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LIBERALISING FOREIGN TRADE

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This dissertation focuses on the issue of trade reform and liberalising an economy, and is a response to the policy shift away from the protectionist paradigm of import substitution. The literature dealing with this is however not unanimous in describing the benefits that arise from this policy. It would appear that we are dealing with a situation, where it depends. In which case what is needed is a different framework with which to approach the subject.

CONTENTS

		Page
SECTION 1 :	INTRODUCTION	1
SECTION 2 :	CONTEMPORARY LITERATURE OVERVIEW	3
SECTION 3 :	ENDOGENOUS GROWTH	7
SECTION 4 :	THE SOUTH AFRICAN DEBATE	9
	4.1 Historical Overview	9
	4.2 Alternatives for the Way Forward	12
SECTION 5 :	WORLD BANK STRUCTURAL ADJUSTMENT PROGRAMMES	15
	5.1 Kenya	15
	5.2 Ghana	17
	5.3 Empirical Evidence	18
SECTION 6 :	AN ALTERNATIVE FRAMEWORK	21
	6.1 The Vent for Surplus Theory	21
	6.2 The importance of sequencing	22
	6.3 Balance of Payments Adjustment Mechanism	22
SECTION 7 :	CONCLUSION	25
REFERENCES		26

SECTION 1 : INTRODUCTION

The eighties were characterised by a shift in favour of policy advocating the liberalisation of economy as a means of securing higher output levels and growth. This shift in policy represented a move away from the protectionist paradigm of import substitution that had its roots in the pessimism of developing country performance in the international arena. The policy shift derived its impetus from the economic success stories of the Newly Industrialised Countries (NICS) that had pursued outward oriented strategies. It is important though not to confuse outward-orientation with a laissez-faire approach to development, as the two are not synonymous.

The literature dealing with trade reform and liberalisation is however not unanimous in describing the benefits that arise from this policy, which serves as a warning against regarding liberalisation as a panacea for economic problems.

Because we are dealing with a situation where there is a lack of clarity concerning the appropriate development strategy to follow, what is needed is a different paradigm with which to approach the issue of opening up an economy to foreign trade. The Classical Vent for Surplus Theory would appear to be more applicable to developing countries, and it also takes one away from the dichotomy of regarding import substitution and export oriented industrialisation as alternative industrialisation strategies.

Section 2 is an overview of contemporary literature that deals with trade reform and liberalisation. Both arguments for and against are dealt with. The arguments in favour of liberalisation generally centre around the traditional efficiency gains that are argued to be the result of reform, where the important issue of causality assumed. The arguments against draw their substance from the shortcomings of empirical investigations. This section serves to illustrate that the way forward is

not an issue devoid of contentious debate.

Section 3 deals with Romer's endogenous growth theory. While this section may appear to be somewhat out of context, it is important in that he looks at the role of human capital and technological progress within trade as being important growth determinants.

South Africa is situated within the debate in Section 4. A brief historical overview of our trade policy is presented. Possible solutions that are put forward by the different authors are also discussed.

Section 5 deals with World Bank Structural Adjustment Programmes. This is important as conditionality has centred around the requirement of liberalising the foreign trade sector, yet the empirical evidence concerning these programmes is not entirely positive. It is shown that these programmes are shrouded in neo-classical economics, an institutional framework that is not applicable in a developing country context, and it is this that largely accounts for the failure of the programmes. It would appear that the World Bank too, takes the issue of causality for granted.

Section 6 describes an alternative framework with which to approach the liberalisation of an economy - the Vent for Surplus Theory. This emphasises the rough and ready nature of the adjustment process as opposed to the instantaneous adjustments of the world of neo-classical economics, and as such is more applicable to developing countries. The appropriate sequencing of the liberalisation process is emphasised. Failing to adhere to this introduces problems in the opening up process and threatens sustainability.

The challenge for South Africa is to find the appropriate international trade strategy within the ambit of an overall development strategy. It is essential that

we generate self-sustaining growth and bring about a more equitable distribution of income. Failing to do so will introduce credibility problems and threaten the political settlement, something which the economy can ill afford to do.

SECTION 2 : CONTEMPORARY LITERATURE OVERVIEW

In this section, an overview of the recent literature on trade reform and liberalisation is presented. Both arguments, for and against are examined. Contemporary literature abounds with support in favour of liberalising an economy. This, is a controversial topic, as the evidence in support of it is inconclusive, suggesting that what is required is a different paradigm with which to approach the debate of liberalising foreign trade.

Michaely, Papageorgio and Choksi (1991) define trade liberalisation as any act that makes the trade regime more neutral - nearer to a trade system free of government intervention. It is the freeing of trade flows between the country concerned and its actual or potential trade partners. In their study they take for granted the benefits of open trade, and as such do not focus on the issue of "whether", but rather on the question of "how".

Bhagwati (1987) comes out uncomprisingly in favour of an outward-oriented or export-promoting strategy, as a means of achieving rapid export and economic growth. Dornbusch (1992) is similarly optimistic about the benefits accruing from trade liberalisation, and justifies World Bank conditionality of trade liberalisation by describing the favourable performance of countries that adopted outward oriented policies. The crux of Bhagwati's theory lies with the price incentives that remove a bias against exports, so that there exists neutrality between relative incentives for home and export sales. This is achieved through trade and exchange rate policies. Economic performance of countries following an export promoting trade policy, he asserts is superior to those pursuing an import

substitution policy, assuming the causality to be from trade orientation to performance.

Even though Dornbusch is aware of the difficulties involved in testing the hypothesis that more open economies experience higher growth, due to the absence of a single and internationally comparable measure of openness and the problems with trying to standardise for all factors impinging on growth performance, he maintains that developing countries should 'bite the bullet' and proceed with liberalisation as the benefits outweigh the costs of a possible worsening of their terms of trade.

Outward orientation, both authors argue, produces allocative efficiency, and raises productivity due to access to a variety of foreign inputs at a lower cost, shifting the economy's production function outwards. Free trade leads to a more rational market structure due to the reaping of economies of scale from wider markets, and is also argued to lead to greater innovation, again the causality is assumed. Negative consequences of an import substituting strategy that Bhagwati cites, are that it gives rise to rent-seeking activities, channelling resources into unproductive but profitable enterprises, and a manifestation of x-inefficiency due to a lack of exposure to foreign competition.

Edwards (1993) in a different vein reviews trade policy in developing countries and questions whether outward oriented economies have in fact secured better outcomes than those countries that followed more inward looking strategies. Specifically, it is the question of the role of trade liberalisation within an outward oriented strategy, that lacks clarity. Edwards (1988). As already mentioned, trade liberalisation is a central condition of World Bank lending, despite uncertainty in the literature concerning the benefits or the sustainability of these reforms, thus this article is an important contribution to the discourse.

He analyses multi-country studies of protectionist and liberalisation periods as well as cross-country regression analyses that focus on the relationship between export growth and economic performance. The limitations of these cross-country studies in his opinion, are that indices of protection and trade orientation are difficult to compute and that a theoretical framework dealing with commercial policy, trade orientation and growth has not been established, even though on a superficial level the studies do yield some useful insights. These are however not robust, and therefore caution is called for when interpreting the results for policy purposes. For example, in dealing with Little, Scitovsky and Scott and Balassa's work on effective rates of protection (ERP), he points out that although the same technique for computing the ERP of the Philippines manufacturing sector was used, different results were obtained. Yet on the basis of these calculations the authors all asserted that the level of protection on manufacturing value added was higher than what nominal levels would suggest, impacting negatively on exports, hence the policy prescription of a reduction in protection and the opening up to international trade.

The difficulty in measuring trade orientation pervades these studies, with attempts to overcome the problem including the use of dummy variables and the growth rate of exports as a proxy for policy orientation. The measures remain largely subjective.

He is similarily weary of econometric studies of the relationship between trade orientation and growth on the grounds that the estimated functions are unable to capture all the relevant factors, and whether the results can be generalised. The issue of causality is of fundamental importance. There is not unequivocal support for one way causality from exports growth to GDP growth, yet there is a tendency in the literature to assume this, while the study of Jung and Marshall (1985) indicates that this is not so. In only four out of thirty-seven cases they established the causality to be from export growth to GDP growth.

Thus Edwards concludes, "much of the cross-country regression based studies have been plagued by empirical and conceptual shortcomings. The theoretical frameworks used have been increasingly simplistic, failing to address important questions such as the exact mechanism through which export expansion affects GDP growth". (Edwards. 1992:1389), and questions the significance of these results on the trend in favour of outward orientation.

Goldin and Evans (1991) also challenge the bias in favour of outward looking policies from a similar perspective, in terms of model specification, and maintain that the regression analyses are inconclusive. They call for scepticism in assessing the findings on the contribution of liberalisation to economic growth and the choice of policy instruments and strategies that were important in effecting development. Their sceptism is enforced by studies such as those done by Harrigan and Mosley (1991) who identify an alarming trend in terms of the effect of World Bank aid on investment. This will be discussed at a later stage.

Rodrik (1992) believes it is still early to comment on trade reform, "At its best, trade policy provides an enabling environment for development". (Rodrik. 1992:103), but not a panacea for economic problems, especially in the context of macroeconomic disequilibria. He maintains that where trade reform is argued to work by reducing or eliminating the distortions in the structure of relative prices, macroeconomic instability hinders this by interfering with price signals. The worst time to embark on a policy of trade reform is in the face of disequilibria. A lack of appreciation of this can produce a contradiction in policy. For example, where the exchange rate is a target against inflation, it can not be used for the external balance, as a real exchange rate appreciation leads to a deterioration in the external balance. He is also concerned about the impact of liberalisation on unemployment. He therefore cautions against placing too much faith on the magic of liberalisation, as the efficiency consequences are uncertain, and if present, small.

This introduction serves to highlight that the international literature on the benefits occurring from liberalisation is by no means unanimous in the support of this policy. The arguments for liberalisation are simplistic in that they gloss over the issue of causality. The arguments against are important as they call for caution when regarding liberalisation as a panacea for economic problems especially in the face of macroeconomic disequilibria.

SECTION 3 : ENDOGENOUS GROWTH

This section deals with Romer's endogennus growth model. It emphasises the importance of human capital and technological progress as determinants of growth, something which the literature on inward orientation versus export orientation tends to omit.

Something which Edwards (1993) identifies as lacking within the literature as being attributed as a potential growth factor for GDP is educational attainment and research and development. As such he describes work done by Romer as an important contribution to the derivation of a more convincing and rigorous conceptual framework for the analysis of the relationship between trade policies and growth.

Romer (1990) presents an interesting analysis of endogenous growth. For him the question is not a matter of endogenous growth stressing the importance of investment or exogenous growth stressing technological progress, as there exists a blurring between the two. Within the process of generating growth there is an endogenous interaction which is evident in terms of human capital. Technological progress is a residual - but it is devoid of meaning without the element of human capital.

By abandoning the neo-classical assumptions of the production function he is able to introduce technological progress as an endogenous process, augmenting the factors of production. By dropping the assumption of constant returns to scale he describes the quality of human capital as the driving force of growth. The unequal and uneven pattern of growth that exists is attributed to the uneven augmentation process between technology and human capital. The stock of human capital determines the rate of growth. Too little human capital devoted to research in equilibrium accounts for a slow growth rate.

A good that is non-rival and excludable is important in terms of growth theory. For example, a design is non-rival because once it has been created it can be used over and over again generating knowledge spillovers. Non-rivalry is linked to non-convexity, and in terms of production theory, if there are any non-rival inputs, output will increase more than proportionately with an increase in all of the inputs. However the ability to add is rivalrous. Because the world of perfect competition has been left behind by the abandoning of the neo-classical assumptions, he introduces an element of monopoly in the handling of technology. Thus he looks at inventions as public goods, but introduces an element of monopoly control.

Knowledge enters into production in two ways. A new design enables the production of a new good that can be used to produce output. The new design also increases the total stock of knowledge, thereby increasing the productivity of human capital in the research sector.

The stock of human capital therefore determines the rate of growth. Having a large population is not sufficient to generate growth, but an economy with a larger stock of human capital will experience faster growth, thus international trade and integration into world markets can speed up growth. It is important to integrate into the world economy as it is a means of tapping into a larger stock of human capital.

This brief section has shown that there are other determinants of growth, that are also important to trade policy, vis-a-vis, technological progress and human capital.

SECTION 4 : THE SOUTH AFRICAN DEBATE

In this section South Africa is situated within the debate of trade liberalisation. It is clear that there is an urgent need to find a successful way forward. Failing this our political settlement may be jeopardised, as credibility problems will be created.

In the face of increased globalisation South Africa cannot afford to go it alone. The challenge is to determine the appropriate international trade strategy, within the context of an overall development strategy. As a participant at the Uruguay Round of Multilateral Trade Negotiations of the General Agreement on Tariffs and Trade (GATT), South Africa has committed to a reform of our international trade policy, where the addressing of the anti-export bias, created through protection, forms an important component of this. The assumption is that the development of competitive, outward-oriented industries will best serve our economy. South Africa's offer at GATT comprised of a rationalisation of the customs tariff where uniformity, transparency and simplification as well as a phased reduction of tariffs were seen as important in the achievement of this. Attempts will also be made to improve on the side of administration. The proposed phasing down period is five years, although in certain industries a longer period may be required to secure effective restructuring and rationalisation in production. This is in line with the IDC's emphasis on the need to produce at prices in line with world prices.

A brief historical overview of South African trade policy follows, with possible ways forward, discussed.

4.1 Historical Overview

South Africa has followed an import-substituting policy since the 1920's. The Pact Government sought to industrialise through import substitution, specifically: to create employment opportunities for the large number of poor-whites; the

creation of an economic base that could take over when gold reserves ran out and economic nationalism. McCarthy (1991). Tariff protection and the establishment of public corporations as manufacturing concerns were central to policy. This was pursued rigorously after World War II. The manufacturing sector did flourish in domestic terms, but largely has not managed to perform well in export markets. McCarthy (1988) identifies a sectoral transformation that fits the general pattern of import substitution from consumer goods through to intermediate and capital goods, accounting for the change in the structural composition of the sector. It was during this stage that import substitution was an important source of growth.

He makes the interesting point that in terms of import-substituting industrialisation defined as a reduction in the ratio of imports to GDP, the results are not significant, and in fact suggest that import substitution has not taken place, as the average propensity to import has remained relatively unchanged over the sixty years of the policy being pursued. Bell (1993) concurs with this. Hence we are still dependent on imported goods, especially intermediate and capital goods. Specifically it is the heavy industries such as chemicals that have a large import content, due to the need to import scientific equipment and technology.

Holden (1990) maintains that there is scope for further import substitution in the areas of intermediate and capital goods, but economies of scale are essential for low cost production. Failing this the costs would be too high to justify the pursuit of this.

McCarthy goes on to comment that while up to the late fifties and early sixties, the policy of import substitution was both successful and the main impetus for industrial growth, "once imports of consumer goods and the less sophisticated range of goods requires an amount of capital and a degree of skill disproportionately high in relation to the size of the market in a developing

country. Consequently import substitution peters out as a source of sustainable and viable growth". (McCarthy. 1991:9). Hence import substitution can take an economy so far, but then a switch in policy to export-led growth is needed to further develop the industrial base. What prevented this from occurring was a hostile international climate which precluded penetration into foreign markets, resulting in the further pursuit of import substitution.

Scheepers (1982) identifies a difficult task for policymakers as the determination of policy direction of the second stage of the import substitution process, once the first stage is completed. The choice is between further import substitution or export promotion, or a combination of the two. He maintains that South Africa entered into the second stage in the fifties where the emphasis was again on inward-orientation. This in his opinion was the wrong strategy to have chosen, as is evidenced by the fact that in the sixties, imports as a percentage of GDP started to increase. The structure of which was of intermediate and capital goods - as McCarthy has already mentioned - while exports of merchandise and services as a percentage of GDP showed a decline, suggesting that import substitution was harmful to exports. The net foreign exchange benefits derived from the pursuit of import substitution, he argues were small, while the domestic resource costs were high. The appointment of the Reynders Commission of enquiry into export trade signified the government's realisation of the difficulties that the economy was experiencing in its industrialisation attempts

The late seventies and early eighties saw exporters receiving various incentives ranging from tax rebates to cash grants, on the recommendation of the Reynders Commission and the Van Huyssteen Committee that trade policy be slanted towards exports. Concurrently, protection was provided to the domestic market, although there was a shift in the type offered from quantitative restrictions towards tariff protection, a move which Holden (1992) describes as a step in the direction of trade liberalisation. The structural adjustment programmes for the

motor vehicle, textile and clothing industry as well as the General Export Incentive Scheme (GEIS) represented attempts at addressing the anti-export bias, but have been beset with problems. Under GATT, GEIS is to be phased out, as the export subsidisation is illegal. Problems with GEIS centre around its high budget and that it has not met its objectives in that the effect on exports and job creation have been minimal. Instead of increasing the exports of smaller operators, conglomerates who would have exported anyway appear to be the largest beneficiaries. More serious are the allegations that the scheme has not done enough to encourage the exportation of finished goods, and that it is biased against the smaller labour intensive firms, as limited support is offered in cases of low domestic value added. Fraudulent claims are also a drain on the budget. The National Economic Forum is addressing the important issue of an export promotion package. (Business Day, Wednesday, July 27, 1994).

4.2 Alternatives for the way forward

Broadly, Holden states that South Africa has experienced considerable trade liberalisation. The remaining scope lies with the achieving of neutrality between incentives for domestic and export production. In terms of positive incentives being offered to export production, neutrality does not require the elimination of tariffs, but rather a reduction in them, which needs to be accompanied by the appropriate exchange rate policy. She warns in a similar fashion to the international literature in support of trade liberalisation, of monopoly power as well as rent-seeking and corruption that protection affords domestic producers, and states that costs incurred can amount to a significant proportion of GDP. She therefore favours the phased withdrawal from present tariff protection in concertina fashion, as well as export promotion, with the government playing a role in the development and dissemination of market information, research and development, education, quality evaluation and control, rather than selective protection and subsidisation.

Bell (1990) in a different vein, questions whether the pursuit of import substitution after the seventies was such an inappropriate strategy to follow, especially in light of the effect of real exchange rate changes on the competitiveness of South African manufactures arising out of fluctuations in the gold price, and sees import substitution as an important part of development for a mineral-rich economy like South Africa.

He looks closely at South Africa's experienc, with trade liberalisation, and challenges the view that further import liberalisation via a reduction in tariffs is essential for the restructuring of the South African economy. Bell (1993). He maintains that where trade liberalisation is defined as the relaxation of quantitative restrictions, tariff reductions, export promotion packages and a currency devaluation, South Africa has already made significant inroads towards trade liberalisation as the outstanding component lies with tariff reductions.

Within the debate on the desirability of comprehensive tariff reductions, he raises the important point that Rodrik (1992) also raises, and that is that tariffs constitute an important source of government revenue, hence reductions can impede fiscal balance. Rodrik estimates trade taxes to generate approximately 15% of government revenue in developing countries, and that while substitutes for tariffs may be implemented, they are time consuming and difficult to introduce. Bell estimates customs tariffs and import surcharges to have amounted to 5,8% of tax revenue for 1992-93. This is not a paltry sum, especially in light of South Africa's attempt to broaden the tax base, and the need to deliver in terms of increased expenditure. Thus when considering the costs of import liberalisation, one must be sure that the benefits outweigh the costs before embarking on the policy.

He describes South Africa's shift in the direction of outward orientation as a response to the foreign exchange constraint, rather than as a means of securing traditional efficiency and growth benefits argued to be the result of trade liberalisation. What is important, is to establish whether in fact the existing levels of protection granted by tariffs is a constraint to export expansion, instead of assuming the causality between import liberalisation and export growth. Edwards (1988) states that there is no well developed theoretical model that links very low or zero import tariffs to higher growth.

Bell warns of aggregated estimates suggesting overall poor export performance, as they mask important structural changes within the South African manufacturing export sector. Poor performance, he attributes to adverse trends in a few individual sectors, such as chemicals and basic metals, while healthy performance was recorded in the areas of metal products, machinery, electrical machinery and transport equipment, barring motor vehicles. Thus the obstacle to growth of manufactured export lies not with the structure of tariff protection. Improved growth of non-traditional manufactured exports had little to do with trade policy, but was the result of real exchange rates changes, the domestic recession and growth in world trade. He states, "by 1991, any initial anti-export bias had already been greatly reduced, is reason for doubting whether further trade liberalisation, through tariff reductions, is likely to have a significant additional effect on exports". (Bell. 1993:113). For the time being he opts for a rationalisation of the existing structure instead of a comprehensive reduction.

It will be difficult to increase our competitiveness of manufactured goods, especially as other developing countries are aiming to achieve the same. An industrialisation strategy for South Africa needs to generate self-sustaining growth as well as bringing about a more equitable distribution of income. A solution, outlined by Zarenda (1992), where outward orientation is regarded as a component, rather than a source of growth, is to widen the domestic market so that economies of scale may be reaped, and then used as the basis for exporting manufactures. The emphasis here is on outward-orientation's long run potential, rather than as a short run panacea.

Although there is unanimity within policy making circles of the urgent need to find an appropriate industrialisation strategy for South Africa, differences of opinion as to what the contents should be, prevail. An important issue which lacks clear consensus concerns that of tariff reductions.

SECTION 5 : WORLD BANK STRUCTURAL ADJUSTMENT PROGRAMMES

This section deals with World Bank Structural Adjustment Programmes. This is important to the debate as liberalisation of foreign trade is central to conditionality. The empirical evidence is not favourable, which comprises the approach.

Strydom and Fiser (forthcoming) evaluate World Bank structural adjustment loans in respect of less developed countries (LDCs) from the point of view of the analytical framework underlying the approach as well as empirical evidence. A cornerstone of the lending's conditionality lay with the requirement of liberalising the foreign trade sector. It would appear that the World Bank was also guilty of assuming a simple causality between trade orientation and growth. They conclude that the structural adjustment programmes have failed to live up to their expectations partly because the framework which the programmes were shrouded in was representative of neo-classical as well as new classical macroeconomics, which lacks applicability in the environment of LDCs.

The World Bank maintained that macroeconomic stabilisation had to be supported by policy reform in trade, agriculture, industry, energy and human resources. The aim was to secure greater economic efficiency and flexibility via the encouragement of market forces, which was to be achieved via these institutional reforms. Importance must be placed on the sequencing in the process of liberalising markets in LDCs. The liberalisation of the goods market must precede the liberalisation of the financial market.

Mosley, Harrigan and Toya (1991) look at various economy's experiences with structural adjustment programmes. I shall draw on two African experiences to illustrate the problems and domestic conflicts that are inherent in the programmes.

5.1 Kenya

Kenya, in 1979 sought a World Bank structural Adjustment Lending Programme as a means of securing a rapid disbursement of low interest finance. Their Balance of Payments deficit as a percentage of GDP stood at 9,5% and foreign debt amounted to $US1.2bn. The conditionality of the structural adjustment loan centred around industrialisation becoming more outward-oriented with policy recommendations including the replacement of quotas with tariffs; the rationalisation of the tariff structure; boosting of export incentives and the control of external borrowing.

The timing of the policy was inopportune and reflected poor diagnosis on the Bank's part, as liberalisation in the face of a Balance of Payments imbalance is only likely to exacerbate the situation. Export performance was poor. The deterioration on the external account brought the liberalisation process to its own natural conclusion. Some goods even had tariffs of 100% imposed on them.

The approach of the second structural adjustment loan was equally misguided, but the emphasis lay in the area of agricultural reform. The bank requested that annual price reviews be closely monitored, to ensure that they reflected export parities, the rationale being that getting the prices right would encourage production. Conditionality with respect to maize decontrol and the rationalisation of protection required institutional changes, more difficult to implement than price related policy changes, as they were often met with fierce internal resistance.

1985 saw the Bank shifting towards sectoral based lending, a move that incorporated an inclusive strategy in the area of policy formulation as the ministry of the relevant sectors enjoyed input in the policy making process - a move in the right direction. Success has however not been great. The Industrial Sector Package of 1988 again focused on restructuring trade policy. A Bank survey asserted that the efficient industries were those that had average levels of

effective protection significantly lower than those of inefficient industries - hence the policy prescription of reducing the levels of protection enjoyed by import substituting industries.

Evidence is not favourable. The 1980-86 GDP growth rates per annum were actually lower than those recorded prior to the structural adjustment loans. Investment as a proportion of GDP fell from 26.0 to 20.6, which impacted negatively on potential growth rates. This reflected the Bank's attempts at reaching fiscal discipline, the brunt of which fell on reduced development expenditure. It was only annual export growth that was at a higher 1976-80 level.

5.2 Ghana

During Ghana's first Economic Recovery Programme (ERP I) 1984-86, the Bank's lending took the form of programme aid to support the Balance of Payments, and project aid to rehabilitate and develop infrastructure. Within (ERP II), sectoral adjustment loans funded specific sector policy reforms for Ghana's liberalisation phase. Policy recommendations included privatisation and streamlining. The underlying assumption here was one of perfect factor mobility where those workers that had been retrenched are absorbed into more efficient sectors, an assumption which is not applicable in a Third World development context. In certain cases the Bank advocated privatisation without due consideration of those departments that were operating efficiently.

The conditionality of the Industrial Sector Adjustment Credit centred around a phased programme of import liberalisation and an export promotion strategy, which included devaluation. Export performance did improve, but it was not a matter of getting the prices right alone, that accounted for this success. Timber played a significant role in this increase - which is not entirely unproblematic. It

would appear that this industry lacks a long term strategy, in that sustainable offtake has not been established, and it is not clear that the replanting that occurs is in itself sustainable. Falling world cocoa prices have made evident the problems of reliance on traditional exports and a narrow export base, and hence the need to diversify.

Generally Ghana's Economic Recovery Programme was a success, but this was not only the result of World Bank intervention. Fortuitous exogenous factors, such as good rains gave impetus to agricultural output. Because Ghana's export base comprised primarily of agricultural commodities, this translated into increased exports. An improvement in their terms of trade, the result of a decline in the price of imported oil, raised export receipts. Between 1984-88 the economy experienced positive growth and an increase in the share of gross capital formation.

5.3 Empirical Evidence

In terms of an empirical assessment of structural adjustment programmes, Mosley, Harrigan and Toye evaluate the impact in terms of its effect on real GDP growth, investment, real growth in foreign trade and the Balance of Payments on current account.

A tabular comparison was performed between 20 countries undergoing structural adjustment programmes and 20 other developing countries, that formed a control group. A country from the latter group was then paired with a recipient country. Countries were paired in terms of similarities in economic characteristics and level of development. Although no pairing is perfect, the investigation did yield some interesting results.

Countries that were supported by structural adjustment programmes experienced a more pronounced fall in real GDP as opposed to the control group. This was

especially so in countries that recorded low slippage with respect to conditionality. Consumption as a percentage of GDP increased in both sets of countries which does not support the view that receiving structural adjustment loan financing merely allows the country to sustain high levels of consumption. More serious were the results that indicated that investment as a percentage of GDP fell in all countries - but more significantly in countries following structural adjustment programmes. Favourable results were recorded in the area of the external balance. Countries under structural adjustment programmes had better current account positions than the control group, a result that was generated through the stimulation of exports and a decline in the growth rate of imports. From the analysis it is not clear how much of this favourable trend can be attributed to other lending institutions or to bilateral agreements.

Another set of empirical testing centred around regression analysis on 19 countries receiving structural adjustment loans. Five regression equations were estimated to analyse the effect on GDP growth, export and import growth, investment as a share of GDP and indirectly the inflows of foreign private finance. Within the group, two subgroups, a sub-Saharan group and a middle-income country group exist.

In terms of GDP growth the regression analysis shows a weak positive overall effect of structural adjustment programmes on growth. The co-efficients of the estimator of the effect of investment on GDP growth are small in all three cases as well as statistically insignificant. The effect of compliance with the requested policy returns has a positive effect on GDP growth rates, with the exception of the sub-Sanaran country group. Good weather and favourable movements in the terms of trade impact positively on output.

In terms of the estimation of the export growth equation, Bank finance has a negative impact particularly in the current period or short run. The implementation

of tho Bank's conditions has a positive effect and is statistically significant in the current period, a reflection of the stimuli that the requested policy reforms encompass. Bank finance produces a negative impact on the import growth rate equation. The same applies to the effect on investment as a share of the GDP equation.

It is sometimes argued that the intervention by institutions such as the IMF and the World Bank facilitates the inflow of foreign private capital. Empirical testing and experience suggests that this is largely unfounded.

Thus it can be seen that in terms of the empirical evidence the only significant result lies in the area of the Balance of Payments. Very disconcerting is the result that the structural adjustment programmes were not instrumental in generating sustainable growth and also the negative result in terms of the effect on investment which compromises future growth potential.

It is clear therefore that the anticipated benefits of liberalisation that the World Bank hoped for, were not always forthcoming, and where they were forthcoming, it was not necessarily because of the Bank's policy prescriptions. The primary reason for the failure of the programmes was that the underlying assumptions of the theory was contradicted in the environment of developing countries, frustrating the attempts at liberalisation. The Bank appears to have taken the issue of causality from outward orientation to growth for granted.

SECTION 6 : AN ALTERNATIVE FRAMEWORK

This section presents an alternative framework for the liberalisation of foreign trade based on Adam Smith's Vent for Surplus Theory. This theory acknowledges the existence of rigidities, unemployment and surplus productive capacity and as such is a development over neo-classical economics, in terms of su ability in a developmental context. The sequencing of the opening up policy is essential to a successful outcome.

Thus far it is clear that there is not unequivocal support in favour of liberalising an economy, or of the benefits accruing from such a policy. If we are dealing with a situation, where, it depends, then what is required is a new framework to adequately describe the opening up process of developing countries to international trade. This new paradigm, The Vent for Surplus Theory, described by Strydom (1992) takes one away from the dichotomy of import substitution and export promotion as alternative development strategies. Central to this framework is the importance of sequencing in the process of liberalisation.

6.1 The Vent for Surplus Theory

The Vent for Surplus Theory appears to be more applicable to LDCs than neo-classical trade theory, as it acknowledges the existence of unemployment, rigidities and surplus productive capacity, as opposed to the latter which assumes allocative effects under full employment. Markets are often poorly developed, and the adjustment process is of a rough and ready nature, instead of being instantaneous where resources are allocated in terms of Pareto optimality by responding to differentials between domestic and world price ratios.

In this paradigm, trade is seen as a compensatory measure for the limitations of the domestic market, as it provides an outlet for surplus products that are in excess of domestic requirements. Thus the export sector has the dynamic

function of reshaping the economy by utilising the excess productive capacity in export promotion without competing for resources employed in domestic production. Export promotion is favoured, but not at the exclusion of import substitution, thus emphasising the complementarity of the two to attain a balanced process of progress.

It is clear therefore that this theoretical framework supports export promotion, and as such is an important contribution over neo-classical trade theory which is ambiguous in the favouring of outward or inward-oriented policies. The analytical basis should be effective in eliminating some of the confusion within trade and development theory, and the misapplication of neo-classical economics, as its assumption of full employment clearly contradicts and cannot address the former issues of unemployment and surplus productive capacity.

6.2 The importance of sequencing

The sequencing of opening up and liberalisation is essential in the support of the rough and ready adjustment process and the generation of spillover effects, which creates market processes through which information can be disseminated to participants. In terms of this sequencing the liberalisation process must start with the real sector, as this adjusts slowly in comparison to the financial sector because the production process is not instantaneous. Exports are promoted and protection on imported intermediate goods for the production of exports is lowered, as a means of generating foreign exchange. In terms of the Productivity Theory, entering world markets produces a better division of labour, by broadening the market and improving productivity. Once this phase is up and running, the second phase is entered into, comprising of the implementation of macroeconomic stabilisation policies to support the adjustment process on the current account via controlling domestic demand.

6.3 Balance of Payments Adjustment Mechanism

Within the Balance of Payments adjustment mechanism, one can distinguish between price and income changes

A change in the rate of exchange of a country with respect to another country affects the price of tradable goods. Where country A's, exchange rate is depressed through intervention, the price of her exports falls, while the price of imported goods increases. Thus the exchange rate induces an adjustment process which should reduce A's deficit. Within this approach it is assumed that the supply of goods is elastic and that demand is relatively price elastic. This is reflected in the Marshall-Lerner condition: price changes through exchange rate variations will have a positive effect on a country's trade balance, if the sum of the elasticities of demand for a country's exports is greater than one. In terms of adjustment through income changes - where income changes affect the demand for imports, it impacts on the trade account. Devaluation will improve the current account if it leads to a decrease in spending, absorption.

In the present institutional framework of floating exchange rates, price changes play the more important role in the Balance of Payments adjustment mechanism, although income effects are not necessarily excluded. Where the price sensitivity of imports and exports is too low, one can not rely on an effective Balance of Payments adjustment. Strydom (1988) maintains that in South Africa, the trade account does not react effectively to price changes as the price sensitivity of imports and exports is not high enough to secure the required adjustments. This could well be the case for a broad range of developing countries, in which case, a depreciating exchange rate must be accompanied by restrictive monetary and fiscal policies to complement the price effect in dealing with a trade account deficit.

This is important in overcoming a balance of payments constraint. Once this has

been achieved, the authorities can proceed with further import liberalisation.

The final stage of the opening up process lies with the liberalisation of international capital flows. Because assets can be created in a rapid manner, the financial sector contradicts the Vent for Surplus framework of a rough and ready adjustment process, and thus it is important that this is proceeded with last, to prevent it from being caught up in the overall economic framework of the rough and ready adjustment process.

Failing to adhere to these principles introduces problems in the opening up process.

This framework would appear to be more applicable to LDCs. The adherence to this paradigm as well as the appropriate sequencing process should prove to be more beneficial and sustainable in liberalising an economy than the neo-classical approach. Sustainability is important, as aborting a liberalisation programme introduces credibility problems which would frustrate any later attempts at opening up. This framework emphasises the rough and ready nature of the adjustment process as opposed to the world of neo-classical economics which emphases instantaneous adjustments in the presence of price differentials. Failing to adhere to the sequencing of liberalising the real sector first and only then proceeding with the financial sector will threaten the opening up process.

SECTION 7 : CONCLUSION

This dissertation has been concerned with the issue of liberalising an economy. The topic gained importance and popularity within the literature, as the protectionist framework of import substitution would appear to be saturated as a mechanism for generating further growth and development. The lively debate that this has generated in the literature makes it clear that the issues involved are neither simple, nor enjoy unequivocal support. This leads to the conclusion that what is required is a new paradigm with which to address the question of liberalisation.

Orthodox approaches to opening up, such as suggested by the World Bank have failed to live up to their expectations, as their underlying assumptions are contradicted by the institutional environment of developing countries. The Vent for Surplus Theory would appear to be more applicable, as it acknowledges the existence of rigidities, unemployment and surplus productive capacity. This framework takes one away from the dichotomy of input substitution versus outward orientation, as it describes the complementarity involved in the two approaches. The appropriate sequencing in that the real sector be liberalised before that of the financial sector is essential to the success of the opening up process.

It is hoped that South Africa will be able to find a successful and sustainable way forward. The implications of a failed further industrialisation attempt are disastrous.

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