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The Politics of Trade Policy: Trade, Development, and the AfCFTA

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TRADE AND DEVELOPMENT

Nicholas Kaldor, the distinguished Cambridge Economist used to tell his students three things about development:

- ✓First, the only way for a country to develop is to industrialize;
- ✓Second, the only way to industrialize is to protect oneself (protect domestic industry from unsustainable competition); and
- ✓Third, anyone who says otherwise is being dishonest!

INTRODUCTION

- Nations have traded among themselves for centuries.
- The need for trade have never been in doubt.
- “Nations cannot live alone any more effectively than individuals”.
- A single family, living in isolation and providing for all its needs can obtain only a meagre and primitive living,
- … even among primitive peoples there was some rudimentary specialisation together with an inevitable sharing or exchange [trade] of its fruits.

TRADE POLICY

- The use of Tariffs and Non-Tariff Barriers to affect the flow and direction of traded products;
- Tariffs are custom duties often expressed as a percent of the value of the product;
- Tariffs are denoted as price restrictions on trade
- Non-tariff barriers are non-price restrictions;
- They are many and varied:
- Examples include quotas, outright bans, phyto-sanitary measures etc.

TRADE POLICY – HOW SHOULD TRADE BE CONDUCTED?

- Debates about international trade have a long history, even predating the emergence of economics;
- Historically, countries have differed on how trade should be conducted;
- In the 15th century, the mercantilist argued for nations to increase their export while limiting their imports;
- In their view a nation can benefit from trade only at the expense of the other(s);
- This view of international trade dominated for a long time.
- Adam Smith and his peers including David Ricardo managed to convince nations that free trade was superior to protectionism.

TRADE POLICY – HOW SHOULD TRADE BE CONDUCTED?

- They advised nations to export what they can produce cheaply and import everything else;
- Their concept of free trade was on removing border barriers such as quotas and tariffs;
- In the last four decades, this view of trade has triumphed.
- The proposition is that trade or free trade will create a sanguine climate for economic growth and development.
- Economic growth will in turn create employment and reduce poverty;
- Trade barriers distort the allocation of resources to their most efficient uses. They lower economic growth and employment
- This is the premise of orthodox economics.

THE POLITICS TRADE POLICY

- The mainstream trade theory is based on the law of comparative advantage ;
- The theory simply says that countries will gain by specializing in the production and export of goods which use their most abundant factor of production (Heckscher, 1919; Ohlin, 1933).
- For example, Ghana will gain if it concentrates on the production and export of cocoa.
- The same is true for Kenya if it continues to produce and export tea
- The country cannot and indeed ought not capture the enormous value that accrue beyond the production of cocoa beans.
- It is for this reason that Ghana and Cote d'Ivoire, the two countries responsible for 70 percent of world cocoa outputs only receive 10 percent of the value of the global confectionary industry.

THE POLITICS TRADE POLICY

- Indeed “Comparative Advantage” is a theory of “how not to develop”
- Shumpeter’s verdict on the theory of ”comparative advantage is that:
- “it is an excellent theory that can never be refuted and lacks nothing but sense”
- Yes, the theory has “everything but sense.
- According to Erik Reinert ‘…the theory of comparative advantage actually may lock poor countries into a poverty trap, into primitivisation: specialising in being poor’ (Reinert, 2007).

THE POLITICS TRADE POLICY

- International Monetary Fund (IMF), World Bank and World Trade Organisation (WTO) were all founded on the orthodox premise of welfare gains derived from comparative advantage.
- They have so far functioned according to the script that says freer trade is not only good for economic growth, employment, and poverty but also it is the only way to achieve all three objectives.
- The IMF is purposefully structured to lend to countries in balance of payment difficulties to prevent such countries from imposing trade barriers.

THE POLITICS TRADE POLICY

- Keynes (1930) observed that “free trade assumes that if you throw men out of work in one direction you will reemploy them in another direction. As soon as this link in the chain is broken the whole of the free trade argument breaks down”.
- This is equivalent to assuming that people who lost their employment in Ghana’s textile manufacturing sector following the rapid liberalization of the sector will immediately be equipped to gain employment in the thriving cocoa sector.
- Free trade economists also assume that trade liberalization will preserve equilibrium in the balance of payment.
- Trade liberalization often leads to imports growing faster than exports. This results in balance of payment crisis unless the exchange rate deteriorates fast and deep enough to limit imports and/or spur exports.
- If the exchange rate fails to do the job, then a stabilization programme that limit outputs (growth/incomes) is warranted/needed to reduce imports.

THE POLITICS TRADE POLICY

- This will reduce employment and bring about welfare losses. This has been the story of many other countries in Africa; countries forced to prematurely adopt trade liberalization.
- It is also entirely possible for trade to accrue dynamic gains (in addition to static gains). This will be in the form of flow of ideas, knowledge, investments, and economies of scale.
- But dynamic gains from free trade is dependent on whether a country specializes in natural resource extraction or manufacturing activities.
- Specializing in the production and exports of natural resources confers no dynamic gains on a country.
- This, according to Reinert (2007) amounts to specializing in diminishing returns activities and in being poor.

TRADE AND DEVELOPMENT

- For trade to bolster growth and development on a sustainable basis, countries will have to move beyond static comparative advantage and venture into new areas of comparative disadvantage.
- In other words, countries will have to acquire new comparative advantage in goods that have favourable production and demand characteristics – goods that are subject to increasing returns to scale.
- Poor countries must shift from "diminishing returns activities" and "perfect competitive markets" to "increasing returns activities and "imperfect markets"
- No country in the world has achieved this shift through free trade.
- All countries that have successfully made this transition have done so through protectionism.

TRADE AND DEVELOPMENT

- Stiglitz (2006) makes the point more succinctly:

Without protection, a country whose static comparative advantage lies in, say agriculture, risks stagnation; its comparative advantage will remain in agriculture, with limited growth prospects. Broad-based industrial protection can lead to an increase in the size of the industrial sector which is, almost everywhere, the source of innovation; many of these advances will spill over into the rest of the economy as do the benefits from the development of institutions, like financial markets, that accompany growth of an industrial sector. Moreover, a large and growing industrial sector (and the tariffs on manufactured goods) provide revenues with which the government can fund education, infrastructure, and other ingredients for broad-based growth (p.72)".

TRADE AND DEVELOPMENT

- The evidence is conclusive:
  - that free trade does not propel a poor country with static comparative advantage in agriculture and commodities into one with dynamic comparative advantage in manufacturing.
- Bhagwatti (2001), the high priest of free trade admits as follows:

"Those who assert that free trade will lead necessarily to greater growth either are ignorant of the fine nuances of the theory and the vast quantity of literature to the contrary on the subject at hand or are nonetheless basing their argument on a different premise…"

TRADE AND DEVELOPMENT

- Historically, all countries that have developed and are today the giants of international commerce did so behind high tariff walls, and not free trade.
- France and Germany embraced free trade briefly, found they were losing out, and reversed course in the 1880s;
- Britain industrialised behind the Corn Laws. Its only began to preach free trade after it had gained technological advantage.
- Fredrich List (1856) described British admonishing on free trade as “kicking away the ladder”.
- Instead of free trade, the US industrialised through the 19th and most part of the 20th century behind high tariff walls and protectionism.
- The newly industrialised countries of Southeast Asia followed the same route.
- China has pursued the same logic of selective and strategic protection and has achieved spectacular rise in industrial production.

TRADE AND DEVELOPMENT

- The evidence is overwhelming, and it is not on the side of free trade.
- It begs the question why poor countries seeking to transform their economies continue to pursue free trade and why professional economists insist on free trade.
- According to Stiglitz (2006) “economists who promise that trade liberalisation will make everybody better off are being disingenuous”.
- Both theory and evidence suggest otherwise.
- What is most uncontested is the historical experience that as countries get richer, they lower barriers to trade or become more laisser-faire.
- Countries do not get richer because they liberalise trade (Thirlwall, 2013).

TRADE AND DEVELOPMENT

- This is not to say that trade is not important for development;
- The problem is not trade itself.
- The problem is the premise and the particular approach to trade that has been forced on poor countries.
- Indeed, it is difficult to argue against trade
- Trade played important roles in the development miracle of Korea and the other countries of East Asia.
- And certainly, China’s giant strides in the last 4 decades owe much to international trade.
- A unique feature of these countries is that they liberalised export sector long before liberalising their import sectors – their domestic firms used their domestic markets as breeding grounds to make all their mistakes.

TRADE AND DEVELOPMENT

- Properly calibrated, trade can serve the development needs of the world's poor including workers.
- The reality, however, is that for many countries and for many people particularly in Africa, trade has been a nightmare.
- It has destroyed employment across Africa:
- The manufacturing sector has been decimated as imports of basic products saturate domestic markets.
- Domestic firms have been wiped out unable to compete with matured and highly subsidized firms from the developed world.
- Existing firms are on the brink facing unfair and unsustainable competition.
- The current regime of rules under which trade is conducted is part of the problem

TRADE AND DEVELOPMENT

- The existing rules are effectively rigged against development and against the interest of world's poor.
- The result is that while it is difficult to argue against trade, it has become equally difficult to defend the current global architecture under which trade is conducted.
- Oxfam (2002) likened the international trading system to a hurdle race in which the weakest athletes confront the highest hurdle.
- In fact, international trade is at the behest of Multinational Corporations and they are aided by governments of the United States, the European Union, Japan and Canada.
- Acting together in the WTO and in concert with the International Monetary Fund (IMF) and the World Bank, they have forced opened markets around the world.
- However, their own markets remain firmly protected using both old and new trade barriers.

THETRADE AND DEVELOPMENT

- Attempts to change the rules of international trade resulted in the launch of the Doha Round of Trade Negotiations in 2001.
- The Doha Round had sought to address the development needs of developing countries;
- After more than 20 years of fruitless negotiations, the Doha Round is moribund
- The rich world has demonstrated its unwillingness to give up its privileges even at the cost of the poor and planet.

TRADE, DEVELOPMENT AND AfCFTA

- It is in this context – trade theory/policy and the rules of international trade – that we must talk of Africa Continental Free Trade Area (AfCFTA);
- ***It's a free trade***

Africa Continental Free Trade Area (AfCFTA)

- The most ambitious attempt at the continental level to establish a customs union, harmonise trade policies, and strengthen trade links among African countries.
- It offers opportunity for Africa to circumvent the constraints it faces in the unbalanced rules of the WTO and the emerging mega regional agreements such as the Trans-Pacific Partnership (TPP).
- However, challenges remain and appear to be overlooked as the continent is gripped in the euphoria of a continental agreement.
- The AfCFTA is by no means the first attempt to promote trade among African countries.
- The Regional Economic Communities (RECs) have been in the business of promoting intra-African trade for half a century.
- But they have failed.
- Intra-African trade stands at only 15 per cent. This compares to 61.7 per cent in the European Union, 40.3 per cent in the NAFTA and 23 per cent in the ASEAN region.

Africa Continental Free Trade Area (AfCFTA)

- The failure of the RECs highlights the risks entailed in the AfCFTA.
- The ACFTA appears to ignores the lessons of history – including Africa’s own.
- Historically, all countries that have developed and are today the giants of international commerce did so behind high tariff walls, and not free trade agreements.
- Several studies have shown that economic growth, capital accumulation, and strong production systems always have preceded trade liberalisation.
- So it is only Africa that is seeking to industrialise, diversify its economies, and capture greater share of world trade through trade liberalisation.
- This is tantamount to swimming against the tide of economic common sense of the past centuries.
- We do not even have the infrastructure for Africa-wide trade!