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The External Sector of Africa's Economy

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Introduction

There is a striking contrast between the attention given by African policymakers and private sector actors to the external sector of their economies and the limited volume and scope of the existing literature, in comparison to other development-related issues. This observation serves to justify this book and the detailed studies that it includes. From the perspective of the book, external sector is viewed from two angles. At the national level, it refers to the extent to which individual countries manage the degree of openness of their economies with respect to trade, foreign direct investment (FDI), and international financial flows all of which translate into their participation in globalization. External sector also encapsulates the cross-border arrangements such as regional integration or various forms of policy harmonization like common external tariffs. The main underlying motives for increased interest in the external sector can be listed as follows. First, after more than half a century of efforts, African countries have failed to achieve their goals in domestic resource mobilization and have felt the need to look beyond their borders to finance their development.

Second, inward-looking economic policies of the 1960s and 1970s epitomized by rhetoric such as infant industry arguments or transfer of economic surplus from the agricultural sector to industry have not borne fruit. Third, the growing wave of globalization that swept the world, developed and underdeveloped, and the influence of multinational companies on the world scene have exposed African countries alike, in some instances against their will, to a higher degree of presence of their external sector than during earlier periods. The advent of globalization has also revealed the need to compete internationally, thus to focus on their comparative advantage, create sub-regional groupings and promote export-led growth strategies. Over the last three decades, several elements of evolution in the world economy have put the external sector in the forefront. They include inception of the World Trade Organization (WTO), advent of several external debt crises and programs to remedy them, economic partnerships between Africa and other world regions and the strong realization that African countries are too small and that sub-regional groupings might help improve their economic prospects. Yet, despite the failure of African

countries to industrialize in particular, and to converge towards industrialized countries, new opportunities such as information and communication technologies (ICTs) give new impetus to the Continent's economic fate.

In light of the evolution described above, new questions are raised with respect to Africa's external sector and require new answers. In this respect, the stakes underlying external sector policies in Sub-Saharan Africa (SSA) can be summarized by three policy targets. First, how to secure high and steady access to development finance through debt flows and FDI? Second, how to achieve a higher level of international trade and gain more international market share? Third, how to create larger domestic markets through regional integration arrangements on the Continent?

The book examines three aspects of the external sector, namely Regional Integration, External Trade, and Macroeconomics and Political Economy.

In the first chapter, Seck assumes that economic welfare is pursued by an African country considering or evaluating its Regional Integration Arrangement (RIA) membership. He proposes an approach that assigns to inputted residuals computed from pre-integration trend lines the change in after-reform per-capita GDP and gives an estimate of the economic gain that arises from the integration initiative for each member country. The timing of the gain is also identified starting from the year of integration enactment. For the sampling period 1970–2016, the results show that members of the UEMOA benefitted significantly and rapidly from the reform of 1994 while CEMAC countries reaped a significantly lesser gain. Considerable gains also accrued to EAC members over the period 1978–2016.

In the second chapter, Chuku Chuku et al. seek to understand three main issues: first, what are the long- and short-run determinants of current account balances in West Africa; second, is there a sustainable path for the current account position that is consistent with regional integration; and if so, what has been the process of adjustment towards such a path. They address these questions by first identifying the long-term determinants of the current account, and then using the results to calculate the equilibrium sustainable targets for the current account in the region. After accounting for short-run disequilibrium adjustment processes, they show how far apart each country is from the regionally sustainable path. Their key findings are as follows: the determinants of current account dynamics differ depending on the time horizon; the real exchange rate, fiscal policy, trade openness, investment, and income levels are the key determinants in the short run; there is considerable variation by country in the deviation of each country's current account position from the regionally sustainable equilibrium path.

Doukoure analyzes in chapter "Obstacles to Strengthening Economic Integration in the West African Economic and Monetary Union" the obstacles to strengthening economic integration in the West African Economic and Monetary Union (WAEMU). Several studies show that strengthening economic integration requires an increase of intra-trade in Regional Trade Agreements (RTAs). But it is not the case in WAEMU where trade between member countries is rather low. He seeks to identify both the economic and political factors that limit economic integration in WAEMU and how they impact trade between members. In order to rank such

potential obstacles, he develops an extended gravity model, using a panel dataset for WAEMU from 1996 to 2013 for all member countries. Bilateral export flows between member countries are used as endogenous variables.

In addition to the usual variables (income, population size, and distance), the effects of three factors (infrastructure, economic policy, and political tensions) are taken into account. The empirical results show that the state of infrastructure gaps—in particular, telecommunications and transport networks slow down significantly economic integration within WAEMU.

External trade is also investigated as a prime component of the external sector of African countries. In chapter "Growing External Trade, Development and Structural Heterogeneity in West Africa: Examining the Evidence", Ekpo and Omotor's study sets out to determine the extent to which West African economies are integrated and assess their take in the global value chains and some important parameters which could influence their trade flows given the perceived structural heterogeneity among them. The findings and results from the West African Enabling Trade Index, their participation in Global Value Chains and estimated simple gravity model among others suggest that trade performance of the sub-region does not sufficiently improve its export performance. Second, access to trade finance and identifying potential markets and buyers are among the most problematic factors that inhibit export trade in the region. The implication is that reducing these barriers will enable trade and contribute to prosperity and welfare.

In chapter "Driving Factors of Intra-regional Trade in Agricultural Goods: The Case of West African Economic and Monetary Union", Houeninvo et al. examine the impact of distance (transport/logistical cost) and the level of development on intra-WAEMU agricultural exports. They analyze the determinants of intra-WAEMU trade in agricultural products and therefore the variables on which policymakers could act to promote intra-regional trade. Using a panel data estimation in a gravity model over the period 1996–2013 covering seven West African countries with yearly data, they show that two gravity factors, the level of development measured by GDP as well as the distance are highly significant at 1% with the expected signs. Regarding the four control variables population (pop), foreign direct investment (FDI), political stability, and the common external tariff, all of them have the expected signs but only FDI with 2 lags is significant, at 1%.

In chapter "Trade Openness and Food Security in Africa: A Comparative Study of CEMAC and WAEMU Countries", Assoumou Ella and Eba Nguema conduct a comparative analysis of the effect of trade liberalization on food security in EMCCA and WAEMU countries with data spanning the period 1987–2014. Their findings lead to the conclusion of a negative effect in general. The beneficial effect of trade on the food situation is most visible in terms of availability. Also, it leads to lower prices. However, adverse terms of trade appear to wipe off the positive effects and lead to food insecurity. This outcome is robust for both the EMCCA and WAEMU samples. With regard to policy, these countries should implement trade policies to facilitate openness, while supporting and diversifying domestic food production.

Okah Efogo in chapter "Trade in Services for Growth and Structural Transformation in West Africa" seeks to identify the categories of services likely to foster

structural transformation and economic growth in ECOWAS. With data on ECOWAS countries over the period 1995–2015, she estimates a dynamic panel model and shows that for each ECOWAS county there is at least one category of services that promotes structural transformation and/or economic growth. Services trade (imports and/or exports) could be a powerful tool for economic growth, structural transformation, and integration if the various countries rely on the appropriate service for this purpose.

Macroeconomics and political economy issues are studied in three chapters. In chapter "Macroeconomic Effects of Commodity Price Shocks in ECOWAS Members", Tule et al. examine the effect of commodity price shocks on ECOWAS member countries using a panel data analysis of 13 member countries for the period 2000–2015. Dynamic General Method of Moments (GMM) technique was adopted using an instrumental variable (IV) regression model. Their results show that precious metals are positively but insignificantly related to gross domestic product per capita. Also, there is a positive and statistically significant relationship between energy prices and the dependent variable. However, a negative relationship is observed between non-energy prices and gross domestic product per capita. In addition, the results show that 87% of the economy is susceptible to energy price shocks. This result forces a rethink of the integration agenda not only along monetary lines, but also along diversification integration.

In chapter "Is Currency Devaluation Appropriate for Improving Trade Balance in the Wamz Countries?", Englama et al. examine the appropriateness of devaluation in improving trade balance in the six West African Monetary Zone (WAMZ) countries. The motivation is largely derived from the need to reverse the deteriorating external sector of these countries which has become worrisome particularly from the latter half of 2014 on the backlash of a slump in commodity prices and tight global monetary condition. The study employs descriptive analysis, granger causality technique, and Vector Error Correction Model (VECM) to analyze the impact of devaluation on trade balance in these countries. Two other control variables, domestic and global output, are included in the model to capture the impact of domestic and global shock while the data covers the period 1980–2014. The trend analysis reveals considerable volatility in real exchange rate in all the countries with the exception of the Gambia while there is a virtual absence of co-movement between devaluation and trade balance in all the countries. All the series are integrated to the first order while Johansen cointegration test indicates the existence of long run relationship among the variables employed in the study.

Results of the normalized long run model indicate that the coefficient of real exchange rate is positively significant for only Liberia while it is negatively significant in the Gambia only. Real exchange rate is not significant in the remaining four countries, suggesting that devaluation may not lead to an improvement in trade balance in the WAMZ countries except probably in Liberia. Results from the models further suggest that external conditions like expansion in global output tend to have a positive impact on trade balance though the effect is not significant in all the countries. The variables are virtually not significant in the short-run models for all the countries while the vector error correction term suggests that the impact of shock

on trade balance does not wane rapidly. The study recommends, among others, that devaluation may not be the most appropriate policy option to improve trade balance in these countries while these economies should endeavor as much as possible to improve the export content of gross domestic product in order to allow local economic conditions to drive trade balance.

In chapter "The ECOWAS–EU Economic Partnership Agreement: Towards Inclusive Development?", Acheampong and Ortsin analyze the ECOWAS-EU EPA agreement attempting to answer the question: how does the agreement foster both international trade and inclusive development by promoting investment and sustainable growth? Using evidence from countries in the ECOWAS sub-region, this discussion paper covers the following thematic areas: (1) external sector development impact of the EPA agreement and (2) the impact on fostering inclusive growth and development. Their results indicate that the EPAs will pose a number of policy challenges for West African countries as their economies increasingly integrate into the global economy. However, the EPA provides an opportunity to fast-track global trade and the regional integration agenda in West Africa. It is important that the EU treats the EPA as an instrument of development cooperation and not a conduit to pursue mercantilist corporate interests as did happen in colonial times. They also find out that balanced growth and poverty reduction are not automatic outcomes from liberalization processes, but rather these objectives must be actively promoted by complementary policies in conjunction with appropriate fiscal adjustments in order to fully gain from trade liberalization.

While the ten chapters of the book cover a broad area of the external sector in the context of SSA, it leaves unaddressed a number of key issues whose elucidation would facilitate better understanding of the challenges faced by the sub-region. First, how do external sector policies, even the most appropriate, cause economic growth and, for each individual country, which specific external sector policy would yield the best results? Second, the degree of control of countries over external sector interventions needs to be ascertained. In other words, to what extent can a country unilaterally set the level of, say, its export earnings, inbound FDI, or even external indebtedness from private sources which constitute the largest sources of debt markets in the world? There is no doubt that the external sector of SSA could contribute significantly to its economic growth but the right mix of policies to achieve that goal requires considerable more work.

Dakar, Senegal Diery Seck
June, 2018

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