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Trade Integration in Sub-Saharan Africa: Lessons for Malawian Trade Policy

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Trade integration is a potentially powerful driver of economic growth in developing countries, particularly if it creates export opportunities and promotes value addition in manufacturing sectors. Given the prominence of agriculture in Sub-Saharan African countries—both as a source of employment and as an earner of foreign exchange—increased market access for agricultural exports is a common interest in these countries' trade negotiations. Trade negotiations, however, typically involve a complex set of interactions, bilaterally, regionally, or multilaterally. Therefore, countries need to understand how they might be affected by these agreements, and also how different agreements might interact with one another. This brief provides some insight on the matter for Sub-Saharan Africa in general, and Malawi in particular, based on simulations of actual, proposed, or hypothetical trade integration scenarios.

Trade negotiations: lost in complexity

Trade negotiations are becoming increasingly complex. Sub-Saharan African (SSA) countries, for example, have to navigate *multilateral* trade liberalization at the World Trade Organization (WTO), several free trade agreements (FTAs) at the *regional* level, and *bilateral* free trade agreements with the European Union (EU). Capacity constraints often hinder independent analysis of trade agreements, thus limiting effective engagement in negotiations. There is also the question as to whether SSA countries should prioritize regional or multilateral integration.

This brief highlights selected results from Douillet (2011) in which a global computable general equilibrium (CGE) model is used to explore the impacts of different trade integration scenarios—some hypothetical and others closer to reality—on SSA countries in general and Malawi in particular. Although not a major focus in this brief, Douillet also considers outcomes under Economic Partnership Agreements (EPAs) being negotiated between African, Caribbean, and Pacific (ACP) countries and the EU.

Box 1 (back page) provides detail on the simulation setup. Two WTO multilateral agreements are simulated: the Doha Development Agenda (DDA) and a Duty Free Quota Free (DFQF) agreement. Regional integration scenarios include a simulation of the combined impact of four regional FTAs in SSA, as well as a hypothetical subcontinent-wide FTA.

Regional integration in Sub-Saharan Africa

Africa has by far the lowest level of intracontinental trade in the world. During 2000–2007, however, African intracontinental trade grew more rapidly (25 percent) than African exports to the rest of the world (16 percent), thanks in part to renewed political commitment from African governments and development agencies to accelerate regional integration from historically low levels.[i]

While increased regional integration may be partly politically motivated, it also makes economic sense. First, the growth potential for domestic and regional consumer markets is large considering the small base it is starting from and recent extended spells of rapid growth in the subcontinent.[ii] Second, at present SSA exports are concentrated in primary agricultural products. Less than half of agricultural output is supplied to domestic processing sectors. This suggests massive scope to intensify agricultural processing activities before exporting goods to regional and international markets.[iii] Third, SSA's share in world trade volume has decreased from five percent in 1960 to less than two percent in 2008, caused in part by weak growth and increased competition from other developing or emerging economies.[iv] Some of these losses can be recouped by exploiting the cost advantage of trading within the region.

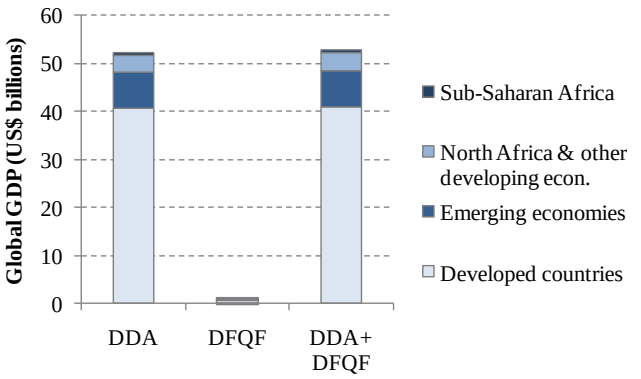
Malawi itself is representative of the subcontinent in that a very small share of its agricultural exports is destined

for countries within SSA. After years of specialization in burley tobacco, Malawi is now the world's largest exporter of this commodity, but it has lost market share in traditional export products, such as sugar, to competitors from emerging economies.

Global and regional gains from trade liberalization

The DDA and DFQF could potentially open up world markets for SSA, thus providing an opportunity to African countries to reverse the trend of a declining global trade share. Of the two agreements, DDA has by far the greatest impact globally, with global GDP gains exceeding US$52 billion (Figure 1). However, 78 percent of the gains accrue to developed nations. Comparatively speaking, additional global gains under DFQF are minimal ($1.2 billion), although DFQF itself is much more favorable for developing economies, who share half of the gains. SSA countries gain $0.23 billion, or 19 percent of global gains under DFQF. The dominance of DDA means that gains under the combined DDA + DFQF scenario are still biased in favor of developed countries.

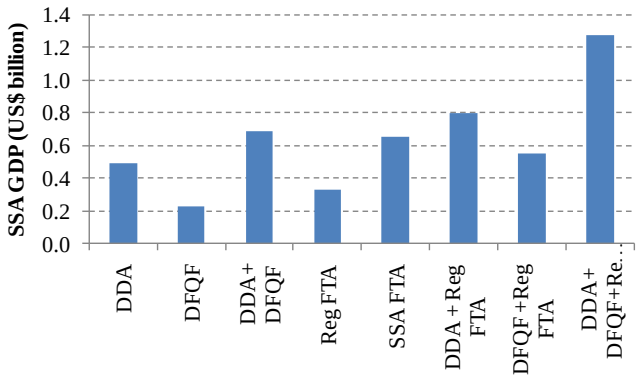
Figure 1. Multilateral trade liberalization and changes in global GDP (US$ Billions)



Source: CGE model results

Figure 2 shows the outcomes for SSA countries in more detail. Interestingly, DDA + DFQF adds an additional 40 percent to GDP in the subcontinent compared to DDA alone. The figure also compares outcomes for multilateral and regional integration scenarios. Combined benefits from regional FTAs amount to $326 million, while the hypothetical SSA FTA would add $655 million to the GDP in the subcontinent, which is not much less than gains under DDA + DFQF ($686 million). Regional SSA integration could therefore potentially deliver as much as multilateral integration. Combined regional and multilateral integration further enhances gains from trade; for example, under DDA + DFQF + Reg FTA gains equal $1.3 billion.

Figure 2. Trade integration in SSA: changes in GDP (US$ Billions)



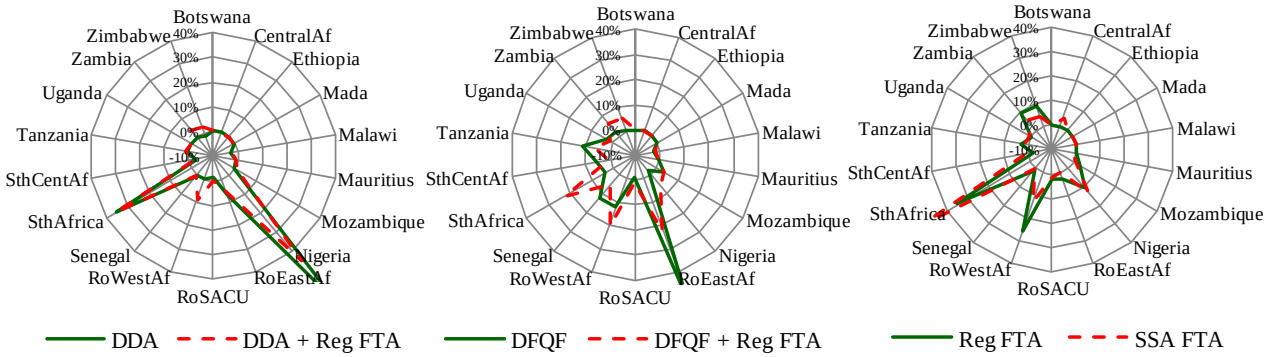
Source: CGE model results

Distribution of gains within SSA

Just as global GDP gains are unequally distributed, gains accruing to SSA as a whole are not equally distributed within the region. Although a detailed discussion of Figure 3 is omitted, it is clear from the figure that larger economies such as Nigeria and South Africa gain most from multilateral agreements, while additional liberalization at the regional level further skews the gains. In fact, while SSA as a whole gains, some countries may in fact lose out. Malawi, for example, either loses out, or the benefits from trade integration are minimal. Under DDA, exports of unprocessed agricultural goods to new destinations increase rapidly, but there is also substantial diversion of exports away from traditional trade partners, such that net production of unprocessed agricultural goods only increases marginally. Agro-industrial exports such as sugar, on the other hand, decline. The net effect is a $15.4 million decline in Malawi's GDP. Similar outcomes are observed under DFQF and DDA + DFQF. For example, in the latter, Malawian GDP declines by US$11 million, which although small (around 0.6 percent of GDP), is nevertheless cause for concern.

Regional trade integration has a more positive outcome for Malawi, although gains remain small. Under Reg FTA, GDP increases by $1.3 million, while SSA FTA brings about gains of $1.9 million. Regional integration does, however, allow for export growth in both agricultural and agro-industrial exports, and hence serves as a potentially important strategy for promoting domestic value addition. Given this, interaction of FTA scenarios with DDA or DFQF counters the tendency to specialize in raw agricultural products, but the effect is not strong enough to reverse the negative impact on Malawi's GDP. For example, DDA + Reg FTA leads to a $14.6 million decline in GDP, while the loss is $8.3 million in the case of DFQF + Reg FTA.

Figure 3. Distribution of regional GDP gains among SSA countries



Source: CGE model results

Do other SSA countries experience similar structural changes in exports?

Multilateral trade liberalization leads to structural changes in exports across all of SSA through promotion of specialization in unprocessed agricultural exports. Regional integration, on the other hand, achieves the opposite, as it raises the production and exports of processed goods, with the region itself becoming an important destination. For example, under DFQF the share of unprocessed agricultural exports increases from 57 to 60 percent, while under SSA FTA the share drops significantly to 28 percent.

Three factors contribute to structural changes in exports: (1) the initial structure of exports to each destination; (2) the evolution of the tariff structure; and (3) changes in trade competition. Intraregional SSA trade is biased towards trade in processed goods, whereas unprocessed goods, which also make up the bulk of exports, are typically destined for countries outside of the region. SSA trade integration thus promotes trade in processed goods, and vice versa for multilateral agreements, even though multilateral agreements reduce tariffs on processed goods more than on unprocessed goods. Multilateral trade agreements, by design, offer the same increased market access to SSA countries as they do to competitors. The changing trade flow patterns therefore partly reflect the fact that SSA countries are not as competitive in the production of processed products as competitors outside of the region, especially from Asia.

How do bilateral EPAs affect the conclusions?

The EU is the main trade partner for many SSA countries, mainly due to the historical long-standing preferences granted to ACP countries (for example, 44 percent of Malawi's agricultural and agro-industrial exports is destined for the EU). EPAs will therefore not imply any direct change to Malawi or SSA exports to the EU, but since liberalization would be reciprocal, Malawi and other SSA countries would be required to remove certain tariffs applied on imports from the EU. Simulation results reported by Douillet show that previous conclusions are robust whether or not EPA negotiations are successfully concluded or not.

Policy lessons for SSA and Malawi

Avoid overspecialization in unprocessed agricultural exports: For countries such as Malawi, multilateral trade liberalization may lead to increased specialization in unprocessed agricultural exports at the detriment of domestic value addition. This contradicts development policy efforts to raise value addition and suggests that attention should perhaps be directed towards regional integration options.

Improve the competitiveness of transformed products: The results illustrate that Malawi in particular is not competitive globally as far as production of agro-industrial goods, such as sugar, is concerned. Other SSA countries also experience declines in their trade shares in certain markets. Increased competitiveness through adoption of productivity-enhancing technologies could raise the gains from trade liberalization.

Think regional: Regional integration allows most countries in SSA to combine increased exports of both processed and unprocessed agricultural products. However, benefits are not shared equally, with large economies such as South Africa reaping most of the benefits. Smaller and less competitive countries should be aware of their disadvantaged position in the region when entering into integration negotiations.

Trade policy needs to be harmonized with other development policies: Domestic development policy and trade policy have the potential to jointly reinforce development objectives, but understanding their

interplay is important. For example, trade policies, which improve market access, will be ineffective if domestic producers are not able to respond by raising production. Similarly, domestic policies that raise production will fail if they are not complemented by policies that improve domestic and international market access.

Future research: Global CGE models operate at a higher level of aggregation and are somewhat limited for understanding country-level implications of trade integration. Future research should focus on the interaction between trade and development policies, which may require linking national and global CGE models in various innovative ways.

Box 1. Modeled scenarios

Multilateral trade liberalization

Typically negotiated at the WTO. Modeled scenarios include:

1. **Doha Development Agenda (*DDA*)**
   Exempts least developed countries (LDCs) from tariff cuts. The only implication for Malawi is a decrease in tariff applied on exports;
2. **Duty Free Quota Free (*DFQF*)**
   Offers all LDCs (including Malawi) free access to OECD markets, including China, Brazil, and India.

SSA regional integration via free trade areas (FTAs)

Negotiated among SSA countries. Modeled scenarios include:

1. **Four regional free trade areas (*Reg FTA*)**
   Current groups include: (1) the Monetary and Economic Community of Central Africa (CEMAC); (2) the Southern African Development Community (SADC), of which Malawi forms a part; (3) the Economic Community of West African States (ECOWAS); and (4) an Eastern and Southern Africa (ESA) group;
2. **Extended SSA free trade area (*SSA FTA*)**
   Hypothetical scenario whereby the entire SSA region forms a FTA based on the combined principles of the existing regional FTAs.

Endnotes

[i] See UNECA. 2010. *Assessing Regional Integration in Africa IV: Enhancing Intra-African Trade*. Addis Ababa: United Nations Economic Commission for Africa.

[ii] Diao, X., and Dorosh, P. 2007. "Demand Constraints on Agricultural Growth in East and Southern Africa: A General Equilibrium Analysis." *Development Policy Review* 25(3): 275-292.

[iii] Poulton, C., Tyler, G., Hazell, P., Dorward, A., Kydd, J., and Stockbridge, M. 2009. All-Africa Review of Experiences with Commercial Agriculture Lessons from Success and Failure. Competitive Commercial Agriculture in Sub-Saharan Africa Study.

[iv] Trade shares from FAO. 2010. *The State of Food Insecurity in the World*. Rome: Food and Agriculture Organization. For more on SSA's marginalization, see Bora, S., Bouët, A., and Roy, D. 2007. *The Marginalization of Africa in World Trade*. Research Briefs 7. Washington, DC: International Food Policy Research Institute; Ng, F., and Yeats, A. 2002. *What Can Africa Expect from Its Traditional Exports?* Africa Region Working Paper No. 26. Washington, DC: World Bank; and Rodrik, D. 1998. *Trade Policy and Economic Performance in Sub-Saharan Africa*. Working Paper No. 6562. Cambridge: National Bureau of Economic Research.

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The Malawi Strategy Support Program of the International Food Policy Research Institute (IFPRI) works closely with the government of Malawi and other development partners to provide information relevant for the design and implementation of Malawi's agricultural and rural development strategies.

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