Internationally mobile capital provides a barometer of investor sentiment regarding the credibility of reforms. Countries that achieve stable, market-oriented institutions have been able to supplement domestic saving with private capital inflows from abroad. Although governments rarely appreciate the daily “policy report card” provided by active financial markets, the concern about losing foreign investment may very well limit officials’ impulse to adopt policies with short-term payoffs but longer term costs (McCulloch and Petri 1998). Conversely, while international investors are more likely to shun countries without strong market institutions, wealthy SSA savers are highly resourceful in finding means to move their own financial assets abroad [ref on capital flight from Collier and Dunning]. Anecdotal evidence strongly suggests that concentration of income and thus of savings facilitates capital flight. In this case, increased income inequality--whatever its effect on the aggregate saving rate—is likely to reduce the amount of domestic savings available to finance domestic capital formation.

Skilled versus unskilled labor [maybe not very relevant—cut?]

In earlier decades discussion of the potential for temporary or permanent increases in income inequality resulting from liberalized trade centered on changes in labor earnings versus return to capital, especially foreign-owned capital. Today’s concern focuses more on the observed increase in the gap between earnings of SSA’s skilled and unskilled workers, which some tie to increased openness. For a world of two factors, the Stolper-Samuelson theorem predicts exactly this outcome in skilled-labor-abundant countries like the United States. However, the same model also predicts a shift to a lower ratio of unskilled to skilled labor ratio in production, the opposite of what has been observed in most industrial nations. For this reason, Lawrence and Slaughter (1993) argue that skilled-biased technical change rather than trade lies at the heart of the controversial trend. Moreover, the Stolper-

Samuelson model predicts a fall in the same differential for unskilled-labor-abundant countries, i.e., less-developed countries, while in fact the skill premium has risen in many such nations.

One explanation for a rising skill premium in developing countries is that the technology transfer associated with growth of nontraditional exports causes a temporary increase in demand for skilled labor. Even though the exports themselves may be unskilled-labor-intensive in production, skilled labor is needed initially to adapt and implement the imported technologies (Pissarides 1997). Also, the Stolper-Samuelson and factor-price-equalization theorems predict changes in *equilibrium* factor rewards with both factors fully mobile between sectors, and then only under other special conditions. Given the recent pace of policy change in the developing world, the situation can hardly be viewed as representing an equilibrium.

Related concerns are the perceived increase in the volatility of earnings and the increased uncertainty of job tenure associated with participation in international markets (Rodrik 1997). These concerns can to some extent be addressed through a social safety net, and indeed Rodrik demonstrates a high correlation between measures of countries' openness and social spending. Furthermore, he points out that increased international mobility of capital implies that such a safety net cannot be financed primarily through taxes on income from capital. However, as long as openness produces *aggregate* gains to a nation's labor force, social insurance for workers can be financed without increased taxes on capital income.

The recent high unemployment rates in some SSA countries reflect slow adjustment to trade and macroeconomic reforms in the presence of labor-market distortions. But whatever their causes, increased income inequality and/or volatility can undermine the perceived "fairness" of outward-oriented policies even if they are accompanied by enhanced growth of per capita income. While countries differ widely in the approaches used to make these changes acceptable to their citizens, it is an issue that must be addressed if integration with international markets is to remain politically viable. Several decades of reform in Mauritius were accompanied by a variety of measures to protect employment and create new jobs, measures that sacrificed allocative efficiency but may have helped to maintain the political viability of the reform process.

Q: Any other examples of this in SSA? How about examples of reforms that led to political upheaval because of job losses or income reductions? Data on employment?

Sequencing of reforms (aka Malcolm's bete noir—can you live with this? read it before exploding...)

In the developing world (as well as in centrally planned economies), an import-substitution trade regime has typically been one element in a broad complex of dirigiste policies affecting all domestic economic activity--extensive public ownership, selective subsidies, and government restrictions affecting operation of domestic capital and labor markets as well as the foreign exchange market.²⁰ Furthermore, many developing countries experienced double- or triple-digit inflation rates during the 1960s and 1970s thanks to over-reliance on money creation to finance government spending. Experience suggests that attention to sequencing of economic reforms may help to minimize the period of economic distress following liberalization. A large literature has addressed the issue of sequencing, but without achieving consensus on an optimal sequence that is independent of the particular circumstances of a given country.²¹ Moreover, the sequencing literature typically treats trade liberalization as a single element in a broader reform program. Questions less often addressed concern the sequencing of the individual policy changes required to complete a country's successful transformation from import substitution to outward-oriented growth, changes sometimes carried out over a period of years or even decades.

Notwithstanding theorists' concentration on the costliness of restrictions on imports, successful liberalizers in East Asia and Latin America most often began the process of integrating into global markets by restoring incentives for exporters. The same is true of Mauritius, which developed export-oriented manufacturing in an export-processing zone long before liberalizing the trade barriers that protected its import-substituting manufacturing sector. In practice, the initial impetus for import

²⁰ Krueger (1993) points out that the perceived need for these policies may arise from the negative consequences of import substitution--a vicious policy cycle.

²¹ Edwards (1995) summarizes the main findings of the sequencing debate but comments that sequencing of reforms has come to be viewed as largely a political issue. McPherson (1995) likewise argues that, in the case of Zambia, economic performance would have been improved "if only some economic reform had been sustained, irrespective of how the policies were sequenced."

liberalization has frequently come from the needs of current or potential *exporters* who look to world markets for capital goods, raw materials, or intermediate inputs. In East Asia and Latin America, measures to facilitate export growth, often enacted in advance of comprehensive reforms, have included rebates of import duties on capital equipment and/or intermediate inputs used to produce exports; establishment of export-processing zones; favorable access to licensed foreign exchange and restricted imports; and other incentives intended to raise the profitability of all or selected export-oriented activities. Subsequent reforms usually include broader measures such as elimination of import licensing, tariffication of quantitative import restrictions, rationalization of the tariff structure, and elimination of multiple exchange rates used to discourage “nonessential” imports. In SSA, however, issues of credibility and rent-seeking may impede the ability of governments to jump-start the liberalization process through fiscal incentives. As noted previously, SSA attempts to stimulate exports via tariff exemptions on imports were plagued by fiscal problems, administrative delays, and corruption. This argues for an across-the-board approach that requires a minimum of administrative support, administrative discretion, and funding. The most obvious such measure is a large real devaluation, preferably carried out along with reductions in nontariff barriers to imports. The advantage of linking these two measures is that real devaluation makes domestic producers more competitive, thus cushioning the effects of removing import barriers.

In fact, the first step in comprehensive reforms has usually been a real devaluation, sometimes along with unification of any multiple exchange rates (Thomas, Nash et al. 1991). In some Latin American countries, an early real devaluation tended to make quantitative import restrictions redundant, thereby facilitating their speedy removal. Although Edwards (1995) notes the increased speed and intensity of Latin American trade reform programs in the 1990s, broad tariff reductions have typically been implemented in stages over several years according to a schedule announced at the start. At this stage, the goal is less to spur exports than to move domestic relative prices closer to international prices and to eliminate large discrepancies in domestic effective protection rates.

The Lerner Symmetry Theorem implies that removing barriers to imports is equivalent to removing barriers to exports. Nonetheless, there may be dynamic advantages in pursuing export promotion prior to general liberalization on the import side. The most controversial aspect of trade

liberalization is not the configuration in the new equilibrium versus the old one, but the path by which the economy moves from one to the other. In the new outward-oriented equilibrium both imports and exports will be much larger. However, the extent of overall economic losses and income redistribution, and hence the difficulty of maintaining adequate political support for needed reforms, all depend critically on whether imports grow sooner or later than exports, i.e., whether the current account improves or deteriorates during the period of adjustment. Marked deterioration of the current account signals a likely return to protection (Michaely, Papageorgiou, and Choksi 1991), thus undermining credibility of the reforms. Proceeding first with export promotion (including real devaluation) also creates a set of early supporters for further reforms, including both local firms with export potential and foreign direct investors establishing export-oriented subsidiaries.

The external policy environment

The case for import-substituting industrialization, as developed by Prebisch, Singer, and other writers, rests in part on export pessimism: the assumption that global markets offer less-developed countries little opportunity for gains through increased exports. Development along lines of international comparative advantage was interpreted narrowly to mean additional export of raw materials and commodities, since these made up about four-fifths of the value of existing exports from less-developed countries as a group. The authors assumed that the international prices obtained for these exports would decline over time, exacerbating the gap between rich and poor nations (Edwards 1995). Moreover, their narrow view of outward-oriented growth seemed to offer no role for development of a modern manufacturing sector (Krueger 1997).

Notwithstanding the past successes of export-led industrialization in Asia and Latin America, the question of global market receptivity to nontraditional exports is always lurking in the background, and often with good reason. Apparel exports, the first step on the export-led-industrialization ladder for a host of countries, is also the most protected manufacturing industry in most industrial nations,

including the United States.²² Likewise, agricultural exports from SSA have been limited by quotas, tariffs, and other restrictions.²³ On the other hand, the Lome Convention has offered preferential access to the highly protected European market for limited quantities of agricultural commodities as well as manufactured goods. Under the Generalized System of Preferences developed in the 1970s, the United States and other industrial countries likewise offer preferential access to many types of manufactured exports from SSA countries. However, these special programs are limited in scope and subject to periodic revision. Thus, they provide a narrower and less reliable basis for export-oriented investment than trade liberalization that is locked in through WTO negotiations, as discussed below.

The World Bank study of trade policy reform in the 1980s identified growing protectionism in international markets as one of several factors constraining exporters' response (Thomas, Nash et al. 1991). Indeed, it is almost axiomatic that export-oriented development would work better if the rich countries were more willing to adjust out of sectors that have clearly lost their comparative advantage. But, as Sachs and Warner (1995b) conclude, it works even under less than ideal external conditions: "With the...exception of Haiti, there is not a single developing country that had substantially open trade and yet failed to grow by at least 2 percent per year" between 1970 and 1989.

Studies focusing instead on countries that have remained insulated from global markets tell a similar story. As noted above, World Bank research into the causes of SSA's declining share in world exports concludes that OECD trade barriers in potential export markets are not to blame: "Rather, the Sub-Saharan African countries' own trade and transport policies incorporate a substantial anti-export bias, which lessens their ability to be competitive in international markets" (Yeats, Amjadi, Reincke,

²² The Uruguay Round of multilateral trade negotiations produced an agreement to phase out the Multifibre Agreement (MFA), the global network of quantitative restrictions on trade in textiles and apparel, over a ten-year period. However, many trade policy experts are pessimistic about a return to open markets for these important developing-country exports. They interpret the long phase-out period as indicating a lack of real commitment to liberalization on the part of OECD nations. Some analysts believe the extent of OECD protection of these import-competing industries may actually increase, at least temporarily, during the phase-out process.

²³ As discussed below, the concern about finding export markets underlies much of the interest in RTAs.

and Ng (1996)). If anything, exports from SSA should have gained an advantage in the markets of industrial nations from trade preferences under the Lome Convention as well as the Generalized System of Preferences, but these preferential arrangements were apparently insufficient to offset the anti-export bias of the nations' own policies. Rodrik (1998) likewise concludes that "trade policy in Sub-Saharan Africa works much the same way" as elsewhere; dismantling SSA's high trade restrictions can be expected to improve trade performance significantly, notwithstanding the region's geography and poor infrastructure.

However, as SSA countries reform their own policies, the benefits from import liberalization in important market countries are accordingly increased. In the past SSA has been marginalized in GATT/WTO negotiations by well-intentioned but ineffective rules on special and differential treatment for less-developed countries. These rules, based on the outdated notion that developing countries benefit by building up their industries behind protective walls, exempted developing countries from the reciprocal liberalization required of wealthier members. Developing countries lost twice, first because of the reduced incentive to eliminate their own trade barriers, and second because bargaining tended to focus on the goods of greatest interest to the industrial countries. In their assessment of Africa's past and future role in multilateral negotiations, Wang and Winters (1997) argue that although SSA countries won fewer concessions in the Uruguay Round than other developing countries, possibly because they offered fewer, they nonetheless emerged from the round facing fewer restrictions. Wang and Winters maintain, however, that SSA countries stand to gain through active participation in the next round of negotiations, both giving and requesting concessions.

External shocks

Still to be addressed:

Was donor conditionality a positive factor?

What was the influence of external factors, e.g., supply shocks?

Did a change of government make a difference?

Encouraging non-traditional exports.

Using privatization to remove monopolies and special concessions.

5. Unilateral versus Reciprocal Liberalization

[a much-shortened version of this stuff should probably be included as one heading in the "Breaking the Cycle" section above—examples pro or con would be helpful]

Along with the rest of the world, SSA has experienced a resurgence of regional trade initiatives (see Table xx). These have produced new or revamped customs unions with negotiated common external tariffs:..... Other new or restructured arrangements have been free trade areas, including Unlike the inward-looking regional agreements of the 1960s, these agreements have been formed or revived at the same time that at least some of their members are liberalizing trade on an MFN basis also. Even the language of the new agreements has typically been outward-oriented, emphasizing enhancement of international competitiveness, export growth, and receptivity toward foreign direct investment. Some observers are unenthusiastic about the regional initiatives, fearing losses from trade diversion, a return to nontransparent protection, rising external trade barriers, and reduced interest in future rounds of multilateral trade negotiations (e.g., Bhagwati and Panagariya 1996). An additional concern in SSA is that negotiating and maintaining regional trade agreements may further tax the limited administrative resources of member countries (Radelet 1997). However, other researchers (e.g. Fernandez 1997) argue that regional agreements may help to maintain a region's movement toward openness by enhancing credibility of reforms, a substantial benefit for the many SSA countries where reform has been repeatedly halted or reversed.

Given the range of potential benefits from and obstacles to successful liberalization discussed in the previous sections, together with the recent intellectual climate of general support for market opening in general, what can be said about the choice between unilateral and reciprocal liberalization? Relative advantages may reflect differences in anticipated size of eventual benefits, costs of adjustment, and political feasibility of reform. But in light of recent patterns of policy change, it may

be misleading to cast unilateral and reciprocal liberalization as mutually exclusive alternatives. Rather, they may offer complementary strategies for implementing market-oriented structural reform (McCulloch and Petri 1997), an idea that has been termed open regionalism in the Asia-Pacific context.

Size of benefits

An RTA is likely to cause trade diversion, i.e., substitution of imports from higher-cost partners for goods previously obtained from nonpartners.²⁴ The cost associated with trade diversion thus reduces potential gains from liberalization with preferential elements; in a free-trade agreement, these costs may be increased by application of restrictive rules of origin. Nonetheless, unilateral liberalization may produce an inferior final outcome for an individual country that is large enough to influence the terms of trade. If its initial tariffs are below the theoretical “optimum,” a large country’s unilateral liberalization raises world welfare but at its own expense. If large countries instead liberalize bilaterally or multilaterally, associated terms-of-trade effects tend to balance out, reducing the possibility that any one country can actually be worse off even after full adjustment. Although many SSA countries are classic “small” economies that face externally determined prices in their trade, a few are large enough overall or in one or more commodity exports so that negative terms-of-trade effects from liberalization are a significant concern. For these countries, grouping with major trading partners in the region can neutralize much of the potential impact.

Also, by promoting action on the part of countries that might otherwise choose to free-ride, reciprocal liberalization may result in more liberalization and thus greater global as well as national gains. This is, of course, is the logic underlying the multilateral trade negotiations that have helped to reduce many types of barriers to trade in the advanced countries. Essentially the same benefits might be obtained from what could be called “strategic unilateralism,” a scenario in which one country’s unilateral liberalization induces its trading partners to follow its example (Coates and Ludema 1996). This kind of leader-follower behavior may be plausible in a repeated-game context. However, the

²⁴ In a world of many overlapping preferential arrangements, apparent trade diversion may in fact represent redirection of trade flows along lines of comparative advantage, i.e., correction of previous trade diversion. Example for SSA?

reverse is also possible: countries may delay trade reform in hope of getting “credit” for their action in a subsequent regional or multilateral negotiation.²⁵

Finally, negotiation of regional agreements may be a way to prod other trading partners into mutually beneficial multilateral or regional negotiations. Under USTR William Brock, the Reagan administration in the United States announced its willingness to negotiate a free-trade agreement with any country; the explicit goal was to increase support abroad for initiation of a new GATT round. Chile, supposedly next in line to join an expanded NAFTA, meanwhile negotiated a free-trade agreement with Mercosur (1996), perhaps to remind a foot-dragging United States of its earlier declarations of interest. Examples for SSA?

Cost of adjustment

Any liberalization entails adjustment costs that must be measured against the eventual gains from superior efficiency. In the typical case, distorted domestic factor markets exacerbate these costs. The simultaneous opening of several national markets reduces the required extent of dislocation and adjustment for any one of them. An important aspect of this advantage is the reduced need for a lower real exchange rate, an advantage for countries still fighting domestic inflation. Lower cost of adjustment constitutes an economic benefit and also reduces the political difficulties of implementing and maintaining the liberalized trade regime. Moreover, in East Asia and Latin America, much of the new regional trade has been intra-industry trade, presumed to be associated with lower adjustment costs than inter-industry trade.

Political feasibility

An element of reciprocity usually reduces the political obstacles to trade reform. Indeed, greater political feasibility appears to be the most important reason why countries engage in various types of reciprocal rather than unilateral liberalization. In particular, discriminatory liberalization,

²⁵ In the Uruguay Round, negotiators agreed informally to give developing countries credit for earlier unilateral tariff reductions which were subsequently bound under the GATT/WTO. Finger, Reincke, and Castro (1997) find evidence from the pattern of total and bound concessions that developing-country binding of earlier unilateral reductions was "treated at the round as an action of substantial value."

although almost always suboptimal in at least its initial outcome, offers clear benefits to readily identified domestic sectors in the form of trade diversion, thus ensuring the support of export interests that are known to be regionally but perhaps not globally competitive. Unilateral liberalization offers benefits only to the much smaller number of export firms and sectors that appear ex ante to be globally competitive (ex post, the general-equilibrium consequences of a successful liberalization always bring to light export potential not apparent in advance). A reciprocal process, whether regional or multilateral, also enhances public acceptance of liberalization. Reciprocity undercuts the public perception that the country's policy makers are giving something away (market access) with no quid pro quo. On the other hand, reciprocal liberalization may mean lengthy delay of needed reforms. The decision to liberalize unilaterally seems to occur in conjunction with comprehensive across-the-board reforms. In such instances, liberalization by trading partners would be welcome (for the reasons noted above) but the cost of delay is too high. Crisis conditions call for prompt action, and so may be associated with unilateral trade reforms, as in the case of...(examples of reforms that started with a crisis?) In practice, however, international institutions and bilateral aid agencies have in most provided external support for SSA countries in crisis willing to commit to even modest steps toward reform.

Complementarity

Unilateral, multilateral, and regional initiatives are often discussed as if they were mutually exclusive alternatives. The conventional wisdom is that RTAs induce costly trade diversion and increase political opposition to future reductions in external trade barriers (e.g., Bhagwati and Krueger 1995). Yet Latin American experience in the 1980s and 1990s suggests that these three liberalization strategies may represent complementary ways for a country to move toward greater integration into global markets. In recent years most of the countries in the region reduced their own MFN trade barriers, joined RTAs, and participated in GATT/WTO negotiations. Argentina and Brazil were among the last countries to join the region's recent wave of trade reform, in both cases after previous failed attempts. It is plausible that the Mercosur agreement helped to minimize backsliding despite significant external shocks including the Mexican peso crisis in 1994 and the Asian crisis in 1997.

The apparent complementarity of unilateral and reciprocal liberalization may reflect scale effects from formation of a larger integrated market as well as changed political and economic circumstances and incentives resulting from the RTA. In a world of constant costs and perfect competition, trade diversion is necessarily welfare-reducing for the importer. But if non-Vinerian benefits such as increased competition and larger market size are sufficiently important, trade diversion may transform the favored partner into a low-cost producer that is competitive globally as well as regionally. And when non-Vinerian benefits are minor, trade diversion associated with formation of a free-trade area gives each member the incentive to reduce its own external tariffs on product categories where trade diversion is most damaging (Richardson 1993).²⁶ Moreover, nonmembers who have lost export markets because of trade diversion may be motivated to join later, as has occurred in the European Union and ASEAN.

The trade diversion associated with RTAs also provides a way to raise political support for a more-open trade regime. In addition, by promoting a shift in each member's production structure toward sectors that are at least regionally competitive, an RTA can serve as a stepping stone to future nondiscriminatory trade reforms. Of course sectors benefiting from trade diversion will lobby to retain their favored positions. However, these sectors would have opposed multilateral liberalization in any case, while the initially weakest and thus most protection-oriented sectors in each member country have been vanquished through the milder discipline of the RTA and are thus no longer present to oppose further liberalization (McCulloch and Petri 1997). In Latin America, formation of Mercosur, with its member economies all shaped by decades of import substitution, represented a politically feasible way to eliminate the many domestic firms and sectors that cannot prove themselves to be even regionally competitive, thus setting the groundwork for further liberalization in the future.

Finally, participation in international agreements to open markets can raise the viability of reforms by raising the domestic and international political cost of reversing them. Like GATT/WTO membership, RTAs therefore lend greater credibility to reforms, especially in countries whose recent history has included numerous liberalization reversals. In Latin America, Mexico's NAFTA

²⁶ Trade diversion due to bilateral trade agreements with Mexico (1991), Venezuela (1993), Colombia (1993), Ecuador (1994), and Mercosur (1996) prompted Chile to announce further cuts in its already low unified import tariff.

membership was billed explicitly as a way to lock in market-oriented reforms and thus increase their credibility (Tornell and Esquivel 1997). Likewise, establishment of Mercosur helped to bolster the credibility of the latest trade liberalizations in countries with prior records of many policy reversals.

Any evidence of this for SSA groups? Admittedly they seem like a feeble bunch, but is there any ray of hope?

Promoting favorable dynamics with RTAs

The recent proliferation of RTAs in Latin America, as well as the evident enthusiasm on the part of the United States for these arrangements, has raised concerns about their compatibility with further progress toward multilateral liberalization. The key issue is the way RTAs evolve over time and the associated effects on the political viability of future regional or multilateral liberalization. Theory has demonstrated that formation of RTAs can have either positive or negative effects on the success of subsequent multilateral liberalization (Haveman 1996, Levy 1997, Richardson 1993). But in comparison with their theoretical counterparts, real-world RTAs seem decidedly benign in their effects. As indicated above, the evidence for Latin America suggests considerable complementarity between regional and multilateral liberalization. In fact, regional blocs not only appear to facilitate their members' shift from inward-oriented to open trade regimes, but their formation is sometimes explicitly motivated by this goal.

Critics of RTAs worry that these arrangements will be dominated in their effects by costly trade diversion²⁷ and will cause their members to lose enthusiasm for further multilateral negotiations. Yet much of the evidence from actual RTA behavior suggests that policy makers do not typically choose this strategy over participation in multilateral liberalization but, rather, see the two types of

²⁷ The traditional literature, following Viner's lead in focusing on the case of constant opportunity cost in production, has probably overemphasized the costliness of trade diversion. As noted above, benefits associated with creation of a larger integrated market can transform a high-cost trading partner into a globally competitive one (Wonnacott 1996; McCulloch and Petri 1997). Moreover, apparent diversion can include welfare-increasing reversal of previous diversion.

liberalization as complementary ways of pursuing gains from integration into international markets. Often the anticipated gains from an RTA are exactly the efficiency-boosting effects of a larger market that theorists find most difficult to capture in a model: scale and scope economies, increased competition, technology transfer.

Nor do members of actual RTAs show signs of systematically exploiting their collective market power by raising their protection toward nonmembers. Nations interact over many issues other than trade, rendering adherence to a blatantly exploitive external trade policy short-sighted. In any case, GATT/WTO rules place limits on the impulse toward higher external barriers. Rather, the increased protection associated with RTAs has typically taken the form of restrictive rules of origin for free-trade areas and discriminatory application of safeguards. These developments are significant worries because they represent a return to the inefficiencies associated with nontransparent barriers, not because the RTA members are optimally exploiting their joint market power in trade with nonmembers.

Theory suggests that an RTA may help to overcome political obstacles to future multilateral liberalization to the extent that trade creation shrinks the size and political power of the region's least competitive firms (McCulloch and Petri 1997). Conversely, trade diversion under an RTA might be expected to strengthen resistance to any future enlargement or multilateral liberalization. In practice, however, it appears that RTAs dominated by trade diversion are ones that never get off the ground because potential members are reluctant to accept the associated losses (e.g., the Andean Pact of the 1960s). The observed tendency for established RTAs to grow in size and diversity over time suggests that membership in an RTA gradually changes the balance of producer interests in ways that promote eventual inclusion of new members who were previously "too competitive" to be allowed to join.

The recent prominence of RTAs has raised interest in a revision of GATT/WTO rules to increase the likelihood that such arrangements will make positive contributions to multilateral liberalization. One possible approach is suggested by Kemp and Wan's (1976) theoretical

demonstration that the external barriers of a bloc can always be adjusted to leave trade with third countries unchanged--i.e., to rule out trade diversion--while allowing net gains for members. Variants of a no-trade-diversion rule have been proposed as alternatives or supplements to Article XXIV of the GATT, which currently restricts RTAs principally through the requirement that countries must fully eliminate internal barriers (Bhagwati 1992, McMillan 1993). However, minimizing diversion does not necessarily produce the most favorable dynamics. Trade diversion may be critical to the political viability of a particular RTA, and if the RTA represents an essential step in the transformation of a country's industrial structure, then a no-trade-diversion constraint may actually have retard subsequent multilateral liberalization.

6. Concluding Comments

Are there any lessons for African countries? Is the institutional setup robust enough to promote and sustain reform? Is there leadership to ensure that reforms are sustained? What are the compelling political reasons to promote and sustain reform? How would a reform-minded government ensure that the forces seeking to reverse reform are deflected?

About the attached tables: some indicate what would be nice to have, a couple actually have entries
About the references: some are superfluous, to be weeded out at the end. Please take note of any missing references, either ones already referred to but omitted or ones we ought to refer to but don't.

Table 2.

Average minimum and maximum tariff rates by selected country, 198x-9x

Country and years	Average minimum tariff rates, weighted (per cent of import value)			Average maximum tariff rates, weighted (per cent of import value)		

Source: UNCTAD (1994), ??? Sectoral tariff rates weighted by shares in world trade flows.

Table 5.

Trade liberalization in Sub-Saharan Africa

Country	Sachs-Warner (1995a) Date of opening	Dean et al. (1994) Initiation of reforms (1985-1991)	Sharer et al. (1997) Initiation of IMF-supported programs with trade objectives	Thomas and Nash (1991) Recipient of World Bank trade adjustment loan, 1979-87
Angola	Never open	Not covered		
Benin	1989	Not covered	ESAF 1993, no progress toward target (6,6)	
Botswana	1979	Not covered		
Burkina Faso	Never open	Not covered	SAF 1991, ESAF 1993, target achieved (10,7)	
Burundi			ESAF 1991	x
Cameroon	1993	1989		
Cent. Afr. Rep.	Never open	Not covered		x
Chad	Never open	Not covered		
Comoros			SAF 1991, target achieved (10,8)	
Congo	Never open	Not covered		
Cote d'Ivoire	Never open	(1984-86) 1990		x (intensive)
Ethiopia	Never open	Not covered	SAF 1992, target achieved (10,8)	
Gabon	Never open	Not covered		
Gambia	1985	Not covered		
Ghana	1985	1987		x (intensive)
Guinea	1986	Not covered	ESAF 1993, target achieved (5,3)	x
Guinea-Bissau	1987	Not covered		x
Kenya	(1963-67) 1993	1987		x
Lesotho			ESAF 1991, no liberalization targeted (8,8)	
Madagascar	Never open	1987		x
Malawi	Never open	1988		x (intensive)
Mali	1988	1986	ESAF 1992, target achieved (8,5)	
Mauritania	1992	Not covered	ESAF 1992, no liberalization targeted (9,9)	x
Mauritius	1968	Not covered		x (intensive)
Mozambique	Never open	Not covered	ESAF 1990, target achieved (10,6)	
Niger	Never open	Not covered		x
Nigeria	Never open	(1986-1988)		x
Rwanda	Never open	Not covered	ESAF 1991	
Senegal	Never open	(1996-89)		x (intensive)
Sierra Leone	Never open	Not covered	ESAF 1992, no liberalization targeted but some achieved (5,4)	
Somalia	Never open	Not covered		
South Africa	1991			
Tanzania	Never open	1996	ESAF 1991, target achieved (9,5)	x
Togo	Never open	Not covered		x
Uganda	1988	1987		
Zaire	Never open	1990		x
Zambia	1993	Not covered	ESAF 1992, target achieved (7,4)	x
Zimbabwe	Never open	Not covered	EFF 1992, ESAF 1992, reform but short of target (10,8)	x

Notes: Sachs and Warner (1995a) classify a country as open if nontariff barriers cover less than 40 percent of trade, the average tariff rate is less than 40 percent, the black-market exchange rate of the domestic currency is less than 20 percent below the official rate, and there is no government monopoly on major exports. Dates in parentheses indicate liberalizations satisfying these criteria that were later reversed. Other dates are based on trade policies only. Dean, Desai, and Riedel (1994) and IDB (1996) cover liberalizations initiated since 1985.

Table 6.

International trade taxes as a share of total central government revenue

By selected SSA country, 1980 and 1994 (percent)

Country	1980	1994
Burkina Faso	44	na
Burundi	40	na
Cameroon	38	20
Congo	13	na
Cote d'Ivoire	43	na
Ethiopia	33	20
Gabon	20	na
Guinea	na	48
Madagascar	28	43
Mali	18	na
Mauritius	52	41
Namibia	na	31
Niger	36	na
Rwanda	42	31
Senegal	34	na
South Africa	3	2
Tanzania	17	na
Togo	32	na
Zaire	38	44
Zambia	8	16
Zimbabwe	4	na

Source: World Bank (1997a) Table 4.17.

Table 7.

Regional trade arrangements in Sub-Saharan Africa
(arrangements still in effect in 1997)

Arrangement, date, membership	Type of arrangement	Objectives, status in 1997	Comments
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