Free Market Foundation of Southern Africa

African Liberal Network: Free Trade Policy

Free Trade to Improve Wealth and Health

Free Market Foundation

2013

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The Free Market Foundation

The Free Market Foundation (FMF) is an independent non-profit public benefit organisation founded in 1975 to promote and foster an open society, the rule of law, personal liberty, and economic and press freedom as fundamental components of its advocacy of human rights and democracy based on classical liberal principles. It is financed by membership subscriptions, donations and sponsorships.

Most of the work of the FMF is devoted to promoting economic freedom as the empirically best policy for bringing about economic growth, wealth creation, employment, poverty reduction and human welfare (including better healthcare, increased life expectancy, literacy and educational quality). As a think tank the FMFs fundamental approach to policy questions is consumer-based. Individual consumer choice is placed at the centre of any policy recommendations that the FMF espouses. Consumer satisfaction is generally achieved by an absence of barriers to entry into the provision of goods and services, allowing consumers a choice between the offerings of freely competing providers, and the absence of regulations that impose avoidable costly burdens on the providers of goods and services.

Executive Summary

For centuries humans have been trading. Whether by primitive barter exchange or modern society's exchange of goods for currency, the motivation for trade is always the same: to improve one's situation, to make one's life more convenient and more comfortable. Most economists agree that trade liberalisation improves wellbeing by increasing economic growth and average incomes. More and more studies are also revealing the link between free trade and better health outcomes. Yet, despite the overwhelming evidence that free trade leads to higher levels of prosperity and improved health outcomes, there remain significant government imposed barriers to free trade. Over the course of the last two decades preferential trade agreements have proliferated all across the globe. Although these agreements have the ability to improve conditions for consumers, they are a second best alternative to unfettered free trade. The most principled case for free trade is a moral one: voluntary exchange is inherently fair, benefits both parties, and allocates scarce resources more efficiently than a system under which government dictates or limits choices. Free trade is a necessary but not sufficient condition for substantially improving economic growth rates and reducing poverty. Trade is only a facilitating device and complementary factors are required for any democratic society to flourish.

Introduction

Trade liberalisation since World War II

One of the most striking features of the economic environment in the post World War II period has been the extent of trade liberalisation carried out by the global community. Many large multilateral organisations such as the World Bank (WB) and the International Monetary Fund (IMF) have regularly promulgated advice based on the belief that openness generates predictable and positive consequences for economic growth. Indeed, most economists agree that trade liberalisation improves wellbeing by increasing economic growth and average incomes (for example, Dollar, 1995; Dollar & Kraay, 2001; Frankel & Romer, 1999; Sachs & Warner, 1995). Even dissenters such as Rodriguez and Rodrik (2000) agree that trade protection is not good for economic growth. Rodriguez and Rodrik state that they have seen no credible evidence to support the notion that trade protection is good for economic growth, at least for the post-1945 period (Word Bank, 2005).

Trade liberalisation increases GDP by 1.5% annually

More recently, Wacziarg and Horn-Welch (2008) state, "...over the 1950–98 period, countries that liberalized their trade regimes experienced average annual growth rates that were about 1.5 percentage points higher than before liberalization. Post liberalization investment rates rose 1.5 – 2.0 percentage points, confirming past findings that liberalization fosters growth in part through its effect on physical capital accumulation". Integration into the world economy has thus proved to be a powerful means for countries to promote economic growth and development and to substantially reduce poverty.

Humans have been trading for centuries for mutual benefit

That increased trade increases economic growth and reduces poverty is by no means a new idea. For centuries humans have been trading. Whether by primitive barter exchange or modern society's exchange of goods for currency, the motivation for trade is always the same: to improve one's situation, to make one's life more convenient and more comfortable. Without that motivation, why would anyone choose to exchange goods and services over simply doing things themselves?

Specialisation, population growth, spread of investment and technology all resulted from expansion of global trade over past 200 years

The World Trade Organisation (WTO) (2013) notes, "The rise of the world economy, the spread of investment and technology, the growth of international specialisation, the ascent of new economic powers, the dramatic surge in growth and population – none of this in turn would have been possible without a massive expansion of global trade over the past 200 years". And more specifically, "Although the outlines of a world economy were already evident in the 17th and 18th centuries – as advances in ship design and navigation led to Europe's discovery of the Americas, the opening up of new routes to Asia around Africa, and Magellan's circumnavigation of the globe (Maddison, 2008) – it was the arrival of the industrial revolution in the early 1800s which triggered the massive expansion of trade, capital and technology flows, the explosion of migration and communications, and the 'shrinking' of the world economy, that is now referred to as 'the first age of globalization' (Ikenberry, 2000)".

Improved transport technologies reduced "the tyranny of distance"

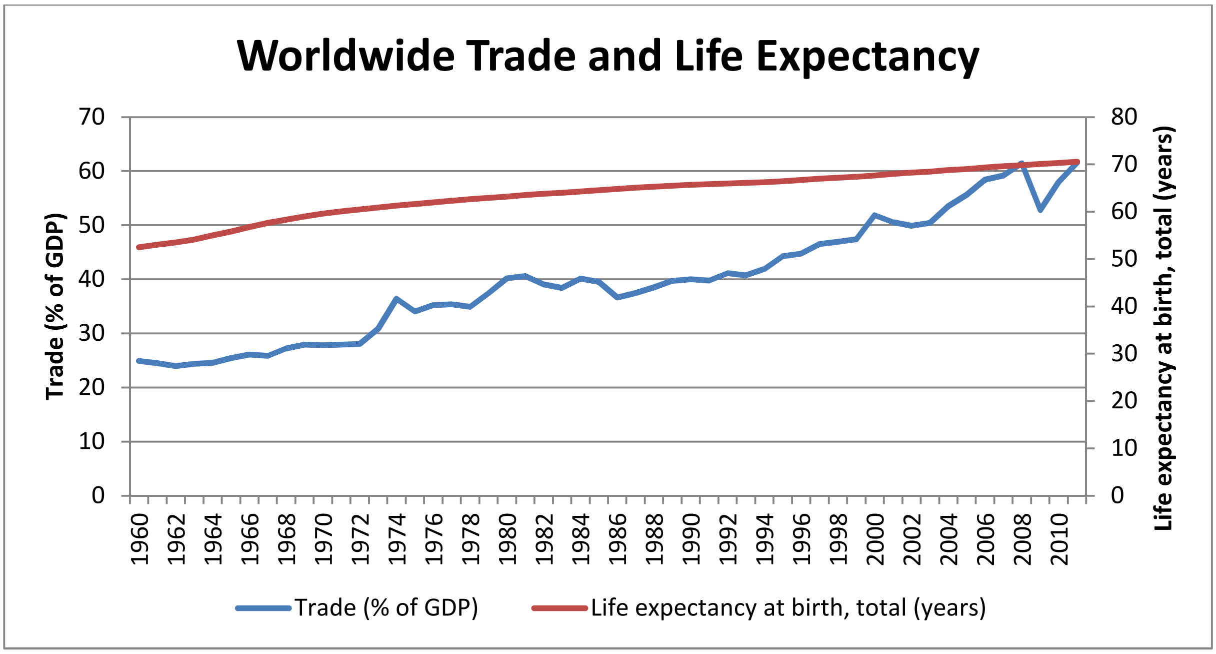
In particular, breakthroughs in transport technologies opened up national economies to trade and investment in ways that differed radically from what had gone before, relentlessly eroding what economic historian Geoffrey Blainey has termed "the tyranny of distance" (WTO, 2013; Blainey, 1968). Today, all countries not only trade internationally, but at increasingly faster rates as evidenced by the increasing proportion of trade exchanges as a percentage of national incomes. While higher income countries still accounted for three quarters of global trade in 2000, lower income countries have seen their share climb by one third as they have cut tariffs and dismantled other barriers to free trade. According to the WB (2013), the average tariff in low and middle income countries has fallen from approximately 25 percent in the late 1980s to approximately 10 percent in 2012.

Increased involvement in global trade had remarkable benefits for developing countries

The relatively recent entry of developing countries into global markets has had an astonishing impact not only on economic growth but also on human welfare. During the second half of the twentieth century, life expectancy rates in lower-income countries rose rapidly as incomes increased and new technology arrived from overseas, described by Gwatkin (1980) as the third of three great waves of mortality decline. This period saw increased access to safe water and sanitation services, increases in per capita food supplies, the arrival of basic public health services, greater knowledge of basic hygiene, and new medical technologies (such as antibiotics and tests for early diagnosis), all instrumental in reducing mortality rates (Urbach *et al*, 2012).

Average life expectancy increased by an average of 24 years in about 60 years

As a result of these advances, life expectancies everywhere increased. Global life expectancy increased from an average 46.6 years between 1950 and 1955 to 70.4 years in 2011 as wealth and knowledge spread around the world (see Figure Worldwide Trade and Life Expectancy below).



Source: World Bank, World Development Indicators & author's own calculations

Longer better quality of life became possible through trading with each other

Material enjoyments and the increased longevity that we are accustomed to today are accessible only through exchange. If people did not exchange, individuals would be relegated to a subsistence livelihood and struggle to produce the goods they need to exist. People would eke out a living as their ancestors did for tens of thousands of years, but they certainly would not enjoy any of the benefits offered by today's modern living standards. To borrow a phrase from Thomas Hobbes, "Life of man [would be] poor, nasty, brutish and short".

Trading is a win-win process – we only trade what we value less for what we value more – local producers often lobby to stop consumers from getting better value from buying foreign goods

The reason people trade is simple: because it is a win-win situation. After a trade, both parties have something they desired more than the item they were holding and are better-off than they were before. Over 200 years ago Adam Smith (1776) wrote:

> *"In every country it always is and must be the interest of the great body of the people to buy whatever they want of those who sell it cheapest. The proposition is so very manifest that it seems ridiculous to take any pains to prove it; nor could it ever have been called in question had not the interested sophistry of merchants and manufacturers confounded the common sense of mankind. Their interest is, in this respect, directly opposite to that of the great body of the people. As it is the interest of the freemen of a corporation to hinder the rest of the inhabitants from employing any workmen but themselves, so it is the interest of the merchants and manufacturers of every country to secure to themselves the monopoly of the home market."*

In one short paragraph, Adam Smith demonstrates not only the virtues of free trade but also provides insights into the main reason why we do not have unfettered free trade today; namely, vested interests (the interested sophistry of merchants and manufacturers) who lobby government to erect myriad protectionist barriers (to secure to themselves the monopoly of the home market).

Typically, these vested interests lobby their governments to introduce tariffs on foreign produced goods. A tariff is simply a tax on foreign produced goods that serves to artificially raise the price of the good in question.

Non-tariff barriers (NTB's) such as "anti-dumping" duties interfere with free trade and prevent consumers from gaining from the most beneficial trades

Non-tariff barriers (NTBs) such as technical barriers to trade, anti-dumping duties, sanitary and phytosanitary measures, taxes and subsidies, etc, are increasingly used by governments to protect certain vested interests within their respective economies.

Free trade between people over greater areas of the globe improve the lives of increasing numbers of people

When goods, services, and capital flow freely across borders, people are afforded the option of taking full advantage of the myriad opportunities available in the international marketplace. When trade is open, it is the domestic and foreign consumers who decide which industries will prosper. They cause increased competition between companies and individuals scattered all across the globe which leads to greater efficiency overall, and, eventually, to greater prosperity. Free trade allows individuals not only to acquire the best and least expensive goods and services the world has to offer, but also the opportunity to sell their own goods and services to the most promising markets, or to access international investment options. Study after study has shown that countries that are more open to the global marketplace grow faster and achieve higher incomes than those that restrict trade (Ikenson and Lincicome, 2011; Dollar and Kraay, 2001).

Free Trade and Health

Trade openness brings about better health outcomes

This section focuses on how trade liberalisation benefits human welfare. Only a modest amount of empirical research has been conducted into revealing the relationship between free trade and health. Without better knowledge of what impact trade liberalisation has on human welfare, it will be difficult to maintain support for the global trading regime, which currently is facing a series of challenges at the highest level, including the stalled negotiations of the WTO's Doha Round.

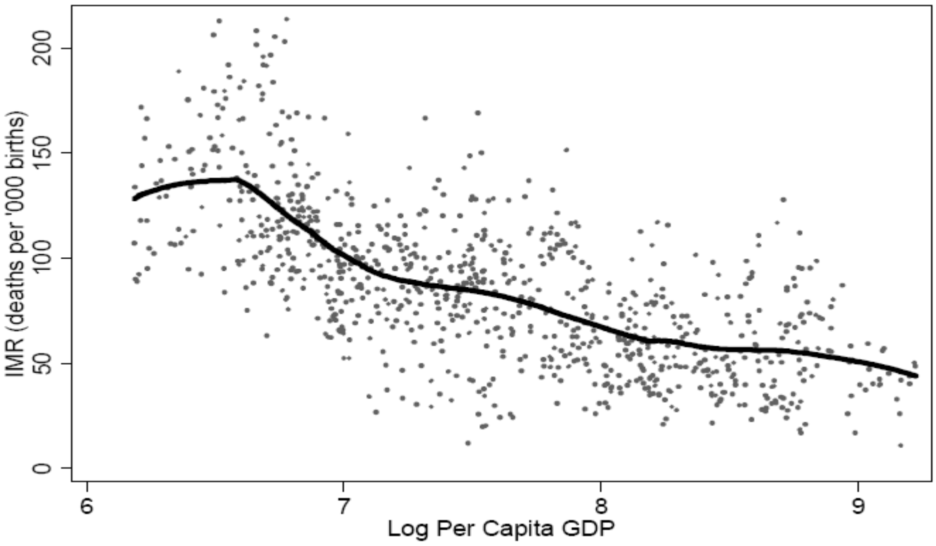
Several studies revealed a statistically significant positive correlation between increased trade openness and improved health outcomes (measured in terms of life expectancy and infant mortality). For Owen and Wu (2007), this relationship was particularly important for countries lower down the income scale. The implications are clear: policymakers – particularly those from low and middle income countries – should continue to pursue trade liberalisation to improve the welfare of their citizens.

Increased incomes and knowledge transfers improve health outcomes

There appear to be two main mechanisms through which trade liberalisation improves health: firstly, and most obviously, via the increase in income that arises from increased openness to trade; and secondly, via the global diffusion of knowledge that has accompanied greater economic globalisation and trade liberalisation.

In the first instance, it is intuitive that there is a strong relationship between income and health, not least because greater wealth buys greater access to the basic determinants of health: nutrition, better accommodation and sanitation. This relationship was confirmed by a seminal 1996 study by economists Lant Pritchett and Lawrence Summers, who showed the dramatic effect that increases in incomes can have on health. They found a strong causative effect of income on the infant mortality rate (IMR) and demonstrated that, if the developing world's growth rate had been 1.5 percentage points higher in the 1980s, half a million infant deaths would have been averted (see *Graph: Infant Mortality Rate (IMR) and GDP per capita* below).

Graph: Infant Mortality Rate (IMR) and GDP per capita



Source: Pritchett and Summers (1996)

The Industrial Revolution brought about an acceleration in economic growth

In fact, ever since the Industrial Revolution (from about 1760 to 1840) when economic growth accelerated, the health of the world's population has been improving and infant mortality and life expectancy rates increased dramatically around the world. Increasing numbers of people were able to abandon the precarious subsistence agrarian lives of their forebears and gain access to increasingly cheap food, better accommodation and improved public health and sanitary infrastructure, often in towns and cities.

Health indicators improved markedly in rich countries during the second half of the 19th Century

Basic health indicators improved noticeably in rich countries from the mid- to late-nineteenth century as nations cleaned up their water supplies and instituted basic public health measures, such as sanitation, pasteurisation, and vaccination. And then, in the first half of the twentieth century, antibiotics, pesticides and an array of vaccines were added to the arsenal of weapons to fight against disease.

After essentially conquering the traditional infectious and parasitic diseases, the richer countries turned their ingenuity and wealth to dealing with the increasing burden of non-communicable diseases such as heart disease, cancer and pulmonary conditions. While these have yet to be entirely defeated, a vast array of new treatments, drugs and technologies now exist to mitigate their effects and, in some cases, cure.

It is clear that humanity owes its current, unprecedented good health to growing prosperity and the diffusion of advances in knowledge. This knowledge would be of limited value without the economic resources required to implement it; sewage systems are expensive, for example, as are mass vaccination programmes or the construction of hygienic dwellings. Much of this economic growth and diffusion of health knowledge could never have been achieved without the dramatic increases in international trade that characterised the late nineteenth century and the second half of the twentieth century.

"Knowledge spillovers" are an outcome of increased international trade that depends for its success on openness to trade

Increased openness to trade is clearly one determinant of the income of a country, and income obviously has a bearing on health status. A less obvious relationship between trade and health, however, is not so much economic, but rather related to 'knowledge spillovers' that occur as people, goods and technologies move more freely around the world. The notion that these exchanges of ideas have been instrumental to improving health in developing countries is shared both by Owen and Wu's analysis, and Jamison, Sandbu and Wang in their 2001 analysis prepared for the WHO's Commission on Macroeconomics and Health (Jamison *et al*, 2001; Owen and Wu, 2007).

Knowledge spillovers are an intrinsic outcome of increased international trade. The freer the trade, the easier it becomes to disseminate to other countries knowledge, techniques and medical products from the countries that developed them. This can have a profound impact on health outcomes. For example, the discovery by John Snow in London in 1854 that cholera is spread by contaminated water had significant implications for the prevention of infectious diseases throughout the world. As this discovery gradually filtered from London throughout Europe, other scientists researched it and developed more refined and applicable methods to identify and limit the role of microbes in the spread of disease. The result was that city authorities upgraded water and sewage systems to prevent human waste from contaminating essential water supplies.

Technologies developed in rich countries and transferred to developing countries have led to sharp declines in mortality rates

The development of some of the most effective medicines such as antibiotics and vaccines started in richer countries. The international manufacture and trade of such technologies has made them readily available in most parts of the world. Between the 1920s and 1940s, huge advances in medical discovery were made, including penicillin, sulfa drugs, bacitracin, streptomycin and chloroquine. In the post war years, with the arrival in Asia of these and other drugs, effective treatments became available at low cost and are largely responsible for the remarkable declines in their crude death rates. In the 1940s, Asia ended several decades of relative economic and cultural isolation and started to integrate into the global economy. This brought with it a massive transfer and diffusion of public health programmes, technologies and techniques that originated in richer countries. Furthermore, the invention of DDT in 1943 gave authorities a hugely powerful weapon in the fight against malaria which allowed the disease to be eradicated from the United States and Europe, and to lower caseloads by over 99 percent in parts of Sri Lanka and India (Gramiccia and Beales, 1988).

As a result of the widening availability and decreasing cost of such interventions – made possible by freer trade – crude death rates dropped steeply, particularly in eastern Asia in the late 1940s. By the 1950s and 1960s, fewer and fewer children and young people were succumbing to the easily preventable diseases which had historically depressed the region's health indicators, and life expectancy was on the rise throughout the world (Bloom and Williamson, 1998).

Perverse policies actively conspire against new technologies in some countries

This process continues today. New drugs and medicines invented in one place are made available elsewhere via international markets. If free trade helps improve welfare by making health technologies more widely available, it would be perverse to enact policies that actively conspire against the diffusion of such technologies. Nevertheless, in many countries across the globe, including Africa where life expectancy at birth is lowest, this is precisely the case.

Governments impose tariffs and other taxes on imported medicines principally as a means to raise revenue since most African countries do not manufacture pharmaceutical products domestically. Such taxes and tariffs are regressive since they disproportionately affect the poorest and most vulnerable members of society. These taxes unnecessarily drive up the cost of medicines, making all classes of drugs less affordable for patients (many of whom pay for their entire healthcare out of pocket) and third party payers. According to Stevens and Linfield (2010), even though vaccines are widely recognised as one of the most cost-effective public health interventions for lower-income countries, high-disease burden countries continue to levy punitive tariff rates: for instance, Burundi at 15 percent, and Ghana at 10 percent (Stevens and Linfield, 2010).

In addition to tariffs on imported pharmaceutical products, many African governments also levy a range of other taxes and mark-ups on medicines. Value-added tax (VAT) is extremely common, as are sales taxes. For example, South Africa has eliminated all tariffs on pharmaceutical products and although this move should be applauded, it continues to levy VAT at a rate of 14 percent on medicines. If African countries are to benefit more widely from the 'knowledge spillover' effects of free trade, then abolishing these regressive taxes and tariffs should be a policy priority.

Trade liberalisation is important for economic growth but also for improving human welfare and health

From the foregoing, it is clear that trade liberalisation should remain an important goal, not just for economic purposes, but also for improving human welfare and health. This is particularly important for lower and middle income countries, many of which still labour under a plethora of tariff and non-tariff barriers (NTBs). Whilst a small minority of economists and those with vested interests may dispute the economic benefits of free trade, there is an increasing body of evidence that demonstrates a strong link between trade openness and better health outcomes. To improve the health of the world's people, more free trade is needed – not less (Urbach *et al*, 2012).

Free Trade is Preferable to Preferential Trade

Not every step towards trade liberalisation is necessarily positive

Preferential trade agreements (PTAs) between countries and groups of countries have increased in number and scope in the last two decades. Krishna (2012) states, “The rise in preferential trade agreements between countries stands as the dominant trend in the evolution of the international trade system in the recent two decades, with hundreds of GATT/WTO---sanctioned agreements having been negotiated during this period and with nearly every member country of the WTO belonging to at least one PTA”. More specifically, the WTO *World Trade Report, 2011* reveals that the number of such agreements more than tripled between 1990 and 2010, from around 70 at the beginning of the period to nearly 300 at the end (WTO, 2013; WTO, 2011). It is important to note however that not every step towards trade liberalisation is necessarily a positive one.

Complex rules are expensive to apply, can divert trade rather than increase it, and are not necessarily in the best interests of consumers

Since the pioneering work of Jacob Viner in the 1950s, economists have known that bilateral and regional trade agreements can reduce a nation’s welfare if they merely divert trade, rather than create new trade (Viner, 1950). Not all increases in trade flows within a PTA can be counted as gains. Trade diversion can sometimes cause members of the PTA to end up buying from higher cost sources, that is, their partners within the preferential agreement, rather than from more efficient producers who are not part of the PTA. Furthermore, a complex web of costs arises from the need to observe rules of origin (ROO) when PTAs require a substantial proportion of the components of a good to originate in the member country. The impact of a significant number of ROO operating within a PTA is commonly and aptly referred to as the “spaghetti bowl effect”.

According to Krishna (2012), “It is sometimes asserted... that the fact that countries choose preferential agreements is proof on the basis of ‘revealed preference’ that the agreements must be welfare improving. While this might hold if trade agreements were decided on by welfare maximizing governments, it is decidedly incorrect in practice. Trade agreements, as a practical matter, are the outcomes of intensely political processes in which powerful domestic lobbies often prevail over less powerful groups (for instance, domestic consumers) in influencing governments and moulding policy to best serve their interests”.

Preferential, bilateral and regional trade agreements can represent stumbling blocks to the adoption of multilateral free trade

Well-known international economist, Jagdish Bhagwati, has also suggested that, in addition to the trade diversion and creation aspects associated with PTAs, bilateral or, more generally, regional trade agreements can act as stumbling blocks to eventual multilateralism (Bhagwati, 2008). Krishna (2012) says, “Despite the proliferation of PTAs in recent years, the actual amount of liberalization that has been achieved through preferential agreements is actually quite limited. Specifically, trade flows between partner countries that receive tariff preferences are a relatively small fraction of world trade. This casts doubt on the claims concerning the efficiency of preferential agreements in achieving trade liberalization”.

Trade between Preferential Trade Agreement (PTA) partners has increased significantly but the volume of trade that actually benefits is quite low

The WTO *World Trade Report, 2011* notes that there has been a significant increase in the value of trade taking place between PTA members. In 1990, trade between PTA partners made up around 18 percent of world trade and had increased to 35 percent by 2008 (in both cases, the figures indicated exclude intra-EU trade). When the European Union is included, intra-PTA trade rose from about 28 percent in 1990 to a little over 50 percent of world trade. In dollar terms, the value of intra-PTA trade, excluding the EU countries, rose from US$537 billion in 1990 to US$4 trillion by 2008 and from US$966 billion to nearly US$8 trillion once the EU is included (WTO, 2011).

These data suggest that a large share of world trade is taking place between PTA members. As the World Trade Report points out, however, these statistics vastly overstate the extent of preferential trade liberalisation and thus the extent that is taking place. The reason for this is because much of the trade between PTA members is in goods on which they impose most-favoured-nation (MFN)[1] tariffs of zero. Moreover, goods that are subject to high MFN tariffs are also often subject to exemptions from liberalisation under PTAs, so that the volume of trade that benefits from preferences is, on average, quite low (Krishna, 2012).

More specifically, the WTO *World Trade Report 2011* calculations indicate that despite the recent explosion in PTAs, only about 16 percent of world trade takes place on a preferential basis (the figure rises to 30 percent when intra-EU trade is included in the calculations). Furthermore, less than 2 percent of trade (4 percent when the EU is included) takes place in goods which receive a tariff preference that is greater than 10 percent (Krishna 2012; WTO, 2011).

Preferential Trade Agreements are a second-best solution to unfettered free trade

The successful completion of an ambitious multilateral tariff reduction package is often mentioned as the most effective means of overcoming any negative effects resulting from the proliferation of PTAs (Lamy, 2009). The logic of this is that as MFN tariffs approach zero, the relevance of PTAs disappears (Suominen et al., 2007; WTO, 2013).

It is important to note that carefully considered agreements do create new opportunities for gains from trade and are often an improvement on the existing situation if, as a result of lowering trade restrictions between trading partners, consumers are able to access cheaper goods and services produced in partner countries. However, the most effective way to ensure that trade liberalisation leads to efficiency improvements is for a country to remove its trade barriers against *all* countries. Preferential trade agreements are a second-best solution to unfettered free trade.

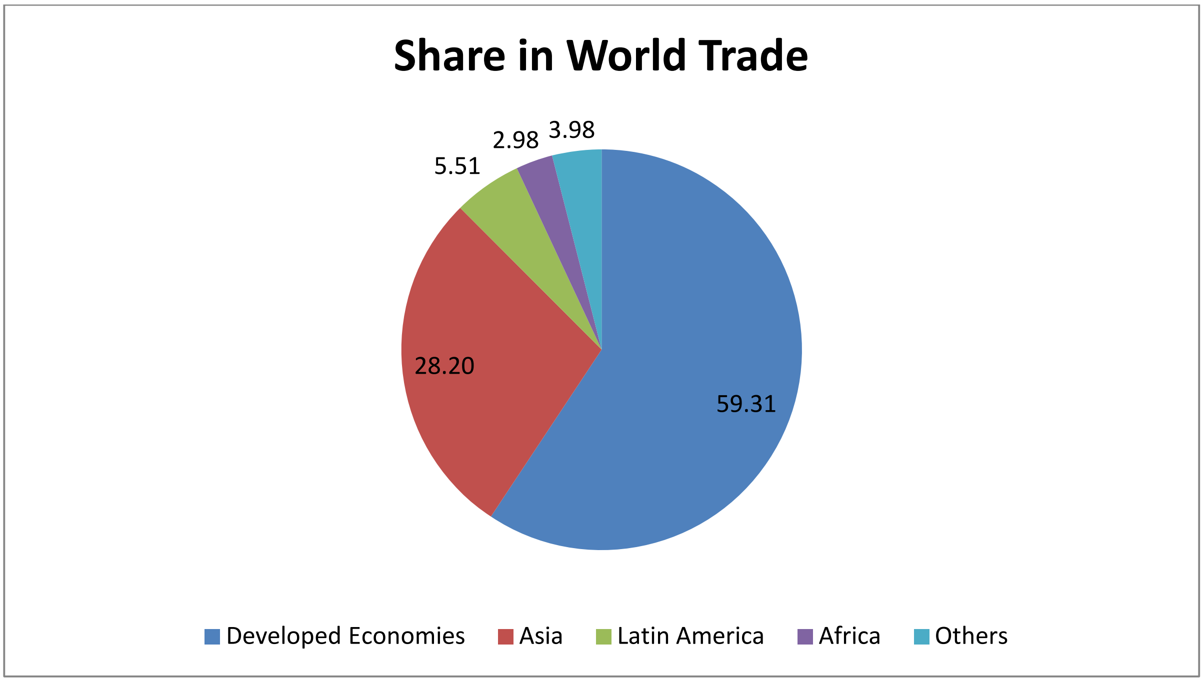
[1] Most-favoured nation (MFN) - Under the WTO agreements, countries cannot normally discriminate between their trading partners. Grant someone a special favour (such as a lower customs duty rate for one of their products) and you have to do the same for all other WTO members.

Intra-African Trade

Regional trade has increased significantly in Asia since 1990 but not in Africa

As noted previously, trade has tended to become more regionalised since 1990 with the proliferation of PTAs. Africa's intra-regional trade share doubled from 6 percent to 12 percent between 1990 and 2011 but this remains remarkably small compared with more industrialised regions. The explosion of PTAs has been particularly pronounced in Asia, where the share of intra-regional trade in exports rose from 42 percent in 1990 to 52 percent in 2011, giving Asia the largest share of intra-regional trade in exports of any geographic region (WTO, 2013).

There are currently 17 regional trade blocs on the African continent, of which 8 are officially recognised by the African Union (UNCTAD 2009). Despite the relatively large number of trading blocs, "African countries have not made significant progress in boosting regional trade. Over the period from 2007 to 2011, the average share of intra-African exports in total merchandise exports in Africa was 11 percent compared with 50 percent in developing Asia, 21 percent in Latin America and the Caribbean and 70 percent in Europe" (UNCTAD, 2013). Moreover, "In 2009, Africa's contribution to global trade stood at just under 3 percent of global trade, compared to close to 6 percent for Latin America and a significant 28 percent for Asia (African Development Bank, 2012) (See Graph *Share in World Trade* below)".



Source: UNCTAD, 2013

Africa's trade with the rest of the world, by contrast, has increased rapidly

More specifically, according to UNCTAD (2013), "The level of African merchandise trade (exports and imports) with the world rose from US$251 billion in 1996 to US$1,151 billion in 2011. In 2011, exports and imports for Africa totalled US$582 billion and US$569 billion respectively, while exports and imports among developing economies totalled US$18,211 billion and US$7,321 billion respectively. In terms of nominal growth rates, Africa has kept pace with the surge in world trade that has occurred over the last decade. Exports to the world grew at an annual average rate of 17.5 percent during the period from 2001 to 2006, outstripping growth both among developing economies (11.5 percent) and developed economies (9.3 percent). Similarly in the period from 2007 to 2011, African exports grew annually on average faster than those in the developing and developed worlds (12.2 percent as against 9.9 percent and 7.4 percent respectively)".

While the value of intra-African trade rose by a factor of 4.1 from 2000 to 2011, in volume terms it rose by only a factor of 1.7. As a share of the value of African world trade, intra-African trade rose steadily from 19.3 percent in 1995, to peak at 22.4 percent in 1997 before falling to 11.3 percent in 2011. This decline can be attributed to a faster rate of growth in African trade with the rest of the world rather than to a slowdown in intra-African trade *per se*. More specifically, from 1996 to 2011, intra-African trade rose at a robust rate of 8.2 percent on average per year but African trade with the rest of the world grew faster at 12 percent on average per year (UNCTAD, 2013).

Intra-African trade, however, remains a very low percentage of African trade with the world (see table *Share of intra-African trade in total trade of Africa* below).

Share of intra-African trade in total trade of Africa: Imports and Exports (USD, millions)

Year	Total African Trade		Intra-African trade		Share of Intra-African in total African trade (%)	
	Import	Export	Import	Export	Import	Export
2002	134,699	133,902	19,491	15,978	14.47	11.93
2003	163,559	171,972	23,302	18,831	14.25	10.95
2004	202,967	223,489	27,556	23,540	13.58	10.53
2005	247,141	305,712	33,741	30,014	13.65	9.82
2006	280,540	365,693	38,132	38,835	13.59	10.62
2007	354,023	412,530	46,783	42,763	13.21	10.37
2008	455,074	555,589	59,240	59,785	13.02	10.76
2009	395,873	378,124	50,283	53,153	12.70	14.06
2010	455,131	487,170	60,809	62,682	13.36	12.87

Source: UNCTAD, 2013

While intra-African trade remains relatively low there is a large volume of informal trade crossing borders

As these data suggest, intra-African trade remains very low. And although there are no systematic statistics on the value and volume of informal trade[2] on the continent, surveys undertaken in some regions suggest that it represents a large share of officially recorded trade. For example, in the Southern African Development Community (SADC)[3] area, UNCTAD (2013) reports, "Informal cross-border trade could amount to US$17.6 billion per year, representing 30 to 40 percent of total intra-SADC trade".

[2] Informal trade or unrecorded trade is broadly defined as all trade activities between any two countries which are not included in the national income according to national income conventions because they are not captured by official national income statistics.

[3] The members of the Southern African Development Community (SADC) are: Angola, Botswana, Democratic republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe

Informal trade between the central and eastern parts of Africa could account for as much as 80 percent of official trade. “Ugandan informal exports to the Democratic Republic of the Congo, Kenya, Rwanda, the Sudan and the United Republic of Tanzania represented $224 million or 83 percent of its total recorded trade to these countries in 2006. In 2009 and 2010 Ugandan informal exports to its neighbours were worth $790 million and $520 million respectively” (UNCTAD 2013).

Estimates of informal cross-border trade in West Africa, furthermore, show that it could represent 20 percent of GDP in Nigeria and 75 percent of GDP in Benin (Afrika and Ajumbo, 2012). These estimates of informal cross-border trade suggest that the true figure for the proportion of intra-African trade relative to total trade is higher than the official figure of around 11 percent. Although it is difficult to ascertain the true extent of informal trade that is occurring, the reason such a large volume occurs is due to restrictive policies and bureaucratic red tape that complicates exchanges in the formal economy.

Africa remains a marginal participant in world trade despite its vast size and abundant supply of human and natural resources

Although there has been significant growth in intra-African trade over the past two decades, the levels remain very low compared to the levels observed on other continents. Africa remains a marginal player in terms of world trade, despite its abundant supply of natural and human resources, which should form the basis for a more considerable expansion of trade. For example, with 733 million hectares of arable land, Africa has about 27 percent of the world’s arable land while Asia has 628 million hectares and Latin America 570 million hectares (Juma, 2011).

Obstacles to Free Trade

Africans benefit substantially from international trade and globalisation

Most of us take for granted the fruits of international trade and globalisation that we enjoy on a daily basis. We are transported in vehicles that were either imported in their entirety, or contain at least some foreign content. Cellular telephones that have become ubiquitous across the African continent and form an indispensible part of our lives are all been assembled outside the continent from parts made in multiple countries. People all across the African continent have more to save or spend because retailers are able to pass on cost savings made possible by their access to thousands of foreign producers scattered across the globe.

African entrepreneurs are able to design and sell products that would never have been commercially viable without access to the cost efficiencies afforded by transnational production and supply chains. Africa's people are able to enjoy fresh imported produce from exotic destinations. They receive higher earnings because their employer can sell to customers abroad. Africans are living longer, healthier lives due to the fact that they are able to access medical technologies developed and produced in foreign countries.

Developing countries have more to gain from open trade than developed countries

According to the WTO (2013), "Developing countries have a lot more to gain from a dynamic economic and open trade environment than developed countries and they have more to lose from a gloomy, confrontational scenario. Services will play a more important role in world trade for practically everyone. Despite the regionalization of trade being a current trend, multilateral trade relationships are unlikely to lose their importance and have the potential to increase significantly".

Trading across borders in Sub-Saharan Africa remains the most difficult

As noted in the previous section, however, intra-African trade and Africa's trade with the rest of the world is low. The World Bank *Doing Business Report, 2014*, notes that the sub-Saharan Africa (SSA) region is where trading across borders remains the most difficult. For example, the Doing Business report (2013) states, "Document preparation time [in the SSA region] is a considerable hurdle for trade — with an average delay of 16.8 days for exports and 20.6 days for imports". Moreover, the report continues, "In some African economies revenue losses from inefficient border procedures are estimated to exceed 5% of GDP". Inefficient border procedures, therefore, remain a significant obstacle to trade within the region. But goods produced face other major obstacles before they even get to border posts

Poor quality roads and inadequate airports and sea ports in Sub-Saharan Africa increase transport costs and reduce trade

The World Bank *Doing Business Report, 2014* states, "In Sub-Saharan Africa reducing inland travel time by 1 day increases exports by 7%". Poor quality roads, or no roads at all, severely limit the ability of entrepreneurs to transport their goods to market on a regular basis and push the costs of transporting goods so high that they disincentivise increased production. To lower transport costs and increase the availability of goods and services, the infrastructure connecting entrepreneurs to markets needs to be improved. More specifically, the WTO (2013) states, "Investment in roads, ports and other transport infrastructure reduces trade costs and hence could, for example, enhance the participation of Africa in world merchandise trade. For instance, the empirical literature suggests that doubling the kilometres of paved roads or the number of the paved airports per square kilometre of a country's territory can boost trade by 13 percent and 14 percent, respectively". The desperate state of roads and other infrastructure across Africa should lead governments to consider all options for improvement, including policies that would create room for private sector entrepreneurs to tackle these problems.

Obstacles to trade are adding enormously to costs, reducing trade, and reducing the potential for increasing the general welfare of African people

According to the World Bank (2012a), "Shoprite reports that each day one of its trucks is delayed at a border costs US$500. And in Durban, the Citrus Growers' Association in South Africa estimates that delays there cost its growers US$10.5 million per season (on approximately US$400 million of exports)". Several empirical studies have attempted to quantify obstacles to trade on the continent as well as quantifying the benefits of increasing trade. The following are some examples of the results from these studies:

- Trade within West African Economic and Monetary Union (WAEMU) could increase threefold if all intra-state roads linking the countries of the Union were paved (Coulibaly and Fontagné, 2005).
- Reducing the distance with trade partners, which means exploiting the trade potential with neighbouring countries, could increase African countries intra-regional trade by 173 percent (Montinari and Prodi, 2011)
- Simulations also show that if all African countries removed intra-African tariff barriers, and adopted the lowest applied transport cost in the region, welfare would increase by 1.013 percent per year on average. Some regions would experience higher welfare effects than others. In the Southern African Customs Union (SACU)[4], average welfare would increase by 1.615 percent per year, translating into an increase of 17 percent over 10 years (UNDP, 2011).

Progress is being made in reducing tariffs between African countries

Significant progress has been made in reducing tariffs between African states to promote intra-African trade. For example, SADC has been trading on preferential terms since 2000 and, based on the implementation of tariff phase-down commitments under the SADC Trade Protocol, formally launched a free trade area (FTA) in August 2008. Under this, 85 percent of intra-SADC merchandise trade flows are now duty-free (World Bank, 2012a). It should be noted, however, that although tariffs have been substantially reduced across the SADC region, there remain significant tariff peaks. One advantage to addressing remaining tariffs is that tariff reform can often be dealt with by "a stroke of the pen" approach as opposed to some of the other barriers where reforms are more complex (World Bank, 2012a).

Non-tariff barriers (NTBs) must also be removed to increase African regional trade

Reducing tariff barriers is not sufficient to substantially increase cross-border trade. The lesson from countries around the globe involved in regional trade agreements demonstrates that tackling tariff

[4] The members of the Southern African Customs Union (SACU) are Botswana, Lesotho, Namibia, South Africa and Swaziland.

barriers is not sufficient to enhance trade. African countries must also aim to reduce the negative impacts of non-tariff barriers (NTBs) such as restrictive product standards or complex rules of origin. For example, a mapping of the various NTBs reported by firms in SADC countries shows that these barriers impacted US$3.3 billion of regional trade in 2008, or one-fifth of regional exports. This is also a lowest cost estimate of the impact of NTBs on trade in the region since some barriers are so restrictive that preferential trade is effectively prohibited (e.g. wheat flour) and, of course, others which affect all trade and not just individual products (e.g. customs delays, transport costs) which are not captured in this estimate (World Bank, 2012a).

"NTBs have a widespread effect on regional trade. On average, the tariff equivalent of NTBs is 40 percent, which for most products is much higher than the MFN tariff applied by most countries" (World Bank, 2012a). NTBs significantly increase costs both for firms that source intermediate inputs from the region as well as for consumers. For example, "In SADC, Woolworths reports that prices in its franchise outlets in non-SACU SADC countries are 1.8 times higher than those within SACU because of higher expenditures associated with sending goods to these markets as well as the higher costs of doing business in them" (World Bank, 2012a).

Local content requirements and their rules of origin (ROOs) requirements add considerably to the cost of regional trade

The World Bank (2012a) states, "Onerous local content requirements in rules of origin (ROOs), particularly in labour intensive sectors (e.g. clothing) that use capital intensive inputs not produced competitively in the region (e.g. fabrics), and high compliance costs with administering certificates of origin reduce the utilization of tariff preferences offered by RTAs and therefore the incentive for Southern African firms to trade regionally". A recent example of the costs associated with meeting ROOs involves SACU moving to more restrictive rules (double transformation) on selected clothing imports from Malawi, Mozambique, Tanzania, and Zambia following the expiration of the MMTZ-SACU Market Access Arrangement at the beginning of 2010. This has resulted in some clothing producers in these countries (e.g. Bidserv in Malawi) being no longer able to compete in the regional market. It has also further distorted investment decisions as some of these firms have relocated to the BLNS (Botswana, Lesotho, Namibia and Swaziland) countries as a result of the change to avoid the loss of preferences in supplying the South African clothing market (World bank, 2012a).

For other products where ROOs have been so contentious (e.g. wheat flour) or simply not agreed upon (e.g. certain electrical products for which rules were only finalised in April 2010), preferential trade within the region has been effectively prohibited (Naumann 2008). Further costs arise from the administrative requirements for certificates of origin, which can account for nearly half the value of the duty preference. For example, Shoprite spends US$5.8 million per year in dealing with red tape (e.g. filing certificates; obtaining import permits) to secure US$13.6 million in duty savings under SADC. Woolworths does not use SADC preferences at all in sending regionally produced consignments of food and clothing to its franchise stores in non-SACU SADC markets. Instead, it simply pays full tariffs because it currently deems the process of administering ROO documentation to be too costly (World Bank, 2012a).

Trade permits, export taxes, import licences and other documentary requirements can lead to up to 1,600 documents having to accompany each truck that crosses a SADC border

The World Bank (2012a) further states, "Other barriers such as trade permits, export taxes, import licences and bans also persist. Shoprite, for example, spends US$20,000 per week on securing import permits to distribute meat, milk, and plant based goods to its stores in Zambia alone. For all countries it operates in, approximately 100 (single entry) import permits are applied for every week; this can rise up to 300 per week in peak periods. As a result of these and other documentary requirements (e.g. ROOs) there can be up to 1,600 documents accompanying each truck Shoprite sends with a load that crosses a SADC border".

Protection of "infant industries" has been used to justify import bans

In SACU, national protection for infant industries has often been used to justify import bans. The World Bank (2012a) states, "Namibia has used the provision to protect a pasta manufacturer and some poultry broilers, and still maintains protection on UHT (Ultra Heat Treatment) milk even though its eight-year limit to do this recently expired. Botswana has recently limited imports of specific varieties of tomatoes and UHT milk". Seasonal import restrictions on maize, wheat, and flour also ensure that domestic production is consumed first. For example, "Swaziland's imports of wheat flour were effectively prohibited for half of 2009 because no import permits had been issued since June of that year" World Bank (2012a). As economists have pointed out the problem with protected infant industries is that they have no incentive to grow up because doing so will mean the loss of their protection.

Export taxes prevent the development of regional trade and reduce the potential profits that could be earned by producers and reduce benefits for consumers

Export taxes also impose costs and inhibit the development of regional supply chains. According to the World Bank (2012a) a case in point concerns small stock exports from Namibia. Since 2004, the Namibian Government has limited exports to encourage local slaughtering. Quantity restrictions were originally used but have recently been replaced by a flexible levy of between 15 and 30 percent, effectively closing the border for the export of live sheep to South Africa. The impact of this restriction is affecting the small stock industry in *both* Namibia and South Africa. In the former, exports of live sheep declined by 84 percent between 2004 and 2008 as farmers have switched to alternative activities like cattle and game farming. The sheep farmers that remain are now almost entirely dependent on the four Namibian export abattoirs that exist whereas previously they were able to sell more sheep to the South African market and receive higher prices (PWC 2007). Some livestock smuggling occurs as people try to avoid the tax. In South Africa, almost a thousand full-time jobs are at risk because of the scheme, especially in the bigger abattoirs in the Northern and Western Cape that focus on slaughtering Namibian sheep during the low season to better utilise their capacity (Talijaard et al. 2009).

The current system and the barriers remaining to trade impose unnecessary costs for producers which limit trade and raise prices for consumers. Many of these barriers do not serve any real purpose and are simply wasteful. Import bans and delays create uncertainty over market access and limit investment. Thick and fragmented borders limit possibilities for regional production chains in which countries can exploit their comparative advantage (see Box 1 below) in specific tasks and intra-industry trade.

Box 1: Comparative advantage explained

As long ago as 1815, David Ricardo introduced the concept of comparative advantage, demonstrating that producers should focus on those goods which they are best at producing. Consider the following hypothetical example that uses two countries, Industria and Languidia, and two products, computers and drilling machines. Let's say a worker in Languidia can produce a drilling machine in half an hour, or a computer in one hour. A worker in Industria can produce a drilling machine in twenty minutes, or a computer in ten minutes. If Languidia and Industria do not trade, it takes one and a half hours to produce both a drilling machine and a computer in Languidia, whereas in Industria it takes half an hour.

If there is free trade, both countries will trade with the other and both will be better off. If the Industria worker makes two computers in twenty minutes while the worker in Languidia makes two drilling machines in one hour and then they trade one drilling machine for one computer both are better off than when they started. Industria gets a drilling machine (without having had to make it) and a computer for twenty minutes of labour (as opposed to half an hour) and Languidia (without having had to make a computer) also get both goods for one hour of labour (as opposed to ninety minutes).

This mutual exchange is a win-win process. In a more complex world drilling machines and computers may not be directly exchanged for one another. Languidia may sell drilling machines to Balazar who in turn sells diamonds to Janipia who uses them to make special machines required for the manufacture of computers, which Janipia then sells to Industria who make the computers to sell to Languidia.

Countries can only afford imports if they produce exports to pay for them. If this is in doubt the extreme case may be illustrative. Consider a country that wants to be completely self-sufficient and bans all imports. In this extreme scenario, the export industry will certainly die because there will be no reason to earn foreign exchange to purchase imports. Policies that seek to restrict imports are therefore in complete contradiction to policies that seek to encourage exports.

Concluding Remarks

Free trade is morally right

Despite the overwhelming evidence that free trade produces the best economic outcomes there remain significant obstacles preventing mutually consenting individuals from engaging in free trade. Ikenson and Lincicome (2011) argue, "The most principled case for free trade is a moral one: voluntary economic exchange is inherently fair, benefits both parties, and allocates scarce resources more efficiently than a system under which government dictates or limits choices". The fact that arguments for restricting trade are so pervasive and resounding speaks to a failure of free trade advocates to make their message understood and worth defending. Unfortunately, people in general need to be constantly reminded of how they and the economy benefit from being free to choose how and with whom to conduct commerce. Those who are opposed to free trade are highly adept at peddling myths to mislead the public into believing that it is preferable for government to limit their choices and direct where their resources should be utilised (Ikenson and Lincicome, 2011).

Advocates of free trade are not doing a good sales job

Some of the scepticism towards free trade can be attributed to the perpetuation of myths about how unfair foreign trade practices have destroyed the local manufacturing sector, or how the trade deficit reflects a failure of trade policy and constitutes a drag on economic growth. However, free trade advocates need to bear some of the responsibility for not winning the hearts and minds of the average man on the street. As Ikenson and Lincicome (2011) state, "The scholarship is there but we need better salesmanship". To rectify this situation, it is crucial that the case for free trade be made more clearly, comprehensively, and consistently than it has been done in the past (Ikenson and Lincicome, 2011).

Beneficiaries of interventions in trade profit at the expense of fellow citizens

"Government intervention in voluntary economic exchange, on behalf of some citizens, necessarily comes at the expense of others and is inherently unfair, inefficient, and subverts the rule of law. At their core, trade barriers are the triumph of coercion and politics over free choice and economics. Trade barriers are the result of productive resources being diverted to achieve political ends and, in the process, taxing unsuspecting consumers to line the pockets of the special interests that succeeded in enlisting the weight of the government on their side" (Ikenson and Lincicome, 2011).

Historian, Will Durant, who ascribes the growth and success of Athens to trade, wrote in 1939 that, "The cross roads of trade are the meeting places of ideas, the attrition ground of rival customs and beliefs; diversities beget conflict, comparison, thought; superstitions cancel one another and reason begins".[5]

Free trade is not only about more goods and services, and freedom, it also stimulates thought and makes us more cosmopolitan, and, ultimately, keeps us civilised.

[5] See: http://cafehayek.com/2011/07/quotation-of-the-day-29.html Accessed: 05 November 2013

There is a close connection between free trade and free people

Harvard economist, Robert Barro, demonstrates that there is a close connection between free trade and free people and claims "... that improvements in the standard of living ... substantially raise the probability that political institutions will become more democratic over time." He concludes, "Countries would contribute more to the welfare of poor nations by exporting their economic systems, notably property rights and free markets, rather than their political systems, which typically developed after reasonable standards of living had been attained. If economic freedom can be established in a poor country, then growth would be encouraged, and the country would tend eventually to become more democratic on its own".

Freedom to trade is just one of the necessary freedoms for the existence of economic freedom

Barro's central premise rests on the importance of economic freedom. Despite the many virtues of free trade it is by no means a panacea. Indeed, free trade is a necessary, but not sufficient condition for substantially improving economic growth rates and reducing poverty. Trade is only a facilitating device and complementary factors such as impartial courts, the respect of private property rights, law enforcement, etc, are fundamental institutions for any democratic society.

Economic Freedom of the World measures the level of economic freedom and its impact

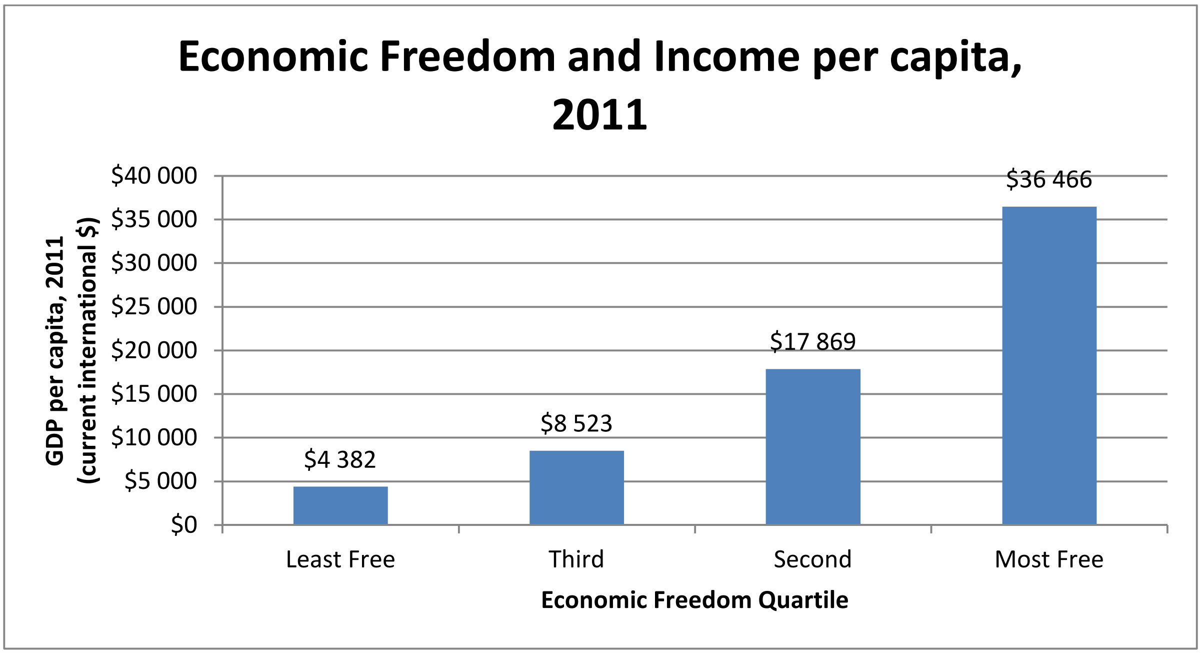
The index published in *Economic Freedom of the World* (EFW) measures the degree to which the policies and institutions of countries are supportive of economic freedom – one of the components is voluntary exchange. The cornerstones of economic freedom are personal choice, voluntary exchange, freedom to compete, and security of privately owned property. Forty-two variables are used to construct a summary index and to measure the degree of economic freedom in five broad areas:

1 Size of Government;
2 Legal System and Property Rights;
3 Sound Money;
4 Freedom to Trade Internationally;
5 Regulation.

Since the first publication of the EFW report in 1996, numerous studies have used the report's data to examine the impact of economic freedom on investment, economic growth, income levels, and poverty rates. Virtually without exception, these studies have found that countries with institutions and policies more consistent with economic freedom have higher investment rates, more rapid economic growth, higher income levels, and a more rapid reduction in poverty rates (Fraser Institute, 2013).[6]

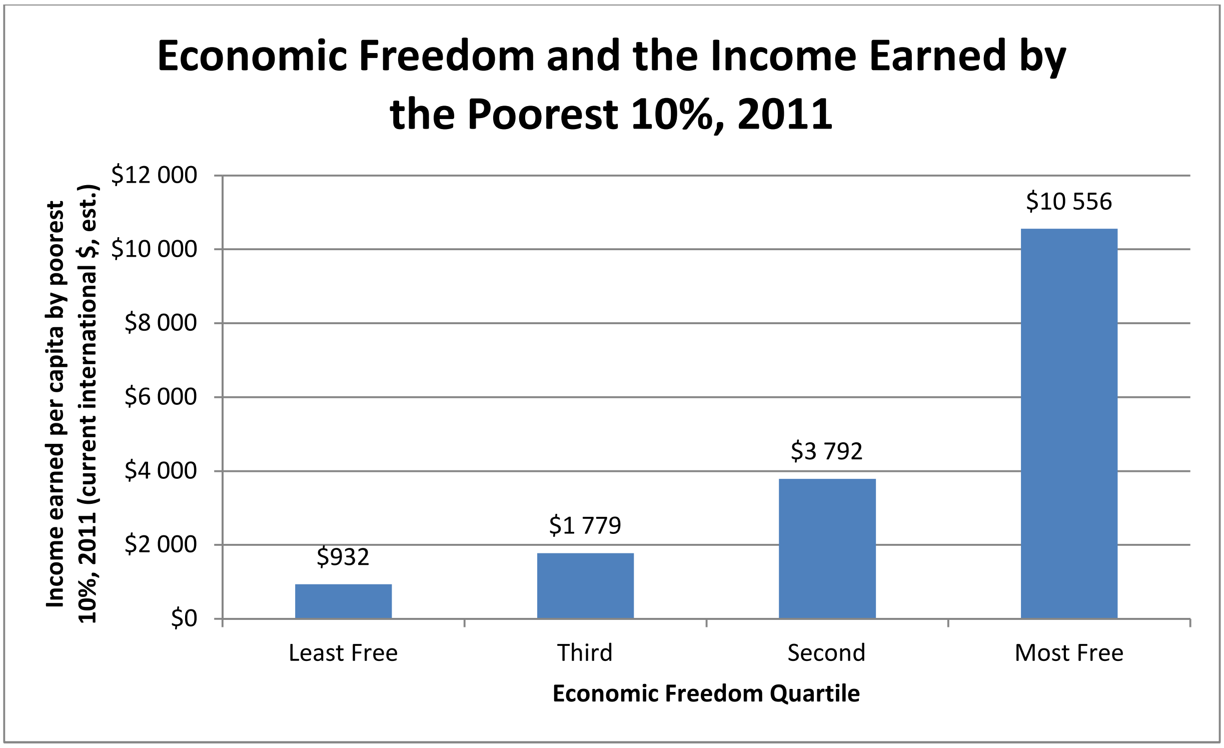
The EFW reports demonstrate that nations that are economically free out-perform non-free nations in indicators of well-being. Nations in the top quartile of economic freedom had an average per-capita GDP of $36,446 in 2011, compared to $4,382 for nations in the bottom quartile in 2011 (US (PPP) dollars). (See Figure: Economic Freedom and Income per capita, 2011 below).

[6] For a review, see Hall, Joshua, and Robert Lawson (2013). Economic Freedom of the World: An Accounting of the Literature. *Contemporary Economic Policy*. http://onlinelibrary.wiley.com/doi/10.1111/coep.12010/abstract>.



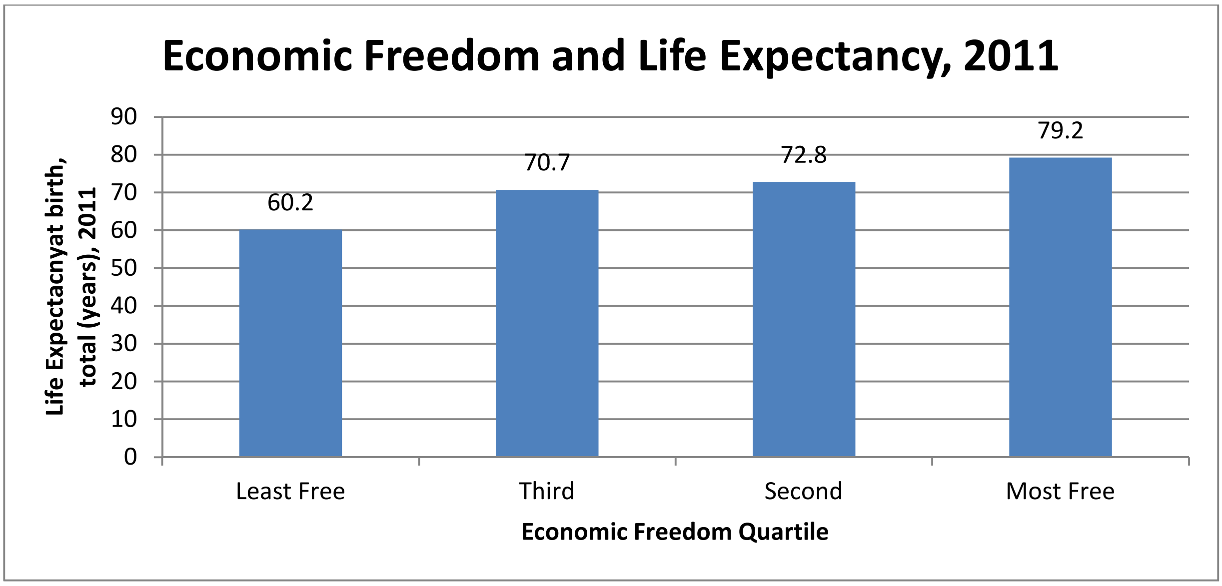
Source: Fraser Institute, Economic Freedom of the World: 2013 Annual Report

The EFW report (2013) reveals, interestingly, that the average income of the poorest 10 per cent in the most economically free nations is more than twice the overall average income in the least free nations. More specifically, the report demonstrates that the poorest 10 percent of the population in countries ranked in the top quartile have an average income of $10,556, compared to $932 for the poorest 10 percent of people living in countries ranked in the bottom quartile in 2011 (measured in US PPP dollars). (See Figure Economic Freedom and the Income Earned by the Poorest 10%, 2011 below).



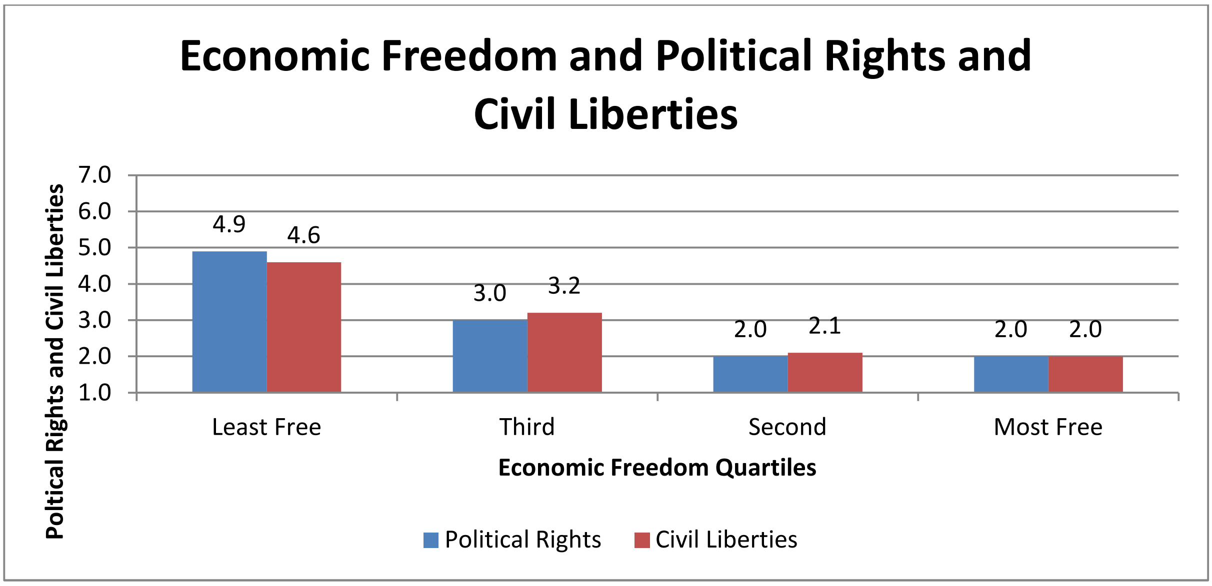
Source: Fraser Institute, Economic Freedom of the World: 2013 Annual Report

Life expectancy is also much longer for people who reside in the freest countries on earth. The average life expectancy for countries ranked in the top quartile is 79.2 years, compared to 60.2 years in those in the bottom quartile. (See Graph Economic Freedom and Life Expectancy, 2011 below).



Source: Fraser Institute, Economic Freedom of the World: 2013 Annual Report

Finally, political and civil liberties are considerably higher in economically free nations than in unfree nations. (See Economic Freedom and Political Rights and Civil Liberties below).



Source: Fraser Institute, Economic Freedom of the World: 2013 Annual Report

Opponents of political and economic freedom cannot argue with the data

Despite a plethora of evidence that economically free societies are better off by virtually every measure of wellbeing than societies that are directed and controlled by a central authority, there continues to be significant opposition to ideas of political and economic freedom.

In such an economic climate, government, like business, should focus on its core activities. Part of a government's core functions is to ensure that there is sufficient policing, the courts are impartial and efficient, and the rule of law is respected and enforced. Security of property rights is essential for economic growth. If individuals know that their land and possessions are protected, they have an economic incentive to go out and earn a living and to improve on their investments.

Promoters of freedom of trade can demonstrate the benefits of all freedoms

In order to promote freedom for all, it is essential to win the 'hearts' and 'minds' of Africa's people and provide them with the knowledge and understanding of the benefits of individual freedom. People need to understand that economic growth is not hindered due to investment gaps, or technological gaps, but rather due to very real gaps in human liberty caused by measures imposed by oppressive government. Gaps that result when leaders impose barriers that hamper entrepreneurship, restrict property rights, interfere with the ability of individuals to trade freely across borders, and deter the free movement of people and capital.

Individuals dedicated to promoting ideas about individual freedom have gained significant victories by winning over the 'minds' of many prominent opinion leaders with first-hand accounts of what 'works' in development. Sadly, the theories, statistics and graphs gathered by these individuals that show why markets work, fail to capture the emotions of the masses who need to understand before they will ever be able to convince political leaders of any need for change. Indeed, as noted previously, proponents of economic freedom may have the scholarship but lack salesmanship skills.

Economic freedom is efficient but it is the way that it improves lives that convinces people

Experience proves that efficiency arguments are not sufficiently compelling to influence the majority. In addition to providing the intellectual ammunition that demonstrates that markets deliver superior outcomes to state-led and controlled economies, we need to relate powerful stories of individuals educating poor children, fighting disease, supplying clean water, and doing myriad other things that generate wealth and improve standards of living. This is imperative if we are to counter the very vocal claims of individuals espousing that state-led growth is the most effective way to alleviate poverty.

Promoting individual freedom requires a combination of media and public debate to target both the 'mind' (using evidence based on sound scientific knowledge) and the 'heart' (emotion) (using anecdotal evidence that the 'man on the street' can relate to). By disseminating information on 'what works' we should be able to begin to reshape the belief systems of Africa's people and make 'real' what has appeared to be abstract. Ultimately, effective reform must be generated internally by individuals within the African continent, who work to change their environment and succeed in overcoming the resistance of vested interests.

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