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Jürgen Zattler\*

## Trade Policy in Developing Countries A New Trade Policy Consensus?

*Development institutions are currently revising their traditional positions on the question of adequate trade policies for developing countries. Against this background the following article takes stock of the degree to which developing countries have become integrated into the world economy and considers the opportunities and risks which the integration process presents. Problems confronting national policies in less successful developing countries are then outlined which make further, efficient integration of these countries into the world economy more difficult. Finally, policies are identified which could ease further integration.*

The academic and political debate on the question of an adequate trade policy strategy for developing countries is by no means new. The lively and passionate discussion pursued in the 1960s and 1970s of whether to reject or embrace global market integration, etc., only began to abate in the 1980s with the "revival" of the neoliberal doctrine which essentially assumes that – based on a static interpretation of the concept of comparative cost advantages – state intervention in national production structures falsifies the "natural" specialisation of the economy according to its factor endowment and should therefore be eschewed: international trade leads to an alignment of factor rewards between different countries by raising the price of those production factors which are available in relatively large amounts; state intervention thus has the effect of hindering the use of resources in accordance with their relative availability.

The debate surrounding trade policy strategies was rekindled at the end of the 1980s. Three developments are responsible for this. Firstly, the growing real integration of individual national economies has attained a new quality, and it has even been possible for many developing countries to participate in the "globalisation" of the world economy. It is increasingly recognised, even by representatives of developing countries, that this process opens up significant potential opportunities for trade and development. The second aspect responsible for the renewed stimulation of trade policy debate concerns the exploitation of this trade

and development potential. The old neoclassical policy recommendation, which states that active trade policy is either superfluous or damaging or both, was called into question by the success of the countries of South East Asia which clearly applied unconventional instruments. The trade and economic success of these countries finally acquired a theoretical foundation with the formulation of the so-called New Trade Theory<sup>1</sup> and the New Growth Theory.<sup>2</sup> Within the framework of these new theoretical approaches, some of the traditional model's restrictive assumptions as well as the concept of perfect competition were lifted, and a serious examination took place of such phenomena as economies of scale, external effects, technological advance, product differentiation, market structures and the role of human capital.

These theories lead to the conclusion that national competitiveness requires active promotion. While the question of competitiveness does not even arise in the traditional model, since, with free trade and flexible exchange rates, the "correct" production structure evolves automatically and the economy becomes competitive, these new analyses concentrate on the question of how factor

<sup>1</sup> For an overview of the various contributions to the theory of strategic trade policy, see Henning Klodt: Theorie der strategischen Handelspolitik und neue Wachstumstheorie als Grundlage für eine Industrie- und Technologiepolitik?, Institut für Weltwirtschaft, Arbeitspapiere No. 533, October 1992; and Elhanan Helpman, Paul R. Krugman: Market Structure and Foreign Trade, 1988.

<sup>2</sup> For an overview see, e.g., Michael Stolpe: Ansätze der neuen Wachstumstheorie – ein Literaturüberblick, Arbeitspapier No. 508, February 1992; Robert J. Barro, X. Sala-i-Martin: Economic Growth, New York 1995; and Rainer Wilhelm: Endogene Wachstumstheorien und ihre Implikationen für Entwicklungsländer, in: Entwicklungsökonomische Diskussionsbeiträge, No. 20, University of Gießen, 1996.

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endowments can be altered. In this context, policies aimed at promoting technological capacity, human capital and productivity become increasingly important.<sup>3</sup> The question of how a country can actively influence its production structure is of particular significance. Here, as a rule, the original concept of comparative cost advantages is not challenged as such, but is subjected to dynamic interpretation: factor combinations and specialisation structures change during the development process; it is not a case of wanting to deny the critical role of endowments for choosing an appropriate specialisation, but to accelerate the process of structural change by means of an appropriate economic policy. Consequently, the main aim of such a policy is to shift the national economic activity – bearing in mind its current strengths and comparative advantages – to sectors for whose products the income elasticity of demand is high, in which labour productivity growth is fast, and where perspectives for growth are therefore favourable.

The fact that development institutions are currently reviewing and revising their traditional positions on the question of adequate trade policies for developing countries appears to be a result of these three aspects. It is even possible – for the very first time – that a consensus on questions of trade policy could be established among the relevant development institutions such as the World Bank and UNCTAD. This view is confirmed by the UNCTAD IX conference on trade and development which was concluded in the Republic of South Africa in May.

The following article attempts to outline this possible consensus which would involve recognising the advantages of global market integration – especially in view of the integration of national economies which is currently taking place – and deliberately exploiting trade advantages by introducing an active policy of trade promotion, including the use of unconventional instruments. The article first takes stock of the degree to which

developing countries have become integrated into the world economy and considers the opportunities and risks which the integration process presents. Problems confronting national policies in less successful developing countries are then outlined, problems which make further, efficient integration of these countries into the world economy more difficult. Finally, policies are identified which could ease further integration and which could be implemented with relatively little difficulty. It is implicitly assumed that the administrative capacity of many of these countries is very limited and insufficient to implement relatively complicated policies such as those practiced by the successful East Asian countries.

### Globalisation of the World Economy

The world economy is growing ever closer together. In the last two decades world merchandise trade has increased continuously. Trade in industrial products developed particularly fast, more than trebling in volume from 1973 to 1994. The share of industrial goods increased from around 60% in 1985 to approximately 78% in 1995.<sup>4</sup>

World trade growth rates in the last decades were thus considerably higher than those of global production. The same is true of developments in foreign investment which increased greatly, largely on a cyclical basis, during the second half of the 1980s and has been rising again since 1995, with a rate of increase of 40% in 1995 alone.<sup>5</sup> The resulting drive towards global integration in the goods and capital markets – in contrast to the labour market – has led to a new stage of world economic integration. While in the past companies used to try to improve their production and sales conditions by exploiting trade advantages, today this is done increasingly by means of shifting production locations. As a result, global production networks are emerging.

Following the conclusion of the Uruguay Round the globalisation of the world economy took a major step forward and will probably continue in the years ahead, albeit presumably at a slower pace. According to World Bank estimates,<sup>6</sup> world trade should grow at an average of 6% p.a. up to the year 2005. As in the past, production growth is unlikely to keep pace, reaching around 3.5%. As far as expected import growth is concerned, East Asia leads the field with 11%, while sub-Saharan Africa and the OECD countries bring up the rear with 5.5% each. For Latin America the World Bank expects an annual growth rate of 6%. East Asia also leads the field in export growth with 10%, while

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<sup>3</sup> Competitiveness of the national economy can be achieved both by lowering real income – e.g. by currency devaluation – and by increasing productivity. Lasting competitiveness can only result from an increase in productivity. Static analysis blurs this difference (cf. Irfan ul Haque: *Technology and Competitiveness*, in: Irfan ul Haque (ed.): *Trade, Technology and International Competitiveness*, EDI Development Studies, World Bank 1995, pp. 11-48).

<sup>4</sup> World Trade Organization: *International Trade – Trends and Statistics*, Geneva 1995.

<sup>5</sup> Cf. OECD: *Recent Trends on Foreign Direct Investment*, in: *Financial Market Trends* 64, June 1996.

<sup>6</sup> Cf. World Bank: *Global Economic Prospects and the Developing Countries*, Washington 1996.

only 4% and 5% is expected for the Middle East and sub-Saharan Africa respectively. Latin America is again expected to achieve 6%.

A number of different factors are responsible for the increasing globalisation of the world economy. On the one hand, progress in communications technology has both greatly reduced the transaction costs of foreign trade and increased market transparency worldwide. On the other hand, the multilateral and unilateral liberalisation of trade and investment regimes as well as worldwide harmonisation of legal and institutional frameworks have also played a decisive role in reducing transaction costs.<sup>7</sup>

With the globalisation trends mentioned above, the borderline between domestic and foreign policy becomes blurred. As barriers to foreign trade fall, domestic economic regulations increasingly become the focus of multilateral negotiations. State regulations concerning taxation, competition or industrial policy are thus seen increasingly from the point of view of international competition.

### Role of the Developing Countries

The developing countries' share of world merchandise exports reached a peak of 28%<sup>8</sup> in 1980 and has since stabilised at approximately 22.5%. Behind these figures, however, is a restructuring process towards processed products and away from raw materials, especially oil. Since 1973, developing countries have managed to treble their share of world industrial product exports. In 1995 it stood at approximately 20%.

It is hardly surprising that individual groups of developing countries have participated to very different degrees in the growth of merchandise exports. While the Asian developing countries have increased their share considerably, Latin America's share of merchandise exports has stagnated and that of Africa and the Middle East has declined. These figures reflect the fact that the Asian developing countries and China primarily export processed products and, in part, products for dynamic markets, while the other countries export a considerably higher proportion of raw materials with stagnating markets worldwide.

As a group, developing countries have participated substantially in the rise in worldwide foreign investment – albeit only as from 1990. In 1994 they attracted investments worth 84 billion dollars or approximately 37% of all foreign investments. Foreign investments have thus become the developing

countries' largest source of external capital, outstripping official development aid. It should be noted, however, that China alone received a 34 billion dollar share of this total. Altogether, the Asian-Pacific region collected the largest part of world foreign investments in 1994 with a sum of 61 billion dollars, followed by Latin America with 20 billion dollars. In contrast, sub-Saharan Africa received only 1.8 billion dollars and North Africa 1.3 billion dollars. Investments in Africa are linked above all to raw materials and to the oil sector in particular.<sup>9</sup>

As a result of this development, the degree to which developing countries, particularly in Asia, are integrated into the world markets has increased considerably during the last twenty years. This is manifested in trade growth and in foreign investments as a share of GNP.

### Import Liberalisation

The international prerequisites for the economic integration of developing countries improved with the conclusion of the Uruguay Round. Irrespective of any obligations entered into in the Uruguay Round, most developing and transformation countries have now opened up their economies, usually as an integral part of structural adjustment programmes. This has also improved the relevant conditions within these countries for exploiting the new export opportunities.<sup>10</sup>

Average import protection has fallen continuously, more as a result of these unilateral measures than of multilateral trade liberalisation.<sup>11</sup> Moreover, the extent of foreign trade liberalisation is insufficiently documented in the average levels of import duties levied, since the sub-Saharan countries, for example, first started opening up their economies to the world markets by abolishing their foreign exchange

<sup>7</sup> Cf. Jürgen Wiemann: Rahmenbedingungen und Anforderungen an Handelsförderung in Entwicklungsländern – die Perspektiven nach dem Abschluß der Uruguay-Runde, Deutsches Institut für Entwicklungspolitik, Berlin 1996.

<sup>8</sup> Excluding China.

<sup>9</sup> Cf. UNCTAD: World Investment Report, New York and Geneva 1995.

<sup>10</sup> Bleaney and Fielding assume that in 64% of all cases, foreign trade liberalisation measures were part of structural adjustment programmes. (Cf. Michael Bleaney, David Fielding: Investment, Trade Liberalisation and Structural Adjustment, in: The Journal of Development Studies, Vol. 32, No. 2, December 1995, pp. 175-194.) However, these reforms were only partially implemented. Possible reasons for this partial implementation of import liberalisation will be considered below.

<sup>11</sup> Most developing countries, and the least developed in particular, currently enforce considerably lower levels of import duty than were put forward as binding in the Uruguay Round. This is the main reason why the Marrakesh agreements are currently of little significance for import duties in developing countries.

allocation systems and exchange rate adjustment policies. Nonetheless, levels of import duty in most regions have been lowered considerably. Unweighted average import duty levels are currently highest in South Asia at 45% (compared to 60% at the end of the 1980s). In Africa, average import duty levels are around 25%, while Latin America and East Asia have lowered average duty levels to approximately 15%.<sup>12</sup>

### Opportunities Resulting from Globalisation

The process of globalisation and liberalisation presents significant trade opportunities to all the developing countries including the least developed countries (LDCs). The most significant possibilities are largely the result of generally improved access to export markets for products from developing countries due to a reduction in levels of import duty as well as in quantitative import restrictions in purchasing countries. The fast-growing sales markets of the dynamic Asian economies represent an important export potential for less developed countries. Market opportunities should improve for non-traditional agricultural products in particular (tropical fruits, fruit and vegetables, high-value fish products, etc.) due to changing consumer preferences, income growth and the liberalisation of agricultural trade.<sup>13</sup>

Furthermore, new possibilities arise as access to technology and capital improves. In times of increasing international capital mobility, international communications processes and the ever swifter sequences of innovation and imitation, "lack of capital" becomes more and more insignificant as a development bottleneck. Nowadays, it is easier for developing countries to link up to the process of technological development taking place in the industrialised countries, provided they can adapt generally available technologies to local conditions. Moreover, as wages and productivity in the newly industrialising countries increase, LDCs could in future become more attractive as production locations for labour-intensive semi-finished products, assuming that they manage to implement adequate policies.

<sup>12</sup> Cf. World Bank, *op. cit.*

<sup>13</sup> Cf. UNCTAD: *The Least Developed Countries - 1996 Report*, New York and Geneva 1996.

<sup>14</sup> Cf. European Commission: *The Design of Economic Reforms in the Context of Political Liberalisation - Issues Paper*, Brussels, March 1994; and European Commission: *The Design of Economic Reforms in the Context of Political Liberalisation - Findings and Conclusions from Case Studies*, Brussels, December 1994.

### Risks and the Need for Complementary Policies

Globalisation of the world economy also entails big risks, however. As a result of the globalisation process, pressure of competition has also intensified on developing countries' domestic markets. Moreover, further trade liberalisation heightens the risk of macroeconomic destabilisation. If exports fail to take off while at the same time imports increase as trade restrictions are relaxed, foreign trade imbalances will increase. The longer structural adjustment continues without economic activity and exports taking off, the more difficult it becomes for governments to subdue domestic political resistance to economic policy reforms. Only a lasting increase in production and exports can sustain a government's will to reform and safeguard political liberalisation in the relevant countries.<sup>14</sup> It is this recognition which unites the reform programmes currently being implemented and the development policy aim of promoting the process of political liberalisation in developing countries.

### Problems for further Integration

Characteristic of the structural adjustment programmes carried out in the 1980s was that trade reforms were introduced in a situation which - e.g. compared to the 1970s<sup>15</sup> - was hallmarked by large current account deficits and debt burdens, high real exchange rates and external shocks. This was allowed to happen despite the fact that there was a relatively broad consensus amongst economists that a stable macroeconomic framework is a key prerequisite for the successful implementation of microeconomic reforms.<sup>16</sup> This realisation was born, at the latest, of the - unsuccessful - Latin American experience of trade liberalisation in the 1970s.

In the meantime, further liberalisation of foreign trade appears to be running into difficulties in many countries.<sup>17</sup> It is reasonable to assume that major reasons for this are inadequate progress in reducing macroeconomic deficits and the unsatisfactory

<sup>15</sup> Cf. V. Corbo, P. Rojas: *World Bank-supported Adjustment Programmes: Country Performance and Effectiveness*, in: V. Corbo, S. Fischer, S. B. Webb (eds.): *Adjustment Lending Revisited: Policies to Restore Growth*, World Bank, Washington 1992.

<sup>16</sup> Cf. D. Rodrik: *Trade and Industrial Policy Reform*, in: J. Behrman, T. N. Srinivasan: *Handbook of Development Economics*, Vol. III B, 1995, pp. 2927 ff., as well as the literature quoted there.

<sup>17</sup> Cf. IMF: *World Economic Outlook - Prospects and Policy Issues*, Washington 1996.

<sup>18</sup> However, these figures include grants from overseas.

development of export business. Successful trade liberalisation requires complementary policies. The opportunities of globalisation can only be exploited if these countries succeed in implementing adequate fiscal and export promotion policies.

### Importance of Fiscal Policy

Many developing countries, particularly LDCs, have great difficulty in reducing their budget deficits, which also hampers further liberalisation of their foreign trade regimes. It is true that, on average over all the developing countries, budget deficits have been reduced in the last five years: they ran to 5.5% of GNP during 1983-89 and 3.0% during 1990-95.<sup>18</sup> The private savings rate and the private rate of investment also increased on average – by over 3%.

The situation varies greatly, however, from region to region and from country to country. On average, budget deficits in the African countries have further increased in the last few years, from 4.8% during 1983-89 to 5.3% from 1990-95. Comparing these two periods, the current account also worsened in both Africa and Latin America. The budgetary situation is also giving cause for concern in LDCs outside Africa, such as Bangladesh or Pakistan. These figures probably belie the true public financial situation since in the past few years governments – often under external pressure to reduce state expenditure – have entered into semi-fiscal obligations such as the provision of state guarantees for public companies which do not (as yet) appear in the budget.

Large budget deficits are not only a problem in themselves, they also impair the competitiveness of the national economy. As long as these deficits are financed externally, a real revaluation of the exchange rate takes place – *ceteris paribus* – as a result.<sup>19</sup> This favours the non-tradable goods sector and makes exports and foreign investment unattractive. Financing budget deficits by means of domestic monetary expansion also has a detrimental effect on national competitiveness.

This problem of reducing budget deficits and raising tax revenues is a decisive reason why many countries have not lowered levels of customs duty any further.<sup>20</sup> Further reductions of duty levels would have involved the danger of further increases in budget deficits, since these economies are highly dependent upon customs revenue to finance their state budgets. On average over all the developing countries, customs revenues represent approximately 30% of state revenues. This figure is considerably higher in

Africa and the LDCs.<sup>21</sup> In comparison, customs duty revenues in the industrialised countries account for just 3% of state revenues.

What is therefore required is the introduction of complementary reforms aimed at stabilising macro-economic conditions which are coordinated with trade liberalisation policies. Countries which have initiated such complementary policies have on the whole achieved better results.<sup>22</sup> A number of reforms are required in order to achieve lasting macro-economic stability, including tax system and tax administration reforms in particular as well as the development of suitable instruments of fiscal and monetary policy. These reforms, in contrast to the “stroke-of-the-pen reforms” of trade liberalisation, take a long time and are difficult to implement. For this reason, successful trade liberalisation requires simultaneous efforts to develop instruments of fiscal and monetary policy aimed at reducing the rate of inflation. The crucial challenge is therefore to synchronise the timing and sequence of trade liberalisation measures with these other structural reforms. This has been a central weakness in the conception of economic and trade reforms, particularly in the least developed countries with weak administrations.

### Export Development and Balance of Payments

In many countries, especially in Africa, neither improved market opportunities resulting from the conclusion of the Uruguay Round and continuing multilateral liberalisation nor unilateral measures aimed at dismantling trade protection (in particular structural adjustment programmes) have so far led to lasting economic growth or export success. In spite of

<sup>19</sup> This is also valid if development aid is the source of external finance as long as this aid does not help promote export production or import substitution but is used for consumptive purposes. This is why it is of crucial importance how – in the wake of structural adjustment programmes – import structures in the countries in question are altered. It has been established in a number of cases that import structures in this context have shifted towards imports of consumer goods (cf. Jennifer Sharpley: *Supply Oriented Sequencing of Adjustment Policies – Study of Mozambique, Sierra Leone, Uganda and Kenya*, European Commission, DG VIII, April 1993).

<sup>20</sup> “Increasing efficiency in the public sector, including tax administration, would also help to ensure that fiscal imbalances do not impede structural reforms, such as the liberalization of trade and the financial system.” (Cf. IMF: *World Economic Outlook*, 1996, p.109). The same source goes on: “Concern about inadequate tax revenues have also slowed the pace of trade and financial liberalization in some developing countries. Countries that have traditionally been dependent on trade taxes for a significant portion of revenues have dismantled trade barriers only gradually, despite the potential long-term benefits of liberal trade regimes.” (*ibid.*, p.113)

<sup>21</sup> Cf. IMF, *op.cit.*

<sup>22</sup> Cf. World Bank, *op. cit.*

drastic structural adjustment programmes, many countries have so far failed to achieve any noticeable improvement in the development of their export trade, whereby it is not merely a question of the quantitative expansion of export volumes, but of a qualitative improvement of the range of export goods by means of diversification towards higher levels of product processing and improved product quality.

According to World Bank calculations,<sup>23</sup> real gross domestic product (GDP) in the sub-Saharan countries of Africa fell between 1991 and 1995 by an average of 1.5% p.a.. In contrast, the East Asian countries posted GDP growth of 8% and Latin America of 1%. Average sub-Saharan per capita exports fell during the same period by 1.5% while those of East Asia grew by 14%. The processed goods share of total sub-Saharan Africa's exports is just 7%, while the sale of processed products accounts for more than 20% of Latin American and over 50% of South and East Asia's export revenue. For foreign direct investment (FDI) there was a share of 0.3% of GDP for South Asia and 3% for East Asia, while foreign investment played a relatively minor role for the African countries.<sup>24</sup>

Nevertheless, various studies have demonstrated that, as a rule, countries which have carried out extensive structural adjustments have a better – if little better – export development and higher growth rates to show for it.<sup>25</sup> On average, however, investment rates are declining even for this group of countries, which seems to suggest that their relatively favourable export and economic development is based on the fact that externally financed structural adjustment programmes have increased their (short-term) import capacities. This suspicion is confirmed

<sup>23</sup> Ibid.

<sup>24</sup> However, since 1994 there have been positive signs for the least developed and for the African countries. Of the 48 LDCs, fourteen enjoyed relatively strong growth – over 5% – in 1995. This trend is expected to continue in 1996. African countries achieved the greatest improvement in growth rates in 1995, although the absolute rates are still unsatisfactory. The GNP growth rate increased by 2.2% compared to an average of 0.6% during 1990-1994. Eight African countries even managed to achieve growth rates of over 5% in 1995. The average growth rate among Asian countries stood at 4.6% in 1995 (compared to 4% in 1994). However, relatively favourable climatic conditions, stabilising political and social conditions in a number of countries, and increases in commodity prices were largely responsible for improvements in the LDCs' economic situation.

<sup>25</sup> Cf. for example V. Thomas, J. Nash et al.: *Best Practices in Trade Policy Reform*, World Bank, Washington 1991; S. Webb, K. Shariff: *Designing and implementing adjustment programs*, in: V. Corbo, S. Fischer, and S. B. Webb (eds.): *Adjustment lending revisited: Policies to restore growth*, World Bank, Washington 1992; D. Greenaway, O. Morrissey: *Structural Adjustment and Liberalisation in Developing Countries: What Lessons Have We Learned?*, in: *Kyklos*, Vol. 46, pp.241-261; P. Mosley, J. Harrigan, J. Toye: *Aid and Power: The World Bank and Policy-based Lending*, London 1991.

by the fact that capacity utilisation in this group of countries has risen.<sup>26</sup>

The greatest cause for concern, however, is the development in balances on current account. Current account deficits (as a percentage of GNP) have, on average, remained high. Comparing the periods 1983-89 and 1990-95, these deficits fell on average from 1.5% to 1.4% of GNP.<sup>27</sup> In Africa and Latin America they have risen considerably, despite sometimes quite far-reaching structural adjustment programmes. While there are certainly many roots to this problem, there is every reason to believe that a conflict of aims exists between trade policy liberalisation and foreign trade stabilisation.

General import liberalisation which is not combined with a deliberate programme of export promotion can quickly lead to an increase in imports and a shortage of foreign exchange revenue. The risk of such a development is particularly great in times of high inflation – which is usually an indication of deficient monetary policy instruments – and over-valued exchange rates. Two lessons should be learnt from this.

□ The first measures to be implemented within the framework of an import liberalisation programme should be those which also have a positive effect on the balance of payments and/or export developments and the budgetary situation. This means that import liberalisation must take the requirements of the economy's productive and exporting sectors into consideration. Transforming quantitative import restrictions into import duties, for example, does not lead to losses of revenue – in contrast to reductions in import duty – but opens up a new source of income. Liberalisation of imports, which should be concerned initially with important inputs for the production of export goods, can ensure that there is an even balance between the foreign exchange requirements of those sectors which produce goods for the domestic markets and the export sectors which earn foreign exchange.<sup>28</sup> Such policies confront the danger of the possible negative effects which trade reforms can have on foreign exchange and tax revenues.

<sup>26</sup> Cf. Howard Pack: *Productivity and Industrial Development in Sub-Saharan Africa*, in: *World Development*, No 21 (1), pp.1-16.

<sup>27</sup> Cf. IMF, *op. cit.*

<sup>28</sup> As far as import liberalisation is concerned, the World Bank prefers the so-called "concertina method" which allows for a step-by-step reduction of import duties, beginning with relatively high duties. This often leads to a relative worsening of the situation for local industry which depends on the import of capital goods and intermediary products while favouring imports of consumer goods, since duties on consumer goods are usually higher.

□ It is reasonable to assume that the weak supply response to national trade liberalisation programmes is partly due to a lack of an export promotion apparatus. Since no such apparatus exists and because there is insufficient capacity to deliberately promote competitive export sectors, it has, as a rule, proven impossible to reduce the foreign trade deficit. This makes it difficult to exploit the market opportunities sketched out above.

It is therefore essential to deliberately strengthen the supply capacity of the export sectors at the same time as carrying out trade reforms. There are many reasons for these countries' poor supply capacity. The underdeveloped private sector with its lack of technological, organisational and marketing capabilities, the low levels of worker education and training, and poor infrastructures are not the only problems. In developing countries, structural factors systematically discriminate against exports: relatively high and fluctuating rates of inflation together with a lack of the monetary and fiscal instruments needed to control this problem deprive the export sector of a basis on which to calculate costs and income; weak administrations mean long procedures, for example in the procurement of imported products; weak transport and communications infrastructures as well as a lack of facilities such as export financing and export credit insurance present additional problems.

Given the administrative hurdles and financial bottlenecks at home and the high transaction costs involved in international trade (the search for buyers and the cost of adapting products and production procedures to export market requirements), the first steps down the road towards export marketing are very stony for private companies in a developing country.<sup>29</sup> These supply capacity bottlenecks have always posed a problem, but their negative consequences are being amplified in the wake of the globalisation and liberalisation process. Thus in future, LDCs will also face increased competition in their own domestic markets.

### **Instruments of Deliberate Trade Promotion**

The task of trade promotion, especially in the least developed countries, must be to improve conditions such that they, too, can better utilise the new opportunities of global markets and international investment. Exports of processed products from developing countries apparently require additional promotion in order to overcome the many impediments on the way to the export market<sup>30</sup> and to

counteract any destabilisation of the balance of payments caused by import liberalisation. Export promotion can take many forms. The following measures represent a minimum standard which should also be aimed for in countries with weak administrative structures:

□ *Creation of "free trade conditions" for all direct and indirect export activities.* Unhindered and un-bureaucratic access for export companies to imported inputs is one of the most important prerequisites for export competitiveness. Depending on the administrative conditions in a particular country, this can be achieved e.g. by means of free export zones, the establishment of individual export companies operating under customs supervision (bonded factories), or procedures which provide tax relief for export transactions (e.g. duty-drawback schemes).

□ *Construction of an institutional infrastructure (for technology transfer as well as production and sales-oriented services).* Such an infrastructure could – possibly with the help of corresponding state support – also be provided by commercial service companies.

□ The strategic role which is increasingly attributed to the development of technological capabilities in international competition has long since led to the creation of a variety of promotional instruments in the western and Eastern Asian countries. Better co-operation between educational institutions, research establishments and private industry with regard to the development of technological capabilities would be of advantage for other countries, too. Furthermore, the success of the East Asian "tiger economies" has demonstrated the strategic significance of the education factor – especially vocational training – for the assimilation not only of modern technologies, but also of modern management and marketing concepts. In this respect, *the promotion of educational institutions which develop such capabilities and the creation of a close association between these institutions and private industry* appears increasingly important in addition to public support for further education within private enterprises.

<sup>29</sup> Cf. Jürgen Wiemann, op. cit.

<sup>30</sup> Cf. the following World Bank publications: P. Harrold, M. Jayawickrama, D. Bhattasali: *Political Lessons for Africa from East Asia in Industrial and Trade Policies*, World Bank Discussion Papers, Washington 1996; Y. W. Rhee: *Instruments for Export Policy and Administration – Lessons from the East Asian Experience*, World Bank Staff Working Papers, No. 725, Washington 1985; Y. W. Rhee, T. Belot: *Export Catalysts in Low-Income Countries*, World Bank Discussion Papers, Washington 1990.



□ Active export promotion requires a close exchange of information between state administration and private industry and its organisations. Cooperation of this sort, which allowed the state administration to formulate and, if necessary, revise, strategic goals for the development of industry and exports, was one of the conditions which led to East Asia's economic miracle. Despite all the scepticism regarding the transference of institutional structures from one cultural sphere to another, it does seem judicious for developing countries to complement measures of trade policy with new forms of coordination between state administration and private industry. Close collaboration in mixed-membership coordination bodies should contribute towards dismantling the mistrust which exists in many developing countries (and in Africa in particular) and help initiate a learning

process in which both sides can recognise their specific roles more clearly and fill them accordingly.

□ The increasingly perceptible and complicated environmental and health requirements which consumers and legislators in the OECD countries place on domestic and imported products pose a particular challenge within the new trading environment. It is to be expected that environmental requirements which have hitherto been placed on products alone will also be extended to include production processes in some form or another (seal of environmental approval, international standards for the burden placed by production processes on the environment). It is therefore increasingly important to support the adaptation of export production to environmental and health standards.

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## Germany's Stake in Exchange Rate Stability

*The position taken by politicians and important pressure groups in Germany concerning EMU will depend to a large extent on its labour market implications – and thus on the (perceived) impact of exchange rate variability on employment and unemployment.*

*Most economists would assume this impact to be minor.*

*The purpose of this paper is to show that this presumption might be wrong.*

Why should Germany want EMU? It is often argued that it can only lose in economic terms: it is unlikely to gain in terms of price stability and the demand for its exports is rather inelastic so that exchange rate fluctuations should not have a strong impact on its economy. It has indeed been difficult to document a strong relationship between the amount of trade and exchange rate variability.<sup>1</sup> But this argument might be besides the point: German policy-makers presumably are concerned mostly with the performance of the economy at home. Trade matters only if it has an impact on the factors that are crucial for re-election, namely inflation and unemployment. The former is the responsibility of the Bundesbank,

but the government is held responsible for the state of the labour market, which can be decisive for elections. The position important pressure groups, such as trade unions, take concerning EMU will also depend more on its labour market implications than on the volume of trade.

German support for EMU should thus depend on the (perceived) impact of exchange rate variability on employment and unemployment. Given the factors mentioned above most economists would assume that it should be minor. The purpose of this paper is to

<sup>1</sup> For a recent survey see André Sapir, Khalid Sekkat and Axel A. Weber: The Impact of Exchange Rate Fluctuations on EC Trade, Centre for Economic Policy Research (CEPR), Working Document No. 1041, 1994.

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