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Charles Beck and Jaime De Melo

International Growth Centre

Considerations for South Sudan's Trade Strategy

If a country wants to experience sustained growth, it needs to be a well-connected member of today's global economy – the relative economic experiences of Latin America and East Asia in the 1960s and 1970s cast doubt on the prospect that a country can grow without being open. Indeed, this is why Latin America abandoned their inward-looking industrialization strategies in the 1970s. For South Sudan, this is especially true as it is a landlocked economy facing high transport costs (Arvis et al. 2007). This note draws on Melo (2013). It starts by briefly examining what the nature of South Sudan's economy means for its trading challenges and opportunities, and then considers the nature of regional trading agreements today. It concludes by suggesting that two pre-requisites are necessary for South Sudan to be in a position to benefit from the opportunity to engage in international trade. Five pillars are put forth as helpful for a successful integration, first in the regional, then in the world economy.

South Sudan's fragmented economy and the case for trade

The great challenge for South Sudan's growth is to achieve a more diversified economy. At present, the economy is mainly made up of very small-scale agriculture and oil sectors, neither of which is integrated into the rest of the economy. Diversification into manufacturing activity, though, requires economic activity – carried out in firms – being able to achieve scale, specialisation and interdependence. This allows for gains in productivity and efficiency. Indeed, even small increases in scale can have dramatic improvements in productivity, as Soderbom (2012) found in the case of Ethiopian manufacturing.

Yet, the challenge South Sudan faces is that its economy is small and isolated with low population density which inhibits it from realising these gains in scale and efficiency, as noted by Collier (2012). In effect, there are three inter-related problems. The first two are a sparse population and sparse economic activity. Imaging of light intensity at night, a reliable indicator of economic density and geography, confirms that the country's economic activity is distributed very widely and it is thin. The third, compounding problem is that there are high transport costs, both because of poor infrastructure and because of low trade volumes. As high transport costs can outweigh the gains from increased scale, there are low incentives to exploit the economies of scale which would allow firms to grow and become more efficient. This, in turn, inhibits interdependence and specialisation.

To elaborate briefly, with high transport costs between towns, it is unprofitable for firms to base themselves in one location to exploit scale economies and then transport their goods to another. As a result, when transport costs are higher than the savings which firms would gain from economies of scale (possibly leading to lower cost products and thereby higher real wages), firms will keep production for the local market, staying in the towns, and remaining small. There is, as a result, a further implication which reinforces the dynamic: with low levels of hinterland trade and absent economies of scale, there is little justification for investment or maintenance in infrastructure – roads remain poor and the trap continues. It is vital for South Sudan's growth that the country be able to overcome these challenges.

The role of trade and regionalism

The nature of South Sudan's economy is both a challenge and an opportunity, and trade is fundamental here. As the global economy has spread different parts of production across developing countries in inter-connected ways, South Sudan, like many other developing countries, has an opportunity for its firms not to be limited by the domestic market and to participate in a larger market and achieve economies of scale and productivity gains.

Whilst the prospect of serving a more global market is the great opportunity of trade today, the same challenges which have kept South Sudan's economy small and sparse are still present and could prevent the country from reaping the benefits of trade. These must be addressed if South Sudan is to prosper, and that is the real challenge: making functional any such efforts.

The regional dimension has an important role in this. Indeed, Collier and Venables (2007) offer evidence that regional integration can have the largest impacts for a country like South Sudan – landlocked and dependent on primary commodity exports. South Sudan is landlocked so it is natural to start exporting towards regional partners before reaching out to far-away markets. Neighbouring countries will allow South Sudan to participate in a much larger market which offers prospects for increased economies of scale and interdependence of firms. This will create room and impetus for the country to learn, adapt and grow with regional participation as a stepping stone to global markets. It will also offer an avenue for the country to overcome vested interests and general domestic resistance to reform. However, participating in regional trade agreements requires more than simply signing up to them.

The nature of today's regional trade agreements

Regional trade agreements today are fundamentally different to the trade agreements of the past. 20th Century agreements were seen as bargains between trade partners for market access at the expense of non-member countries. The basis for this model was an understanding of the integration process as a linear one: start with a free trade agreement that eliminates tariffs and non-tariff barriers on goods; next, build a customs union and a common external tariff, followed by a common market allowing for mobility and capital and then finally a currency and fiscal union.

However, this linear model of regional integration suffered from two significant shortfalls. The first was that it ignored the role of services. Global trade is not simply the exchange of finished goods, but rather it depends on a nexus between services, foreign direct investment (FDI) and goods. While FDI brings a host of benefits, including capital and technical and managerial knowledge and expertise, services are also essential inputs in production, enhancing productivity and competitiveness. Indeed, countries that are more open to trade in services are associated with increased efficiency and better growth (Hoekman and Matoo, 2008). Most of all, though, the nexus between FDI, services and goods is at the heart of a country's ability to participate in global economic activity as tasks are spread around the world.

The second problem from which the linear model suffered was that it also did not take account of any behind-the-border measures that show up as trade costs. Behind-the-border measures affecting trade costs can be wide and varied, including the high transport costs mentioned earlier, but also soft infrastructure, such as institutions supportive of trade. These are, arguably, harder to change but remain essential for a country's trading ability. In their review of regional integration in Africa, Melo and Tsikata (2014) note that neglecting the benefits of integration services markets was a major shortcoming of past regional integration in the region.

In response to these two deficiencies with the 20th century's linear model of integration, trade agreements in the 21st century have changed focus and now involve bargaining over domestic reforms in order to build that FDI-services-trade nexus that will allow more effective participation in global trade. Given this objective, trade agreements have moved to include five key components: (i) guarantee of non-discrimination; (ii) disciplines on expropriation; (iii) guarantee on transfers of funds linked to FDI; (iv) control domestic content measures; and (v) guarantee investors liberty in the selection of managers.

In sum, while trade policy once was concerned largely with what happened at the border, today it has moved on to consider a much wider range of internal issues. As a result, South Sudan will need to include these behind-the-border domestic issues in its efforts to open up its economy to foreign trade.

Concluding thoughts: two prerequisites and five pillars for South Sudan's trade strategy

Two prerequisites are necessary for South Sudan to be in the position to reap the benefits from trade. Five pillars will be necessary for trade to be an engine of development. The first prerequisite is to build infrastructure and reduce transport costs across the country (and the region via regional cooperation). The reduction in these costs will allow for a greater concentration of economic activity and the possibility of realising economies of scale and efficiency. This will help to make South Sudanese firms more competitive and will allow exporting activities to develop. If it also leads to a reduction in the cost of goods, then real income for the population should also increase. However, it is worth noting that evidence from research in Malawi that looked at demand for transport, even with good roads, found that transport services could not be profitable and self-sustaining in certain areas because operating a single bus would require transport prices beyond what villagers would be willing to pay (Raballand et al. 2011). The outcome was due to demand being spread over large areas, and given the similarity with South Sudan, this should be investigated.

The second prerequisite is to have a competitive real exchange rate. A competitive real exchange rate will be necessary to spur exports, while an overvalued one will hinder exports. South Sudan may even want to consider engineering an undervalued exchange rate, as research has found that growth and export surges are preceded by, or at least accompanied by, several years of undervaluation of the exchange rate (Freund and Pierola, 2011). Although politically sensitive, the value of the exchange rate will be a fundamental factor in South Sudan's ability to achieve export success.

While the above two actions are pre-requisites the country will need to realise, there are five further areas, or pillars around which South Sudan should build its trade strategies for greater success.

The first is learning about trading possibilities. This will require the collection and analysis of data on the costs of trade (see e.g. Croke et al. 2013). This will shed light on trade costs and exchange rate misalignments, and will help focus policy efforts where most effective.

The second is to look at the success of Rwanda in overcoming the challenges of a small landlocked economy. There are seven lessons to draw from Rwanda that are documented in Melo and Collinson (2011) of which two stand out. The first is that, like Rwanda, South Sudan should consider unilateral reforms, independent of any trade agreement. The second is that it should consider managing its oil resources the way Rwanda managed its substantial aid inflows, that is preventing the financial flows from leading to an appreciation of the currency.

The third pillar is that South Sudan should continue with regional integration into the EAC. This will help the government implement reforms in spite of push-back from interest groups, provide policy lock-in and credibility, and it will also allow South Sudan to learn and build capabilities from its membership in the EAC.

The fourth pillar is that the country should begin to start looking at accession to the WTO since there are significant changes this will entail and the process takes a long time – up to a decade. Analysis of what WTO membership will entail and the reforms necessary should be prepared with the easier ones implemented unilaterally sooner rather than later.

The fifth and final pillar for South Sudan's trade strategy, closely related to the fourth, is to try to ensure the legal compatibility with WTO rules when the country drafts its own laws around trade facilitation and customs administration.

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International Growth Centre,
London School of Economic
and Political Science,
Houghton Street,
London WC2A 2AE

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