Module-2

The Role of Trade in South Asian and Sub-Saharan African Development

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This module is written under a research grant from the Economic Affairs Division of the Commonwealth Secretarial, London to CUTS International, Jaipur. Views expressed in this module are those of the author and not necessarily reflect those of their institutions and of the Commonwealth Secretariat and CUTS International.

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Acronyms

GDP	Gross National Product
ELGH	Export-led Growth Hypothesis
EPZ	Export Processing Zone
EU	European Union
FDI	Foreign Direct Investment
LDCs	Least Developed Countries
RMG	Ready Made Garments
SA	South Asia
SEZ	Special Economic Zone
SSA	Sub-Saharan Africa
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organisation

1. Introduction

International trade plays an important role in accelerating economic growth and poverty reduction in developing countries though the link between trade and poverty reduction is neither straight nor automatic. Yet it is found that trade can help improve income levels of people and thereby reduce poverty in developing countries.

The countries of South Asia and Sub-Saharan Africa (SSA) are one of the poorest in the world today, where a large proportion of people are living below US$1 per day, the international poverty line as suggested by the World Bank. Recognising the fact that the international trade can facilitate economic growth and employment generation, the SSA countries were early in opening up their economies to the global economy as compared to their South Asian counterparts. However, since the beginning of the 1990ss, South Asian countries underwent economic reforms whereby international trade was, *inter alia,* accorded priority.

Trade liberalisation measures undertaken by South Asian countries have helped increase their share in the world trade and their trade/GDP ratios. South Asian countries' share in the world trade has witnessed a relatively small yet a continuous rise from 1.35 percent in 1990 to 1.86 percent in 2006. While, on the other hand, the SSA countries' share in the world exports have witnessed slight fall during the same period from 2 percent to 1.33 percent. As compared to SSA countries, the South Asian countries have been able to diversify their export basket. Industrialisation has come a long way in the South Asian countries. For example, India, being the largest country in the South Asian region, has experienced a significant rise in the share of services exports in the total exports during last decade or so. In 1994, services exports constituted nearly 19 percent of total exports, which steadily rose to 28 percent in 2004 and now has captured around 30 percent mark.

Poverty stricken developing countries of both SSA and South Asia regions need to open up their economies to reap the fruits of globalisation, which in turn, requires that their trade policy should be integrated with other domestic policies like the industrial, fiscal and monetary policies.

The paper briefly describes the role of trade in SSA and South Asian countries. Section 1 is the introductory section followed by Section 2 that provides a detailed account of the significance of and trends in merchandise trade in SSA and South Asian countries. Section 3 gives an account of trade in services in the two regions. Section 4 tries to establish a theoretical link between trade, economic growth and overall economic development with empirical data from these regions and comparing with other regions of the world. Is there any relationship between trade and poverty is the subject discussed in detail in Section 5. Section 6 attempts to evaluate the export-led hypothesis with empirical evidence drawn from these two regions.

2. Significance of and Trends in Merchandise Trade in South Asia and SSA

International trade plays vital role in the SSA countries where the trade/GDP ratio in 2003 rose to 66 percent from 53 percent in 1990 showing their increasing dependency on foreign trade. Alternatively, these countries are much open and integrated with the rest of the world compared to the South Asian countries, albeit their share in world trade, standing at around less than two percent, are relatively insignificant. Relatively still small players in the world trade the countries of South Asia are steadily increasing their share in the world trade, from less than one percent in 1990 to nearly 1.5 percent in 2006.

On the other hand, the South Asian countries were (and still) less open to international trade as compared to their counterparts in SSA. Their ratio of total trade to GDP was 35 percent in 2003 registering an increase of about 40 percent over 1990. However, the region's export/import to GDP ratio has very marginally improved during the same period (see Table 1).

Table 1: Structure of Trade in South Asian and SSA Countries (in percentage)

Items	**South Asia**	**South Asia**	**Sub Saharan Africa**	**Sub Saharan Africa**
	1990	2004	1990	2004
Imports/GDP	13	16	26	26
Exports/GDP	11	12	27	27
Trade/GDP	24	28	53	53
Primary exports/ manufactured exports	--	43	--	--
Manufactured exports/merchandise exports	71	61	--	--

Source: adopted from World Development Report, 2006

The countries of both South Asia and SSA have shown a rise in trade/GDP ratios between 1990 and 2003. The SSA countries have been the exporters of primary commodities and that too restricted to small number of commodities, which affect these countries badly when their international price fluctuations are high creating balance of payments difficulties.

Countries like Angola and Nigeria depend on fuels, which claim as high as 98 percent of their total exports in 2005, while half of the total exports from Kenya are constituted by food and agricultural raw materials and nearly two-fifths of total exports of Zambia are ores and metals. In most of these SSA countries, the share of manufactured products in their total exports is less than one-fourth of the total exports. While on the other hand, South Asian countries are exporting more of the manufactured products, the share of which is as high as 90 percent for Bangladesh and over 70 percent for India and Pakistan in 2005.

The exports and imports of SSA countries have doubled during the period between 1990 and 2004. Out of 47 countries of SSA 9 important countries' export and import data for the period are shown in the Table 2. During the period between 1990 and 2004, total exports from SSA countries rose from US$69bn to US$142bn and imports from US$58bn to US$126bn Angola, Congo and Nigeria have shown significant increase in exports during this period while Zambia has decelerated in its export performance. The European Union (EU) claims significant share in SSA's total exports and imports followed by North America.

Table 2: Growth of Merchandise Exports and Imports in SSA 1990-2004

Country	Export (US$ millions)			Imports (US$ millions)		
	1990	2000	2006	1990	2000	2006
SSA	69617	92265	142400	58665	81192	126524
Angola	3884	7921	31155	1578	3040	11275
Botswana	1785	2713	3919	1947	2469	2945
Cameroon	2002	1833	3880	1400	1484	3217
Congo	981	2489	6660	621	737	1871
Kenya	1032	1734	3392	2223	3105	7175
Nigeria	13671	21174	46590	5627	8721	22596
Tanzania	331	663	1440	1364	1524	2535
Zambia	1309	666	2981	1220	993	2378
Zimbabwe	1725	1925	1992	1839	1864	2763

Source: UNCTAD Handbook of Statistics, 2006-07, UNCTAD, Table 1.1.1, p.4-5.

In the South Asian region, India is the largest country and a very significant player in the international trade followed by Pakistan and Bangladesh. These three countries together share nearly 90 percent of total trade of the region. India alone captures a lion's share of three-fourths of total region's trade (see Table 3). While exports from SA countries rose from US$27bn in 1990 to US$100bn in 2004, the imports outgrew those of exports, which rose to US$133bn from US$39bn during the period.

Table 3: Growth of Merchandise Exports (fob) and Imports (cif) in South Asian Countries1990-2006

Country	Export (US $ millions)			Imports (US $ millions)		
	1990	2000	2006	1990	2000	2006
South Asia	47033	92735	222570	57416	95548	271667
Afghanistan	235	137	340(1)	936	1176	2520(1)
Bangladesh	1671	6399	12277	3618	8360	16017
Bhutan	70	103	304(1)	81	175	500(1)
India	17969	42379	120887	23580	51523	169835
Maldives	78	109	225	137	389	927
Nepal	204	804	817	672	1573	2604
Pakistan	5589	9028	16470	7376	10864	28405
Sri Lanka	1912	5430	6735	2685	6281	10353

(1) Figures related to the year 2005.
Source: UNCTAD Handbook of Statistics, 2006-07, UNCTAD, Table 1.1.1, pp.6-7.

The structure of trade of the SA countries is more diversified –both in terms of commodity composition and trade direction as compared to SSA countries. For example, India exported 259 commodities/products[†] as against 198 commodities by Kenya in 2005. The Concentration Index for India's exports in 2005 worked out at 0.134 while it was 0.276 for Kenya for the same year. This shows that Indian exports were less concentrated as compared to the one from Kenya in 2005. Similarly, India exported to 120 countries while Nigeria to only 76 countries during 2003. Nearly half of India's total exports in 2004 went to developing countries, of which about six percent to SSA countries. The trade between the developing countries (i.e. South-South trade) has remained historically low, albeit it is rising now, which is currently about one-fifths of total trade of developing countries.[‡]

3. Significance of and Trends in Services Trade

Services trade include transport, travel, communications, construction, computer and information services, insurance, financial services, royalties and licence fees, other business services and personal, cultural and recreational services. These all are commercial services. In fact, trade in commercial services is becoming important world over and both SSA and South Asia are witnessing significant increases in their services trade in the last one decade or so especially after globalisation policy pursued by the countries of Africa and Asia.

The trade patterns of developed and developing countries reveal that the higher the levels of industrialisation the greater the services trade captures share in total trade. Since both SSA and South Asia countries are relatively less developed and thus one can easily predict that the services trade would be low in overall trade of these countries. Table 4 shows that in SSA countries, 16 percent and 32 percent respectively of total exports and imports were carried out in the commercial services in 2004. Barely three percent of total exports were made under the commercial services exports in Angola while they claimed as high as 97 percent of total imports (due mainly to very low level of merchandise imports) in 2004. Thus the balance of trade in services was extremely unfavourable for Angola in 2004, albeit its overall merchandise trade was significantly surplus in the same year. Similarly, in Nigeria about 1/3 of the total imports were claimed by the services and only 11 percent of the total exports were services during 2004.

Table 4: Growth of Services Trade of SSA during 1990-2006

Country	**Export (US $ millions)**			**Imports (US $ millions)**		
	1990	**2000**	**2006**	**1990**	**2000**	**2006**
SSA	11192	16207	33346	21176	26936	59074
Angola	108	267	177(a)	1807	2699	6791(a)
Botswana	210	325	909-	376	547	884
Cameroon	382	590	445(b)	1045	957	1098(b)

† Number of products at SITC, revision 3, 3-digit group level, See UNCTAD Handbook of Statistics 2006-07, p.204. Similarly UNCTAD presents measure of Concentration Index which varies from 0 to 1 (maximum concentration)

‡ Calculated from UNCTAD Handbook of Statistics, 2005, UNCTAD, P.52, 53, 209,210.

Congo	99	137	235(a)	769	738	1560(a)
Kenya	1138	993	1974	700	719	1173
Nigeria	965	1833	4164(a)	1976	3300	7321(a)
Tanzania	131	627	1226(a)	288	682	1164(a)
Zambia	107	114	294	386	340	724
Zimbabwe	264	311	--	496	398	--

(a) Figures related to 2005. (b) Figures related to 2003.
Source: UNCTAD Handbook of Statistics, 2006-07, UNCTAD, Table 5.1.1, pp.248-50 & 256-57.

In South Asia, trade in services has been less pronounced compared to that of SSA. It was less than 15 percent of both total exports and imports in South Asian countries (see Table 5) Since India's level of industrialisation is higher than those of any other country of South Asia, its share of services trade in overall trade is relatively higher. In India, nearly 34 percent of total exports were constituted by the services exports while their share in imports stood at 28 percent in 2004. Out of total export revenue from commercial services trade during 2003, computer and information technology (IT) services captured nearly half of the total, earning about US$11.4b for India.[§]

Both SSA and South Asian countries are experiencing deficits, i.e. services imports exceed those of exports. However, SSA countries are importing much more commercial services than they export it and thus facing much higher services trade deficits than their counterparts in SA. Globalisation and liberalisation policies adopted by SSA and South Asian countries have widened the scope of exports and imports of commercial services.

Table 5: Growth of Services Trade in South Asian Countries during 1990-2004

Country	Export (US $ millions)			Imports (US $ millions)		
	1990	2000	2004	1990	2000	2004
South Asia	7219	20685	33029	9735	25029	38827
Afghanistan	--	--	--	--	--	--
Bangladesh	392	815	1093	700	1620	1913
Bhutan	28	13	--	28	39	--
India	4625	16684	29210	6090	19187	31592
Maldives	101	348	--	38	110	--
Nepal	204	506	--	167	200	--
Pakistan	1429	1380	2726	2073	2252	5322
Sri Lanka	440	939	--	639	1621	--

Source: UNCTAD Handbook of Statistics, 2006-07, Table 5.1.1, P.252-53.

In SSA, Kenya and Nigeria are two important services trading countries while in South Asia, India is the single largest services trading nation. In SSA, transportation, travel and communications services – both from exports and imports point of view – are significant, while India has recently become an important exporter of computer and IT services, including an important business process outsourcing (BPO) destination.

§ UNCTAD Handbook of Statistics, 2006-07, Table 5.1.1, P.252-53.

4. Why Trade is Important for Economic Growth and Development

The idea that openness to trade is inherently good for growth and development now enjoys almost universal support. As Dani Rodrik has written, "Trade has become the lens through which development is perceived rather than the other way round". [**] Indeed, over the past 20 years the fastest growing regions have also had the highest export growth (see Table 6). The East Asian economies, which have registered the highest GDP growth rates, have also shown the highest export growth rates during the period 1980-2000, while Africa has experienced very low growth rates in both GDP and exports during this period.

Table 6: Average Annual Growth Rates of GDP and Exports during 1980-2000 (in percent)

Regions	GDP	Exports
East Asia	7.3	11.1
South Asia	5.5	7.9
LatinAmerica & Carribeans	2.5	6.9
Africa	2.2	2.8

Source: World Development Report, 2006

The study by David Dollar and Aart Kraay[††] came with the idea that an increase in trade as a share of GDP of 20 percent points increases growth by between 0.5 and 1 percentage point a year. Their study has further found no evidence of a systematic tendency for inequality to increase when international trade increases. International trade can expand markets, facilitates competition and disseminates knowledge, creating opportunities for growth and (human) development. Trade can also raise productivity and increases exposure to new technologies, which can also spur growth. Trade and in particular export growth can play a number of different roles in supporting economic growth. These include: [‡‡]

- Static efficiency gains which arise through specialisation according to current comparative advantage;
- Increased capacity utilisation which arises if external demand enables the employment of previously idle (or surplus) labour and land resources which previously were not utilised owing to a dearth of effective domestic demand or if trade reduces the costs of wage goods;
- Increased physical and human capital investment owing to improved returns to investment which can arise either through the identification of new opportunities associated with external demand or through the improved profitability of investment following the cheapening of the production costs;

** Rodrik, D. (1999). The New Global Economy and Developing Countries: Making Openness Work. Washington D.C.: Overseas Development Council, Essay No. 24.

†† Dollar, D. and Kraay, A. (2001). Trade, Growth and Poverty, World Bank Policy Research Department, Working Paper No. 2615, Washington DC.

‡‡ The Least Developed Countries Report 2004 "Linking International Trade with Poverty Reduction" UNCTAD, New York and Geneva, 2004, Part Two, Chapter 1, P.71.

- Productivity growth which can arise through the transfer of technology or increased efficiency owing to the pressure of exposure to international trade competition;
- Export-accelerated through the transfer of technology or increased efficiency owing to the pressure of exposure to international trade competition; and
- Relaxation of the balance of payments constraint on sustained economic growth.

The relative importance and the mix of these roles vary between countries. In developing countries, agriculture plays very vital role – both in producing goods and services and providing employment. However, it is afflicted by weak productive capacities. Exports, therefore, are necessary in such situations which enable developing countries to import goods, such as food grains, fuel, raw materials, intermediate inputs, machinery and equipment, consumer durables, means of transport and spare parts which are/can not be manufactured domestically but which are very essential for economic growth and poverty reduction. In the presence of idle resources, such as untapped minerals, underutilised land and surplus labour – a situation of a "vent for surplus"[§§] export growth may be achieved without constraining the growth of other domestic sectors. Exports provide an opportunity to use the idle resources, which would enable the country to import more necessary goods and services for accelerating its economic growth.

The empirical evidence supports the view that in the initial stages of development the income elasticity of imports[***] remains high and therefore, it is essential that the export growth should be high and stable to satisfy growing import demand. If the growth of exports is not fast enough to cater to the growing import demands, then this may lead to balance of payments deficits, and in the absence of capital inflows in the form of grants and compensatory financing facilities to cope with temporary shocks to export earnings, the sustainability of economic growth will be threatened by the buildup of an unsustainable external debt.[†††] Trade is a vehicle of globalisation. The empirical evidence suggests that those globalisers (i.e., countries that reduce trade barriers) have shown much faster reduction in their poverty levels compared to those non-globalisers. (see Box 1). Dollar and Kraay (2001) have estimated that the fraction of people living below US$1 per day fell sharply between 1980s and 1990s among the globalisers, from 43 percent to 36 percent in Bangladesh, from 20 percent to 15 percent in China and from 13 percent to 10 percent in Costa Rica.

§§ The concept that a country -- especially a developing country -- may be able to gain by exporting the products of factors that would not be employed at all without trade. This "vent for surplus" theory of trade was developed especially by Myint (1958), who attributed the term to Williams (1929) and before that to Mill (1848) and the idea to Smith (1776).

*** Income elasticity of demand for imports refers to the responsiveness of demand for imports due to changes in income. As income grows there is more demand for imports and vice versa.

††† Darrat, A.F. (1987). "Are exports an engine of growth? Another look at the evidence" Applied Economic, 19, 2, (February): P 278.

Box 1: Definition of Globalisers and Non-globalisers

Dollar and Kraay (2001) have classified developing countries into two categories: globalisers and non-globalisers. Those developing countries "that have significantly opened up to foreign trade since 1980s" and to compare their experience with that of developing countries "that have remained closed" (pp 7). The two groups called "globalisers" and "non-globalisers" respectively and are identified on the basis of trade/GDP ratios (in constant prices) and reductions in average tariffs.

The higher the extent of globalisation (i.e., more openness and exposure to international trade competition) would bring both static and dynamic efficiency gains through specialisation based on current comparative advantage. Similarly, export growth would provide opportunities for exploitation of hitherto untapped natural and human resources. Increased capacity utilisation would accelerate economic growth, which would further increase the country's capacity to imports. More and deeper diversification in trade, product and markets would bring more and rapid structural changes in the economy.

5. Is There Any Relationship Between Trade and Poverty?

There is a vast theoretical literature supported by empirical evidence to show the relationship (albeit indirect one) between trade and poverty. Winters (2000) suggests that trade liberalisation and poverty is a sub-set of a number of policy issues within the general problematic of trade and poverty. There are at least 11 (not exhaustive) interrelated issues, which have two-way linkages.[‡‡‡] Each one reinforces the other one either positively or negatively. For example, more trade liberalisation may lead to export/import instability and/or food security, which may result in increase in poverty. Reduction or elimination of export/import instability may require more trade liberalisation. More trade may lead to increasing wage inequality between exporting and non-exporting firms when exporting firms offer higher wages to their workers as compared to non-exporting firms. Therefore, all issues relevant to the understanding of the trade-poverty relationship are included.

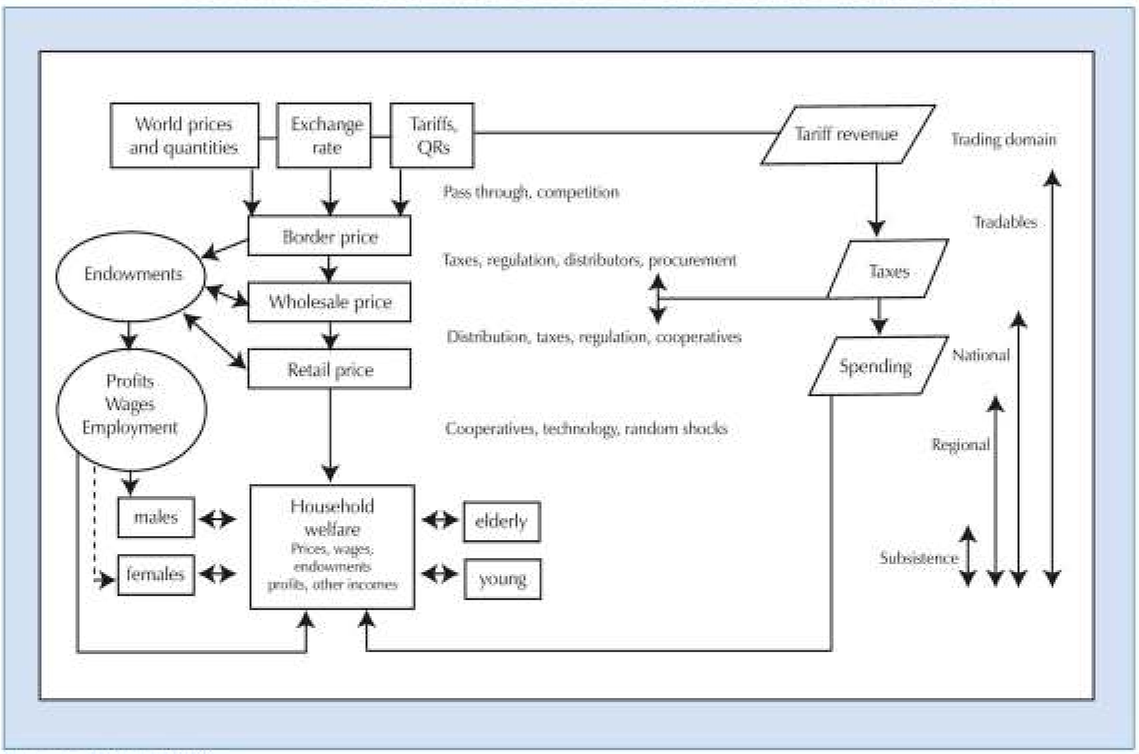
The 11 issues as stated above linking trade with poverty are elaborated more systematically in an analytical framework by Winters (2000) as shown in Diagram 1. Within this analytical framework, trade policy reform is seen as a price shock which has: (i) expenditure effects, which arise because of changes in the prices of the goods that are consumed; (ii) income and employment effects, which arise because of changes in the remuneration of factors of production; and (iii) effects on changes in tariff revenues and taxes, which affect transfers and the provision of public goods as well as affecting the risk and uncertainty that poor

‡‡‡ The Least Developed Countries report 2004 "linking International Trade with Poverty reduction" UNCTAD, New York and Geneva, Part Two, Chapter 1, Chart 6, P.72. Allen Winters has stated following 11 issues linking trade and poverty: Trade and employment, export/import instability & food security, upgrading and exclusion, gender relations and export development, trade, poverty and conflict, terms of trade and poverty, exchange rate and poverty, trade and wages inequality, bargaining power in global production chains, trade liberalisation and poverty, "curse" of primary commodity dependence, and balance-of-payments constraints & poverty.

households face and giving rise to short-term and medium-term adjustment costs. There is a spate of empirical research going on to identify the factors explaining the complex trade and poverty interrelationships and such efforts further complicate the issue, as very rightly pointed out in the UNCTAD Report (2004), "the ongoing methodological work on trade liberalisation and poverty is generating ever more technically complex model-based analyses, which are in their turn spawning their own empirical and methodological controversies".

Diagram 1: Analytical Framework Linking Trade and Poverty

ALAN WINTER'S ANALYTICAL FRAMEWORK FOR LINKING TRADE LIBERALIZATION AND POVERTY



Source: Winters (2000).

Source: The Least Developed Countries Report 2004 "Linking international Trade with Poverty Reduction" UNCTAD, New York and Geneva, 2004, Part Two, Chapter 1, Chart 5, pp. 69.

There are direct links between trade and poverty through increased employment opportunities offered by export growth which in turn help increase income and consumption, improve human development and create food security. The wage rates in exporting industries are found to be higher than those in non-exporting industries. There are indirect links between trade and poverty. Trade offers opportunities for increase in production capacities, enhance capital accumulation and brings in structural changes and technological progress. These forces in turn directly affect employment opportunities and trade. All these facilitate development process, which give rise to greater trade, both exports and imports.

6. What is Export-led Growth Hypothesis (ELGH) and What is Its Relevance to South Asia and SSA? What is the Empirical Evidence of This Hypothesis?

The export-led growth hypothesis (ELGH) postulates that export expansion is one of the main determinants of growth. It holds that the overall growth of countries can be generated not only by increasing the amounts of labour and capital within the economy, but also by expanding exports. According to its advocates, exports can perform as an "engine of growth". The association between exports and growth is often attributed to the possible positive externalities for the domestic economy arising from participation in world markets, for instance, from the reallocation of existing resources, economies of scale and various labour training effects. However, these mechanisms are frequently invoked without any theoretical support or any empirical proof available is far from conclusive and this situation explains to some extent why this debate still exists in the economic literature.

The relationship between trade and poverty is often envisaged through an export-led growth strategy. However, export expansion is 'no guarantee' for improvement in poverty situation (UNCTAD 2004). Therefore, even without becoming the "engine" of growth, export activities can contribute to poverty alleviation. The link between export and poverty reductions through growth is indirect but through employment generation is not only direct but also supportive of the development of productive capacities.

Since the late 1960s studies have been conducted to examine the role of export performance in the economic growth process. Although the empirical literature can be considered to be vast, its results are clearly contradictory for both developing countries and industrialised economies. Evidence presented in UNCTAD (2004) shows that statistically, there is no significant relationship between export growth and growth in average private consumption per capita (as an indicator of declining poverty incidence) in either the first half or the second half of the 1990s.

There are two different scenarios to analyse the complex and often contradictory approaches to trade and growth linkages. A country can pursue either trade-driven approach to development or development-driven approach to trade. In other words, whether trade should bring development (i.e. trade as an engine of growth) or more growth would enhance trade. The empirical evidence on these approaches is vast and growing yet no conclusive evidence is available so far.

6.1 Enclave-led Growth (trade-driven approach to development)

Given this structure of production, enterprise and employment, there is no guarantee that export expansion will lead to a form of economic growth, which is inclusive. Indeed, there is a great likelihood that export expansion will be associated with "enclave-led growth". This is a form of economic growth, which is concentrated in a small part of the economy, both geographically and sectorally. It is exemplified by the pattern of development in the colonial period in African LDCs where a relatively rich commodity-exporting sector, well connected to roads, ports and supported by ancillary services, existed side by side with large undeveloped hinterlands where the majority of the population lives. But it can equally occur with expansion of manufactures exports confined to an export processing one based on assembly of imported inputs, or tourism enclaves, which are supplied through imports, or capital-intensive mines based on FDI. Enclave-led growth offers a short-term solution to the many binding constraints on economic growth, which are characteristic of a low-income trap of underdevelopment and generalised poverty. [§§§]

The "enclaves" of growth have been/are being referred in Africa and Asia as Export Processing Zones (EPZs) or more recently in India as Special Economic Zones (SEZs), which promote economic development through export growth.

World Bank (2004) reported, "Thirty years ago, 80 SEZs in 30 countries generated barely US$6bn in exports and employed about one million people. Today, 3000 SEZs operate in 120 countries and account for more than US$600bn in exports and 50 million direct jobs. By offering privileged trading terms for manufacturing-based exports, SEZs can attract investment and foreign exchange spur employment, and boost the development of improved technologies and infrastructure".[****]

6.2 Inclusive Growth (Development-driven approach to trade)

The economic growth, to be 'inclusive', needs to generate sufficient productive income-earning opportunities (jobs and livelihoods) to guarantee the households substantial and increasing average incomes. This requires not simply increasing output per capita, but also the achievement of a rate of economic growth and an employment intensity of growth that enable the population of working age to become more and more fully and productively employed. Export expansion contributes to the achievement of this condition because of the employment created through export activities. These may be more labour-intensive than some import-substitution industries serving the domestic market.

Thus although economic growth without export expansion is likely to be unsustainable, economic growth which ignores the domestic market is not likely to be inclusive. "Home demand is a prerequisite for a product to be successful exportable" was propounded by S B Linder (1961) Its importance is evident in its analysis, which estimate the relative importance of different demand-side components of economic growth – the growth of domestic demand, import substitution and export growth. Work by Chenery et al. (1986) on patterns of growth over the period 1950-1983, for example, shows that at the start of the development process the expansion of domestic demand contributed just under 75 percent of economic growth in both small primary-oriented and small manufactures-oriented countries. In the Republic of Korea (1955-1971) and Taiwan Province of China (1956-1971), usually regarded as the best models of "export-led growth", expansion of domestic demand contributed to 68 percent and 55 percent of total economic growth respectively, and the contribution of export expansion was 35 percent and 43 percent respectively.

§§§ UNCTAD Report (2004) P. 88.

**** World Bank: Online discussion July 2004.

Inclusive growth is also facilitated if export expansion is linked to growth with the rest of the economy, which occurs, for example, if there are positive synergies between exporting enterprises and local supplies of inputs, providers of services, subcontracting relationships and local purchases of wage goods. It is particularly important that export expansion helps to strengthen domestic linkages and development complementarities between agriculture, where the majority of the population currently earn their livelihoods, and emerging non-agricultural activities.

The direct effect of trade on poverty is through its impact on the cost of living, jobs and wages, and government revenue for public goods, while the indirect links occur through the development and utilisation of productive capacities. The direct link is important for short-term poverty alleviation, but the latter types are needed for sustained poverty reduction (UNCTAD, 2004). Productive capacities encompass a large number of factors – development of skills, technological progress, savings for investment, quality of investment, etc. These factors are more related to overall development than trade. That is why it is argued that the national and international policies facilitating the development of productive capacities must be rooted in a development-driven approach to trade rather than a trade-driven approach to development.[††††] Observing, "An exclusive focus on trade, which assumes that poverty is reduced through trade rather than through development, is likely to prove counter-productive", Razzaque has recently emphasised this argument.

6.3 Empirical Studies

The export-led growth hypothesis (ELGH) has been subject to considerable research in the last two decades, yet the link between exports and economic growth, which has been subject to empirical scrutiny, remains a subject of debate. The successful growth performance of some of the East Asian countries, the so-called 'East Asian Tigers' has renewed the interest in the ELGH study and more recently the debate has been revived due to two new developments. First, 'new growth theory' has resulted in some reappraisal of the determinants of growth in modelling the role of exports in the growth process. Second, the development of new econometric techniques such as time series concepts of co-integration and causality testing has further expanded the debate on export-growth relationship.

The robust growth performance of exports in many developing countries of East Asia, Bangladesh and others has led many observers to justify the export-led growth (ELG) hypothesis for their faster economic development. The ELG theory postulates a causal effect of exports on GDP and allows for significant positive externality effects of exporting activities on the non-export sectors (Feder 1982). However, the evidence on the beneficial impacts of trade liberalisation is inconclusive in many of the empirical studies. The cross-section studies prior to 1998 found evidence of a correlation between exports and growth and thus supporting the ELGH. In fact, the recent evidence on time series, which makes

†††† Razzaque, M.A. (2005) "Trade, Development and Poverty Reduction: The Bangladesh Perspective" Background Paper on Project Launch Meeting on Trade, Development and Poverty Reduction, organised by CUTS-International. pp.14.

extensive use of co-integration techniques, casts doubts on the positive effects of exports on growth in the long run, and is thus not as conclusive as it was previously thought to be.[‡‡‡‡]

It was not until recently that this line of research began to focus on country-specific studies, for both industrialised countries and developing countries. Surprisingly, more than half the empirical investigations published in the 1990s found no long-run relationship between exports and economic growth; rather, the studies suggest that it arises only from a positive short-term relationship between export expansion and growth of GDP.[§§§§]

The studies of industrialised nations have presented the cases of Canada, France, Germany, the UK, the US and Switzerland, among others. In only a few cases have the empirical results confirmed that export expansion was a key element in the economic success of those countries (see Kugler, 1991; Afxentiou and Serletis, 1991; Henriques and Sadorsky, 1996). Even more astonishing is the finding in relation to Japan, which says that internal forces were the handmaidens of the great Japanese economic success in the 20th century, including the post-war period, and not trade as many have claimed in the recent past (Boltho, 1996).

Though the short-term studies do not lend much support to the ELGH for poor countries of South Asia and SSA, there is growing evidence that long run export-led growth may be sustainable which may come in the first place through enclave-led (such as EPZs/SEZs) growth. The policy orientation for developing countries would be to attain inclusive growth in the long run through short term policy instruments such as EPZs/SEZs (enclave-led export oriented growth). The experience of enclave-led growth (in terms of EPZs/SEZs) has been mix. No conclusive evidence can be given as to whether enclave-led growth has lead to economic growth through export expansion and thereby poverty reduction.

A study by A Razzaque (2005) does not lend much support to the ELGH in improving development prospects through trade liberalisation in Bangladesh. He reports:

"The impressive performance of the export sector has also been attributable to trade liberalisation measures in Bangladesh (Ahmad and Sattar, 2004) which is difficult to support. This is because the RMG sector – the main driver of export growth – grew mainly because of a restricted trade policy regime of the developed countries. After the abolition of MFA quotas, Bangladesh's exports have now become subject to fierce competition, with a number of studies predicting adverse consequences for the country. The response of other export items has been very weak. It has been estimated that, of the 17 percent annual average growth in exports during 1990-96 and of 8 percent during 1997-03 the contributions of non-RMG items were respectively 1.31 and 0.11 percent respectively. The dismal performance of all these export commodities seems to suggest that trade reform measures may not have been successful in stimulating export response".[*****]

‡‡‡‡ Ibid.

§§§§ Ibid

***** Ibid

Among the LDCs, there is deeper trade liberalisation in the African LDCs than in the Asian ones, and also in the commodity-exporting LDCs than in the manufactures and/or services-exporting LDCs. This is an intriguing pattern, as in general, the export performance of the Asian LDCs has been better than that of the African LDCs, usually because of their greater specialisation in manufactured exports. However, it would be wrong to think that because the Asian LDCs have more restricted trade regimes, according to the IMF classification, no trade liberalisation has occurred there. Bangladesh, for example, undertook extensive trade liberalisation in the 1990s. The mean tariff on all products in Bangladesh declined from 114 percent in 1989 to 22 percent in 1999.[†††††]

††††† op.cit., Chart 33A and 33B, P 180.

Issues for Discussion

- How would you explain the role of trade in a developing country?
- Discuss the composition and direction of trade of SSA and SA countries.
- Analyse the mechanisms through which international trade can have growth effects.
- How would you explain Allan Winter's Analytical Framework for linking trade liberalisation and poverty?
- What do you understand by enclave-led growth and inclusive growth? Why Inclusive Growth approach is more suitable for developing countries?

Suggested Readings

1. UNCTAD, (2004). *The Least Developed Countries Report 2004- Linking International Trade with Poverty Reduction*, United Nations publication, Sales No. E.04.ll.D.27, Geneva
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3. Berg, A. and Krueger, A., (2003). *Trade, growth, and poverty: a selective survey*, *IMF* Working Paper, WP/03/30.
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