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TRADE EXPORT PROMOTION & POVERTY REDUCTION

Assessing the Connection



WEST AFRICA TRADE HUB TECHNICAL REPORT #29

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ASSESSING THE CONNECTION

West Africa Trade Hub Technical Report No. 29

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ACRONYMS AND ABBREVIATIONS

C&F	cargo & freight
ELG	export-led growth
GDP	Gross Domestic Product
GHS	New Ghana Cedi
GNP	Gross National Product
mT	metric tons (1,000 kg or 2,200 lbs)
PRSP	Poverty Reduction Strategy Paper
RCN	raw cashew nut

EXECUTIVE SUMMARY

Sub-Saharan Africa's share of world trade has declined from about 4% of the total in 1970 to about 2% in 2005. The reason for this drop was the rapid rise in exports from China, which overtook manufacturers in Africa and other parts of the world. Donor-financed export promotion programs in sub-Saharan Africa aim to assist firms in the region to regain that lost ground under the assumption that the decline in export competitiveness has impeded economic growth and poverty reduction.

While the empirical literature is ambiguous concerning the contribution of trade to economic growth, it seems clear that trade is necessary for growth, but not sufficient. Export-promotion programs bring targeted assistance to certain sectors and have the effect of "pulling" production from the national economy to meet world demand. The corresponding increase in export activity creates new jobs and enhanced household incomes. That growth in export activity, however, requires that the underlying economic processes of the national economy are coherent.

Economic coherence means that if cashew farmers experience an increase in the demand for their product:

- (1) There is a supply of willing and qualified workers;
- (2) Credit markets are ready to offer operating loans at competitive and feasible rates;
- (3) The transport system is able to offer cost-effective movement of inputs and final product;
- (4) Governmental procedures can be complied with in a timely manner; and
- (5) The associated transaction costs do not impede efficient realization of promising business opportunities.

There are five stages in the switch from an economy that is minimally reliant on trade (a "closed" economy) to an economy that is increasingly connected to the global economy (an "open" economy). These are: (1) The Status-Quo Ante: Low-Level Equilibrium; (2) Induced Disequilibrium; (3) Systemic Diagnosis; (4) Induced Institutional Change; and (5) A New (More Efficient) Equilibrium.

The West Africa Trade Hub is measuring the level of exports from West Africa with the export-promotion program in place, compared to what the level of exports would have been without the export-promotion activity. Gross attributable exports is the total annual value of exports from West Africa clearly attributable to the activities of the Trade Hub. This new export activity will give rise to increased employment and household incomes in the economy. These are the direct impacts of gross attributable exports that can be measured. The empirical challenge is to measure the indirect impacts of gross attributable exports, which include the increased employment and household income for those businesses serving firms engaged in export activity.

Finally, increased exports bring about induced efficiencies attributable to the demands for improved economic performance in order that exporters might take advantage of the new export possibilities. These newly induced efficiencies represent gradual relief from the low-level equilibrium trap that persists in most of these economies.

1. Trade and Economic Growth: *The Contested Connection*

Global markets are the most hostile to the products produced by the world's poor—such as agricultural products and textiles and apparel [World Bank, 2005, p. 132].

Sub-Saharan Africa's share of world trade has declined from about 4% of the total in 1970 to about 2% in 2005. However, this statement warrants elaboration. Specifically, the sub-continent's falling share of global trade is explained by the fact that Asia's share has increased over this period from a little over 5% to over 23% now [Carey, et al. 2007]. Economic stasis on the African continent has been costly. The standard view is that development in the absence of trade is impossible. Having said that, no serious economist believes that trade alone will do the trick. Trade seems necessary for growth, but not sufficient.

The role of trade in economic development has a long and contentious history [Bardhan, et al., 2006; Feder, 1982; Fosu, 1990; Helleiner 1990; Jung and Marshall, 1985; Ram, 1985; Rodrik, 1997; Samuelson, 1962; Singer and Gray, 1988; Stiglitz, 2002; World Bank, 2005]. In seeking to summarize the large literature on the topic, a few citations must suffice. In summarizing studies on the general subject, Singer and Gray write that:

An empirical study by Helleiner (1986) concludes that for the low-income countries there is no evidence to support the proposition that the degree of export orientation is associated with growth performance either in Africa or in poor countries generally; and that there is support, especially powerful in Africa, for the view that greater import volume instability is associated with slower growth [Singer and Gray, 1988, p. 396].

These authors continue by noting that “Countries achieve high growth rates of export earnings only when external demand is strong. During a period of slack demand, this no longer holds irrespective of trade policy, although outward orientation limits the fall in export earnings [Singer and Gray, 1988, p. 400].

Helleiner [1990] attempted to study the role of trade in “medium-term adjustment” issues for low-income countries. The emphasis here was on trade strategy, of which export promotion is a key component. Of course the debate gets caught up in the controversy about whether exports can trump import-substitution policies—but this controversy turns, to a large extent, on foreign exchange considerations. Helleiner concludes that:

There is recent econometric evidence that the positive growth effects with which export expansion had previously been associated were significantly damped in the post-1973 period...Export strategy must therefore be carefully constructed; and global-level information about market prospects coordinated and made more widely available [Helleiner, 1990, p. 889].

The author goes on to cite Jeffrey Sachs:

The Asian experience ...suggest(s) ...that successful development might be helped as much by raising the quality of public sector management as by privatizing public enterprises or liberalizing markets (Sachs, 1987, p. 294) [Helleiner, 1990, p. 889].

I will return to this conjecture below. For now, turning to export promotion in particular, Jung and Marshall, in an assessment of 37 countries, find that:

The results are remarkable for the lack of support they provide for the export promotion hypothesis. Only Indonesia, Egypt, Costa Rica and Ecuador pass the causality test from export growth to output growth and have export growth coefficients that are significantly positive....More interestingly, many of the countries most famous for the miraculous growth rates that appeared to arise from export promotion policies (e.g. Korea, Taiwan, Brazil) provide no statistical support for the export promotion hypothesis [Jung and Marshall, 1985, p. 10].

Of course this finding stands in contrast to a number of studies that seem to support the idea that export growth causes growth in GDP [Balassa, 1978; Emery, 1967; Fajana, 1979; Feder, 1982; Maizels, 1968; Michaely, 1977; Tyler, 1981; Voivodas, 1973; and Williamson, 1978]. These studies offer several elaborations of the basic hypothesis: (1) export growth may represent an increase in demand for the country's output and thus increase real GNP; (2) an increase in exports may loosen a foreign exchange constraint thereby permitting imports of needed intermediate inputs thus increasing output of domestic goods and services; and (3) export growth may induce efficiency gains and thus allow greater output.

The Jung and Marshall challenge to these empirical studies comes not in terms of economic theory but rather in terms of the econometric approach taken. Invariably these studies regressed some form of real output growth on real export growth. When the analyses uncovered a significant coefficient on the export growth variable, causality was said to be present. But as Jung and Marshall comment, this approach has a severe methodological flaw. First and foremost, since exports are included in GDP, autocorrelation biases the findings [Sheehy, 1990]. Moreover, all studies have tended to capture correlation without being sure of causality. Perhaps general economic growth caused a growth in exports?

The solution is found in Granger causality. That is,

A variable X is said to cause another variable Y , with respect to a given information set that includes X and Y , if current Y can be predicted better by using past values of X than by not doing so, given that all other past information in the information set is used [Jung and Marshall, 1985, p. 5].

In answering the question as to why their results differ from earlier work, Jung and Marshall cite the methodological problems they corrected by using Granger causality. That is, the other studies employed a multi-country regression approach that stifles the quest for coherent results—the coefficients of such studies are structurally unstable. These authors tested each individual country's time series in isolation from the influence of other countries.

In their recent and exhaustive assessment of the literature, Giles and Williams write about the efficacy of export-led growth (ELG) in the following terms:

The effectiveness of export promotion is, in the end, an empirical issue; over the last 20 years or so there has been a plethora of such investigations, using a number of statistical techniques. Overall, it is difficult to decide for or against ELG, as there are conflicting results. The aim of this paper is to provide a summary of the empirical literature; to this end we provide information on more than 150 papers [Giles and Williams, 2000, p. 262].

These authors conclude that bringing in the improvements of Granger causality will not produce decisive and robust results. The evidence from a properly specified econometric assessment of exports and growth suggests that there are reasons to be skeptical about the connection. That is, the evidence is not exactly robust that growth in exports causes growth in GDP. Notice the emphasis on growth in each factor (exports and GDP), and notice the emphasis on causation. Do exports help growth more than they hurt growth? The answer depends on what is being exported. As we know from the literature on the resource curse, some exports—oil, diamonds, gold—generally impede growth. Are there instances in which export growth seems unequivocally tied to—causal of—growth in GDP? The Asian Tigers (and of course China) come to mind [Findlay and Watson, 1996]. Might the lessons of Asia apply to Africa? This is highly unlikely, as I will explain below.

2. Export Promotion, Export Growth, and Economic Growth

If exports—with the obvious exception of China and a few of the Asian Tigers—seem to have very little to do with bringing about economic growth, why should development assistance programs in the developing world devote funds to export-promotion programs? One rather obvious answer is that since the empirical evidence is so mixed, it is impossible to make a plausible case against export-promotion activities.¹ Perhaps export growth does enhance general economic growth. The trouble with this line of thought is that it situates all of the burden of proof for development assistance on clear evidence of economic growth. Lost in this framing is the realization that much of what needs doing by way of development assistance is to solve daily problems in people's difficult lives. Perhaps the traditional emphasis on growth misses the central point of development? With that idea in mind, a few comments on the development debate seem in order.

2.1 Growth Causes Development

As we see in the extensive literature cited (and referred to) above, the standard approach considers economic growth to be the main reason behind the entire development-assistance endeavor. This pre-occupation with growth owes its existence to theoretical processes in economics dating back to the development of formal growth models of the Harrod-Domar, Hecksher-Ohlin and Solow-Swan genre. This persistent emphasis on growth—with its attendant focus on technology and the existing stock of human capital, both in need of investment—provides the essential core of the received wisdom regarding how to go about the development process. If good institutions are in place then development assistance will produce growth—if not, then development assistance will have little good effect [Burnside and Dollar, 2000]. Of course this claim is unsatisfying. After all, if “good policies” are in place then development assistance ought to be unnecessary—or at the very most temporary and in the nature of overcoming particular hurdle problems. If policies are not “good” then there is no point in development assistance since it will not work anyway. What are we to do with this curiosity?

The growth-first approach reached its height during the era of structural-adjustment lending and the subsequent prescriptive certitude of the Washington Consensus. In the 1990s it was thought essential that countries must adopt a specific set of macro-economic and legal arrangements that were considered to be “pro-growth” in their implications. The skeptics insisted that growth-inducing policies generally fail to lift the poorest of the poor out of their misery, and may indeed lead to less equality. Although this is not the place for a review of that large literature, the argument seems to be borne out by the evidence.

2.2 Development Causes Growth

By way of contrast, the development-first advocates suggest that countries should focus their development assistance efforts on programs that address problems of poor schooling, poor health care, environmental degradation, impaired socioeconomic status of women, declining agricultural productivity, skewed economic opportunity, flawed economic incentives, persistent class demarcations, lack of meaningful employment, and debilitating flaws in governance. The main idea here is that institutional incoherence lies at the core of why countries are poor and seem unable to escape that situation. Ideal development programs are concerned with modifying those particular institutions that give rise to (that explain) undesirable social and economic outcomes.

Those who advocate a development-first approach tend to put initial emphasis on the diagnosis of particular unwelcome outcomes—why are schools bad? Why is job creation failing to keep up with population growth? Why are low-birthweight babies so prevalent in this region? Why is the transportation system so bad?

¹ On second thought we do know what causes GDP growth in the poorer countries of the world—good policies. And what are good policies? They are ones that cause GDP growth (see Burnside and Dollar [2000]).

Notice that proper diagnosis is necessary if development assistance programs and projects are to stand a chance of doing good. This approach also regards economic development as a continuing activity in which a gradual and self-reinforcing evolution of new institutions is launched—all the while being informed and guided by the explicit goals of: (1) solving explicit problematic situations; (2) encouraging improved economic performance; (3) enhancing the equality with which the benefits of that improved economic performance are shared among the population; and (4) assuring that natural resources are not degraded in a manner that will compromise future growth and the continued equitable sharing of the benefits of that growth.

Those committed to the development-first approach suggest that economic growth—increases in per capita national income—is not sufficient unless it is accompanied by a simultaneous and sustainable decrease in social inequality, and unless that economic growth is not destructive of future prospects for growth and continued development. It is worth pointing out that this broader perspective was the original animating idea of development [Arndt, 1987]. The failures of growth-oriented development programs, as seen above, give added credence to this original notion of development assistance.

One of the reactions against the pro-growth idea of the Washington Consensus was that growth could not possibly be beneficial if it were not sustainable growth. And so the 1990s was also known as the era of sustainability and environmentally sustainable growth. Soon it was realized that poverty held serious implications for environmental sustainability—poor people are often situated on marginal lands—and hence alleviating poverty could be good for the environment. And of course a degraded environment made it difficult for the poor to thrive. The decade was therefore preoccupied with sustainable development, alleviating poverty, and with programs to link growth to these concerns for poor people and poor environments. The Poverty Reduction Strategy Paper (PRSP) became a necessary part of much donor activity in the developing world. Few programs and projects could be supported by international donors if they did not somehow eliminate poverty. And to no one's surprise, it was not long until most anything donors wished to do could somehow be justified in the PRSP as “fighting poverty.” The PRSP became a rationalization document to justify most anything.

I now turn to a specific focus on export promotion in an effort to sharpen our focus on the problem at hand.

3. The Theory of Export Promotion

As we saw above, there is a tradition in development economics in which exports are claimed to conduce to economic growth [Balassa, 1978; Feder, 1982; Michalopoulos and Jay, 1974; and Ram, 1987, among others]. It is now necessary to explore that specific idea in greater detail. As Sheehy [1990] notes, the general model is presented as:

$$\dot{Y}_i = a_0 + a_1 \dot{K}_i + a_2 \dot{L}_i + a_3 \dot{X}_i \quad (1)$$

Where the dot over the variables for real domestic gross product (Y), the real capital stock (K), the labor force (L), and real merchandise exports (X), denotes annual percentage rates of growth compared to the pre-export (sample) period. The growth in the capital stock is taken to be the ratio of gross investment to GDP (I/Y).

The essential assumption in this literature is that those commodities being exported are fundamentally different from the commodities that are not destined for exports. Since exports must compete in world markets it is necessary that there be economies of scale—and perhaps the marginal productivity of labor and capital are higher in the export sectors than in the rest of the economy. With these assumptions, a development strategy of export promotion will raise the rate of growth of GDP. An auxiliary assumption is, of course, that the world demand for exports is more robust than is the domestic demand for commodities in a country with a minimal middle class in control of agreeable disposable incomes. That is, the openness of an economy to foreign demand introduces a powerful engine of economic advance that is missing if all domestic production were limited to the demands predicated on local incomes.

Empirically it may be noticed that exports are, in equation (1) a part of GDP and so it would seem to follow that as exports increase, so must GDP. In response to this colinearity concern Feder [1982] partitioned the economy into those commodities clearly destined for export and those clearly destined for domestic consumption. On this reformulation, and with the above assumptions about scale economies and marginal productivities in the export sector, he then asked that we regard exports as yet another factor of production (in addition to capital and labor). Feder's new partitioned GDP function then became:

$$\dot{Y} = b_0 + b_1 I/Y + b_2 \dot{L} + [d/(l+d) + F_x] \dot{X} X/Y \quad (2)$$

We see that the export growth variable ($\dot{X} X/Y$) is now weighted by the share of exports in GDP, and that the coefficient of this variable ($d/(l+d) + F_x$) combines the differential productivity across the two sectors with the “externality effect” of exports on the non-export sector (F_x). Indeed it is this F_x that often captures our attention when we ponder the “multipliers” of exports. That is, how is it that exports spread their good effects through the economy? In Feder's telling, this becomes the basis for shifting attention to the export sector since production for domestic consumption is thought to lack this crucial “kick” to the economy [Sheehy, 1990]. Exports are better for growth than is production for domestic consumption.

Sheehy conducts empirical tests for 36 developing countries in an effort to ascertain whether promotion of exports is more conducive to growth than is the promotion of other sectors—services, construction, agriculture, manufacturing, government. He finds that the promotion of any sector has roughly the same results on GDP. He summarizes the discussion by noting:

Our results suggest that the strong empirical link between exports and GDP growth found in previous applications of these techniques is not specific to exports but, in fact, is common to all major production categories....Finally, it should be stressed that these results in no way overturn the case for an export promotion strategy. They merely indicate that a large body of evidence that is supposed to demonstrate the superiority of this strategy has no bearing on this controversy. The same tests support the 'promotion' of all

the sectors of production considered. An export promotion strategy, if it does provide the benefits widely attributed to it, must rely on evidence other than these cross-country tests [Sheehy, 1990, p. 115].

In the face of these indifferent empirical findings relating export promotion to growth in GDP—indeed in the face of rather indifferent results relating increased exports to increased GDP—it does seem that our attention might better be focused on other indicators. This different focus is warranted by the realization that growth in GDP is an exceptionally crude and often-misleading indicator of the life prospects of many people in the developing world. I will suggest an alternative line of analysis that will bring our work into general agreement with those who argue that foreign assistance programs should focus their efforts on development rather than growth in GDP.

This alternative approach is consistent with the basic rationale for export-promotion programs—jobs will be created, new income streams will arise, and over time poverty will gradually be reduced. An emphasis on job creation is certainly worthy of renewed attention. Indeed, the recent world-wide economic crisis has focused attention on the fate of industrial workers in the developed world. Not surprisingly, it is in such economies that the important matter of job creation invariably surfaces during political campaigns. Governments in the developed countries are held accountable at the voting booth if their economic policies have failed to produce enough jobs to absorb the annual increment of young people ready to enter the labor market. Indeed, one of the curiosities of development-assistance programs is just how little attention seems to be paid in the poor countries to this fundamental matter of job creation. Instead, most of the discussion concerns the indirect aspects of poverty reduction and GDP growth.

Export-promotion programs provide the opportunity to draw long-overdue attention to this essential aspect of livelihoods and a viable national economy. Export-promotion activities bring focused (even targeted) assistance to particular export-oriented sectors—often called export-ready—and this assistance is then expected to result in expanded export opportunities. In an input-output model of an economy—the first approximation of which is a Social Accounting Matrix—exports represent “final demand” from the regional (e.g. West African) economy to the rest of the world. One can think of export promotion as “pulling” production from the national economy to meet existing world demand.

Under certain conditions the appearance in international markets of new products emanating from export-promotion activities can indeed create a new and enlarged market for a product that was previously in limited world supply. Shea products may hold this potential for West Africa. In other instances the new product may actually compete with existing products—again shea and cashew have this potential. Finally, increased exports can bring about enhanced quality of the traded good as West African producers learn about and adjust to world standards of design, taste, durability, and fashion. Regardless of how enhanced export prospects materialize, the basic argument remains—export-promotion activities seem likely to serve as an engine of jobs and enhanced household incomes in poor countries. The empirical challenge is to measure those impacts.

The measurement task is made more difficult by the reality of general economic processes in the developing countries. The central assumption behind the promise of new jobs and enhanced household income arising from export-promotion activities is that the underlying economic processes of the national economy are coherent. If this assumption holds then we can be confident that an export-promotion program will successfully bring together certain sectors with the world market where many buyers stand ready to absorb whatever supplies might be on offer from the West African region.

Unfortunately the assumption of basic economic coherence is often difficult to sustain. Indeed it is rare that the pertinent economic processes in a developing economy function well and thereby give rise to feasible arbitrage opportunities for all participants. In practical terms, the notion of economic coherence means that if cashew farmers experience an increase in the demand for their product, all necessary factors of production will be available at prices conducive to an effective response on the part of producers. This implies that: (1) there is a supply of willing and qualified workers; (2) credit markets are ready to offer operating loans at competitive and feasible rates; (3) the transport system is able to offer cost-effective movement of inputs and final product; (4) governmental procedures can be complied with in a timely manner; and (5) the associated transaction costs do not impede efficient realization of promising business

opportunities. Economic coherence also means that other links in the commodity chain (e.g. processing facilities) are reasonably efficient and responsive to the new opportunities.

This matter of economic coherence can be explained by exploring the properties of a developing economy in which exports are to be promoted. In general, we can distinguish five stages in the process of moving from an economy that is minimally reliant on trade (often thought of as somewhat “closed”) to an economy that is increasingly connected to the global economy (often thought of as somewhat “open”). I will discuss these five stages.

3.1 The Status-Quo Ante: Low-Level Equilibrium

Prior to much export activity a poor economy can be thought of as being in a low-level equilibrium. Traditional economic activities function well enough, but the economy is in stasis and will exhibit two kinds of serious inefficiencies.

The first inefficiency arises from the fact of autarky itself. In the absence of trade the economy is entirely dependent on its own natural and human resources. Its man-made capital stock is usually rudimentary and can only be augmented from the mobilization of domestic savings—of which there cannot be much. Consumers in this economy are restricted to the goods that can be locally produced since there is little foreign exchange (derived from exports) to permit much in the way of imports. By failing to take advantage of a wide range of goods available on international markets, and by failing to sell its own products on international markets, the economy is caught in a productivity trap.

This productivity trap gives rise to a second form of inefficiency—I call this the market-imperfection trap. Even if an economy is open to world markets for both imports and exports, it is still possible that many of the exports consist of unprocessed raw products such as oil, timber, cotton, minerals, and various raw agricultural commodities. If these commodities are mined or produced by foreign companies we often see an enclave effect in which there is minimal reliance on local labor and commodity markets. More seriously, the major share of revenue earned from exports goes directly to foreign companies and rarely brings much to the economy of the country from which the exports occur. Any royalty payments to governments may or may not be used to benefit the country. The presence of these enclave sectors is both the result of—and the cause of—persistent market failures in the economy.

This situation is the result of market failures because the firms engaged in such activities know that the persistence of irremediable economic incoherence leaves them little choice but to have a minimal commercial presence in the country. This situation is the cause of enduring market failures because these highly efficient foreign companies have little incentive to encourage national governments to eliminate the imperfections.

These two economic situations—limited autarky and persistent market imperfections—define the status quo ante in much of West Africa. This is the low-level equilibrium trap. Export-promotion activities may hold some promise to rectify both aspects and to lift these economies out of their debilitating torpor.

3.2 Induced Disequilibrium

There are, in general, two kinds of disturbances that will move an economy out of its low-level equilibrium trap. The first kind, associated with what we call the resource curse, occurs when a large deposit of some natural resource is discovered. Oil in Nigeria, Sudan, and Chad are examples. The danger, as above, is that these activities will be carried out in an enclave economy in which case little economic good is likely to come from the extraction and export of these natural resources. In the extreme, the discovery of diamonds and gold in Southern Africa in the mid-19th century can be understood as the plausible reasons for the imposition of a severe apartheid regime in that region.

A second form of induced disequilibrium—and one pertinent to export-promotion activities—can arise when a raw product that is now directly exported becomes the object of interest on the part of processors who may wish to undertake value added within the country. Or, as in the case of handcrafts, when locally

produced goods find a new market niche in the global economy and become a more significant part of the export portfolio of a nation.

Regardless of the sector, this new focus on increased exports will inevitably encounter an economy that is not geared to this particular economic activity. After all, the prior absence of processing or exports means that there were no good reasons for particular economic opportunities (commercial channels) to exist. The new economic prospects for exports represent an “irritant” in the economy. It is an irritant because those who wish to engage in the expanded export market for handcrafts or processed raw products are suddenly made aware of a number of roadblocks or impediments that were previously unknown.

I call this an “induced disequilibrium” because when some entrepreneur first attempts to undertake this novel economic activity there will be a number of impediments that block effective implementation. These new-found obstacles are the market imperfections prevalent in an economy stuck in a low-level equilibrium. Perhaps the aspiring processor cannot find a sufficient labor force that is trained and willing to work in that particular activity. Perhaps credit markets do not function well and so working capital is unavailable. Perhaps a dysfunctional transport system represents an insurmountable barrier. Perhaps government licensing requirements stand in the way. Perhaps electricity is unreliable and expensive.

These obstacles—these market imperfections—represent binding constraints to the realization of desired new economic activity. This is an induced disequilibrium because few entrepreneurs, intent on the realization of a new income stream, will sit idly by without challenging these impediments. Entrepreneurs will apply pressure at various points in the dysfunctional economic system in an effort to remove the binding constraints on the new income-earning potential. We see that new economic opportunities put new strain on various aspects of the current dysfunctional economic processes. And these strains give rise to efforts to figure out why these impediments exist and persist.

3.3 Systemic Diagnosis

When focused pressure from entrepreneurs is suddenly applied to the points of inefficiency we enter the third—the diagnostic—stage. It is here that there will be a demand to know why credit markets are sclerotic. There will be questions asked about why the transport system is so dysfunctional. Individuals will demand to know why the electricity grid is so unreliable. They will also want to know why it is necessary to offer side-payments in order to get goods moving through the major shipping ports.

The demands from entrepreneurs concerning these market imperfections are the *sine qua non* for necessary institutional change in the economy. Donors cannot play this role, nor should they. The proper role for donors is to show local entrepreneurs what would be possible if particular market imperfections could be eliminated. Export-promotion activities have this beneficial aspect.

3.4 Induced Institutional Change

The institutional change brought about by pressure from aspiring entrepreneurs is the animating source of new and productive economic processes in an economy otherwise stuck in a low-level equilibrium trap. The transport system will gradually be reformed so that goods can be moved with less delay and fewer side-payments. The credit system will gradually be reformed so that low-cost operational credit is available to aspiring producers and exporters. Local government officials will become increasingly open to attracting business to their region.

It must be acknowledged that many of the institutional changes precipitated by one or more sectors will produce beneficial effects throughout the economy. If the transport system is improved as a result of pressure from cashew processors, all firms will benefit—and their business will expand accordingly. If credit becomes cheaper because of pressure from handcraft entrepreneurs then perhaps a large number of other businesses will benefit. If electricity is more reliable—and perhaps cheaper—these positive effects will redound to all commercial operations. Institutional change to remove market imperfections is in the interest of a large number of firms.

3.5 A New (More Efficient) Equilibrium

The final stage in this process of economic transition is one of enhanced economic processes in which new-found coherence replaces the prior endemic dysfunction. This does not mean that all economic processes now work perfectly. It does mean, however, that the introduced irritant of enhanced trade prospects has served a constructive role in mobilizing persistent dissatisfaction with the counter-productive nature of many of the institutional arrangements in the economy.

I like to say that an economy is always in the process of becoming. For some economies that process of becoming occurs at a glacial pace. For others, the process of becoming is rather more accelerated. Export-promotion programs introduce a necessary “irritant” that can speed up the process of escaping the persistent low-level equilibrium trap.

I now turn to the potential impacts from export-promotion activities in West Africa.

4. Assessing the Economic Effects of Export Promotion

Our challenge is to measure the success of export-promotion activities on the economies of West Africa. The notion of “success” can be defined in several ways. The most obvious measure of success would be the increased monetary value of exports clearly attributable to those programmatic activities dedicated to enhanced exports. For this we need to know the level of exports from West Africa over a reasonable period of time prior to the inception of the export-promotion activities, and then the level of exports after the export-promotion activities were underway.

Unfortunately, things are a bit more complicated than this. Specifically, clear attribution cannot be grounded on a simple before-versus-after picture because other events and phenomena may have coincided with the inception of the export-promotion program. Correct attribution therefore requires a “with-versus-without” accounting stance. Specifically, we need to know the level of exports from West Africa with the export-promotion program in place, compared to what the level of exports would have been without the export-promotion activity. Notice that this counterfactual is not easily apprehended.

But we must try and so the first empirical challenge is to ascertain what I shall call the monetary value of gross attributable exports. This is the total annual value of exports from West Africa clearly attributable to the activities of the West Africa Trade Hub’s export-promotion program.

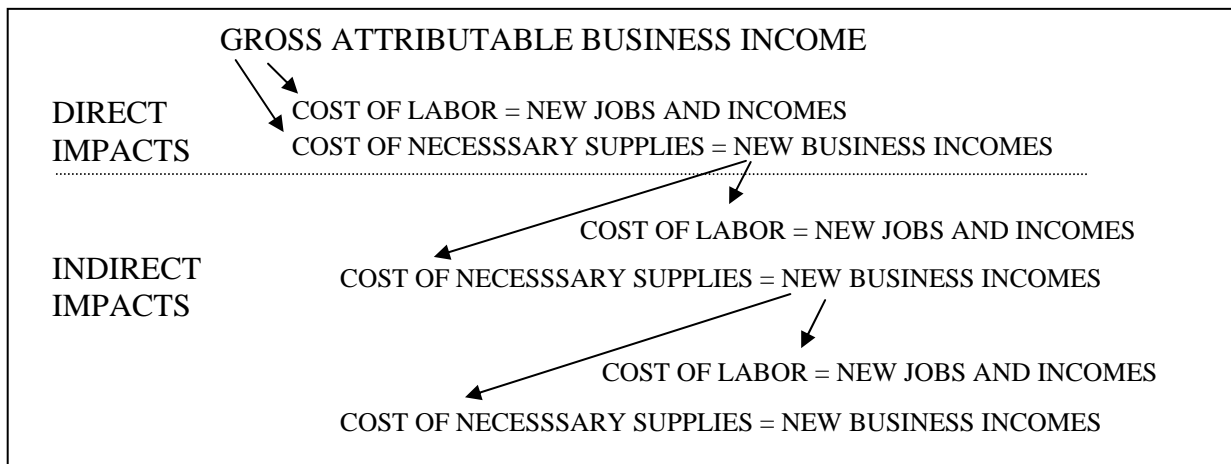
The second empirical challenge, once we have determined the annual value of gross attributable exports, is to assess the extent to which this new level of export activity has brought about—given rise to—increased employment and household incomes in the economy. This new employment and income represent the standard notions of employment and income multipliers. I shall here call these the direct impacts of gross attributable exports.

The third empirical challenge moves us one or more levels beyond the direct employment and income impacts of the gross attributable exports and takes us to the suppliers of those firms whose business has expanded to take advantage of the new enhanced export activity. Here we encounter the business-income gains of the transport sector, ports, the credit sector, the firms that make cashew shelling and drying equipment, the women who serve lunches to workers in the cashew processing firms, the hotels and restaurants serving the increased business associated with expansion of cashew production and marketing, the suppliers of wood, grass, recycled glass, brass, plastic bags, and leather to the handcraft sector, and the sellers of diesel fuel and tires to the transport sector. We see that these indirect impacts are attributable to increases in sales by these firms to business that are directly engaged in export activities. That is, as export-oriented firms enjoy expanded business activity attributable to their increased exports they will necessarily purchase more from firms in the economy. A full accounting of the effects of export-promotion activities requires that we derive an estimate of these indirect impacts of gross attributable exports. We want to ascertain the increased employment and household income within those businesses that serve firms directly engaged in export activity.

4.1 The Usual Multipliers

The above discussion pertains to rather standard assessment of employment and income multipliers. To illustrate the empirical task, I show the flow of these direct and indirect impacts in Figure 1. Below the dashed line—where we enter the domain of indirect impacts—the accounting becomes much more problematic. Notice that necessary outlays by those firms enjoying expanded business from new exports represent new income to those firms one-step removed from the export sector. But most of this new income must then be devoted to the purchase of necessary supplies and increased labor costs for the possible new employment that is generated. We see that these expenditures represent a cost to the direct beneficiaries of new exports but also as income to suppliers and employees of those firms one step removed. The cascade of impacts proceeds through the economy. However, the tractability of these indirect impacts becomes increasingly problematic as we move farther from the direct effects.

Figure 1. Direct and Indirect Impacts of Exports



4.2 The Induced Economic Efficiencies

The final impact to be expected from increased exports attributable to Trade Hub activities concerns the induced efficiencies throughout the economies of West Africa attributable to the demands for improved economic performance in order that exporters might take advantage of the new export possibilities. It is here that we encounter the induced institutional changes that will, if successfully implemented, render all aspects of these economies more efficient. These newly induced efficiencies represent gradual relief from the low-level equilibrium trap that persists in most of these economies. The empirical challenge here differs from the previous challenges in that we will need to estimate the real value of cost savings in the economies of West Africa attributable to the Trade Hub activities.

I will demonstrate the conceptual and empirical issues with the aid of a simple example. Assume that a given quantity of some product, say the “standard” Bolga basket, will fetch the world price at the port of Tema of P_{wb} . Of course it costs something to move that basket from Bolgatanga to Tema and this cost is given by T per kilometer (distance D) between Bolgatanga and Tema. Since the exporter is unable to influence the world price for baskets at Tema these transportation costs must be subtracted from the price he/she can afford to pay the basket maker in Bolgatanga. Let p_b depict the price paid to the basket maker. Since the buyer in Bolgatanga must then pay TD to move that basket to Tema we see that his/her maximum willingness to pay for a basket in Bolgatanga is given by:

$$p_b = P_{wb} - TD \quad (3)$$

The intuition here is straightforward. If the basket maker worked at the port of Tema then there would be no need to move the basket distance D at a cost of T per kilometer. It is also apparent that the higher is the cost of transportation per basket the lower the price that can be paid to the maker of baskets. At this point I want to stop and emphasize the implications of this previous sentence.

If there is a single explanation for much of the poverty and despair in the developing world it can be found in equation (3). That is, the inherent market inefficiencies in such economies, here depicted as nothing more complicated than the cost of moving goods from where they are produced to where they might be sold, means that prices received by producers—whether of agricultural products for consumption in urban areas, whether of baskets made near the ready supply of grass, or whether of cashews destined for export—are so low that scant incentive exists for industriousness and innovation on the part of producers. As above, the economy slides into a low-level equilibrium trap from which escape is impossible without some external shock.

I will now elaborate the basic expression in equation (3) to depict additional problems inherent in the economies of West Africa. Consider equation (4).

$$p_b = P_{wb} - \left(\frac{\varphi_a}{\varphi_v}\right)TD \quad (4)$$

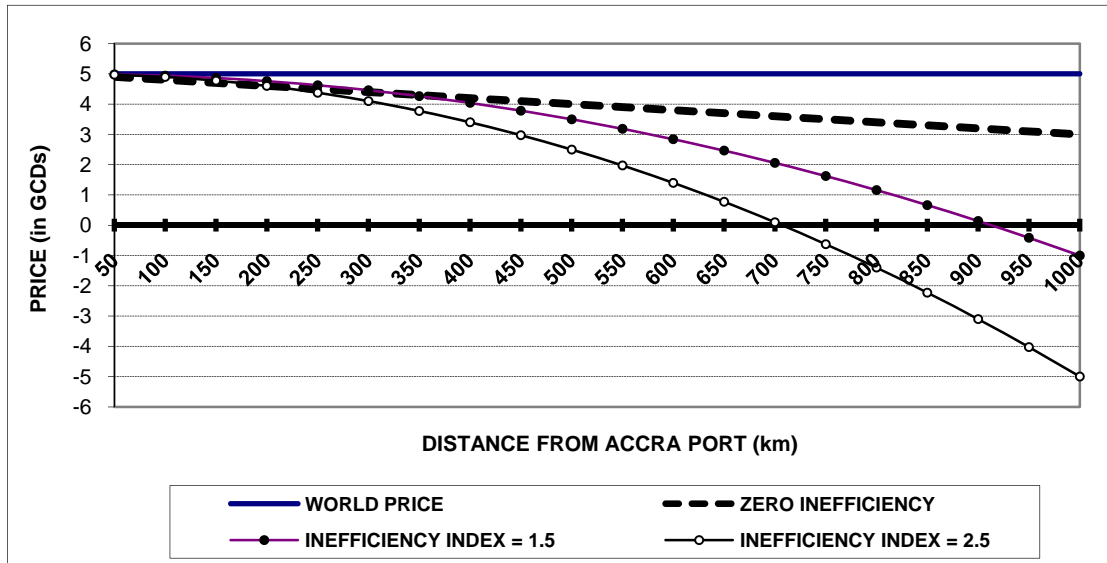
The new component in equation (4) is φ and its role is central to the problems of market imperfections in much of West Africa. Equation (3) depicts transport costs T as a fairly standard idea of freight tariffs for moving goods across space. But if the economy suffers from economic inefficiencies then a simple notion of costs such as T will underestimate the actual costs of moving goods through the country. Common examples of these additional costs in West Africa include the permits, inspection fees, delays, and requisite side-payments owed at the numerous check points. Let φ_a depict an index of these excess costs in the transport sector. To assess the impact of these market imperfections on exports from West Africa we need to relate these extraordinary costs to a market setting in direct competition with the basket sector in West

Africa. For this comparison we might consider Vietnam. The relation $\frac{\varphi_a}{\varphi_v}$ in equation (4) serves to draw the necessary comparison between the economics of the basket sector in West Africa and that in Vietnam—the dominant competitor for West Africa in the world market for baskets.

To get an intuitive sense of the implications of inefficiencies in the West African basket market, consider Figure 2. Assume that the core level of transportation costs (fuel, insurance, depreciation, wages) in both Vietnam and Ghana are similar at GHS 2.00/per kilometer.² Here we see the impact of two different indices of inefficiency in Ghana. Notice that if the transport system in Ghana matched that in Vietnam then basket makers even 1,000 km from port could expect to receive GHS 3.00 per basket. However, if the inefficiency index is 1.5 then basket makers in Bolgatanga, only 800 km from port, will be offered only GHS 1.00 per basket. It is hard to imagine women willing to engage in basket making if the expected price is this low. Indeed, if the index is 2.5 then no buyer would find it profitable to come to Bolgatanga to purchase baskets and we would expect basket making to cease as a source of employment and income.

² These estimates are simply for illustrative purposes.

Figure 2. The Impact of Inefficiency on the Producer Price of Bolga Baskets



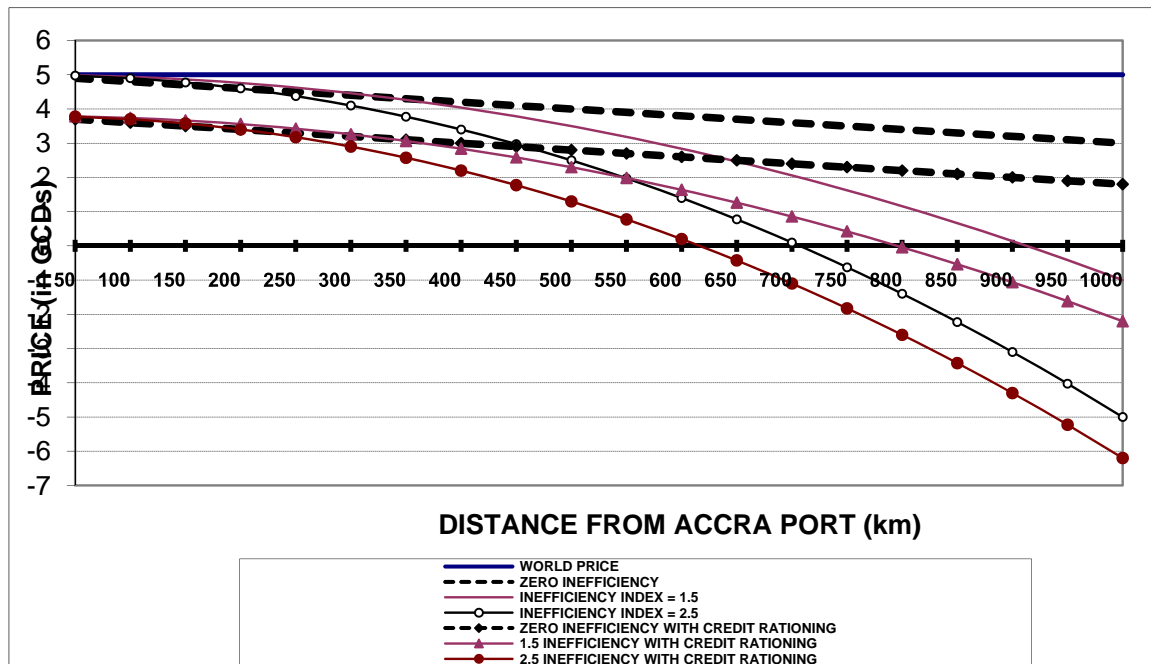
We can usefully consider the difference between the line of zero inefficiency and the other two lines as representing an indication of the willingness to pay on the part of basket makers and transporter to improve the efficiency of the transport system in Ghana. The empirical challenge is then to derive an estimate for both φ_a and φ_v so that the competitive disadvantage of the basket sector in West Africa might be assessed. And of course we are interested in the extent to which the increased opportunities for exports will (might) lead to the elimination of these debilitating inefficiencies. Their elimination, if we can capture the extent of the benefits of same, must certainly be considered one of the benefits of the export-promotion activities of the Trade Hub program.

One remaining economic problem in West Africa warrants discussion—the high price of operating capital. The indications from my time in the field are that operating capital is severely rationed to small producers. A constant complaint was that banks were not interested in lending to small businesses, and that annual rates of interest often ranged between 25-30 percent. Such high rates can be explained by the perception of the risk of lending to small businesses, but can also convey a sense that banks have no desire to deal with small businesses even if the risks of default are low. There seems to be credit rationing underway. This is an empirical issue that will be clarified during the field research.

Let γ represent a ratio of interest rates for small businesses in Ghana compared to similar loans in an economy competitive in basket making—again Vietnam comes to mind. If we let $\gamma = 1.2$ this would imply that similar loans of comparable risk to the lender are 20% more expensive in Ghana than they are in Vietnam. And of course this higher cost of credit puts the Ghanaian basket sector at a competitive disadvantage compared to Vietnam. This effect is depicted in equation (5), and it is graphically illustrated in the downward shift in all three “efficiency curves” in Figure 3. Notice that this higher host of operating capital has the effect of shifting the outer boundary of basket making even closer to Accra.

$$p_b = P_{wb} - \gamma - \left(\frac{\varphi_a}{\varphi_v}\right)TD \quad (5)$$

Figure 3. The Effects of Credit Rationing in the Basket Market



4.3 The Induced Economic Efficiencies: An Example of Cashews

The discussion of basket making would apply—with slight modifications—to all commodities in the handcraft sector. But there are important issues in the cashew sector that warrant their own conceptual and empirical treatment.

We start with the acknowledgement that cashews are grown in a large number of quite scattered areas in West Africa. In terms of the current research endeavor, Cote d'Ivoire is the dominant producer, followed by Ghana and Burkina Faso. The singular economic issue concerning the cashew sector in these three countries is that the vast majority—approximately 98% [Williams, 2005]—of the raw cashew nuts produced here are exported as unprocessed nuts to India. The loss of regional employment and income from this situation is profound. But there are also transportation and pricing issues that resemble the problems plaguing the handcrafts sector—and other sectors as well.

We see that the pressing economic issue of interest in the cashew sector is why, exactly, there is so little processing capacity in West Africa. The answer to that question will point us to hypotheses about the multiplier effects of other export-promotion activities in the region. One obvious reason for so little processing investment in West Africa is the existence of excess capacity in cashew processing in India. It is claimed that India processing facilities can run only 6 months per year on the basis of domestic cashew production (approximately 500,000 mT). This means that India processors are very interested in acquiring raw cashew nuts from elsewhere in order to keep their plants operating 12 months per year. Whether or not West Africa can construct and operate cashew processing facilities on a scale—and at a cost—that will render them competitive with Indian processing facilities will be a key aspect of the success of export promotion in West Africa. The magnitude of this challenge can be seen in Table 1, derived from Williams [2005].

Notice the extent of the competitive disadvantage faced by a processor in Cote d'Ivoire (or West Africa in general). The C&F price of cashew kernels is cheaper than from India since West Africa is closer to the ultimate consumer in Europe or North America. The only other area in which Cote d'Ivoire is advantaged vis-à-vis India is in the price of the raw cashew nut. But of course this is a serious problem since this low price to cashew farmers is precisely the reason why cashew production in West Africa is so unprofitable for farmers. Even though cashew processors must pay, on average, 77 percent more for raw cashew nuts in India than in Cote d'Ivoire (\$3.72 versus \$2.10), the other costs of doing business in West Africa mean that processors are better off exporting cheap raw nuts to India for processing. As Williams points out,

enhanced processing capacity in West Africa is held back by all of those factors shown in Table 1. Indeed, these are the same economic inefficiencies (“market failures”) identified above. Full enhancement of the value chain in West Africa will depend on the elimination of the existing disparities shown in the Table.

Table 1. The Cashew Sector in Comparison

Attribute (Cote d’Ivoire vs. India)	Cote d’Ivoire to India	Comment
C&F Price	\$4.96 versus \$5.43 per kg	Advantage to Cote d’Ivoire
COST OF RCN		
Kernel recovery	21% versus 24%	Advantage to India
RCN volume (kg/kg of kernel)	4.76 versus 4.17	Advantage to India
RCN price to farmer (per kg of kernel)	\$2.10 versus \$3.72	Advantage to Cote d’Ivoire
Commission (\$ per kg)	\$0.18 versus \$0.06	Advantage to India
Transportation (\$ per kg)	\$0.22 versus \$0.05	Advantage to India
TOTAL COST OF RCN	\$2.49 versus \$3.84	Advantage to Cote d’Ivoire
PROCESSING COSTS		
Fixed and variable costs (\$ per kg)	\$1.45 versus \$0.58	Advantage to India
Financial costs (\$ per kg)	\$0.23 versus \$0.13	Advantage to India
Shipping (\$ per kg)	\$0.30 versus \$0.13	Advantage to India
TOTAL OPERATING COST	\$1.98 versus \$0.83	Advantage to India
COSTS AS % OF REVENUE	40% versus 15%	Advantage to India
Attribute (Cote d’Ivoire vs. India)	Cote d’Ivoire to India	Comment
C&F Price	\$4.96 versus \$5.43 per kg	Advantage to Cote d’Ivoire
COST OF RCN		
Kernel recovery	21% versus 24%	Advantage to India
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Source: Williams [2005].

5. CONCLUDING OBSERVATIONS

The economies of West Africa seem caught in a low-level equilibrium that is reinforced by a persistent inability to engage the global economy in a constructive regime of balanced trade. Domestic agricultural policies in the U.S. and Europe conspire to defeat agricultural profitability in most of sub-Saharan Africa. The emergence of East Asia over the past decade—particularly China—has rendered much low-end manufacturing uncompetitive. The global recession that started late in 2007 brought yet another cruel blow to most of the sub-continent.

Export-promotion activities seem to offer a new way to think about development assistance. For the most part the activity is focused directly on the private sector. The activity is problem-focused in that it builds on relationships with the private sector to overcome barriers to enhanced economic activity. And perhaps most important, it highlights a number of existing economic incoherencies that tend to stifle all entrepreneurial activity.

The empirical challenge is to ascertain whether or not export-promotion activities have the potential to enhance the life prospects of the poor in West Africa.

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