ANALYSIS OF INTERNATIONAL TRADE PERFORMANCE IN SELECTED SUB-SAHARAN AFRICAN COUNTRIES: IMPACT OF INSTITUTIONAL FRAMEWORK

BY

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February, 2011

DECLARATION

I, **Evans Stephen OSABUOHIEN**, declare that this thesis is my own original work and that no portion of the work referred to in the thesis has been or will be submitted in support of an application for another degree or qualification of this or any other university or other institute of learning.

04/04/2011

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CERTIFICATION

The undersigned certify that they have read and hereby recommend for acceptance by Covenant University a thesis entitled: “Analysis of International Trade Performance in Selected Sub-Saharan African Countries: Impact of Institutional Framework” in partial fulfilment of the requirements for the degree of Doctor of Philosophy (Ph.D) in Economics of Covenant University, Ota, Nigeria.

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DEDICATION

This thesis is primarily dedicated to the Triune Godhead -Father, Son and Holy Spirit for His unfathomable and indefatigable hand of Love on me. It is equally my joy to dedicate it to the Son of my youth, the beginning of my strength and the excellence of my glory - Eustin Maduabuchukwu Evans-Osabuohien. God has used your coming to the family to launch me to an entirely different platform and made me taste the sweetness of answered prayers.

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LIST OF ABBREVIATIONS

2SLS	Two-Stage Least Squares
AfDB	African Development Bank
Agrex	Agricultural Export
Apt	Applied Tariff including Preferences
AU	African Union
CC	Control of Corruption
CEPII	Centre d'Etudes Prospectives et d'Informations Internationales (English: Institute for Research on the International Economy)
CIM	Contract Intensive Money
Cod	Customs and Other Import Duties
COMESA	Common Market for Eastern and Southern Africa
CPIA	Country Policy and Institutional Assessment
EAC	East African Community
EAP	East Asia- Pacific
ECA	Europe and Central Asia
ECCAS	Economic Community of Central African States
ecogr	Economic growth rates
Ecoins	Economic Institutions
ECOWAS	Economic Community of West African States
EPS	Export Promotion Strategy
EPZs	Export Processing Zones
Exch	Real Effective Exchange Rate
FE	Fixed Effects
Findep	Financial Depth
Finst	Financial Institutions

Fmex	Fuel and Mining Export
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Products
GE	Government Effectiveness
Gethfra	Generalised Ethnolinguistic Fractionalisation
GMM	Generalised Method of Moments
HDI	Human Development Index
ICRG	International Country Risk Guide
IMF	International Monetary Fund
Infrad	Infrastructural development
IPRs	Intellectual Property Rights
ISI	Import-substitution Industrialisation Strategy
Itnet	Internet Users
Itrapf	International Trade Performance
IV	Instrumental Variable
LAC	Latin America and Caribbean
LDCs	Least Developed Countries
Legalor	Legal Origin and Formalism
Lockd	Landlocked Country
Logmeaug	Acemoglu et al Augmented Settlers' Mortality
Maex	Manufacturing Export
MFN	Most-favoured Nation
Mkpot	Market Potential
MENA	Middle East and North Africa
NIE	New Institutional Economics
NTBs	Non-Tariff Barriers
OLS	Ordinary Least Squares

Pcom	Personal Computers
Plr	Lending Rate
Poins	Political Institutions
PS	Political Stability
RE	Random Effects
RECs	Regional Economic Communities
RL	Rule of Law
RQ	Regulatory Quality
RTAs	Regional Trade Arrangements
SADC	Southern African Development Community
SAP	Structural Adjustment Programmes
SPS	Sanitary and Phytosanitary Standards
SSA	Sub-Saharan Africa
Svex	Service Export
Tel	Mobile and Fixed-line Telephone Subscribers
Toex	Total Export
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Commission for Africa
UNDP	United Nations Development Programme
VA	Voice and Accountability
WDI	World Development Indicators
WEBS	World Business Environment Survey
WGI	World Governance Indicators
WTI	World Trade Indicators
WTO	World Trade Organisation

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GLOSSARY OF TERMS

1. **Balance of Trade***:* This is the balance between exports and imports of a country.
2. **Bilateral Trade**: This is an agreement between two countries setting out the conditions under which trade between them will be conducted. If both parties are already WTO members enjoying the attendant non-discrimination, markets access and other benefits, the main additional reason for bilateral agreement may be a programme of bilateral trade facilitation and trade promotion activities. If one party is not a member of the WTO, the agreement will normally provide for MFN treatment and national treatment, protection of intellectual property rights, consultation and dispute settlement, and other principles and mechanisms necessary for ensuring smooth trade flows and the speedy resolution of problems. Bilateral agreement usually contain a provision for periodic reviews of trade developments at ministerial of official level.
3. **Common External Tariff:** This is the uniform tariff rates applied by members of a customs union against non-members. Members of a customs union agree to eliminate or phase out all tariffs among themselves. At the same time, they replace their individual tariffs with a single tariff applied to third countries. Membership of customs union may therefore entail an unchanged, higher or lower tariff by individual members on a given product. Under WTO rules, the resulting changes may not be used to increase the level of production overall. Free-trade areas do not have a common external tariff.
4. **Common Market:** It is a more developed type of customs union in which, in addition to the free movement of goods between member states, labour, capital and services can also move without restrictions. Common markets lead to highly integrated economies.
5. **Comparative Advantage***:* It was first proposed by David Ricardo in 1817 that a country is more likely to export goods that it can produce relatively efficiently. A country's comparative advantage is reflected in its unsubsidised exports to world markets which is then said to be a country's revealed comparative advantage.
6. **Customs Union:** It is an area consisting of two or more individual countries or customs territories which remove all tariff and sometimes broader trade

impediments between them. The members making up the area then apply a common external tariff.

7. **De Facto and De Jure:** *de facto* is a Latin expression that means "by the fact". In law, it is means "in practice but not necessarily ordained by law". While *de jure* implies "concerning the law" especially when referring to matters of law, standards and governance. Specifically, in legal parlance, *de facto* defines action of what happens in practice but *de jure* describes what the law states in principles.
8. **Economic Institutions:** Generally, they refer to network of commercial organisation (such as manufactures, producers, wholesalers, retailers, and buyers) that generate, distribute, and purchase goods and services. However, contextually, they are essential rules and principles that influence and shape incentives for economic agents in a society. They not only determine the level of economic growth potential of a country, they also determine the distribution of resources and economic gains in the country.
9. **Exchange Rates:** This is also known as the foreign-exchange rate or forex rate. It is the value of a foreign country's currency in terms of the domestic country's currency.
10. **Export:** It is a good or a service sold by residents of one country to residents of another in return, usually, for foreign exchange.
11. **Financial Institutions:** They are generally known as institutions that provides financial services for its clients. Contextually, they involve rules and regulations that are related to financial intermediations in a country. They are closely related to economic institutions; the major distinction is that financial institutions are essentially related to financial assets and financial intermediations.
12. **Free Trade Area*:*** It refers to as a group of two or more countries that have eliminated tariff and all or most non-tariff measures affecting trade among them. Participating countries usually continues to apply their existing tariffs on external goods.
13. **General Agreement on Tariffs and Trade (GATT):** This has been superseded as an international organisation by WTO. An updated General Agreement is now one of the WTO's agreements. The GATT entered into force on 1 January 1948 as a provisional agreement and remained so until it was superseded by the WTO framework on 1 January 1995. It establishes multilateral obligations for trade in goods, including MFN treatment and

countervailing duties, customs valuable, import and export fees and formalities, marks of origin, quantitative restrictions, balance-of-payments provisions, subsidies, state trading enterprises, emergency action on imports (safeguards), customs unions and free-trade areas, among others.

14. **Import License**: It is a document issued by a national government authorizing the importation of certain goods into its country. It is regarded as a non-tariff barrier to trade when used as a way to discriminate against another country's goods in order to protect a domestic industry from foreign competition.
15. **Import Quota:** This entails restrictions or ceilings imposed by an importing country on the value or volume of certain products that may be bought from abroad. They are designed to protect domestic producers from the effects of lower-priced imported products. Imports quotas are a form of quantitative restriction.
16. **Import:** It refers to a good or a service bought by residents of one country from residents in another in return, normally, for foreign exchange.
17. **Institutions**: They are structures and mechanisms of social order and cooperation governing the behaviour of a set of individuals in a given human community. They are made up of formal regulations (e.g. rules, laws, constitutions), informal restraints (e.g. norms of behaviour, conventions, self-imposed codes of conduct), and their enforcement features. They are a central concern for law, the formal mechanism for political decision-making and enforcement.
18. **Intellectual Property:** It generally includes patents, trademarks, industrial designs, lay-out designs of integrated circuits, copyright, geographical indications and trade secrets.
19. **International Trade:** This generally refers to trade that essentially involves willing exchange of goods, services across national boundaries.
20. **Multilateral Trade Agreements:** These are inter-governmental agreements that are undertaken to expand and liberalise international trade under non-discriminatory, predictable and transparent conditions set out in an array of rights and obligations. The motivation for taking on these obligations is that all members will increase their welfare by adhering to a common standard of conduct in the management of their trade relations. Membership of this kind of agreement is open-ended, but countries wishing to accede usually have to demonstrate that their trade regimes are in keeping with the aims of

the agreement, and that the access conditions to their markets roughly match those of existing members.

21. **New Institutional Economics (NIE)***:* This incorporates a theory of institutions into economics by building on and extending neoclassical theory. NIE has developed as a movement within the social sciences, especially economics and political science, which brings theoretical and empirical research examining the role of institutions in economic growth.
22. **Non-Tariff Barriers (NTBs):** They are government measures other than tariffs that restrict trade flows. Example include quantitative restrictions, import licensing, voluntary restraint arrangements and variables levies.
23. **Political Institutions:** They are defined by the nature of political leadership structure or governance structure that is persistent in a given country. They deal with the way the political structure in a country influences the behaviour of individual in a society especially with the distribution of political power. Examples of political institutions include the form of government in a country (democracy or dictatorship), rule of law, and the extent of constraint of political power.
24. **Preferential Trade Area**: An agreement by which a group of countries agree to provide preferential treatment to selected goods originating from member states by a gradual reduction of tariffs over a given period of time, until a zero tariff level is attained. An example is Economic Community for West African States (ECOWAS).
25. **Real Effective Exchange Rate (REER) – (%change, +=appreciation):** This measures the nominal effective exchange rate which is measured by the value of a currency against a trade weighted average of a basket of selected foreign currencies, adjusted by the relative price index between the domestic and foreign countries. REER measures an effective or trade-weighted exchange rate based on real exchange rates instead of on nominal rates as in the case of nominal effective exchange rate.
26. **Real Exchange Rate:** This is the nominal exchange rate that takes the inflation differentials among the countries into account. It can be used as an indicator of competitiveness in the foreign trade of a country.
27. **Sub-Saharan Africa:** Generically, it is a geographical term that refers to the area of the African continent which lies south of the Sahara. A political definition of Sub-Saharan Africa, instead, covers all African Countries which are fully or partially located south of the Sahara.

28. **Tariff**: It involves a customs duty on merchandise imports, which can be levied either as an ad valorem tariff (percentage of value) or as a specific tariff. Tariffs give a price advantage to similar locally produced goods and raise revenues for the government. Tariffs are mostly levied on imports, but there are cases of tariffs on exports.
29. **Tradable and Non-Tradable:** Tradeables are goods and services that can be traded on international markets. In the case of services, this includes, for example, air travel, telecommunications and management consulting, but haircutting would not normally be considered a tradeable service. Non-tradeables are goods and services that are not, or only rarely, traded internationally because they are abundant and cheap everywhere or because the cost of support services needed for trading them would exceed the value of the product in the importing market.
30. **Trade Balance:** This is the difference between the monetary value of exports and imports of output in an economy over a certain period. It is the relationship between a nation's imports and exports.
31. **Trade Creation:** It is a criterion used for the assessment of the impact of free-trade areas and customs unions on others. Trade theory holds that the reduction of barriers to trade will lead to increased trade between members and non-members if external barriers are not raised at the same time. In practice, the validity of the argument is quite difficult to demonstrate for any given area because of the interplay of other factors, particularly secular changes such as technological advances, changing investment patterns, and so on.
32. **Trade Deficits:** This occurs when the value of one's imports exceeds the value of one's exports over a given period. Often, only merchandise trade is considered for this calculation. Taken in isolation, the existence of a trade deficit does not yield any useful insights about a country's economic health. However, it may be that a persistent trade deficit reflects some deficiencies in prevailing economic settings which need to be corrected. Sometimes the anxiety induced by a trade deficit simply reflects symptoms of mercantilism.
33. **Trade Diversion***:* It is also known as trade deflection. One of the criteria used for the assessment of the impact of free-trade areas and customs unions. The creation of such bodies normally leads to the expansion of trade between its members, but economic theory postulates that a share of the increased trade experienced by participants is merely due to a redirection of their trade,

and not increased trade due to the arrangement. This effect can be demonstrated convincingly in models. In practice, trade diversion has always been difficult to isolate because of other factors. These include technological innovation, global reduction in tariffs, changes in investment policies, etc. See also trade creation.

34. **Trade Facilitation***:* This involves the process of removing obstacles to the movement of goods across national borders. Examples include simplification of customs procedures, cooperation in quarantine matters, publication of trade directories, cooperation on technical standards, periodic discussion of trade issues, trade fairs, trade missions, and so on.
35. **Trade Intensity:** It is a measure of importance of trade to a given economy. It is the proportion of imports and exports of goods and services in relation to the total economy.
36. **Trade Liberalisation:** This is a general term for the gradual or complete removal of existing impediments to trade in goods and services. Free trade may be its ultimate aim, but more likely it is freer trade. Investment restriction may also be covered by this term if investment in the target market is necessary for effective markets access.
37. **Trade Policy:** It refers to the complete framework of laws, regulations, international agreements and negotiating stances adopted by government to achieve legally binding markets access for domestic firms. Trade policy also seeks to develop rules providing predictability and security for firms. Fundamental components of trade policy are most-favoured nation (MFN) treatment, national treatment, transparency and exchange of concessions.
38. **Trade Promotion:** It is the sum of activities that are designed to increase a country's trade. It involves the following: participation in trade fairs, trade missions, publicity campaigns, and so on.
39. **Trade Surplus:** This occurs when the value of a country's exports exceeds that of such a country's imports in a given period.
40. **Transaction Costs (TC):** These are costs used for the creation, maintenance, use, and change of institutions and organisations. TC include the costs of defining and measuring claims, costs of using and enforcing the rights specified, and costs of information, negotiation, and enforcement among others.
41. **World Trade Organisation (WTO):** This came into existence on 1st January 1995 as the successor to the GATT and its secretariat with 128

members. As at July, 2008, WTO members had increased to 153. The WTO is an organisation for the discussion, negotiation and resolution of trade issues covering goods, services and intellectual property. It has the functions of administering and implementing the multilateral and plurilateral trade agreements that constitute it, acting as a forum for multilateral trade negotiation, seeking to resolve trade disputes, overseeing national trade policies and cooperating with other international institutions involved in global economic policy-making.

ABSTRACT

Sub-Saharan Africa (SSA) with over 12.3% of the world's population contributed as little as 1.41% of world's total output in 2008. In terms of international trade, SSA region has performed below expectations. Its total, service and manufactured exports shares in world market on the average were at low values of 0.04%, 0.02% and 0.01% between 1995 and 2008, respectively. The values were far lower than the world average as well as what obtains in other developing regions such as Latin America and the Caribbean and Middle East and North Africa. On the other hand, SSA countries had low values on most measures of institutional quality, which were also lower than both the world average and other regions. For instance, the region's value for rule of law and regulatory quality in 2008 were -0.74 and -0.70 compared to the world average of -0.03 and -0.01, respectively.

The background information motivated this study with the main objective of investigating the impact of institutional framework on international trade performance of SSA countries. This objective was achieved using both descriptive and econometric analyses. The econometric analysis involved Fixed Effects model in a panel data format and Two-Stage Least Squares technique for the period 1996-2008 using 34 selected SSA countries. This approach was deemed appropriate given the fact that institutional variables had limited variation. Another reason was the imperativeness of employing some instrumental variables such as legal formation and settlers' mortality that influence institutional variables but are *orthogonal* to the indicators of international trade performance. The empirical models were formulated and estimated in the light of different categories of institutional framework and their impact on the indicators of international trade performance. The impacts

of other factors such as human capital and infrastructures on international trade performance were equally assessed.

The empirical analyses were carried out by *unbundling* institutional framework into three main pillars – political, economic and financial institutions as well as *unbundling* international trade performance by focusing on export performance of five major sectors, namely: total, manufacturing, agricultural, fuel and mining, and service exports. Thus, the ‘unbundled’ institutions were related to ‘unbundled’ international trade performance.

The study found that political institutional variables had positive and significant impact on the indicators of international trade performance with different levels of impact on the indicators of international trade performance. On economic institutions, it was found that the regional economic communities in Southern Africa, notably SADC was more relevant in promoting international trade performance especially manufacturing export compared to others. While, the indicators of financial institutions had significant impact on international trade performance especially service and manufacturing exports. It was also established that service export was more stable than other indicators of international trade performance while fuel and mining export exhibited the greatest instability. The study equally found that real exchange rate depreciation and trade policy did not significantly promote international trade performance in SSA countries. On the other hand, it was established that human capital had positive and significant impact on the indicators of international trade.

Several recommendations were made in the study. Some of them include the need to place more emphasis on service export to mitigate the adverse effects of external shocks. Also, there is need for policy measures that will ease export-supply constraints as well as the pursuance of rule of law, which will enhance the level of contract enforcement. The strengthening of financial institutions; the improvement of the quality of human capital and regional economic communities in SSA that focus more on the provision of trade-related infrastructures in the region were equally recommended.