AFRICA: Does Africa trade too little?

by Alberto Behar

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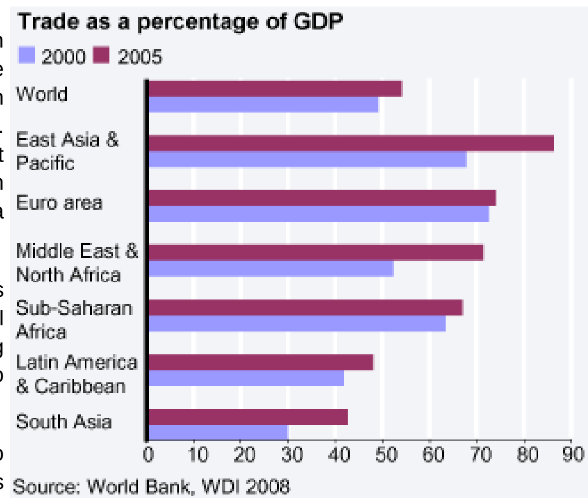
SUBJECT: African exports in relation to the region's economic characteristics.

SIGNIFICANCE: Africa's low share of world exports is not in itself a cause for alarm, nor is it evidence of there being something 'wrong' with African policy. In fact, taking into account the size and location of African economies, the region trades at above average levels.

ANALYSIS: Africa's share of world exports (aggregate) has fallen from over 6.0% in 1974 to 2.5% in 2002. Relatively few African firms export (see AFRICA: Competition and exports key for manufacturing - May 18, 2006). By these measures, Africa is often considered to be underperforming in terms of exports. In a normative sense, this premise is used to argue that African exports are 'too low' for its developmental needs. This has spurred calls for improved implementation of regional integration agreements. It has also led to criticism about poor trade policy, a hostile business environment and a whole host of other institutional inadequacies.

Economic size. However, these trade numbers are misleading. In 2005, Africa's trade as a share of GDP (67.0%) was higher than the world average of 54.2% and higher than two of its developing region counterparts (South Asia and Latin America & Caribbean). Populous South Asia (42.7%) drags the world average down, but Africa still does not have a low share. Rather, it appears that much of Africa's low share of world trade is accounted for by it having a lower share of world GDP (at only 1.2% in 2007).



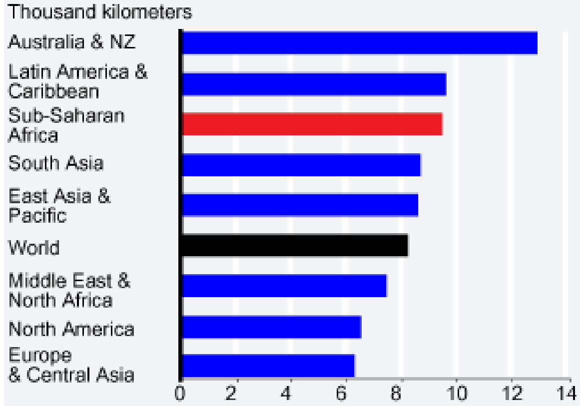
Economic distance. Another useful concept for putting Africa's trade performance into context is 'economic distance'. A typical African is further from world markets than someone living elsewhere. The further away a market is, the more costly it is to transport goods to that market:

- A country's distance from markets is the sum of the distance to every other country in the world, weighted by that destination's GDP. Country distances are aggregated into regional distances by weighting them by each country's population.
- Sub-Saharan Africa is further away from export markets than the world average. A sub-Saharan African is on average further from the large attractive markets, while his or her neighbouring markets are small.
- However, Africa is by no means the most disadvantaged. The Latin America & Caribbean region is slightly more economically distant, while the experience of New Zealand and Australia shows the problem of remoteness from markets can be overcome.

Gravity modelling. Gravity modelling, which accounts for economic size, economic distance and a number of other factors, provides further evidence that Africa does not underperform:

- Gravity models appeal to intuition in terms of Newton's Law of Gravity. The gravitational force between two bodies is proportional to their sizes (mass) and inversely proportional to the (square of the) distance between them.
- Roughly 70% of the variation in bilateral exports can be explained by just two variables: the GDPs of the two countries, representing their size, and the distance in kilometres between them.
- The notion of distance can be expanded to account for cultural factors (such as a common language), artificial barriers (tariffs), technological aspects (transport infrastructure) and geographical features (being landlocked).

Economic distance



Source: Behar & Manners, 2008, CSAE

A pioneering 1993 study by Foroutan & Pritchett found that a typical African country does not trade less with another African country than predicted by the gravity model. If anything, it 'overtrades'. In another study published in 1999, Coe & Hoffmaister found that trade between Africa and industrialised nations of the world was higher than one would expect after accounting for economic size, geographical distance and population.

This year, research by Behar & Manners at the Centre for the Study of African Economies (CSAE) at Oxford University found that a typical African country exports less to countries outside the continent than would be expected, given economic size and GDP, but that two African countries trade with each other more than would be expected. Overall, a pair of sub-Saharan countries trades 46% more than a typical pair of countries anywhere else in the world, controlling for economic size and distance.

Intra-African trade. After falling in the 1970s, the share of African exports destined for other countries in Africa has doubled from about 4% in 1980 to over 8% in 2005:

- Much of this rise in intra-African trade seems to be driven by exports from low income countries and the Southern African Customs Union, but not from other middle income countries.
- Econometric research by the CSAE suggests that the degree to which a typical pair of African countries overtrades, given (changing) economic size and distance, has risen since the early 1980s. This is consistent with Coe & Hoffmaister's study, which finds that the degree to which African countries trade with industrial nations has fallen over time.

The reasons for Africa's increased regionalisation are not yet established, but the pattern is not out of line with world trends. As highlighted in the World Bank's upcoming World Development Report, the 'second wave' of globalisation and falls in transport costs have made it feasible for similar countries in a region to trade similar products with each other rather than produce their own products.

Integration or infrastructure? While the conclusion of various regional trade deals may play a role world-wide, this does not appear to be so for Africa:

- Despite the documented rises in intra-African trade, this is not necessarily matched by increased trade within Africa's many regional trade blocs (see AFRICA: Intra-regional trade fails to deliver - January 18, 2006).
- Ironically, the premise that African exports are 'low' has been used to motivate the need for regional agreements or to conclude that existing ones have not worked (see AFRICA: Overlap and EPAs bedevil regional integration - September 15, 2006).
- While still high, it may be the case that intra-regional non-tariff barriers to trade have engendered more regional trade.

Another potential explanation is the physical trade infrastructure. Cross-country studies associate measures of infrastructure and logistics with exports, and much infrastructure investment has taken place recently, so it is likely that improved regional infrastructure is contributing to this pattern (see AFRICA: Transit needs more than infrastructure boost - August 22, 2008).

Exporting 'too much'? Empirical gravity models are positive models in that they explain levels of trade. They do not recommend them. One of the main components of the developmental argument for expanding exports is that domestic markets are too small for African products. Thus, while low GDP can account for Africa's low exports, it also offers a reason for trying to raise them through a host of policy measures.

CONCLUSION: Once distance to markets and especially GDP are accounted for, the typical African country does not export too little, either with its neighbours or countries elsewhere. In fact, African countries have increased their propensity to export more than expected. Therefore, poor trade performance cannot be offered as evidence that there is something inherently deficient about the African export environment. However, this is does not mean higher exports would not be useful.

Keywords: AF, Africa, economy, foreign trade, growth, infrastructure, integration, policy, reform, trade, transport

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