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African Development Bank

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AFRICAN DEVELOPMENT BANK GROUP

# Commodities, Export Subsidies, and African Trade during the Slump

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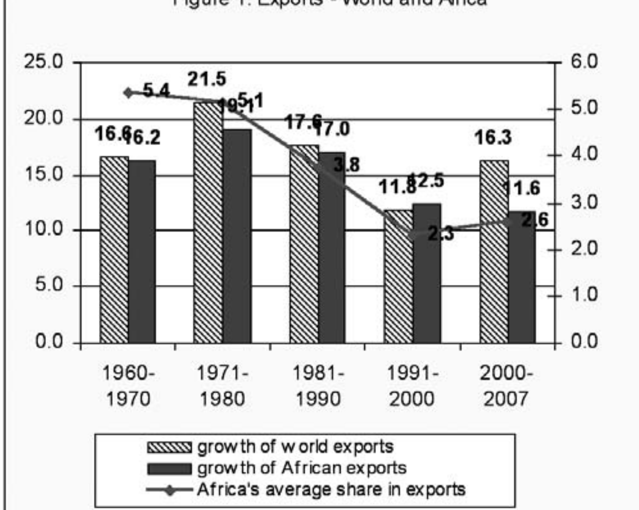
## Trade and growth

The steady increase in trade, especially exports, has been a major driver of past growth performance globally as well as in Africa. However, while African exports have grown significantly and often at par with world trade, the continent's share of global trade remains low. African exports accounted for 5.4% of world exports in the 1960s. This ratio has declined to only 2.6% today (Figure 1). Intra-African trade is also very low, representing only 8% of exports and 9% of imports. By comparison, intra-Asian trade accounts for 45% of total Asian trade.

Today, Africa's trade performance is threatened by the current economic crisis which has reduced global demand and weakened credit markets. African exports are predicted to decline by as much as 7% in 2009. The last decline in African exports was recorded in 2001 (UN, WESP 2009). Lower export demand has already caused substantial job losses in export-oriented sectors. In Angola, the diamond-mining company, De Beers, warned in December 2008 that cuts in production would cause more than 1,000 job losses. In the Democratic Republic of Congo, declining activity in the mining sector has resulted in an estimated 100,000 job losses. As a result of reduced export demand and a slowdown in private sector activity, the continent's growth prospects are bleak: a meagre 2.9% real GDP grow-

Figure 1: Exports - World and Africa



th rate is expected for 2009, down from 6% in 2007 and 5.7% in 2008 (African Development Bank). The tourism sector has also not been spared, with tourists arrivals falling worldwide. The 2% growth registered in 2008 is now projected to be reversed with probable negative growth in 2009. Kenya Airways, for instance, now expects its profits to be cut by 25%, due to the financial crisis.

Promoting African trade is therefore critical to avoiding a growth collapse, which will jeopardize the modest poverty reduction gains made over the years. However, efforts to increase and sustain trade are confronted with several key constraints: falling commodity prices; procyclicality and declining trade volumes; and inadequate and inefficient physical and soft infrastructure

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**Falling commodities prices**

In general, Africa's growth has been attributed to higher commodity prices which were driven by strong demand in developed as well as emerging countries such as India and China. Strong export earnings provided much-needed fiscal space to support infrastructure as well as education and health services. The global financial crisis, which caused a sudden plunge in commodity prices, confirmed the risks associated with volatility in commodity prices. More pronounced has been the impact on the prices of commodities such as oil, platinum, silver, gold, coffee, and others. For instance, the price of crude oil

Table 1: **Commodity prices**

| Commodity | Unit | Benchmark 07/31/2008 | Value at end of Week (13/02/2009) | % Change Index |
|---|---|---|---|---|
| Crude Oil (Brent)* | *US$ per barrel* | 125.73 | 44.09 | -64.93 |
| Gold | *US$ per Troy Ounce* | 918.00 | 935.50 | 1.91 |
| Silver | *US$ per Troy ounce* | 17.48 | 13.37 | -23.51 |
| Platinum | *US$ per Troy ounce* | 1,758.00 | 1,055.00 | -39.99 |
| Cotton | *US$ per pound* | 49.71 | 45.22 | -9.03 |
| Cocoa beans | *US$ per ton* | 2,908.50 | 2,682.12 | -7.78 |
| Coffee, Arabica | *US cents per pound* | 131.10 | 99.00 | -24.49 |
| Coffee, Robusta | *US cents per pound* | 115.09 | 81.75 | -28.97 |

Source: *Bloomberg and Statistics Department African development bank*, January 2009 dropped by 65%, from USD 125.73 per barrel at the start of the financial crisis to USD 43.48 in January 2009 (Table 1). The fall in commodity prices has had severe a impact on African trade performance and current account balances across the continent.

With the deterioration of export performance and declining government revenue, African countries are confronted with a severe problem of “twin deficits” (current account and budget deficits). Consequently, the erosion in the fiscal space makes it difficult for government to implement a fiscal stimulus to boost economic recovery. The prolonged slowdown will put breaks on efforts toward poverty reduction and the attainment of the Millennium Development Goals by 2015.

**Fear of return to export subsidies**

In their search for strategies to cope with the crisis, countries may be tempted to resort to export subsidies as a means of supporting the private sector. However, by acting as implicit barriers to trade, exports subsidies would amplify the negative effects of the crisis. African countries would be particularly hurt by export subsidies, especially given that many of them heavily depend on agricultural exports, which are the most commonly targeted by subsidies. A rise in protectionism in this area will push millions of farmers deeper into poverty as a result of both the decline in farming revenues and the inability of governments to sustain social expenditure, especially in the areas of health, sanitation, and education.

Rising export subsidies will cause deterioration of macroeconomic balances in African countries, further eroding their fiscal space. For example, in Burkina Faso, export growth dropped from 6.9% in 2007 to 3.5% in 2008, following the fall in cotton production and the decline in lint cotton export. The balance of trade sharply deteriorated under the combined impact of falling agricultural production and declining lint cotton export (from CFAF 160 million in 2007 to CFAF 12 million in 2008). The current account deficit is estimated at 12.9% of GDP in 2008, a 3.8 point decline, compared to 2007. Other commodity exporters face the same situation, which largely explains the very negative growth outlook for 2009 on the continent.

It is therefore critical for the world to take all measures to support trade. In particular, all countries should refrain from trade-distorting export subsidies, given their damaging effects not only on growth, but also on the living standards of the poor.

**Procyclicality and declining trade volumes**

Generally, government spending in most countries is cyclical in nature, meaning that expenditure tends to increase with the good times. It was not surprising that most resource-rich countries in Africa raised their public investment levels as their trade volumes surged. What measures should African countries therefore take in order to offset the fall in government revenue linked to declining trade volumes?

It is important for countries to focus on the big decisions that ensure sustainable growth. These priorities include low debt levels, higher infrastructure investment, improving the investment climate, and boosting trade. Countries such as South Africa, which have been severely hit by the financial crisis, have now adopted counter-cyclical policies to meet the financing gap for development needs as a result of the freezing up of funds in the credit market. In this regard, South Africa will revert to the status of a net issuer of debt in 2009. Other countries in similar situations should be encouraged to use domestic instruments such as bonds and tax revenue to offset the loss in fiscal space due to declining trade volumes.

**Infrastructure and African trade**

Infrastructure remains a key factor in facilitating trade and anchoring other economic services. Trade in Africa is atypically costly, both in terms of direct and indirect costs. It is estimated that trade costs represent up to 30% of the price paid by the consumer. Moreover, freight costs constitute about 10% of the value of imports in Africa and other developing countries, compared to 3% in developed countries. For landlocked countries, the challenge is even more daunting. Freight costs account for over 20% of the value of imports for Rwanda, 24% for Mali and 23% for Niger. In addition, delays at border posts account for about 40% of transport time, and imply immense costs associated with the deterioration of product quality and staff time.The high costs are due to inadequate physical infrastructure such as roads and ports, causing long delays in the trade chain.

The Africa's road infrastructure network is inadequate, inefficient and poorly managed. frica's road density is only 7km/100 sq.km, compared to 12km in Latin America and 18km in Asia. Only 30% of the region's roads are paved and many are inaccessible during the rainy season. In addition, ports are in inadequate supply, overloaded, and inefficient. The shipping fleet is also inadequate with vessels that are too small, too few, and often in poor working conditions. Congestion in ports is the norm, resulting in high costs. The time spent in African ports is as high as 80% of total transport time, compared to 20% in East Asia (Nottenboom 2006). These infrastructure inadequacies account for the high freight costs which are often three times those in developed countries.

Consequently, the linkages between high transport cost and deficient transport infrastructure and management are striking. African countries rank low in the global *Logistics Performance Index (LPI)*, except for South Africa which is ranked 24th. Only São Tomé and Principe, Tunisia, Guinea, Sudan, and Mauritania fall within the second top quartile out of a total of 150 countries. This presents a general problem, especially as trade flows have grown much faster than the supporting infrastructure. The financial crisis notwithstanding, the continent faces serious structural constraints to long-term trade growth, especially the inadequacy of physical infrastructure.

**Some recommendations**

In conclusion, this note offers the following recommendations that African countries can consider in order to support the trade and growth agenda in the face of the global financial and economic turmoil:

(1) **Stabilization Mechanisms** – During times of prosperity, countries should be encouraged to build up reserves or set up stabilization funds to help cushion the impact of exogenous shocks which may affect commodity prices.  For example, Botswana's mineral revenue and royalties, which accounted for a substantial portion of government revenue, plummeted to 28% of government revenue due to the financial crisis. Botswana is now dipping into its abundant reserves to meet some of its financing needs.

(2) **Financing for Infrastructure** - Priority should be given to financing Africa's infrastructure investment in order to close the funding gap that existed before the financial crisis, which is necessary to meet long-term development goals. Therefore, the need to scale up aid, targeting infrastructure should feature prominently on the G20 agenda. On its part, the African Development Bank considers infrastructure as one of the priority areas in its Medium Term Strategy.

(3) **Keeping the borders open** – resisting temptations for protectionism which may take the forms of high tariffs and other restrictions (i.e. safeguards or anti-dumping duties) as well as subsidies. Leaders around the world have expressed concerns about protectionism, pointing to its perils in the context of the current economic crisis. This was strongly articulated in the G20 November 2008 summit. Protectionist tendencies particularly threaten some sectors, including agricultural export commodities, which constitute the mainstay of many African economies. The challenge in 2009 is for developed and emerging economies to fulfil their promises of trade liberalization through the Doha Round. Any attempt to "turn inward" will be disastrous for the world economy. It

will, in particular, jeopardize Africa's growth prospects and undermine its chances of reaching its development goals.

(4) **Refraining from introducing/reintroducing export subsidies** – While G20 member countries seek strategies to advance domestic goals such as employment and economic recovery, in general, it is vitally important that they refrain from reintroducing, introducing, or expanding export subsidy programmes. These domestic goals may be achieved through other instruments that are not only good for domestic economies, but also for the global economy as a whole. The G20 presents a forum to raise awareness of the negative impacts of export subsidies and other artificial barriers to trade both for the wellbeing of people living in poor countries.

(5) **Mitigating procyclicality** – African countries need to implement counter-cyclical programs to minimize the impact of the crisis and speed up recovery. Domestic resource mobilization instruments such as domestic bonds can help to finance vital public expenditure. Other interventions should include tax reforms, improvements in debt management and strengthening public service capacity. However, these measures will not be enough in the short term. African governments need assistance from development partners, notably through budget support programs. The G20 summit should provide a forum to advocate for the scaling up and speeding up of assistance to African countries in the context of the global economic crisis.

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