OECD Development Centre

Trading Competitively: A Study of Trade Capacity Building in Sub-Saharan Africa

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Executive Summary

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1. This study addresses the issue of how trade capacity might be built in commodity-dependent African countries. Due to structural and policy impediments inherited from the import-substitution era, enhancing the international competitiveness of developing countries' firms is a major challenge. This is especially the case in those countries whose foreign-exchange earnings are heavily dependent on a narrow range of primary commodities. These countries are more vulnerable to external shocks than those with more diversified export structures.

2. At present, the exports of many African countries are still dominated by primary commodities. The experiences of several resource-rich countries in Latin America and South-east Asia suggest that, given the right set of policies, Africa's commodity-dependent economies have, like them, the potential to diversify their export bases. One possibility is to move towards natural resource-based export-oriented industrialisation (as in the case of Indonesia or Malaysia) or diversify within the primary sector itself (such as agribusiness in Chile or Colombia). International technical assistance currently being provided in the context of trade capacity building should help African countries realise this potential.

3. This study aims to contribute to the on-going policy discussion by reviewing the development experiences over the last twenty years of six East African countries (Ethiopia, Kenya, Madagascar, Mozambique, Tanzania and Uganda). In so doing, lessons are also drawn from several other commodity-dependent countries that have successfully managed to diversify their export bases (Chile, Costa Rica, Colombia and Mexico in Latin America, Indonesia, Malaysia, the Philippines and Thailand in South-east Asia, and Mauritius in Africa). In the early 1970s, most of these countries' economies (except that of Mexico) were characterised by a weak industrial base, a relatively abundant endowment of natural resources and a highly concentrated export structure; their exports to traditional (and dominant) markets — i.e. high-income OECD countries — were overwhelmingly comprised of primary products. For the East African countries there has been little change in the product profile since this time: in the late 1990s, primary products still accounted for 80-90% of the region's total merchandise exports. However, the picture looks quite different for the Latin American and South-East Asian countries: the share of primary products had declined significantly to 65 and 33%, respectively. At the same time, countries in both regions managed to expand the share of processed products in their export basket.

4. Since the late 1980s, all six East African countries have implemented macroeconomic stabilisation and structural adjustment programmes. As a result, countries such as Mozambique and Uganda and, to a lesser extent, Madagascar, have made significant progress in opening up their markets to foreign competition, whilst at the same time attracting foreign firms into export-oriented industries. That said, the supply response has been rather weak. The share of manufacturing value-added relative to GDP is still modest; the decline in agricultural value-added has been wholly absorbed by the increased share of the service sector. Furthermore, in three of the six countries (Kenya, Madagascar and Tanzania) the manufacturing sector shrank during the adjustment period (1988-98). The picture looks a bit better for the two most open economies of the region, viz. Mozambique and Uganda, which during the same period managed to increase the proportion of manufacturing in GDP, increase domestic investment in this sector and attract foreign direct investment (FDI) on a sustained basis. As a whole, however, investment rates relative to GDP – a proxy for export growth potential – are still considerably lower than those observed in their Asian and Latin American counterparts.

5. African countries are becoming increasingly aware of the importance of developing trade capacity in order to achieve effective participation in the world trading system and to reap the full benefits of improved access to OECD markets. At present, various regional and international

initiatives are being undertaken to help them improve their capacity to negotiate and implement WTO rules. These initiatives must be complemented, however, by simultaneous endeavours at the national level to raise the productivity of domestic firms and improve their international competitiveness. Unless this is done, poor countries are unlikely (except where their own trade interests are at stake) to sustain a strong political interest in engaging actively in multilateral trade negotiations and enforcing global trade rules, because this costs them dear in terms of both human and financial resources.

Policies for export diversification and capacity building

6. It has often been argued that countries rich in natural-resources have a weaker incentive to industrialise, especially for export, the logic being that while resource-poor countries are compelled to develop an export-oriented industrial sector to earn the foreign exchange needed to finance imports, resource-rich countries can easily earn foreign exchange without industrialising. However, a growth strategy based solely on the exploitation of natural resources is not a good policy for long-term development because of the limited scope for technological improvements and skill development, which are the keys to economic growth and poverty reduction. Furthermore, natural resource extraction usually fails to establish backward and forward linkages with the rest of the economy and tends to concentrate the value-added in the hands of few people, thereby worsening inequality.

7. Successful experiences in several Asian and Latin American countries show that there exists a wide array of means by which to escape such a “resource curse”. In the 1960s, primary products dominated the export profiles of all three regions. By the end of the 1980s, governments of such countries as Malaysia and Thailand had successfully managed to widen their resource-based sectors, move up the value-added ladder (both in agro-processing and resource-based industries), and develop manufacturing industries, such as electronics. In Latin America, while Mexico and, to a lesser extent, Costa Rica followed the similar pattern of industrialisation, primary products still dominated Chile and Colombia’s exports to OECD countries. The lower level of diversification in Chile, Colombia and Costa Rica in the OECD market does not mean that these countries had failed to diversify their exports as much as other resource-rich countries discussed here. Indeed, these countries rapidly expanded their exports of resource-based and other manufactures within the regional market.

8. Export diversification is typically a slow process, and needs to be sustained by appropriate and coherent policies. Latin American and Asian countries managed to widen their narrow export base by achieving a fairly stable macroeconomic environment and removing the anti-export bias inherited from the import-substitution industrialisation era. Preventing an overvaluation of the real exchange rate was crucial in sustaining non-traditional exports. This is particularly true in countries that are rich in natural resources and highly dependent on aid inflows, and thereby more likely to suffer currency overvaluation. The exploitation of natural resources or large aid inflows raise expenditures in non-tradable goods and services, inducing real exchange rates to appreciate, and siphoning resources away from the tradable sector.

9. The strong performance of manufactured exports in several ASEAN countries was made possible by transforming their economies into new export platforms within East Asia’s business networks. The experiences of Chile and Costa Rica also indicate that export diversification can be greatly encouraged through the provision of the correct incentives for the promotion of primary-commodity processing and resource-based manufacturing activities. These options are not necessarily exclusive. However, government initiatives geared at export diversification must be

placed within a comprehensive and coherent policy framework. Switching from the primary to manufacturing sector is a medium- to long-term goal. Increasing the efficiency of firms operating in the primary sector and developing non-traditional primary exports is a more immediate and feasible option for these African countries, which enjoy low labour costs and favourable agro-ecological conditions, but still lag behind in terms of skills. Successful stories exist in Africa as well. For instance, by exploiting its sugar revenues, attracting export-oriented FDI and at the same time granting selective incentive measures Mauritius has been able to develop a competitive textile sector. The success of this "unorthodox" policy-mix is partly explained by the governance structure existing in Mauritius, where an effective public-private partnership in policy design and implementation exists, securing a large support for the overall development strategy. The experience of Botswana shows that when the right set of policies is put in place diamonds are not necessarily a 'curse'. Of the East African countries, Kenya has the most advanced and diversified production structure, with its rapidly expanding cut flowers and horticulture sectors. What do these success stories have in common?

10. The experiences reviewed here suggest that the changes needed for successful diversification are not just in policy *per se* but also in the national policy-making *process*. By itself, the implementation of good policies will not suffice to enhance the international competitiveness of domestic firms. Macroeconomic and structural reform programmes must be sustained, since gains are not likely to materialise immediately, and complementary policies for promoting trade and investment need to be implemented. Furthermore, the sustainability of such programmes and polices depends crucially on building an effective coalition between government and the private sector through a continuos dialogue and the involvement of all the stakeholders.

Identifying barriers to international business development

11. These conclusions have been reinforced by the 1997 survey conducted by the International Trade Centre (ITC), assessing barriers to international business development as perceived by exporting firms and business associations. The firms surveyed in five African countries (Ethiopia, Madagascar, Mozambique, Tanzania and Uganda) pointed to their "lacking trade support services" and the existence of "inappropriate government policies" as the major obstacles to international business development. Broadly defined, trade support services include trade finance, general business services, telecommunication and transport services and trade promotion and marketing services. While still ranking "lacking trade support services" as the most important barrier, business associations, on the other hand, tend to regard "weaknesses within domestic firms" as more problematic than "inappropriate government policies". Similar results emerged from the Development Centre – IDS (2000) survey on Kenyan firms.

12. Within the sub-group of trade support services, trade finance and transport and communication infrastructure are the primary areas of concern for both enterprises and business associations. With respect to government policies, respondents pointed in particular to the inconsistent implementation of policies, unsatisfactory dialogue between government and business organisations, export-impeding trade regulations and taxes, and laborious customs procedures.

13. The analysis of the available data on the provision of infrastructure and trade support services in East Africa confirms the view expressed by firms and business associations. When looking at trade finance and transport and communication services, the six countries under review rank very low even by developing-country standards. In particular, the development of transport services within and between countries has been slow and unplanned. Inefficient transport services are

likely to impose a heavy toll on exporters of these countries, where, due to the unprocessed nature of most exports, freight costs often represent a high share of export value.

Use and provision of trade support services: preliminary results from case studies

14. In an attempt to shed more light on the question of how firms in the six African countries could improve their connection to international markets, the Development Centre undertook three case studies to supplement the survey data collected by the ITC. Special attention was paid to the role of trade support services as a facilitator of international trade activity, an area where evidence is scarce. These case studies analysed trade support polices and institutions in three countries, Kenya, Ethiopia and Mauritius, with two firm surveys conducted in Kenya (October 2000) and Ethiopia (December 2001) to evaluate actual use of trade support services and satisfaction with existing provision. Three major findings emerge from these studies.

15. Findings emerging from the firm surveys suggest that while the positive role of trade support services is being acknowledged, their actual use has been very limited and that many surveyed firms are characterised as 'passive' and do not invest much in preparing for export. Despite the higher availability of trade support services, Kenyan firms display a rather passive behaviour in that they do not use these services as a lever to break into new markets or develop new products. The most widely used services include the provision of information and of marketing support and the initiation of contacts; pre-export services such as market studies or research and development for new products are rarely used. On the other hand, very few of the Ethiopian firms surveyed regularly use trade support services and modern information technology for their business activity, and many are not fully aware of their potential. The services commonly demanded are few in number, including the provision of market information and export finance. Very little use is made of technical assistance and pre-export services. Again, only a small fraction of firms are able to obtain regular or occasional support for production processing, marketing or training.

16. Flaws on both the supply and demand sides of trade support services partly explain the passive behaviour in export development. On the supply side, the provision of trade support services is still predominantly in hands of public trade promotion organisations, which are by and large not effective. Unfortunately, the emergence of private markets for business services has been rather slow and business associations often lack resources and acknowledgement from government. Additional constraints on the use of services stem from difficulties in accessing financial resources. On the demand side, many exporting firms have not been willing or able to adjust their strategies to the increasingly liberalised and competitive business environment. Inward-looking attitudes developed under the import-substitution policy regime still linger on. Finally, the availability of 'captive markets' at home or in neighbouring countries has made less compelling for firms to adopt more active trade strategies. This seems to be especially the case for Kenyan firms with respect to the East African market.

17. Neither Kenyan nor Ethiopian firms are very satisfied with the trade support services that are currently provided. Both countries established public agencies responsible for provision of trade support services. Surveyed firms, however, do not seem to rely much on them. The use of in-house services as well as reliance on buyers and business partners is a very common feature in both countries. While for some large firms especially in Kenya that can be a deliberate choice of internalisation, for the majority of surveyed firms in-house provision seems to be a necessity caused by a lack of adequate supply of the specific service. This is especially true for small and medium-sized enterprises, which represent the largest part of the sample. Concerns regarding the capability of governments to understand and efficiently meet exporters' needs frequently emerged

during interviews. In both countries, exporters were of the opinion that only a handful of export promotion programmes were truly effective, even though some successful domestic exporters had got their start through them. Private providers are usually thought to be more efficient than existing public or semi-public agencies in charge of export promotion. The latter often lack the expertise and the resources for tackling the issue of export competitiveness and sometimes carry out services that are or could be offered by private-sector organisations. One of the most striking points that emerged from these surveys was the general lack of confidence in the public agencies' services; this probably reflects the inadequate involvement of the private sector in policy design and implementation. Many firms pointed to inefficiency and inflexibility of government services, political interference and high transaction costs as major sources of complaints.

Governance matters

18. The analysis on provision and use of trade support policies in Kenya and Ethiopia indicates that major policy initiatives must be taken if the opportunities created by improved access to OECD markets are to be met. The private sector, especially in Ethiopia, is fragile and it lacks a consolidated business culture and export experience. The institutional frameworks for trade support services, i.e., the agencies in charge of and the regulations governing trade and investment promotion, suffer from several shortcomings. Providers of trade-support services are not matching exporters' needs and the degree of satisfaction with existing supply is not very high.

19. How can these shortcomings be overcome? How best can these countries sustain policies for export diversification? For sure, country specificity calls for targeted solutions. Yet, the mismatch between private sector's needs and government policies point to a more fundamental governance problem – the lack of involvement of non-governmental stakeholders in the policy formulation process – which not only reduces the effectiveness of and the support for polices, but also risks to undermine their 'legitimacy'. Minimal involvement of the private sector in policy making is a common feature in these countries and is confirmed by recent case studies on enterprise networks in Africa, pointing to the virtual non-existence of established processes for public-private dialogues on trade issues.

20. The results of the case study conducted in Mauritius (December 2001) showed that this country has developed an effective governance system in national trade policy making, which greatly contributed to the successful implementation of trade and investment promotion and structural transformation of the economy. Probably because of its multi-ethnic composition, Mauritius has adopted a participatory approach to policy making and built an effective partnership between the government, business and trade unions. All these stakeholders contribute to shaping the national economic strategy and private sector needs are reflected in government policy, in line with the overall development objectives for the country. Incentives and technical support play a key role in the export-oriented development strategy and firms widely use the services provided by specialised public agencies, business organisations and private firms. Specialised public agencies are well funded, staffed with highly professional persons (many of whom have private sector experience) and enjoy high credibility within the private sector. Changes in the range of services provided are always decided upon on the basis of close consultations with exporters, while taking into account the development objectives of the country. Specialisation is taking place, and public agencies step in where market solutions are not available. In this way, private providers are not 'crowded out' by public agencies. Indeed, exporters are encouraged to source their services from private firms, for instance through matching grants and cost-sharing schemes.

Conclusions

21. The trade analysis and firm surveys conducted in the six African countries in this study highlight an apparent mismatch between government policies and exporters' needs in the provision and use of trade support services. While acknowledging the weaknesses of firms in these countries, the study does present evidence confirming the existence of a wide array of policy options for increasing business competitiveness and reducing dependence on primary commodities. Successful upgrading and diversification, however, require not only a right set of macroeconomic and structural policies, but also a substantial change in the policy-making process. A major governance problem undermines the implementation of a successful business plan for export diversification in these countries: the lack of involvement of private sector and civil society in policy formulation.

22. The importance of devising a functioning governance system in the area of trade policymaking is confirmed by the Mauritian experience. A key ingredient to the Mauritian success is the participatory approach to policy design and implementation. This has made it possible to build a national consensus on a clear and shared development vision and provide broad-based support for the reforms needed to achieve it. The private sector's participation in policy design and implementation helps to increase the credibility of government policies and bolster investors' confidence in the nation's economic future.

23. Governments of poor, commodity-dependent countries need to develop their own 'business plans' for export diversification and competitiveness in close consultation with all concerned stakeholders. International technical assistance, both bilateral and multilateral, should continue to help African countries realise their potential and increase their capacity in negotiating and implementing trade rules. At the same time, any effort at trade capacity building in Sub-Saharan Africa should take concrete steps towards improving local conditions for international business development. These initiatives must be co-ordinated and prioritisation informed by the objectives of export competitiveness strategy. A full discussion of the issues relating to trade capacity building and the policy conclusions and recommendations that follow from them are presented in the study.