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ARE FORMAL TRADE AGREEMENTS THE RIGHT STRATEGY?

Sub-Saharan Africa has a long history of regional integration and cooperation agreements but, with a few exceptions, these have yielded disappointing results. This brief is based on a survey* that examines the potential for regional trade agreements with particular focus on southern Africa. The author finds little reason to expect gains from formal regional trade agreements until member countries agree to follow more open trade policies generally. Regional trade agreements may even be detrimental if they encourage regional import substitution. At the least, they squander scarce administrative and financial resources in an effort that cannot succeed without more open trade policies and more disciplined fiscal and monetary policies.

Despite the poor record of achievement of regional integration and cooperation agreements in Africa, there remains considerable enthusiasm for regional integration. Most notably, analysts hope that the political changes in South Africa will lead to increased integration and cooperation around the southern rim of Africa, and that the South African economy will stimulate economic growth in the entire region. USAID, through the EAGER project, provided support for a review of this prospect in 1996. The findings of this review are summarized below.

Even though significant potential for further economic integration and deeper intra-regional trade exists in Africa, formal regional integration agreements (RIAs) do not appear to be the most appropriate mechanism to achieve these goals. Trade is more likely to increase if individual countries pursue outward-oriented trade strategies and if neighboring countries work together on regional cooperation projects.

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Regional Integration Experiences

The goal of most formal regional integration agreements is to remove discrimination against goods, services, and factors of production traded between countries of the region. In practice, RIAs provide preferential treatment for trade between member countries and discriminate against non-members. They range in structure from free trade areas, where members reduce or eliminate trade barriers between each other but maintain barriers for non-members, to monetary unions, where members fully harmonize national economic policies.

For the most part, RIAs involving developing countries have failed to promote trade or industrialization, and have rarely resulted in significant economic gains for member countries. In those cases where trade has grown in developing countries that were members of RIAs, trade expansion preceded the formation of the RIA. Agreements involving industrialized countries have been more successful at stimulating trade and economic growth. This is because the member countries have tended to be more integrated before the agreement; they have been better able to exploit gains from intra-industry specialization and product differentiation; and they have been more successful at actually implementing agreed policy changes.

Trade Policy

Economic theory and empirical evidence indicate that full multilateral, or global, free trade is the best strategy for a government to maximize national welfare. Policy makers often see regional integration agreements as a second best arrangement or as a step towards the goal. However, many RIAs are between developing countries that have high levels of protection for targeted industries. These countries use inward oriented trade policies to expand regional trade as a substitute for world trade. To avoid excess capacity in the protected sectors, RIAs either allow members to impose barriers to entry, or allocate control of specific industries to individual member countries. Since protected industries are less likely to survive global competition, economic actors in the protected sectors are more likely to fight integration with the world economy. Thus, inward oriented RIAs usually fail because they do not prepare firms to compete on global markets.

Formal regional integration agreements are not likely to succeed in Sub-Saharan Africa because these economies continue to be inward oriented and have only modest trade linkages. African governments appear unwilling to carry out the preferential trade liberalization measures necessary to create trade among integrating markets. Since tariffs account for a large share of government revenue in African countries, tariff reductions will cause immediate budgetary and macroeconomic deficits. Therefore, significant expenditure and tax reform must precede trade liberalization. African governments also need to expand intra-regional trade in order for RIAs to be successful. However, intra-regional trade in Africa is hindered by the non-complementary structure of output across countries. Africa's natural resources, such as South African diamonds, Zambian copper, and Kenyan coffee, do not find a large domestic market, while demand for capital goods can only be met by international suppliers. Another obstacle to intra-regional trade is a weak regional infrastructure. Many rail, road, and port facilities were designed to strengthen trade ties with the former colonial powers, and therefore limit the potential for expanding trade with neighboring countries.

Stability

Regional integration requires that each member country be both economically and politically stable. Macroeconomic instability often leads governments to impose controls on imports or capital flows, which can undermine a RIA whose goal is to open trade between countries. Controls are most hurtful when they are imposed on countries with inward oriented economies or countries that depend heavily on a small number of primary commodities for their export earnings. Because these economies have limited flexibility, they are less able to adjust to external shocks. Furthermore integration agreements involving politically unstable governments tend to lack credibility and rarely attract foreign investment. African countries' history of both macroeconomic and political, instability suggests that they would be relatively poor candidates for membership in RIAs.

Implementation issues

In addition to structural flaws, regional integration agreements in Africa also suffer from weaknesses in design and implementation. Most RIAs in Africa confine their sectoral coverage to industry, which does not allow members to exploit their comparative advantage in other sectors, especially agriculture. African RIAs also limit their scope of policy instruments. By focusing on tariff reductions, governments ignore other barriers that restrict the expansion of markets, such as quantitative restrictions, impediments to factor flows, and administrative obstacles. The method by which tariffs are reduced also affects the success of a RIA. For example, implementation of RIAs is particularly slow where tariff reductions are negotiated product-by-product rather than across-the-board.

Regional Cooperation

Regional agreements aimed at cooperation among developing countries are more successful than those aimed at integration. Instead of targeting trade and factors of production, cooperation agreements commit member countries to work together towards a common end. This can be either the harmonization of selected policies through the adoption of common standards and regulations or the joint production of public goods, including infrastructure or institutions. Many economists agree that African countries would be more likely to gain by enhancing regional coordination in these areas than by formal trade integration.

Cooperation initiatives tend to be more selective in their coverage and generally require less long-term commitment by member governments than formal integration agreements. Because their scope and size is more flexible, cooperation agreements are less threatening to the ruling elite and national sovereignty. In addition, they usually have smaller bureaucracies than RIAs, and are therefore less demanding on scarce administrative and financial resources. Finally, cooperation can facilitate intra-regional trade by improving communication and transportation links and by establishing dialogue between governments.

Conclusion

Experience has shown that formal RIAs work best when they are built upon previous steps towards openness and integration. They do not work well when they are a first step towards openness, and have especially poor outcomes when they act as a substitute for more fundamental trade liberalization. Formal regional trade agreements are unlikely to be beneficial to the countries of Sub-Saharan Africa because these countries show few of the characteristics normally associated with successful RIAs, including economic and political stability, strong infrastructure and communication linkages, and an outward-oriented trade policy. Without these characteristics, RIAs could actually be detrimental to the countries involved, either by encouraging import substitution or by absorbing scarce administrative and financial resources. Moreover, unsuccessful RIAs could erode, rather than build, the credibility of member governments. A better approach to promoting trade and factor market integration, both within Africa and globally, is for individual countries to open their economies while working with neighbors on efforts to encourage regional cooperation. Cooperation agreements allow governments to focus on a wider variety of issues, including infrastructure construction, research and development, environmental initiatives, food, security, energy management, improved flows of information, and mutual defense and security, all of which facilitate international trade. In addition, cooperation agreements are self-reinforcing because they are more likely to result in short-term, visible benefits, and because they are easier to administer.

***This policy brief is based on EAGER Discussion Paper Number 20, *Regional Integration and Cooperation in Sub-Saharan Africa: Are Formal Trade Agreements the Right Strategy?* by Steven Radelet, Harvard Institute for International Development, Cambridge, Massachusetts.**

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