Trade Liberalisation and Privatisation: Challenging the Sceptics

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SUMMARY

Trade liberalisation and internal market reform involving privatisation are key components of an outward-orientated economic policy, which have contributed substantially to economic development in many countries over the past 50 years. However, the slower progress made by other countries has led to a body of opinion that policies such as trade liberalisation and privatisation are the root cause of the lack of development (see inset on page 2). This view is challenged by the evidence:

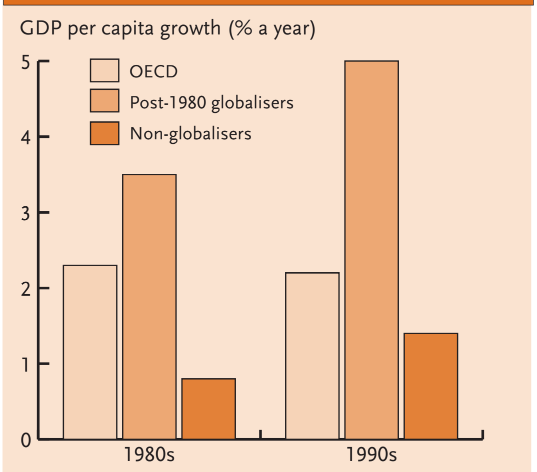
Trade liberalisation contributes to economic growth and poverty reduction:
- In 2003, 30% of world exports of goods, equivalent to $2,275bn, was attributable to WTO/GATT's role in facilitating growth in trade over the past 50 years.
- More globalised developing countries generated growth averaging 5% a year in the 1990s against 1.4% for less globalised countries (Chart 1).
- Developing countries with the fastest growth rates have achieved the greatest reduction in extreme poverty. Share of population earning less than $1 a day halved from 30% to 15% in East Asia and fell by a quarter from 42% to 30% in South Asia between 1990 and 2001 (Chart 2).
- Improvement in the investment climate over the past decade has substantially raised investment and growth and reduced poverty in China, India and Uganda. Foreign direct investment has been a major driver of growth in China.

On privatisation, the available data shows that:
- In Latin America privatised entities are profitable over the long term; generate increases in real wages; and extend service provision to the poor.
- In sub-Saharan Africa privatised companies have replaced inefficient subsidised state-owned enterprises. They have improved access to services and generated rises in wages where an appropriate regulatory framework was put in place.

Domestic policies that facilitate trade liberalisation and privatisation include:
- Securing macroeconomic stability
- Strengthening the institutional and governance framework. This makes a positive contribution to: participation in the political process by all ethnic groups; enabling economies to withstand commodity shocks; improving the climate for investment and trade; generating full value from foreign aid; and securing property rights and title to land.

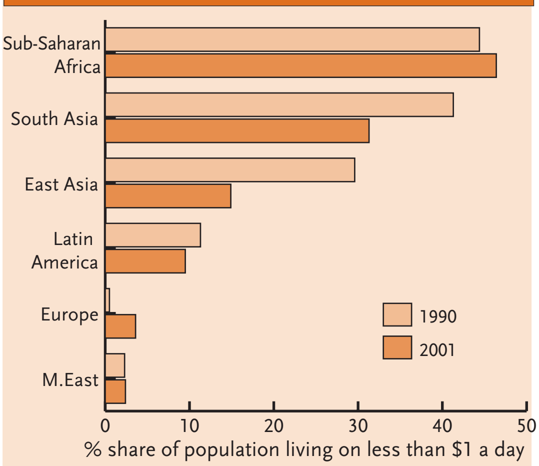
The international community can contribute to market opening through:
- Further reduction in agricultural subsidies in OECD countries to enable developing countries to effectively access those markets.
- Additional funds from official debt relief and foreign aid to support the broader development process.

Chart 1 Divergent growth rates in developing countries



Source: Dollar & Kraay, World Bank

Chart 2 Change in % share of those in poverty



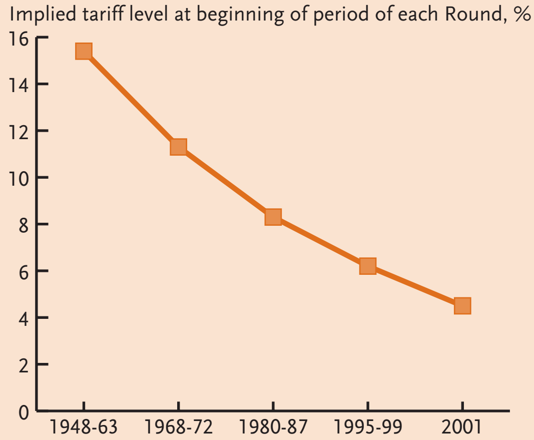
Source: World Bank World Development Indicators

WHAT IS THE IMPACT OF LIBERALISATION OF TRADE?

Studies have drawn attention to a range of benefits arising from a policy of trade liberalisation, which include stronger trade, growth and investment, greater stability and less poverty.

Generates trade World trade in goods and services has expanded rapidly over the post war period and has been a major driver of economic growth in developed and developing countries. A 2003 study by Arviind Subramanian and Shang-Jin Wei *The WTO Promotes Trade, Strongly But Unevenly* investigated the role of the GATT/WTO in promoting trade. It found that 'the GATT/WTO has done a splendid job of promoting trade wherever it was designed to do so and correspondingly failed to promote trade where the design of rules militated against it'.

Chart 3 Tariffs on industrial products



Source: Subramian & Wei, based on WTO data

Implied tariff levels on industrial products have fallen steadily through successive rounds from 15.4% in 1950 to 4.5% in 2001 (Chart 3). Between 1950 and 2000 the organisation was found to have facilitated the creation of an additional 44% of current world trade. On this basis, out of world exports of goods totalling $7,444bn in 2003, 30% or $2,275bn were attributable to the GATT/WTO (Chart 4). As the steady reduction in tariff levels illustrates, The WTO is usually a progressive process that takes place over time. Moving suddenly from closed markets to total trade openness can be disruptive and is not what is advocated.

The growth in exports has been mainly concentrated in industrial countries, where trade has been boosted by 68%, because developing countries have been largely exempt from the GATT/WTO mission of progressively lowering import barriers under the principle of special and differential treatment. Prior

The NGOs' agenda

Many non-governmental organisations (NGOs) that have an interest in development issues and concern about the world's poorest countries take a negative view of trade liberalisation and globalisation. Such NGOs typically make the following claims:

Rules on world trade set by the WTO are decided by rich countries and the resulting 'free trade' is 'unfair': Rich countries keep their markets closed to developing countries. Developing countries are forced to open their markets which are then flooded by subsided products from rich countries.

Privatisation and other economic policies are imposed by the IMF and are unhelpful to developing countries

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Investment and employment practices of multinationals in developing countries contribute to poverty and insecurity.

The debt burden of developing countries is too great and is a major obstacle in the development agenda.

Developing countries do not receive sufficient aid from Western governments.

Challenging the claims of NGOs

These claims ignore how an outward orientation, involving trade liberalisation, has facilitated economic growth and poverty reduction in many developing countries. They also tend to overlook or downplay the need for domestic reform geared to strengthening the institutional and governance framework.

The WTO has contributed substantially to growth in world trade, benefiting both rich and developing countries. Trade barriers in rich countries are much lower than in developed countries. Developing countries are not forced to open their markets as the process of reducing trade barriers and improving market access is a process negotiated through the WTO.

Privatisation has been prompted by the inability of inefficient subsidised SOEs to finance the necessary investment to improve services. The record is positive where a proper regulatory framework is established.

Attracting investment by foreign companies is a key component of creating a favourable climate for investment, as demonstrated by China and India. Foreign companies also contribute technical assistance and raise output in the supply chain.

Funds from debt relief and foreign aid will support the development process, but a strong institutional framework is required to ensure that such funds are used productively.

to the Uruguay Round 80% of all merchandise trade conducted by industrial countries was bound by a commitment to cap tariffs, whereas only 30% of developing countries merchandise trade was similarly capped. Subramanian and Wei found that developing country exports had been boosted by as much a third because of the liberalisation of the imports of their industrial country partners arising from WTO membership. Between 1993 and 2003 the 140% growth in the value of developing countries exports was higher than the 110% rise in their imports (Chart 5). NGOs assert that developing countries typically are forced to open markets, which are then flooded by subsidised imports. But, if this had occurred, imports into developing countries would have risen faster than their exports.

Generates growth Openness is directly linked to higher economic growth over the long term. A 2002 World Bank report *Globalisation, Growth and Poverty* found that more globalised developing countries generated growth averaging 5% a year in the 1990s against 1.4% a year for less globalised countries and over 2% a year in high income countries (Chart 1). The differential in growth rates between more and less globalised countries was almost as wide in the 1980s. The net effect of the higher growth rates was that over the 20 year period 1980-1999, the economies of more globalised countries more than doubled, five times the 25% growth recorded in the less globalised group of countries. The differential in growth rates was facilitated by moves towards globalisation from the early 1980s. This was spurred by technical advances in transport and communications technologies and by larger developing countries improving their investment climates and opening up to foreign trade and investment.

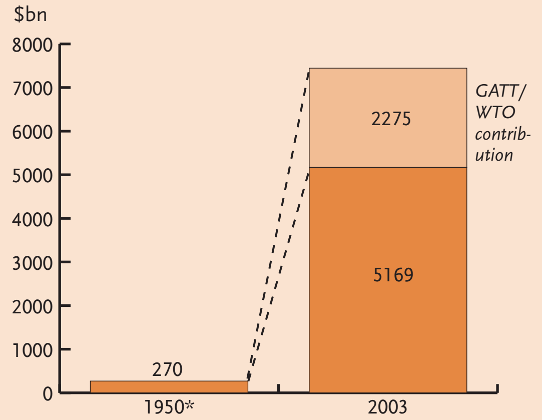
There has been a substantial volume of economic research committed to establishing an empirical link between liberal trade policies and growth. A 2002 CEPR report *Making Sense of Globalisation: A Guide to the Economic Issues* has highlighted the twofold challenge this research has faced: firstly, in obtaining a precise quantitative measurement of tariffs and other restrictions and the extent to which they are implemented; and secondly in relating the direction of causation: Does trade liberalisation cause economic growth or is it one of the results of growth? Studies that have focused on this issue have separated out the effect of components of openness that are independent of economic growth. They have revealed the following findings:

- Frankel and Romer's 1999 study found that a 1% increase in the openness ratio increased both the level of income and the subsequent growth rate by at least 0.5% a year.

- In as study of over 100 countries, Varnvakidis found that multilateral liberalisation over the period 1950-89 was associated with increases in rates of growth, while regional agreements were not.

The CEPR study concluded that despite the methodological difficulties of establishing directly that openness enhances growth, the weight of the evidence lies in that direction. It also noted 'there is certainly no coherent body of evidence that openness is bad for growth'.

Chart 4 Contribution of GATT/WTO to world exports of goods



*Value of exports in 1950 based on subsequent growth in export volumes
Source: IMF, WTO, Subramanian/Wei

Chart 5 Developing countries international trade

Source: IMF, WTO, Subramanian/Wei

The role of trade liberalisation in improving the investment climate in China, India and Uganda

China Beginning in the 1980s China introduced rudimentary systems of property rights and private enterprise, liberalised trade and investment, and embraced a broad program of improvements across the investment climate.

India introduced reforms to reduce tariffs and loosen licensing requirements in the mid-1980s, followed in the early 1990s with more extensive trade liberalisation and a further dismantling of licensing.

Uganda is a recent example of how the benefits of a better investment climate are not restricted to large countries. Beginning in the early 1990s, Uganda embarked on a program to improve its investment climate. Macroeconomic stability was achieved. Expropriations by previous governments were reversed. Trade barriers were reduced. Tax and court systems were reformed. Private sector participation and competition were introduced in telecommunications. Now efforts are under way to improve business regulations.

These initiatives have resulted in:
- Doubling in private investment's share of GDP in China, India & Uganda (Chart 6).
- Per capita GDP measured in international prices rose tenfold in China, four times in India and by 50% in Uganda, when the rise in sub-Saharan Africa as a whole was negligible.
- The share of population living on less than $1 a day has declined substantially: in China from 64% in 1981 to 17% in 2001; in India from 54% to 35% over the same period; and in Uganda from 56% to 35% between 1992 and 2000.

Chart 6 Investment in China, India & Uganda

Source: World Bank World Development Report 2005

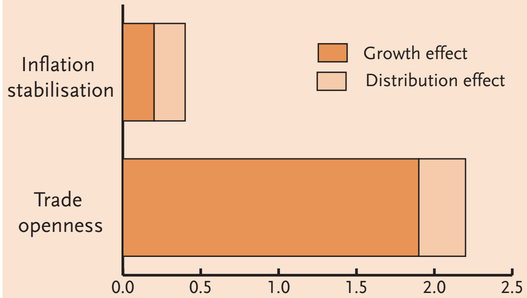
Generates investment The investment climate is a set of factors that shape the opportunities and incentives for firms to invest productively, create jobs and expand. Government policies, such as those in relation to trade openness, can exert a strong influence on costs, risks and barriers to competition surrounding investment decisions. Trade liberalisation has been a key ingredient of investment growth in countries such as China, India and Uganda, which have made substantial economic progress over the past decade (see inset).

Foreign direct investment (FDI) accounts for a relatively small proportion of investment in most developing countries, but has been particularly important in driving growth and exports in China over the past 10 years when FDI has averaged over $40bn a year. Multinationals often provide technical assistance to suppliers in order the raise the quality of products and facilitate innovation. Case studies by Blalock and Smarzynska of the impact during the 1990s of FDI on Indonesia and Lithuania reported increased output in firms in the supply chain. Other positive spillovers included transfer of knowledge to local suppliers and raising product quality and delivery.

Reduces poverty With regard to the impact of trade on poverty, a 2000 study of 80 countries by Dollar & Kraay found that over four decades there was on average a one-to-one relationship between the growth rate of income of the poorest 20% of the population and the growth rate of per capita income. In other words, percentage changes in incomes of the poor on average were equal to percentage changes in average incomes. Of the 2.6% increase in growth rates in the 1990s, 2.2% was based on increased trade openness and 0.4% from inflation stabilisation (Chart 7). Because increased trade has gone hand-in-hand with more rapid growth and no systematic change in the distribution of household income, it has meant that increased trade has been closely linked with improvements in well-being of the poor.

Chart 7 Impact of trade openness and lower inflation on income growth of poor

Factors contributing to higher income growth of poor in 60 developing countries in 1990s compared with 1980s (% a year)*

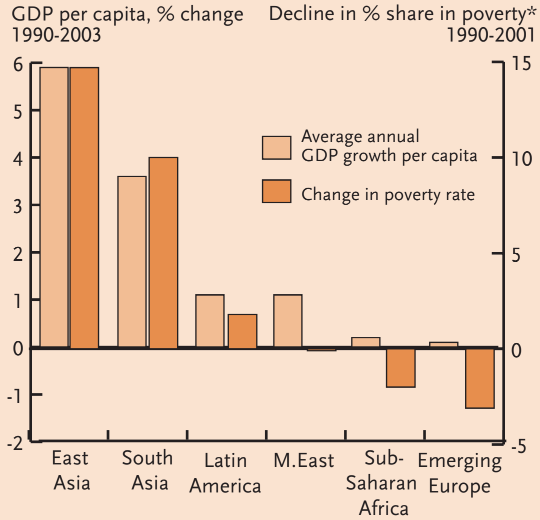


*Poor defined as lowest income quintile
Source: Dollar & Kraay, World Bank

The impact of trade on growth and incomes has contributed to a reduction in the number of people in extreme poverty. Between 1990 and 2001 the number of people surviving globally on incomes of less than $1 a day fell by 130m from 1.22bn to 1.09bn. Against the background of growth in world population this meant that the proportion in extreme poverty globally fell from 28% to 21%. Some of the biggest reductions were achieved in Asia, where the share of those on less than $1 a day halved from 30% to 15% in East Asia and fell by a quarter from 41% to 31% in South Asia (Chart 2). Economic growth in China and India had a significant influence on these Asian trends. The share of those in extreme poverty also fell slightly to below 10% in Latin America, but rose in sub-Saharan Africa from 44% to 46%.

The reduction in extreme poverty in East and South Asia was underpinned by the fastest growth rates in GDP per capita: these averaged 5.9% a year in East Asia and 3.6% a year in South Asia between 1990 and 2003 (Chart 8). Slower growth of 1.1% a year also contributed to the moderate decline in poverty in Latin America. Real GDP per capita in sub-Saharan Africa, however, was virtually unchanged over the period.

Chart 8 Growth and poverty rate



*Decline in % share of population with incomes below $1 a day
Source: World Bank: World Development Indicators

WHAT HAS BEEN THE IMPACT OF PRIVATISATION IN DEVELOPING COUNTRIES?

Privatisation involves the partial or complete sale of existing enterprises, assets or rights from public ownership to the private sector. Following the privatisations initiated by the UK and a number of other countries in the 1980s, emerging markets undertook a wide ranging privatisation programme during the 1990s. Proceeds totalling $316bn from 8,500 privatisations in over 60 emerging markets were recorded by the World Bank between 1990 and 1999. Latin America accounted for 57% of these revenues, with Eastern Europe and Asia each accounting for 20% and Sub-Saharan Africa just 3%, mainly in South Africa, Zambia and Nigeria.

Privatisation in Latin America

Key findings from comprehensive evidence of the impact of privatisation in Latin America have been compiled by the Inter-American Development Bank in a 2004 report *Recouping Infrastructure Investment in Latin America and the Caribbean*:

Profitability was increased with net income to sales rising on average by 14% in a group of six countries including Argentina, Bolivia, Brazil, Chile, Mexico and Peru. The largest gains were in Peru and Argentina where median gains were about 20% (Table 1).

Table 1 Impact on operating efficiency of privatisation in Latin America

% change after privatisation

	Cost per unit	*Sales to assets*	*Sales per employee*
Bolivia	---	25	17
Brazil	-20	30	---
Chile	-12	30	97
Mexico	-20	22	100
Peru	-16	-27	40

Source: Inter-American Devlopment Bank

Improved operating efficiency contributed substantially to growth in profitability. Improved asset utilisation was key to growth in operating efficiency: costs per unit fell by an average of 16% in Brazil, Chile, Mexico and Peru, while the sales to assets ratio rose between 20% and 30% in four of the five countries for which data were available. Peru was the exception as privatised SOEs made substantial investments which exceeded sales growth in the period under review. Sales per employee also increased as the workforce was cut in order to reduce oversized workforces before privatisation.

Output of privatised SOEs rose, the largest gains being in Mexico and Columbia, with average rises of 68% and 59%, while in Brazil sales were up by 17%.

Real wages increased in the four countries with available data - more than doubling in Mexico and Peru and rising by 5% in Bolivia (Chart 9). Industry-adjusted wage increases, which adjust for changes in the make-up of the workforce following privatisation, also doubled in Mexico and Peru and were up 70% in Argentina.

Access to services for the poor was improved Based on evidence from a number of studies, the IDB reached the following conclusions on water and electricity. In Argentina and Bolivia the localities that privatised water services showed a larger increase in households connected to water services compared to those that were not privatised. Overall, in Argentina connections to the water network increased by 11% (excluding Buenos Aires where connection was already comprehensive). As regards electricity, increased welfare in Bolivia and Nicaragua was derived by the lowest income groups from increased access to electricity, despite real price increases.

This evidence is not to deny that some privatisations do not always deliver the expected benefits, although difficulties may be caused by other macro-economic developments. The IDB concluded that where privatisations in Latin America had not performed to expectations, the main reasons could be traced to poor contract design and inadequacies of both the regulatory framework and of corporate governance reform.

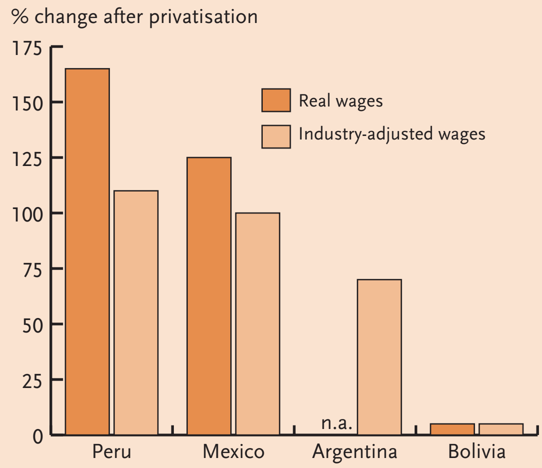
The broad conclusions from the available evidence in Latin American countries are that privatised entities are typically profitable over the long term; result in increases in real wages and extend service provision to the poor. These findings call into question assertions made by critics that privatisations are not profitable beyond the short term, result in lower real wages, and reduce access of the poor to services.

Privatisation in Africa

A comprehensive review in 2004 by the Development Centre of the OECD *Privatisation in sub-Saharan Africa: Where do we stand?* faced particular challenges in its assessment. These partly related to adequacy of data, but also to the fact that privatisation in Africa is still ongoing, having proceeded at a slower pace than the rest of the world where privatisation programmes were largely completed by the end of the 1990s. Between 1979 and 2002, 2,500 organisations had been privatised in 48 sub-Saharan countries, with proceeds reaching nearly $9bn. Privatisation of larger entities did not start until the mid-1990s prior to which most privatised organisations were small.

Privatisation in Africa has been motivated by a number of factors including

Chart 9 Impact of privatisation on wages in Latin American countries



Source: Inter-American Development Bank

Sources of public misperception regarding privatisation of utilities in Latin America

A study on privatisation in Latin America identified a number of misconceptions, largely caused by lack of information, regarding the privatisation process in Latin America. Key conclusions were:

Popular views are being shaped by extreme cases that invited media attention, while widely diffused benefits are rarely noticed. Many of the benefits accrue to a wide range of customers, but their improved welfare is overshadowed by the dramatic losses of the few workers or customers.

The focus on short term implications, such as job layoffs, overlooks the impact over the medium term, when people may be rehired. This reflects loss aversion, which causes individuals to react more sharply to losses than to gains.

Privatisation and trade liberalisation are lumped together in the popular perception.

The reality of how state-owned enterprises actually perform with regard to the fulfilment of basis needs, such as power and water, is overlooked in support of the ideological principle that such utilities should not be the subject of profit motive.

Widespread pessimism is expressed concerning the ability of markets and regulatory oversight to constrain private enterprises to meet the public interest. Although this is realistic in some cases it is exaggerated in many others.

Source: Mookherjee & McKenzie, 2002

budgetary concerns about subsidies and the potential impact on the tax base, economic efficiency; consumer welfare related to prices and access to services: development of financial markets: and the opportunity to obtain finance from the World Bank and the IMF.

Budgetary issues: Privatisations have been initiated for two key reasons:
- The inability of the state to finance necessary expenditure on maintenance and investment.
- The need to stop subsiding state-owned SOEs and release resources for other public expenditure.

State utilities were typically characterised by overstaffing, high costs, unreliable supply and provided inadequate access of the poor to services. The intention was to clarify the role of the state replacing often opaque subsidy mechanisms of state-owned enterprises (SOEs) with transparent accounting of public expenditure. Subsidies were not necessarily well targeted. For example, in the mid-1990s, 94% of the Ugandan population were subsiding the 6% that had access to electricity and in Ethiopia, 86% of kerosene subsidies were captured by the non-poor.

Impact on price Price has been influenced in different ways depending on the sector. In telecommunications where privatisation was accompanied with granting of additional licences, mostly for mobile telephony, competition resulted in price reductions. In power and utilities, price increases were required because they had previously been set below cost recovery. Such price increases were typically regulated through a price cap and were most effective, as in the 2000 reform of electricity in Zimbabwe, when price increases were implemented by the government and regulatory authorities before privatisation.

In the water industry, price increases have been less common owing to the necessity of maximising access. A common practice has been price discrimination, where higher charges are imposed on the better-off. 'Cost-plus' contracts granted to new providers have been less effective, due to the lack of incentive to constrain costs. This led to price increases in Guinea. In the Cote d'Ivoire price discrimination and price caps were combined resulting in a low 'social tariff' for the poorest consumers, real reductions for all customers between 1987 and 1997, and revenues that were underpinned by a high 98% collection rate (Table 2). This was achieved through strong political commitment of the Ivorian government and the regulatory authorities.

Access to services The OECD found that privatisation in power and water sectors is often followed by increases in access, although mainly in urban areas. Policies supporting wider access have included:
- Cross-subsidisation, with rural and urban users being charged the same price although cost of service provision is higher in rural areas;
- Introduction of competition from small scale providers;
- A well-enforced regulatory framework, particularly where the privatised operator has a monopoly.
- The setting of specific targets for electrification of rural communities and poor urban areas.

State-owned enterprises in Zambia

'SOEs were characterised by under-capitalisation, high indebtedness, over-staffing, and inefficiency which contributed to their inability to make profits and effectively rendered most of them unsustainable business ventures. They were also a drain on limited government resources through subsidies and non-payment of taxes. Most of the SOEs had low productivity and could not compete internationally.'

Zambian Privatisation Agency

Table 2 Water prices in Cote d'Ivoire

CFA francs per cubic metre

Type of tariff	1984-87	1996-99	*% change in real terms*
Social	187	184	-36
Domestic	261	286	-26
Normal	330	464	-16
Industrial	458	532	-29
Administrative	261	390	-17

Source: Menard & Clarke, 2000

Countries where access to electricity has been widened by privatisation include Ghana, up from 15% to 45% over the past decade, and South Africa where electrification has reached 50% in rural areas and 80% in urban areas. In the absence of proper regulation the poor in rural and urban and rural communities are likely to be marginalised, as a result of under investment by privatised companies.

Impact on employment In competitive industries, such as telecommunications, privatisation has resulted in a drop in employment levels in the short-term, but with falling prices and increased service provision, employment has picked up strongly within two to three years. Retention of strict public control of the water industry has resulted in fewer job losses there. In the power sector, jobs have been reduced on a larger scale, although in some instances, such as Eskom in South Africa this was undertaken to prepare the enterprise for privatisation. Privatisation has contributed to improved labour practices and increases in wages. However, the political sensitivity of job cuts has led some countries to place greater emphasis on job preservation in the privatisation process.

Preparing for privatisation

A key lesson of privatisation indicated here and experienced in all parts of the world is that reform of state-owned enterprises and regulation of the newly privatised companies needs to be undertaken ahead of the sale process. Implementation of these steps, summarised in the side panel, are key to the new company's ability to thrive in the private sector and meet economic and social objectives.

Reform of state owned enterprises and regulation of newly privatised companies

Aspects of reform to be considered before the sale:

Restructuring to prepare the SOE for sale may be required where it has not previously operated in a competitive environment. This may involve dividing the existing state corporation; allowing entry of new competitors; or selling off non-core businesses.

Corporatisation involves the creation of a company, often by statute, together with the issue of shares.

Modernisation New investment, technology and management skills required where state-owned industries have not moved sufficiently with the market.

Commercialisation involves steps to improve the competitive positioning of the business and development of products and services.

Regulation may be needed for a number of different purposes:
- To control natural monopolies, where it would be inefficient to introduce competition.
- To monitor the competitive market to ensure that no anti-trust issues arise.
- To strike a fair balance between allowing a suitable return to shareholders and protecting the interests of consumers through price controls and ensuring an appropriate standard of service.
- To incentivise companies to increase efficiency.
- To ensure that the privatised entity delivers the level of investment necessary to maintain and enhance service standards in the longer term.

IFSL report on Privatisation 2003

Policies for a development strategy

Based on successful experiences in China, Costa Rica, Korea, Malaysia, Mauritius, Mexico, Singapore, Thailand and Tunisia, The WTO's International Trade Centre has identified policies that are common to a successful competitiveness and development strategy: These can be divided into three broad policy themes:

Macroeconomic policy Stable macroeconomic environment for business investment and planning

Liberalisation of trade, foreign investment and competition:
- Liberal import regime with limited controls and low tariffs on imports
- Strong export strategy designed to push SMEs into export markets supported by service-orientated promotion organisation
- Domestic competition regime with free entry and exit and with regulatory authority to deal with anti-competitive practices
- Proactive targeted foreign investment policy
- Streamlined procedures and regulations to minimise business transaction costs for start ups, as well as for tax administration and work permits

Supply side improvements:
- Sustained investment in people
- Comprehensive technology support to meet international quality and technical standards
- Promotion of selected industrial clusters
- Access to trade finance
- Efficient infrastructure regarding air and sea transport, telecommunications and electricity
- A national public-private sector body to formulate, manage and implement business competitiveness strategy

FACTORS FACILITATING TRADE LIBERALISATION, MARKET OPENNESS AND PRIVATISATION

Based on successful experience in a range of countries (featured in side panel on page 8) the WTO's International Trade Centre has indicated that moves to liberalise trade need to be accompanied by complimentary policies, such as political and economic stability, supply side improvements and outward-orientated moves to attract foreign investment and promote competition within a sound institutional and governance framework.

Securing macroeconomic and political stability through sound fiscal and monetary policies, removing any anti-export bias and adopting an appropriate exchange policy have played a key role in many countries moves to an outward-orientated growth path. The higher volatility of sub-Saharan economies has depressed their ability to sustain growth particularly because of the impact on the investment climate (Chart 10). Volatility of investment has raised the risks associated with future investment decisions.

Moves to achieve economic stability are in part dependent on conflict resolution and political stability. A number of African countries, which have previously suffered severe disruption over many years have benefited from resolution of conflict. Along with other reforms, this has led to improved economic performance over the past decade in countries such as Mozambique, Angola, Uganda and Rwanda, although national income per capita remains very low (Table 3). Elsewhere, Zimbabwe, by contrast, has suffered a major setback as a result of conflict and instability, with the economy declining by a quarter over the 1996-2004 period.

Strengthening the institutional and governance framework A major theme that emerges is raising the quality of institutions, including government, and the establishment of robust legal and regulatory framework. Building such institutions is itself linked or underpinned with other aspects of development such as political and economic stability.

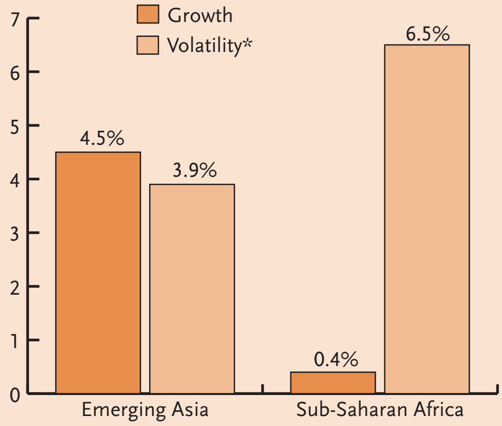
The IMF's *World Economic Outlook* (April 2004) drew attention to the contribution quality institutions have made to Botswana and Mauritius, which have sustained the highest growth rates of GDP per capita in sub-Saharn Africa over the forty years from 1960 to 2000. As a result these two countries have also achieved the highest level of income per capita in sub-Saharan Africa. Institutional building in these countries has been particularly significant from an African perspective in the following respects:

- *Facilitating participation* Strong political institutions have facilitated participation by all groups in Mauritius, where ethnic and linguistic divisions are similar to the rest of Africa, minimising the conflict.

- *Adjusting to shocks* Robust domestic institutions have helped these countries adjust more effectively to commodity shocks.

Chart 10 Impact of volatility on growth in sub-Saharan Africa

GDP per capita, average annual % change, 1970-2000



*Standard deviation of annual growth rate of GDP per capita
Source: IMF World Economic Outlook April 2005

Table 3 Growth and GNP per capita in Africa

Growth in real GDP and GNP per capita in selected African countries

	Real GDP % change annual average 1986-1995	Real GDP % change annual average 1996-2004	GNP $ per capita 2003
Mauritius	7.1	4.9	4090
Botswana	7.8	5.6	3430
South Africa	1.3	2.7	2780
Angola	-0.9	7.1	740
Zimbabwe	2.9	-3.3	480
Nigeria	2.7	4.0	320
Uganda	5.6	6.0	240
Rwanda	-4.5	7.9	220
Mozambique	4.4	8.4	210
Sub-Saharan Africa	1.9	3.8	490

Source: IMF World Economic Outlook September 2004 & World Bank World Development Report 2005

Other broad benefits arising from strengthening institutions and governance include:

- *Improving the climate for investment and trade* An enabling climate to encourage private investment will contribute to the country's ability to participate more effectively in international trade.

- *Generating more value from foreign aid* The likelihood that countries will benefit from aid provided in the form of grants. In general, the provision of grant aid will lead to some reduction in tax revenue as, for example, governments use the aid monies to reduce taxation of business. An IMF study found that the effect of doubling grant aid from 4% to 8% of GDP should be a reduction of tax revenue amounting to 0.4% of GDP (Chart 11). This implies that 10% of each additional dollar in grant aid is offset by lower domestic tax revenue. However, based on the International Country Risk Guide, the IMF found that in relatively corrupt countries domestic tax revenue fell not by 0.4% of GDP but by 1.3% of GDP and in the most corrupt countries by 3.8% of GDP. This means that additional grant aid may be completely offset by reduced domestic revenues in countries where institutions are weakest.

- *Securing property rights and title to land* Institutional reforms that secure property rights and title to land have been key to accelerating the pace of development in many countries.

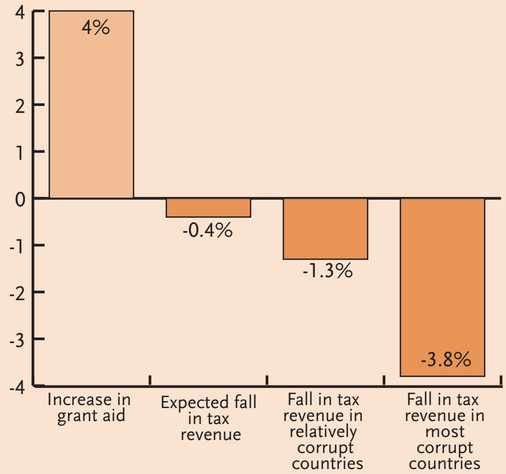
Contribution of international community Issues in which the international community can contribute to the welfare of developing countries include:

Further reduction of agricultural subsidies Support for agriculture provided by OECD countries fell from 38% of total farm receipts between 1986 and 1988 to 31% in between 2001 and 2003 (Table 4). However, it remains at too high a level for producers in developing countries to access OECD markets and also represents a major obstacle to progress on wider liberalisation in the WTO Doha Development Round. The biggest subsidies, equivalent to over 70% of farm receipts, are provided by smaller European countries, such as Switzerland and Norway. Subsidies provided by Japan and Korea are also high at around 60% of farm receipts. Support provided in the EU and the US is 35% and 20% of farm receipts respectively. Australia and New Zealand provide the lowest levels of support at less than 5%.

Additional external funding from foreign aid and debt relief The burden of external debt amongst some developing countries prompted the launch of the Highly Indebted Poor Countries (HIPC) initiative designed to reduce external debt to a sustainable level. Most of the countries that are beneficiaries of this initiative are in sub-Saharan Africa. The focus of the HIPC is to reduce the official and multilateral debts owed to governments, the IMF and World Bank, which accounted for 88% of external debt in Africa in 2002 (Chart 12). As noted above, the extent to which additional funds made available from debt relief and foreign aid will contribute to the development process is dependent on strengthening the institutional and governance framework in those countries.

Chart 11 Impact of foreign aid on domestic tax revenue

Impact on tax revenue, measured as % of GDP, from doubling grant aid from 4% of GDP to 8% of GDP



Source: IMF Finance and Development September 2004

Table 4 Agriculture support in OECD countries

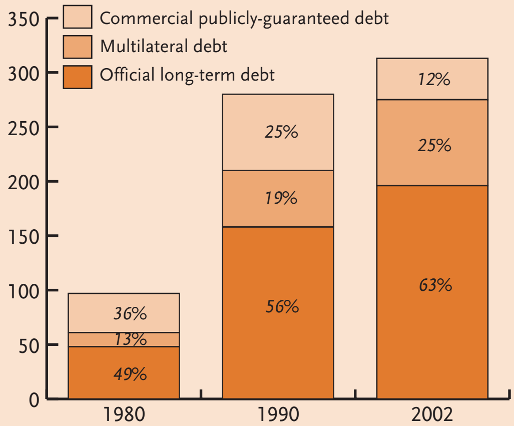
Support to producers, % of gross farm receipts

	1986-88	2001-03
Switzerland	76	73
Norway	70	71
South Korea	70	64
Japan	61	58
EU	39	35
OECD	**37**	**31**
US	25	20
Canada	34	19
Australia	8	4
N.Zealand	11	2

Source: Agricultural Policies in OECD countries 2004

Chart 12 Africa's external debt

External debt outstanding, end-year, $bn



Source: UNCTAD, based on World Bank data

Additional funds can be used to support the broader development process, notably by helping with infrastructure improvement which will enable countries to deliver their products into export markets more efficiently as well as obtaining necessary imports more quickly. It is also important to note that the process of financial services liberalisation is entirely separate from the handling of external debt. The benefits of such liberalisation are set out in a separate IFSL report: *Benefits to Emerging Markets of Financial Services Liberalisation.*

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IFSL

International Financial Services, London (IFSL) is a private sector organisation, with over 30 years experience of successfully promoting the exports of UK-based financial services industry.

Research

IFSL's research informs by raising awareness of the UK's role in international financial markets and by highlighting the major contribution of financial services to the UK economy. Duncan McKenzie has compiled this report and three others in the trade policy area:

Benefits to Emerging markets of Financial Services Liberalisation (February 2003)
Meeting the WTO Agenda for Statistics on Trade in Services (June 2004)
*Capacity Building & Competitiveness in Developing Countries (*January 2005)

IFSL has also produced 12 financial sector reports in its City Business Series and six reports in a separate series that highlight UK product expertise. Other regular publications include International Financial Markets in the UK, UK Financial Sector Net Exports, Financial Market Trends Europe vs US, and World Invisible Trade.

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Data files

Datafiles in excel and html format for all charts and tables published in this report can be downloaded from the Research section of IFSL's website **www.ifsl.org.uk**