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Impact of multilateral trade liberalization and aid for trade for productive capacity building on export revenue instability

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ABSTRACT

This paper investigates the impact of multilateral trade liberalization (MTP) and Aid for Trade (AFT) for productive capacity building on export revenue instability in developing countries. The empirical analysis covers 119 countries over the period 2002–2013. Using the within fixed effects estimator, it shows that both MTP and AFT for productive capacity building exert a reducing impact on export revenue instability. However, these two impacts are dependent on countries' level of development. Furthermore, the higher the level of AFT for productive capacity building (in % GDP), the greater the magnitude of the negative impact of MTP on export revenue instability.

1. Introduction

There is an important literature on the adverse macroeconomic and microeconomic impacts of export revenue instability (e.g., the survey of Araujo-Bonjean et al., 1999; Parimal, 2006). This literature has shown that export revenue instability is a major source of macroeconomic instability, which is welfare costly. Export earning instability could also generate risks for individual economic agents who take into account this instability in their economic decisions, but who in the absence of appropriate credit and insurance devices, find it difficult to get rid of this risk. Indeed, the impact of export revenue instability on an economy could take place through several channels, including, economic growth, investments, exchange rate variability, farmers' revenue, public finances, and governance and political instability. For example, several studies (e.g., Love, 1992; Ramey and Ramey, 1995; Guillaumont et al., 1999; Aiello, 2000; Collier and Hoeffler, 2000; Combes and Guillaumont, 2002; Kaushik et al., 2008) have provided evidence that export revenue instability exerts a negative impact on economic growth and enhances economic growth volatility, through price shocks. Likewise, variability in prices of primary commodities could negatively affect investments by disrupting signals about long term market trends, which would result in poor resource allocation and lower factor productivity. As the instability of markets cannot provide reliable information on the relative profitability of alternative lines of investments, risk-averse investors can become reluctant to invest in sectors that are subject to high volatility. Guillaumont et al. (2003) have argued that in the case of agriculture, farmers are inclined either to scale back their investment and innovation or to forego educating their children, which is an irreversible outcome in a period of price drops. Maizels (2000) has put forth that high price instability of a country's commodity exports could

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adversely affect investments (e.g., financial assets) by channelling private investments into domestic projects that carry short term benefits rather than into more risky ventures, even though the latter may reflect the country's comparative advantage. Instability of commodity prices, which translates into export revenue instability, also constrains economic development through the resulting variability in imports of capital and intermediate products (Adebusuyi, 2004). Adebusuyi (2004) has also argued that export earning instability could discourage farmers from producing for export markets. This could result in a future fall in export earnings. Export revenue instability, which particularly stems from unstable international prices, could lead to real exchange rate instability. This impact could even be associated with the "Dutch disease" phenomenon, as the rise in export prices during a period of boom could translate into an appreciation of the real exchange rate and a loss of competitiveness of the tradable goods sector that has not even been associated with the boom (Guillaumont et al., 2003). Public finances, including government revenue, public expenditure and public debt could be affected by the fluctuations of export revenue, especially if these fluctuations are due to unstable international prices (e.g., Guillaumont et al., 2003). Last but not least, instability in export receipts is likely to lead, through the channels previously highlighted, to political instability due to their significant impact on absolute and relative incomes (Guillaumont et al., 2003). Export revenue instability could be a source of social conflicts, particularly in countries highly dependent on primary commodities for their exports (e.g., Collier and Hoeffler, 2000). Along the same lines, fluctuations in export earnings, notably in countries with high primary commodity dependence could be associated with poor governance (Collier, 2002).

The literature on the determinants of export revenue instability is less voluminous than the one on the economic impact of export revenue instability. This literature on the determinants of export revenue instability has shown that less developed countries tend to experience greater export revenue instability than relatively advanced economies (e.g., Massell, 1964; Naya, 1973; Ming Wong, 1986; Love, 1987; Tegene, 2000; Xin and Liu, 2008). Furthermore, it has provided that the factors that explain export revenue instability in both developed and developing countries can vary from one study to another, although some factors appear to be the same across all these studies. The common factors included, inter alia, the degree of commodity concentration, the size of the export sector, the ratio of goods exports to the total export of goods and services income, (perhaps) the geographical concentration of exports, the proportion of food items exports to total export proceeds, and variations in foreign markets' shares.

In spite of researchers' effort to better understand the factors governing export revenue instability, particularly in developing countries (and poorest countries), the previous studies have overlooked or at least neglected two major factors. These included the multilateral trade agreements and initiative adopted at the multilateral level to address the supply-side constraints of developing countries' exports in the international trade market.

The International trade community, notably the members of the World Trade Organization (WTO) has recently made a major step towards greater trade liberalization at the multilateral level. Indeed, since the creation of the WTO (which replaced the General Agreement on Tariffs and Trade (GATT)) in 1995, WTO members have delivered substantive outcomes on trade, respectively at the 2013 WTO Ministerial Conference in Bali (Indonesia) and the 2015 WTO Ministerial Conference in Nairobi (Kenya). The outcome[1] of the Bali Ministerial Conference includes Agricultural-related decisiondecisions; a decision on Cotton; some decisiondecisions on development and least developed country (LDC) issues, and the adoption of the landmark 'Trade Facilitation Agreement". The package[2] of decisions adopted at the Nairobi Ministerial Conference by WTO members encompasses agriculture-related decisions in favour of least developed countries[3] (LDCs); a decision on cotton for cotton exporting-countries, notably the so-called group C-4, which comprises the four poorest countries – Benin, Burkina Faso, Chad and Mali – that are the most important African exporters of cotton.

The genuine implementation of all these Ministerial decisions and Agreement would surely contribute to greater trade liberalization at the multilateral level, for the benefits of the international trade community, in particular developing countries and LDCs. This would ultimately contribute to reducing existing trade distortions in the international trade market, and consequently lead to lower export revenue instability in these countries.

Recent years have however witnessed a backlash against international trade (and globalization in general), with a risk of undermining future effort by WTO members towards multilateral trade liberalization.

To help countries take advantage of opportunities offered by multilateral trade liberalization, WTO members have set up at the 2005 WTO Hong Kong Ministerial Conference, the Aid for Trade (AFT) Initiative. The latter purports to "help developing countries, particularly LDCs build the supply-side capacity and trade-related infrastructure that they need to assist them to implement and benefit from WTO Agreements and more broadly to expand their trade" (see Paragraph 57 of the Hong Kong Ministerial Declaration in WTO, 2005).

The OECD (Organization of Economic Cooperation and Development) has distinguished three main AFT categories: AFT related to economic infrastructure; AFT related to trade policy and regulations, and AFT dedicated to productive capacity building, which includes banking and financial services, business and other services, agriculture, fishing, industry, mineral

[1] See more details online at: https://www.wto.org/english/thewto_e/minist_e/mc9_e/balipackage_e.htm (accessed 23 May 2017).

[2] The package of the decisions included: agriculture-related decisions included a decision on export competition, a decision on special safeguard mechanisms for developing country members, and a decision on public stockholding for food security purposes. LDCs-related decisions included a decision on preferential rules of origin for least developed countries and a decision on implementation of preferential treatment in favour of services and service suppliers of least developed countries and increasing LDC participation in services trade. https://www.wto.org/english/thewto_e/minist_e/mc10_e/nairobipackage_e.htm (accessed 23 May 2017).

[3] The Group of LDCs has been considered by the United Nations as the poorest and most vulnerable countries to natural and external shocks. The list of LDCs is available online at https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/publication/ldc_list.pdf.