Trade and Debt: Africa's experience

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Introduction and Context

This paper is a contribution to the numerous discussions on Trade and Debt – showing the intrinsic link between them and implications for Africa's development if and when there is a trade off between them.

Africa's debt crisis is very complex although the persistence of this crisis is no longer being questioned. Generally, there is no disagreement about the nature and extent of Africa's debt crisis but how to resolve it. In order for us to be able to establish sustainable solutions to the debt crisis we need to go back to the origins of the crisis.

Africa's debt crisis originates from both internal (mismanagement of resources, under developed structures and institutions, corruption etc) and external factors. During the 1970s, most African countries started experiencing falling commodity prices for their major exports (Eg Copper in Zambia, Cocoa in Ghana, and nickel in Zimbabwe etc) and rising real interest rates. Africa suffered huge weakening terms of trade (i.e. the ratio of prices paid for exports to prices paid for imports). This compelled the African governments to start borrowing to supplement their budget deficits, which were as a result of demands to spend in the social sectors of the newly independent countries.

Many countries in Africa have for a long time relied on primary commodities as their main exports – agriculture and mineral. But the prices of these have been falling steadily for almost a century as well as relative prices of manufacturing. Todaro (1997) shows clearly that during the 1900s real primary-product prices have declined at an average annual rate of 0.6%. And in 15 years between 1977 and 1992, the prices of non-oil commodities relative to those of exported and manufactured declined by almost 60%.

As export receipts have shrunk, so too has the capacity of developing countries' governments to meet their obligations, including repayments of debts that were incurred on the basis of expected export revenues that have now shrunk. Nigeria and Zambia are two typical examples of countries which planned their development programmes on anticipated receipts from copper and oil respectively but ended up with huge debt burdens when the prices of those commodities collapsed.

Another factor to the debt-trade trap was the falling demand for the commodities produced by developing countries. So too has the increased use of synthetic materials that have replaced commodities from developing countries. In the past 35 years, for instance, synthetic substitutes for diverse products such as rubber, wool, cotton, sisal, jute, hides and skins have been manufactured in increasing quantities. Between 1950 and 1980, for example, cotton's share to total fibre consumption dropped from 41% to 29% (UNCTAD 1999).

These commodity price movements have resulted in relatively high losses for export earnings for most African countries. Africa is currently losing approximately US$75 million in trade losses.

To a large extent, the continued deterioration of terms of trade reflects the unequal power balance that exists between developing developed countries and the relatively weak bargaining power/position of the developing countries. This imbalance would need to be shifted otherwise the debt crisis will worsen as the trade losses also persist.

WTO and World Bank/IMF: Instruments for power and policy misdirection

Multilateral institutions like the World Bank/IMF and the WTO still remain the major institutions through which this power imbalance is intensified. Transnational corporations, acting through their governments and multilateral institutions such as the WTO, have largely shaped the current economic institutions to ensure they facilitate their own expansion and capacity to maximize profits.

The World Trade Organisation, started in 1995, has rules that restrict the ability of developing countries to defend themselves against imports, which threaten domestic production while still allowing industrialized countries to protect and support their agricultural sectors. On textiles too, industrialized countries have been slow to reduce protective tariff barriers. But it is precisely in agriculture and textiles that developing countries have comparative advantages; mainly in terms of cheaper land and labour costs over the high cost producers of developed countries.

Present trade rules, for example, allow the European Unions Common Agriculture Policy (CAP) to protect its own countries; agricultural producers and to export its agricultural surpluses at rock-bottom prices, thereby undercutting farmers in developing countries. The impact of the CAP and the significant subsidies given to farmers in the United States is to reduce the earnings that developing countries could expect to earn from agricultural exports in a fairer world market and to increase their spending on imports, because local farmers cannot compete with the artificially low prices of food imported from the European Union.

If developed countries opened up their markets the increased export revenues would significantly boost earnings for developing countries and enable them not only to repay their debts but also make it necessary to borrow as much as they are doing currently to sustain their economies. Furthermore, improved terms of trade through less protectionism would reduce Africa's dependence on aid and strengthen its bargaining power in the World Trade Organisation. It is estimated that an increase in Africa's trade share of exports by just 1% could generate £43 million – five times the total amount of aid received by all African countries. The World Bank has calculated that the elimination of all forms of agricultural protection globally would result in a total income gain of nearly US$250 billion in 2015 of which nearly US$150 billion gain would accrue to low and middle income countries.

Fair global trade has the potential to be far more important than aid or debt relief for developing countries. Echoing Ugandan President Museveni's remarks on debt relief and trade, he says, "Africa needs more trade and access to global markets than it needs development assistance. This will trade our way out of poverty".

The World Trade Organisation's trade rules also do not tackle the issue of falling commodity prices. The advice given to developing countries by the World Bank is that they should diversify

their exports and reduce their dependence on one or two major commodities. This is easier said than done.

On Tariff escalation in which developed countries protect their own food and beverage processors, chocolate is a good example. The UK tariff on cocoa beans, the raw ingredient of chocolate, is taxed at 3% but finished chocolate bars attract an import tariff of 16%. [3] Applied around the world, it means that while 90% of cocoa beans are produced in developing countries, only 44% of cocoa liquor, 38% of cocoa butter, 29% of cocoa powder and a mere 4% of chocolate is produced in developing countries. [4] Importers of fruit juice into the European Union have to pay a tariff of 37% compared to one of 21% if it is in raw material form.

It is clear that Tariff escalation limits developing countries to being mere suppliers of unprocessed commodities when their input and labour costs suggest that they should have a comparative advantage in food processing.

On the other hand, we see the world Bank and IMF, through their roles in policy prescriptions of Structural Adjustment programmes, which have been heavily discredited but have also resurfaced under different guises as elements of poverty reduction strategy papers/Poverty reduction growth facilities and also as necessary reforms in NEPAD, perpetuate this power imbalance between creditors and debtors when it comes to the resolution of the debt crisis.

The enhanced Heavily Indebted Poor Country Initiative (HIPC) remains the major policy framework through which the Debt crisis is being resolved but HIPC, which is supposed to assist countries exit permanently from unsustainable debt levels, has not been fast enough, deep enough to relieve these countries from their debt burden. It is still framed within a conditionality regime (SAPs, PRSPs etc) whose macroeconomic elements do not promote sustainable development.

Uganda, for instance, is one of the countries that followed HIPC religiously - reached decision and completion points which allowed it to access some debt relief which was used in combating HIV/AIDS, building more schools and hospitals etc but this was not sufficient to turn around the economy of Uganda and bring debt to sustainable levels. Today, Uganda remains one of the heavily indebted poor countries with disturbing social indicators. If the creditors were serious about dealing with the problem - Debt, they could have given 100% debt cancellation to Uganda and other countries alike [in Mozambique, Malawi and Tanzania - to boost their immunization programmes for children and in Zambia to stop the charging of school fees] and this would have helped them deal with some economic and social problems. Debt still remains one of the major impediments to development in most of the African countries.

At the core of the HIPC initiative is the issue of Debt Sustainability Analysis (DSA), which every country that intends to qualify for debt relief must do. A Debts sustainability analysis is a mere diagnostic test that is done to examine whether a country's debt is sustainable or not based on its export to debt ratios of approximately 150%. What this means is that a country's export base should exceed its debt burden for its debts to be rated sustainable. Export earnings are a principal component of debt sustainability that is, what a country is supposed to be able to afford in terms of annual servicing of its debt. Thus, trade and trade rules become crucial to determining what a country can earn from its exports.

AFRODAD believes, however, that the extent of debt reduction should be determined according to the incidence and depth of poverty that a country needs to remedy, rather than according to some

arbitrary slice of its foreign exchange earnings. It is clear from historic experiences and current evidence that the productive capacity for most African countries to generate its external viability is still very low as commodity prices continue to fluctuate time and again.

Compounding the difficulties of HIPCs (Heavily Indebted Poor Countries), the World Bank and the IMF have been consistently over-optimistic in their projections of economic growth and export earnings.

An unsustainable debt burden also reduces the capacity of countries to attract domestic and overseas investment and therefore to generate economic growth and enhance trading prospects. Governments facing cash shortfalls will often borrow from their domestic or national credit sources. Such demands on local lenders often mean that interest rates are raised to unacceptably high levels and result in the crowding out of borrowing by domestic producers and investors. The net effect has been to limit investment, to dampen economic growth and to constrain trade capacity.

This is one of the reasons why AFRODAD is advocating that developing countries are given the freedom within WTO rules to protect the livelihoods of small farmers and local production of basic staple food security crops when they are threatened by cheap imports.

Without a fairer system of world trade that will enable poor and indebted countries to use their comparative advantages of cheap land, labour and inputs to export agricultural produce to developing countries, and to move on to simpler manufacturing technologies like textiles, they will never be free of debt. Overseas development assistance and debt cancellation will not always be available to fill the gap between foreign exchange earnings and the cost of imports. In essence, our dream and quest to meet the Millennium Development Goals by 2015 will remain mere illusion.

Conclusion

From the foregoing discussion, it is clear that Africa's debt crisis is closely linked to the unfair trade terms that are being bankrolled by the Brettonwoods institutions, including the WTO. Unfortunately for the region, the poorer it gets, the less influence it has in global negotiations on trade. Accounting for less than 2% of global trade, Africa can be and has been ignored in trade negotiations and it must strategically position itself in the global arena. For greater impact in the global trade negotiations, Africa needs to build a constituency with other developing countries and CSOs (Like they did in Cancun) to negotiate better trade terms and put greater efforts in understanding the implications for their development, of some of the agreements under the trade regime.

While de-linking from the global economy is perhaps not a viable option (Africa's economies are possibly the most integrated in the global economy), it is important for the region to seriously work towards integrating their economies to create a bigger trading bloc that will wield more clout in the international fora. Such integration should, however, be grounded in a clear understanding of the existing unequal power relations between member states in the region and should, therefore, aim for equity in sharing the benefits.

Due to the failure of the IMF/World Bank-imposed policies these institutions should accept their share of the blame for their schemes not working. Alternative models of development that put people at the center of development should be pursued as opposed to the current ones, which place

the market at the center of policy action. Since 1945, the course of international trade has shown that an unfettered global market can fail the poor and that trade liberalization brings huge risks and rarely provides the desired outcome.

African countries should not be forced to open up their markets but should be allowed to manage their own economic affairs.

Finally, the WTO need to change their double standards that trade rules, and the process of negotiations must be made open, fair and democratic.