Trade Policy Strategies for Mozambique

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1. Introduction

It might seem presumptuous of me to advise on economic strategies of central importance to Mozambique's development simply on the basis of several short visits to Mozambique and a reading of a few materials prepared by others. I have always objected to fly-by-night advisors. However, international and regional experience can be a source of relevant and useful perspectives. My strategy, therefore, will be to try to provide some insights based primarily on international experience and to link these as best I can to what I know of Mozambique. The purpose is to elicit questions and provide a framework for discussion of what I think to be some key issues.

2. The Context

There have been large variations in the ability of countries to benefit from globalization of economic relations. The countries that have succeeded in participating in the global economy have experienced much higher rates of economic growth and poverty reduction than those that have not. With a few exceptions, most notably Mauritius, sub-Saharan Africa has so far "missed the boat". However, there are encouraging signs in a number of countries that a decade of deregulation and of trade and investment liberalization is beginning to pay off in the form of increased exports and global competitiveness in a variety of manufacturing sectors.

Domestic policies are the key to effective economic participation in the global economy (Flatters 2001b). First and foremost are trade policies – policies that are broadly neutral with respect to both imports and exports, and which in particular leave potential exporters free of unnecessary regulatory burdens on investment, imports, employment, and production. However, while "open" trade policies are necessary, they are far from sufficient. Stable macroeconomic and exchange rate policies, financial, telecommunications, transport infrastructure, education, law enforcement and a host of other factors all are necessary in providing an enabling environment to promote trade, investment (foreign and domestic) and employment.

3. The Architecture of Global Trade Institutions

The external environment – the international financial, trade and investment architecture – is also important. The evolution of the rules-based international trading system under the WTO has been a key factor, as has been a host of bilateral and plurilateral trading and investment arrangements. Many of these have been very helpful to poor countries attempting to spur development through international trade and investment.

At the same time, there is enormous room for improvement in these international arrangements and institutions, especially from the perspective of the development needs of poor countries. However, small countries such as Mozambique have very little leverage in the evolution of these institutions. Limited domestic resources, together with the inherently weak influence of small countries over international agreements are key factors in deciding how to allocate scarce policy resources between domestic and international policy reform.

The evidence is that the payoffs to domestic policy reform are much greater than tilting at the windmills of international institutions. For a small, poor country, the benefits from domestic reform are generally greater and the costs are much less.

Furthermore, the mercantilist fiction and rules of the game that underlie most international trade negotiations often encourage perverse attitudes and policies that are contrary to the interests of participants, especially those from poor countries. This is especially true of the rules and procedures governing trade liberalization in the WTO.

4. Issues for Mozambique

Within this domestic and international context, we now go on to examine some important trade policy issues facing Mozambique. We begin with some key issues arising from participation in regional and international agreements.

5. The SADC Trade Protocol

The SADC Trade Protocol (TP) suffers from several key and possibly even fatal weaknesses. Without improvement in some of these key areas, the Trade Protocol is likely to be of very little value in increasing regional integration or the development of its Member States.

- SADC's small size means the TP will be useful only if it serves as a platform for increasing competitiveness in the global economy (Flatters 2001a).
- Rules of origin as currently agreed are likely to make the TP, at best, irrelevant. Transparent and often relatively low tariffs have been replaced by much more serious, burdensome and less transparent barriers to trade in the form of rules of origin (Flatters 2002b).

How can Mozambique make best use of the SADC Trade Protocol?

- Change rules of origin: Mozambique has been one of the most articulate and consistent opponents of current rules of origin. The TP has a built-in review process that is scheduled for 2004. There might be some pay off to efforts devoted at rallying the support of other Member States that are now beginning to recognize the costs of the current rules of origin. There might also be pay offs in improving market access to the EU (see following section).
- Back loading and differentiation of tariff reduction schedules: Mozambique's preferential tariff reductions are heavily backloaded, especially on trade with South Africa.
    - The gains from tariff reductions will come only when Mozambique reduces its import duties; why delay (e.g. wheat flour)?
    - The greatest gains are likely to come on imports from South Africa rather than other Member States, from whom Mozambique imports very little. Therefore, tariff reductions on South African trade should come earliest (or no later than other tariff reductions).
- Linking MFN and preferential tariff reductions: Costly trade diversion is a serious danger when granting preferential tariff reductions, especially in an arrangement with high cost and relatively underdeveloped preferential trading partners. This can be avoided, and the gains from tariff reductions can be increased, by reducing MFN tariff rates in parallel with preferential reductions.
- Safeguards and antidumping: Mozambique has proposed the use of such measures without even WTO disciplines for poorer SADC Member States, on the grounds of the lack of capacity in Mozambique to comply with WTO requirements. WTO disciplines are designed to prevent the hijacking of these special measures for purposes of protection, and have been shown to be not very effective. To remove these disciplines would increase the danger of inappropriate and harmful use of these measures, to the detriment of Mozambican users of imported goods. A much more appropriate SADC TP policy on such measures would be to outlaw their use on trade among Member States, rather than to remove disciplines on their use.

6. Preferential Arrangements with the EU

A number of EU preference schemes have been offered as a means to promote development through trade. However, they have been shown to have provided far fewer benefits than may have been intended. This is due to product exclusions and limitations and highly restrictive rules of origin. Under EBA, the rules of origin do not even allow cumulation among LDCs. While restrictive rules of origin are in principle a double edged sword – promoting upstream industries but at the same time raising costs and thus reducing competitiveness – the cost-raising effects have dominated. The cost-raising impacts arise from artificial distortions in production decisions forced by restrictive rules of origin, and from the high and rapidly growing compliance costs being imposed by EU requirements.

A major lesson from EU preferences is that they are based on a flawed development model, and impose costly and harmful requirements that are in fact outlawed under other WTO provisions.

Export-led growth is import-led growth, and flexibility in sourcing inputs and raw materials is essential for global competitiveness. Impeding this flexibility harms both upstream and downstream producers. A healthy downstream industry is the first requirement for the development of successful upstream suppliers.

How should Mozambique respond to post-Cotonou EPA negotiations?

- Without major changes in rules of origin, there will be little market access benefit to countries like Mozambique. Mozambique has very little power to influence the EU market access provisions. Even if these market access constraints are reduced, many of the benefits will be small since most EU tariff rates are already low. Many of the benefits that do arise will accrue to EU buyers; poor country benefits will be diluted by competition among many suppliers.
- There is a great danger in negotiating reciprocal liberalization that Mozambique will suffer from serious trade diversion. The best remedy for this is to extend all preferential tariff reductions negotiated with the EU to all other trading partners on an MFN basis. In other words, the best use of the EPA process might be to push the unilateral MFN-based tariff reduction process in Mozambique.
- Finally, Mozambique might use the EU preferential trading experience as part of a strategy to persuade its SADC trading partners of the folly of adopting EU-type rules of origin as the basis for rules under the SADC TP. Why should SADC do to its own Member States what the EU is doing to them with its rules of origin? In fact, this might be turned to advantage in future EPA negotiations with the EU. The EU says that current rules of origin are not up for negotiation in the current EPA talks. At the same time, the EU argues that SADC must make more progress in freeing up intra-SADC trade before it will be taken seriously in future negotiations with the EU and others. It might be possible to gain some leverage in EPA negotiations by liberalizing intra-SADC rules of origin (revert to the originally agreed rules rather than the current ones, which are modeled after Cotonou) and then press for a similar change in EU rules.

7. AGOA

With the exception of textiles and garments, AGOA rules of origin are much less restrictive than EU rules. The general rule for garments under AGOA is that they must be manufactured from yarn and cloth produced in qualifying countries. There has been a derogation of this rule for LDCs, which permits so-designated countries to qualify for AGOA under a single transformation rule. At the moment, this derogation is in place for only four years, of which two years have already passed.

Investors, both foreign and domestic, and American buyers have been responding to the AGOA incentives (Flatters 2002a). This should not be surprising, since American garment buyers were a major force behind the passage of AGOA. These buyers had already identified sub-Saharan Africa as an important new source of supply for the US market. The recent growth of exports from Madagascar and other LDCs was a signal of this interest. The compromise reached on rules of origin – strict rules, with a derogation for the poorest countries – reflected the outcome of a struggle between competing domestic textile interests in the US.

The strong interest of American buyers means that AGOA might be much more successful than EU preferences, even despite restrictive rules of origin. American buyers are working very closely with regional textile producers to help them develop the capacity to meet the demanding requirements of the US market. Several large investments have already taken place in the upstream yarn and textile industries. Investments in Namibia by the Malaysian company Ramatex promise 18,000 new jobs in the textile and garment industry in the Windhoek area. Similar new investments are taking place in Lesotho.

Mozambique has also benefited from new AGOA-related exports and employment in the garment sector. But why has she not yet elicited the kind of interest shown by investors that have chosen to locate in Lesotho, Madagascar and Namibia? AGOA has presented an opportunity. Whether and how much Mozambique benefits from this will depend on the success of policy makers in creating a hospitable trade and investment environment.

8. WTO Negotiations

Because of its small size, Mozambique has very little to offer to trading partners and thus has virtually no influence in gaining market access under current WTO processes. Furthermore, the mercantilistic fiction underlying WTO negotiations might actually divert and delay efforts to pursue domestic reforms. Special and differential status conferred on poor countries like Mozambique might provide a further excuse to delay domestic reform. The main potential value of the WTO would be in:

- improved market access to external markets, almost all of which will be achieved regardless of Mozambique's participation, and
- any leverage the process confers on domestic liberalization efforts (if it does not do the opposite by entrenching mercantilist and protectionist attitudes).

The most important benefit Mozambique might gain from the WTO process would be to bind current tariff rates in order to remove the temptation and the ability to impose arbitrary tariff surcharges in response to domestic protectionist pressures. The binding of rates in this fashion might also gain some credit for Mozambique in bargaining for key market access concessions from others.

9. Domestic Reform

Mozambique's efforts should focus on domestic policy reform, aimed at improving the enabling environment for investment and promoting international competitiveness of production in Mozambique. There might be many things wrong with the global trading environment and the policies of some of the world's most important trading countries. Mozambique can do little about that. Mozambicans, however, are better equipped than anyone else to understand and deal with the domestic policy environment. And international experience confirms that the benefits from these reforms will provide the largest benefits at the lowest cost to Mozambique.

Trade and investment policy involves not just the traditional instruments of trade policy, but the entire regulatory and policy environment that impinges on investment and competitiveness in the country.

The FIAS (FIAS 2001) and Trade Mainstreaming (Nathan 2002) reports deal with many of the relevant issues. The following sections highlight, discuss and assess some of the key findings.

10. Import Tariffs

Mozambique has made great progress in tariff reform in recent years. However, there is still room for substantial improvement.

- Even after the tariff reductions scheduled in 2003 and 2006 there will be substantial cascading of tariff rates, resulting in very high rates of effective protection for goods produced for the local market. Furthermore, the classification of items such as cloth as final consumption goods imposes a large burden on exporters of garments, which is a sector of great export potential in Mozambique.
- The use of temporary tariff surcharges invites rent-seeking and results in arbitrary increases in protection for successful pleaders, and substantial increases in costs for the users of their products.

Adoption of a much more uniform tariff structure would reduce the large and arbitrary differences in effective protection provided to different sectors. Lower tariff rates would reduce corruption and smuggling. They would reduce the anti-export bias of the current tariff structure. The effects on revenues could be positive or negative, but would not be important in a budget that depends on trade taxes for only about 15 percent of total revenue.

Current (and future reductions in) tariff rates should be bound under the WTO, thus removing the temptation to impose arbitrary surcharges. Binding of rates would provide some limited bargaining power under the peculiar rules of the WTO negotiation process.

Strict disciplines should be imposed on any contingent protection measures introduced for "antidumping" and "safeguard" purposes defined by the WTO. As international experience has shown, there is very real danger that, even with WTO disciplines, such measures will be captured and used for arbitrary protection.

11. Customs and Trade Facilitation

Import duties are only one of the costs of engaging in international trade. Customs, inefficiencies in ports and import procedures, licensing and other regulatory requirements placed on imports and exports impose costs that are more difficult to measure but no less important. Reform of customs and port procedures can reduce the costs of trade substantially. Customs reform measures in Indonesia in 1984 reduced importing costs by over 20 percent in less than a couple of months.

Recent customs reform programs appear to have focused more on revenue than trade facilitation. As a result, customs procedures remain onerous and costly. Port clearance costs are high and unpredictable. Import and export licensing and registration procedures impose further bureaucratic costs with little if any apparent benefit.

12. Exports

The biggest burden of barriers to international trade is borne by exports. The freeing of exports from these costs cannot always await slow paces of reform in import tariffs, customs and trade facilitation. The most effective solution is the creation of EPZ facilities which permit easy access to international inputs and to markets for exports. This was the key to Mauritius' success in overcoming what appeared to be insurmountable barriers to development 30 years ago.

Mozambique has created EPZ facilities for exporters, but they do not work. Rather than freeing exporters to compete in international markets, they symbolize the regulatory burdens that impede Mozambique's development. This is not the right signal to project to world markets. If Mozambique wants to capitalize on the export possibilities made possible by domestic reform and by international opportunities, effective cleaning up of EPZ facilities is essential. This is particularly important in the context of the new opportunities offered under AGOA.

Proposals such as those in the Trade Mainstreaming report (Nathan 2002) to monitor EPZ firms and condition their privileges to linkages with the domestic economy are based on the same failed development model underlying EU and SADC preferential rules of origin. They would further reduce the effectiveness of EPZs in Mozambique.

Reform of EPZ facilities and removal of all other unnecessary barriers that burden exporters with the costs of the domestic regulatory environment must be one of the highest priorities in trade policy reform in Mozambique.

13. Investment Environment

The FIAS report (FIAS 2001) clearly documents many of the basic problems in what best might be termed Mozambique's "disabling investment environment". While Mozambique has attracted several large capital-intensive investments based on natural resource availability, it has had far less success in attracting investments that capitalize on abundant labor resources, and that would contribute in a more direct way to employment growth and poverty reduction. Problems in labor laws, land procedures, tax systems, the financial sector, company laws and regulations, telecommunications, transport, law enforcement, corruption, etc. all beg for reform. Removal of these administrative, legal and systemic barriers has been a slow process. And yet these reforms are a critical complement to effective trade policies.

14. Can Mozambique Compete?

Investors and producers respond to the incentives created by their economic environment. The current trade and investment policy environment in Mozambique discourages investment, employment and exports. The high cost environment protects existing producers from new competition but also discourages them from new ventures, especially in export markets. Improvements in the policy environment would yield rapid changes in the orientation and level of economic activity in Mozambique.

Thirty years ago, Mauritius was in far worse economic shape than Mozambique today. Teams of some of the world's best economists dismissed its prospects as hopeless. Some simple changes in the regulatory environment, most importantly freeing exporters from restrictions on imports and exports, and from other unnecessary regulatory burdens produced a 'miracle' in the Indian Ocean that was no less spectacular than the East Asian miracle on the Pacific Ocean in the final decades of the twentieth century (Flatters 2002a).

Domestic and international changes have created new opportunities for Mozambique. Spurred on by the commercial interests of American buyers, AGOA has created a particular chance. Namibia, Madagascar and Lesotho have already capitalized on this. Mozambique could emulate their experience.

Creation of the appropriate enabling environment is the key to competitiveness and to the transformation of development prospects. Without reform, Mozambique will continue to be unable to compete. An improved trade policy strategy is what is necessary to unleash a new phase of development for Mozambique.

15. Conclusion

A national trade policy strategy must begin at home. The necessary discussions and negotiations will not take place in Geneva, Brussels, Washington or Gaborone. Success depends on an understanding of and an ability to deal with the domestic constraints to competitiveness in the Mozambican economy. Achieving sustainable economic growth and poverty reduction depends on overcoming domestic constraints to effective participation in the global economy. The challenge is large. But the potential returns are also large, and the ability to achieve them rests in the hands of Mozambicans.

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Note: The papers by Frank Flatters can be accessed at: http://qed.econ.queensu.ca/faculty/flatters