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"In this new wave of technology, you can't do it all yourself, you have to form alliances"

Carlos Slim Helu

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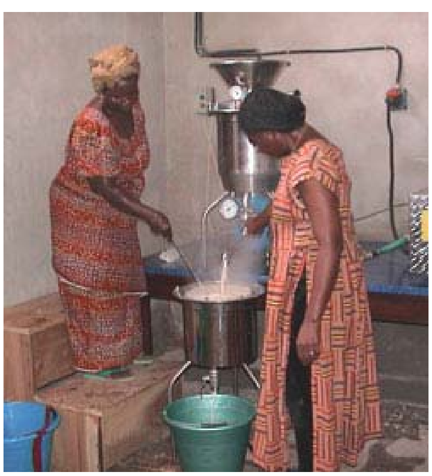
INSIDE THIS ISSUE



Developing the Rural Economy of Ghana through Micro and Small Enterprises (MSEs): Issues and Options

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Abstract

The paper examines the challenges and opportunities of micro and small enterprises (MSEs) operating in the informal sector in rural areas of Ghana. For that purpose, a Business Opportunity Identification Survey (BOIS) was conducted in 2006 by the Science and Technology Policy Research Institute for the Rural Enterprise Project to select at random a sample of 1,542 MSEs in 10 districts. The survey data was analysed by means of a multistage sampling design and complemented by focus group discussions. The paper identified apprenticeship as the dominant source of skill acquisition for a majority of the entrepreneurs while word-of–mouth was their main advertising mechanism. Also, informal MSEs have limited market avenues and used their business premises to sell mostly to individuals. Access to start-up capital was mainly personal savings or family support and this points to the failure of micro-credit schemes in the country. In conclusion, the paper recommends transformations in formal banking policies and the strengthening of Micro Financial Institutions MFIs to adequately support growth-oriented enterprises to enable them to contribute to endogenous developmental role in Ghana.

1. introduction

The role of micro and small enterprises (MSEs) as engines of endogenous development in rural economies is increasingly recognized in development theory and has attracted the attention of policy makers.

- ⇒ They add value to agricultural products and play crucial roles in the decentralised use and distribution of resources (Tacoli, C, et al, 2003).
- ⇒ They augment government efforts to achieve economic growth and poverty reduction in rural and urban areas (African Development Bank 2005). Wangwe (1999) argues further that MSEs tend to ensure balanced economic growth since they are concentrated in different parts of the country.
- ⇒ They have been credited for introducing innovations into the market to serve as a catalyst for societal development (Reijonen and Komppula, 2007).
- ⇒ The development and promotion of MSEs can deepen the manufacturing sector and foster competitiveness.

A vibrant MSE sector can also help to achieve a more equitable distribution of the benefits of economic growth by alleviating some of the problems associated with uneven income distribution (UNCTAD, 2001).

Consequently, many development plans in developing countries have placed strong emphasis on the development of an entrepreneurial middle-class that create employment and has the potential to overcome institutional conditions that hamper growth in rural areas. For example, in Ghana, the Growth and Poverty Reduction Strategy (GPRS I &II) identified MSEs as engines of growth, wealth creation and avenues for employment generation for the majority of its citizens.

In Ghana, a vibrant MSE sector in the rural areas is very important since about 60% of the country's population reside in these areas where poverty is more pronounced. According to the Ghana Statistical Service, about 86% of the total population living below the poverty line in Ghana can be found in the rural areas.

Recognising the critical role of the MSEs in poverty reduction, a number of existing institutions, which have a mandate to promote industrialisation in the rural areas, have been strengthened to facilitate more economic change on the countryside. In order to build strong rural economy, the government of Ghana has set up National Vocational Training Institutions (NVTI), established entrepreneurial development programs as well as favourable conditions for micro financial institutions (MFIs) and other infrastructural services to encourage the growth and development of both informal and formal MSEs in the country.

The paper examines the activities of MSEs in selected districts of the country using survey data from a business opportunities survey conducted by STEPRI in 2006. It identifies the challenges MSEs are facing and how effectively they are addressed by public sector institutions. Finally, the paper suggests how to improve assistance to MSE's and enable them to better contribute to economic growth in rural areas.

2.1 Overview of MSEs and Policy Framework

The MSEs are important to the economy of Ghana. This is buttressed by the fact that the industrial and business sectors are dominated by a large informal sector. For example, about 70% of the Ghanaian enterprises are micro to small sized and it is estimated that nearly 40% of Ghana's GNI is attributable to informal sector activity (Ghana Government, 2002). It is believed that small firms can more easily propel growth in the economy than the large ones due to their numbers and niches they occupy in the national economy (Ghana Government 2002). For the majority in informal enterprises, which are the focus of this paper, a lot more needs to be done in terms of technical, advisory and financial support to enable them to grow and contribute meaningfully not only to the rural economy but the national economic development as a whole .

Results from the Ghana Living Standard Survey-3 indicate that about 69% of the population is employed in the MSE sector with a significant number of them located in the rural areas (Ghana Statistical Service, 2000).

The government policy for MSEs which is under review has the objective of creating a conducive environment for MSEs to grow and facilitate the development of a vibrant, productive and competitive MSEs sector in the country (Ministry of Trade and Industry , 2002). Under the policy, the Government, among others, seeks to:

⇒ Promote dynamic enterprise culture for innovation

⇒ Promote employment growth within the informal sector

⇒ Develop MSE to serve as a means to establish linkages between the formal and informal sectors of the economy

⇒ Improve the technology base, product quality and productivity of the MSE sector

⇒ Upgrade the application of indigenous technologies (Ministry of Trade and Industry, 2002)

2.. Public institutions in support of MSEs in Ghana

The National Board for Small Scale Industries (NBSSI), GRATIS Foundation and the Rural Enterprise Project (REP) have been established to support the development of MSEs in Ghana. Each of these institutions has a special purpose in relation to MSEs:

2.2.1 The National Board for Small Scale Industries (NBSSI)

The NBSSI, a public funded organisation is the apex body charged with the responsibility for the promotion and development of the MSEs in Ghana.

The present form of the NBSSI has the main objectives of:

⇒ Contributing to the creation of an enabling environment for small-scale enterprise development

⇒ Contributing to the development of an enterprise culture in Ghana

⇒ Providing non-financial support for small-scale business development

⇒ Facilitating access to credit for small-scale enterprises

⇒ Promoting MSEs sectoral associations

The NBSSI is further supporting the MSEs with technical and advisory services through its regional Business Advisory Centres found in the 10 regions of the country. It provides training to the MSEs in preparation of business plans, book keeping and simple business management practices.

2.2.2. GRATIS Foundation

The GRATIS Foundation has the mandate to promote small-scale industrialisation in Ghana through transferring appropriate technologies to small-scale industrialists through training, manufacturing and the supply of machine tools, plants and equipment. GRATIS operates through a network of Intermediate Technology Transfer Units (ITTUs), now referred to as Regional Technology Transfer Centres (RTTCs). The RTTC exist in nine regions of the country and is responsible for providing hands-on short and long term training for small business entrepreneurs in areas such as metal fabrication and design, textiles, pottery and soaping and others. GRATIS Foundation has also provided training, business and technical advice, access to equipment and tools to enable artisans and entrepreneurs have a hands-on experience. The Foundation has also introduced women in rural communities to equipment that has been designed and manufactured by GRATIS/ITTU.

The services provided by GRATIS and the RTTCs are made possible through the support of the Government of Ghana, the European Union and the Canadian International Development Agency (CIDA). Funding for specific projects has been provided by the German Agency for Technical Cooperation (GTZ) and the British Department Fund for International Development (DFID), (Ayeetey et al 2001).

2.2.3 The Rural Enterprise Project (REP)

Another important institution is the Rural Enterprise Project (REP) which has the objective of creating wealth and improving living conditions in rural areas, especially the incomes of women and vulnerable groups through increased self-employment.

The Project provides the MSEs with a development package, which involves a mix of business development services, technology transfer, support for apprenticeship training, and rural finance services. The Project is supported by the International Fund for Agricultural Development (IFAD), the Agricultural Development Bank (AfDB) and the government of Ghana.

The Rural Enterprise Project has been collaborating with NBSSI, Rural Banks, District Assemblies, GRATIS and other governmental organisations to support the growth of the MSEs in the rural areas. In conjunction with these organisations, it has been providing training programmes in areas such as business management, record keeping, book keeping and banking procedures, marketing clinics, credit management, costing and pricing, business ethics and negotiation skills among others. It has been organising annual exhibitions for its clients to show case their products and also expose them to markets in the urban areas. The activities of these institutions definitely have made some impacts on the MSEs. However, as illustrated in this paper a lot more needs to be done to build the competence and capabilities of the MSEs to enable them contribute significantly to the rural economies.

2.3. Methodology

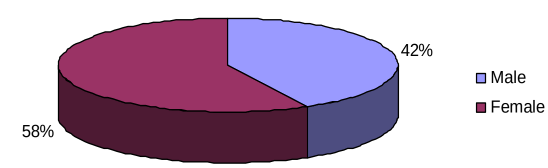
The authors used data from a Business Opportunity Identification Survey (BOIS) conducted in 2006 by the Science and Technology Policy Research Institute for the Rural Enterprise Project. The aim of the BOIS was to provide baseline information for the REP to identify projects in the rural areas which it could extend technical and financial assistance. The BOIS covered a total of 4,981 informal MSEs in 28 Districts selected across the country. The paper used 1,542 MSEs randomly selected from 10 districts. The sample consisted of the most endowed and the least endowed rural communities to ensure a fair representation of the population of interest. In most of the districts, relevant information about the types and distribution of the enterprises was obtained from the District Assemblies and Business Development officers of REP

A multistage sampling design was used. Simple Random sampling was used in the first stage to select the towns to be visited. At the second stage, five categories of professional activities, which are important to the rural economy, were identified. These were agro-processing, production in agriculture and forestry, traditional crafts, primary fabrication, repair works, and service enterprises. From these business categories, a sample of 150 MSEs was selected. However in some districts, a little more MSEs were interviewed due to the size of the district and the number of active MSEs. The response rate was about 85%. The questionnaire covered indicators such as enterprise information, educational level and skill acquisition, sources of funding for business and mode of advertisement among others. The questionnaires were complemented with focus group discussions in all the districts.

2.4 Enterprise Level Information

Figure 1 shows that, 58% of the respondents were women and 42% were men. The gender disparity confirms the fact that women in rural communities' dominate the entire informal sector where a majority of them are employed in off-farm activities. The women were found mainly in the food-processing, and the service sectors of the rural economy.

Figure 1: Gender distribution of respondents



2.5 Type of Business Activities

The service sector plays an important role in the rural economy. About 49% of businesses were involved in the service sector. It comprised activities such as dressmaking, food vending, hairdressing, auto electrical and mechanical repair works (see Table 1). Agro-processing (basically in edible oil, shea butter and cassava processing), constituted about 31% of the sample. Specialized agricultural and forestry products and services such as rodent and snail rearing, mushroom and bee keeping accounted for about 7% while traditional craft (cloth weaving, basketry and sculpture) was 4%. About 6% were involved in other activities. Most of the activities are to meet the needs of the local market. However, in shea butter processing, there are a number of companies which buy the product from the rural processors and export them.

Table 1: Type of Business Activities

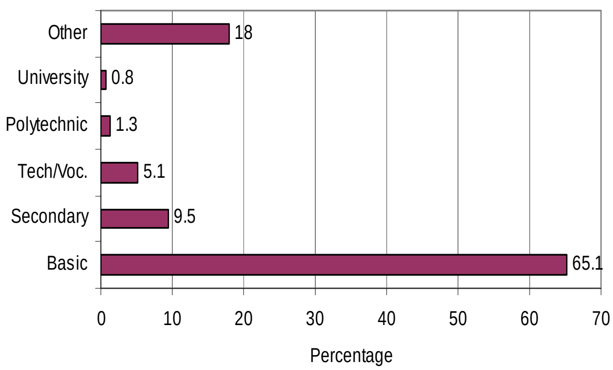
Business Activities	Frequency	Percent
Agro-Processing (e.g. gari-making)	471	30.7
Service enterprises (e.g. tailoring, repairs, hairdressing,	758	49.2
Agric and forest products (e.g. grasscutter, mushroom, snail	114	7.4
Traditional craft	63	4.1
Other	88	5.7
No response	46	3
Total	1542	100

Source: STEPRI Field Data, 2006

2.5 Educational Background and Skill Acquisition

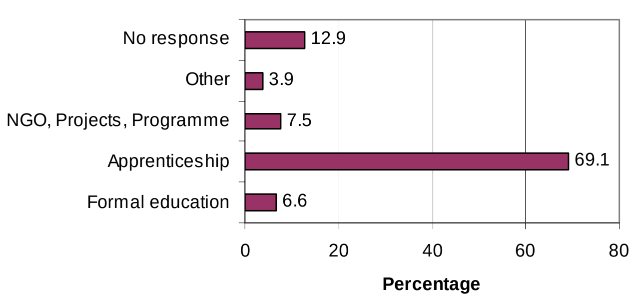
Most proprietors of informal MSEs have low levels of education and this was confirmed by the study where 65% of them had basic education, 10% had secondary education while 5% had vocational or technical education. Only 2% had tertiary education (see Figure 2). It is very important that informal entrepreneurs have access to some from of formal education to facilitate their operations (Anderson, 2001). For example, a beautician (hairdresser) needs some level of formal education to read and understand labels on hair products so as to apply appropriately.

Figure 2: respondents'highest level of education



Apprenticeship turned out to be the dominant source of skill acquisition. Most of the proprietors (69%) acquired their skills through apprenticeship. Formal training in Polytechnic, Technical and Vocational institutions constituted only 7% while 8% acquired their skills through participating in NGO sponsored training programs (Figure 3). Even though apprenticeship is an important source for skill acquisition in the informal MSE sector, the skill acquired will be limited to what the business trainer already possesses. This is based on the premise that one cannot give beyond what he/she already possesses. Therefore, it creates the need to take a critical look at the apprenticeship scheme in the country to ensure that there are mechanisms for apprentice trainers to upgrade themselves.

Figure 3: Source of skill training



Source: STEPRI Field Data, 2006

2.7 Start-up Capital

Access to start-up capital is one of the most important requirements for economic activity especially for graduate apprentices to become self employed (Roeske, 2003). Table 2 shows that, most of the MSEs operate with small capital. As a result, a relatively large proportion (40%) of them had a start-up capital of less than US$400, a quarter had between US$401 and US$500, while about 19% had start-up capital over US$800

The initial investments are in the form of acquisition of temporary structures and basic tools and equipment which are dependent on the activities of the proprietors. For example, a hair dresser in addition to a kiosk may require hair dryers, rollers, comb, bowls and hair products. The size of the start-up capital raises the importance of microfinance in meeting the needs of MSEs to prop up their business activities. As it will be discussed later in this paper, a number of microfinance schemes such as the PAMSCAD Credit Line for Small Scale Enterprises, NBSSI Revolving Fund Loan Scheme, NBSSI-DED Credit Scheme and more recently the Micro-Credit Scheme and Micro-credit and Small Loans Fund have been established in the country, but their impact, at least from this paper have not been very strong.

Table 2: Levels of Set-up Capital	Frequency	Per-cent
Less than US$400	610	39.6
US$401-500	394	25.6
US$501-600	168	10.9
US$-601-700	80	5.2
Over US$800	290	18.8
Total	1542	100

Source: STEPRI Field Data, 2006

2.8 Monthly Profit: High % of entrepreneurs below the national minimum wage

With regards to economic returns, Table 3 shows that about 46% of the proprietors made monthly profit of less than US$20, 24% earned between US$21 and US$50 while 5% earned over US$200. However, the minimum national wage in 2006 was US$48, and this means that a greater percentage of the MSEs earned below the national minimum wage. With these minimum profits, it may be difficult for these entrepreneurs to plough back enough money to improve their scale of production. Consequently, one of the important sources of credit for investment should be through micro credit schemes.

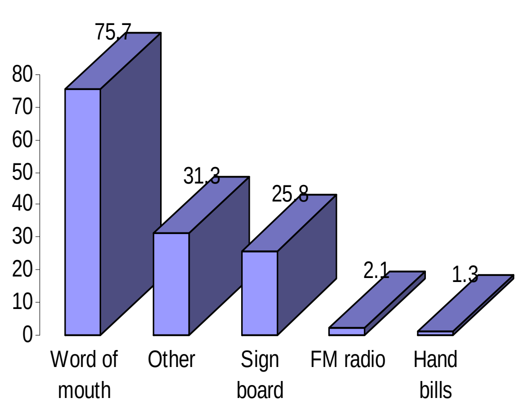
Table 3: Monthly Profit Levels	Frequency	Percent
Less than US$20	709	46
US$21-50	372	24.1
US$51-80	99	6.4
US$ 81-110	71	4.6
US$ 111-200	186	12.1
Above US$200	81	5.3
No response	24	1.5
Total	1542	100

Source: STEPRI Field Data, 2006

2.9 Mode of Advertisement

Advertisement is very crucial to the success of every business venture but the mode depends on the scale of production. From the survey, a large proportion of the enterprises (76%) have adopted word of mouth as the main means of advertising their products, 26% used home-made sign boards displaced on their shops or kiosks, 2% used FM radio, 1% used hand bills, while quite a large number (31%), used other means including hawking. The nature and level of production does not warrant print and electronic advertisement. The word-of-mouth mode of advertisement is highly valued by informal enterprises but better and efficient advertising mechanisms need to be developed, especially by growth-oriented MSEs. In view of their scale of production this group of entrepreneurs needs to reach bigger markets and therefore require a better advertising mechanism. Adoption of more conventional or modern advertising mechanisms hinges on the ability of the entrepreneurs to increase their scale of production to meet the demand that might result from the use of modern advertising modes. The use of electronic press and hand bills may be adopted by MSEs whose capital and production base are relatively large.

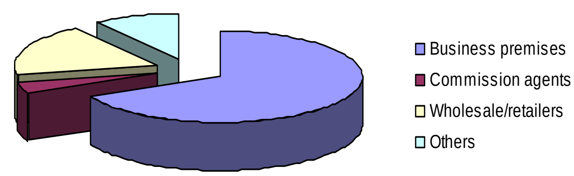
Figure 4: Mode of advertising products/services



2.10 Channels for Distribution of Products & Services

The distribution channels or outlets for the sale of products are important to any business. Also, the type of distribution channel adopted epitomises the scale of production. A large proportion of the enterprises (68%) used their business premises to either sell their products or provide services to individuals, 18% to wholesalers/retailers and 4% to commission agents (see Figure 5). Similar situation exist in Malawi, Swaziland and Zimbabwe where over 96% of the MSEs sell primarily to individuals (Liedholm and Mead, 1999). This situation has arisen because rural entrepreneurs have limited market avenues and as such they do not need elaborate advertising and distribution mechanisms to market their products and services. This is affecting their growth since access to large markets will help them improve their scale of production and acquire more skills to meet the intricacies of such markets.

Figure 5: Outlet(s) used to sell produces/services



2.11 Major Sources of Funds: Where are the rural banks?

The entrepreneurs relied on diverse sources of finance to start or sustain their businesses. These sources include family support, personal savings, Susu schemes, trade credits (microfinance and small loans), bank loan, money lenders and sale of assets. Personal savings was an important source of funds for the operators of the MSEs. Although, there were microfinance institutions established to provide funding for MSEs, most of the informal MSEs (32%) depended on personal savings. About 12% got support from family members while a small percentage (3%) borrowed from the banks, which further buttressed the limited role formal financial institutions play in the operations of the informal MSEs. This also epitomises the failure of the Rural Banks to support the activities of MSEs in terms of institutional credit. The question is who then benefits from the Rural Banks? This question needs to be addressed so as to contribute to addressing the problem of access to institutional credit by the MSEs.

From the focus group discussion, it became clear that a majority of the MSEs have negative perceptions about the Rural Banks which range from poor customer relations, high interest rates and bureaucracies.

Table 4: Major source of financing businesses

Sources of Finance	Frequency	Percent
Family support	187	12.1
Trade credit (microfinance and small loans)	97	6.3
Susu	26	1.7
Local money lenders	41	2.6
Personal savings	494	32
Bank loan	50	3.2
Projects/programmes/NGOs	25	1.6
Other	64	4.2
Not applicable	558	36.2
Total	1542	100

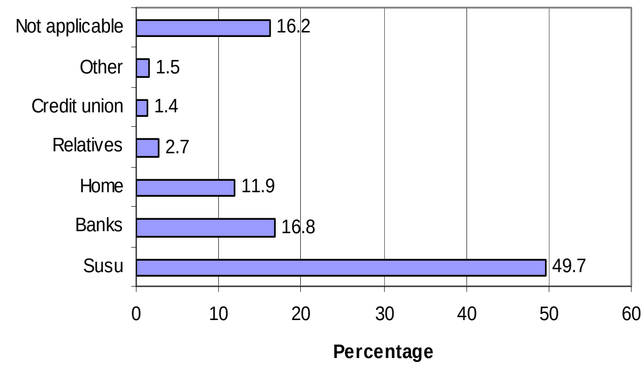
Source: STEPRI Field Data, 2006

As already mentioned, a number of micro credit facilities exist in the country but the data suggests that most of the MSEs have not benefited from the schemes. Though, it did not come out strongly during the focus group discussion, it may be possible that the MSEs which have accessed trade credit and loans from the banks may be those which have the potential to grow.

2.12 Saving

From the previous discussion, personal saving was an important source of funding MSEs in the informal sector. An attempt was made to find out where entrepreneurs deposit their savings. The result was that almost half of them brought their savings to various susu organisations and collectors in their respective towns and districts. Close to 17% saved with the banks, while 12% saved at home. The large number of people who used the susu scheme points to the importance of this scheme in resource mobilisation of informal MSEs. The importance of susu in informal resource mobilisation has attracted the interest of some formal banks such as Ghana Commercial Bank and Barclay Bank. Ghana Commercial Bank has introduced a susu scheme called “Kudi ne Nkusuo” (meaning money is progress) where staff of formal banks collect daily savings from the enterprises. In the case of Barclay Bank, it has entered into partnerships with some susu organisations to deposit their daily collections with the bank. The rationale behind the two banks involvement in the susu scheme has more to do with resource mobilisation of funds outside the financial sector. The susu system maybe be likened to the Raiffaisen Bank in Europe. It is a privately-run savings and credit association which provides credit to all their clients including the MSE entrepreneurs (Aryeetey et. al 1994).

Figure 6: Source of saving

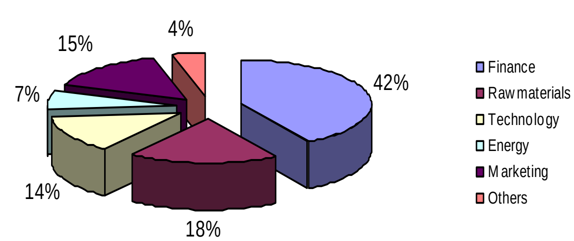


2.13 Problems Affecting MSEs

In Figure 7, a majority of the respondents (42%) cited finance as the main problem relating to business operation. This situation is expected since financial institutions normally perceive MSEs as high risk ventures and shy from giving them credit. Further, administrative bureaucracy and demand for collaterals have hindered the MSEs to access institutional credit. The responses also point to the ineffectiveness of the various micro credit schemes which had been established to ease access to credit by the MSEs.

During the focus group discussions, other problems such as access to raw materials, process technologies and marketing were emphasised. Access to market was the second major problem faced by the MSEs, however some entrepreneurs, especially those in soap making have made some in-roads the markets in the district capitals. This is very interesting bearing in mind that the two main companies (Unilever Ghana Limited and PZ Ghana Limited) have captured the bar soap market in the country. It also supports the argument that MSEs can be competitive if properly assisted with technical and financial support.

Figure 7: Problems relating to business operation

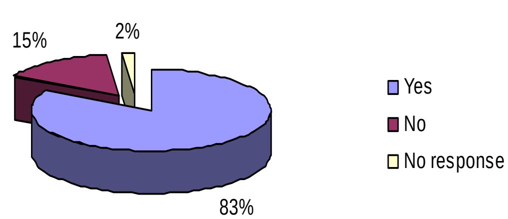


2.14 Innovations and R&D Support Services

Access to proven technologies is very crucial for creativity, competitiveness and innovations. Technology also enhances the adoption of new and better ways of achieving economic growth (OECD, 2000). An innovating MSE will be able to respond to the changes in the market as well as introduce new products and enhance services, which will give it competitive advantage over others. New actions covering innovative aspects of MSE and standardization will be introduced. According to the European Commission (2006), the use of open standards in different business areas reduces costs, simplifies processes and is a key factor in dissemination of technical, managerial and organisational innovations in areas such as production, development, manufacturing, marketing etc.

An attempt was made to find out the level of innovativeness of MSEs. In Figure 8, about 83% of the SMEs claimed to be innovating and have introduced some improvements in their products and services. However, further investigations during the focus group discussions revealed that apparently, enterprises who claimed to have introduced some improvements in their businesses had actually not introduced any serious innovations but basically produced or practiced what was learnt from their masters or mistresses. This is not surprising because most of these MSEs by their size and locations did not benefit from collaborations with universities and the R&D institutions Notwithstanding, some introduced improvements in their process techniques or had experimented with the use of alternative raw materials to make products. For example, the use of shea butter in place of palm oil in soap making.

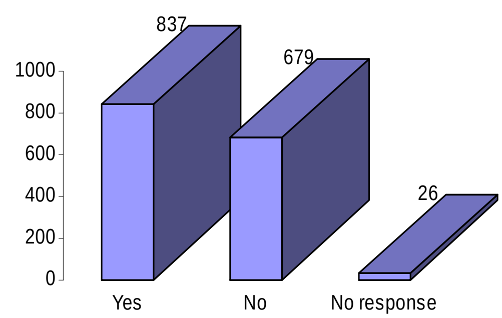
Figure 8: Have you introduced any improvements in your product/service?



Support from research and development (R&D) institutions are very important for the development of the MSEs. However, there is a general perception that the activities of these institutions have not filtered down to the MSEs. In view of this, an attempt was made to find out the extent to which the MSEs have knowledge about the existence of the R&D institutions, and the support they can get from those institutions.

Figure 9 shows that about 54% of the MSEs said they had knowledge and are aware of support they can receive from the R&D institutions. However, from the focus group discussions, it became evident that only few knew about the R&D institutions. The majority mistook NGOs such as Technoserve, Opportunities and Industrialisation Centre and others for R&D institutions. The point here is to find out why the activities of R&D institutions have not permeated deeply into the informal MSE sector. This is a big concern since some of the R&D institutions have the mandate to address industrial problems of MSEs at all levels. For example, GRATIS Foundation has established RTTCs (Regional Technology Transfer Centres) where MSEs can have hands-on experience. It is therefore very important that the MSEs know about this so as to take advantage of it.

Figure 9: Are you aware of support from R&D institutions?



3. Discussions

The examination of informal MSE operations in the country has revealed a number of issues which need further discussion to ensure effective contribution of the informal MSE sector to the development of the rural economy of Ghana.

3.1 Supporting Growth-Oriented MSEs

One critical factor which has hindered the growth of informal MSEs and their progression is the absence of champions who could serve as catalysts for others to follow. The effect of this is lack of motivation and competitiveness in the sector. Addressing this situation requires frantic efforts by the government and other stakeholder in the area of identifying promising growth-oriented entrepreneurs so as to nurture them to transform into bigger entities. Such entrepreneurs should be trained to build entrepreneurial and management skills. They should be creative with ingenuity and determination to grow beyond business horizons. This is critical for the development of a vibrant MSE sector and provides impetus for progression from informal to formal sector as well as from small to medium or large. Liedholm and Mead (1999) argued that such growth is possible if the MSEs have access to inputs, technology, adequate funding and knowledge of product qualities and market requirements.

Furthermore, enterprises that are able to expand their market horizon by selling to traders and manufacturing firms are more likely to achieve sustainable growth than those that sell directly to final consumers (Liedholm, 2001). Access to bigger markets imposes more challenges to entrepreneurs to expand their scale of production and adopt some level of quality control and standardization. In this regard, intervention strategies should focus on market research and analysis to identify market opportunities, develop and produce quality products and the formulation of appropriate marketing strategies.

3.2 Educational Level and Skill Acquisition

The analysis has revealed that most of the entrepreneurs have basic education and this is a handicap since it will restrict their ability to learn modern entrepreneurial skills and acquisition of technical capabilities to enhance their economic activities. For example, in metal fabrication and repairs works, good education will enable the entrepreneur to interpret very rudimentary engineering designs better and adopt a fairly standardised production system.

Also, it has been stated that the main mode of skills acquisition is through apprenticeship. However, due to the limitations of the skill trainers they cannot impart modern and proven skills to their apprentices and consequently, there is recycling of prevailing skills among the apprentices. The situation has negatively affected the growth or migration of the MSEs from informal to formal operatives.

It is worth mentioning that the establishment of the GRATIS Foundation and its RTTCs have provided opportunities for entrepreneurs of MSEs to upgrade and acquire more skills to support their businesses. However, most of the training consists of hands-on experience with limited theoretical support.

In addition, support from the National Vocational Training Institute (NVTI) has not been far-reaching due to the low educational background of the apprentices. Only few of the apprentices have taken advantage of the formal technical training provided by the Institute, and have progressed to the polytechnic (Foster 1999). The challenge for the future of NVTI in Ghana is how it can respond to markets that are highly competitive and dynamic, and how it can produce graduates with skills that can respond to demands of the local and global markets and production technology.

3.3 Access to Financial Resources

Finance is one of the life wires of every economic activity. Access to finance will provide start-up capital for the business as well as funds to meet operational costs. The analysis has revealed that most of the MSEs depend on their personal savings to provide start-up capital with a very small number borrowing from the banks in the country, while others got support through government special projects and from NGOs. However, increased scale of production, especially by the growth-oriented MSEs requires access to institutional credit which can provide far more support than what can be obtained through personal savings, micro credit and other sources.

The risks associated with lending to MSE entrepreneurs have restricted formal sector banks to adequately support these important entities. Lending to MSEs has been characterised by high default rates and high cost of credit administration, as a result only few banks are willing to provide entrepreneurs with financial assistance to improve on their businesses.

To address this critical handicap, a number of financial intermediation schemes have been launched in the country with the overarching objective of providing easy access to finance the MSEs. For example, the government introduced Micro-Credit Scheme in the 2001/2002 periods where by close of 2004, credit amounting to U$101,322 had been granted to over 1500 borrowers. Also the government launched a Micro-credit and Small Loans Fund as a follow-up to the earlier micro-credit scheme which became operational in 2006. The establishment of the fund was part of ongoing initiatives aimed at reducing poverty and promoting growth in the economy. Within two months of operation, over U$161,700 had been disbursed to over 10,000 applications within the Greater Accra Region alone.

The earlier schemes such as PAMSCAD Credit Line for Small Scale Enterprises, NBSSI Revolving Fund Loan Scheme, NBSSI-DED Credit Scheme provided credit facilities to the MSEs. For example, in June, 2002, the NBSSI through its Revolving Fund Loan Scheme had granted over U$2.5million to about 273 MSEs, the NBSSI-DED had disbursed about U$2,437 million to entrepreneurs in Brong Ahafo, Eastern and Northern regions of Ghana. Similarly, the PAMSCAD Credit Line for MSEs had grown from U$4,700 million (seed money) to U$27,581 and had serviced about 1,158 projects.

However, evidence from the survey has shown very low access to micro credit facility by the MSEs either as start-up capital or additional funds to improve their scale of production. And this raises the question of who the beneficiaries are? Though that is not the focus of this paper, however, it can be speculated that corruptive practices and political interference may have diverted funds to individuals who are not operators of MSEs. In some cases, the funds had been used as political rewards for faithful followers of the party in the rural areas rather those actually involved MSE activities.

3.4 Innovations and R&D Support for MSEs

Most of the MSEs had little or no contact with R&D institutions in the country. This is largely due to their scale of production and the markets in which they operate. Such markets are not differentiated and there is no strict competition. However, access to R&D institutions is very crucial in the acquisition of new skills, as well as gaining deeper knowledge about the market and its intricacies. The rural economy stands to gain if it is directly linked to R&D institutions in the country. Low level of educational status among the entrepreneurs, does not promote innovation, diversification and quality of products. Quality products must be based on innovations and technological advancement either through personal creativity or through linkages with R&D institutions. Such linkages will support the growth of the enterprise and help them to progress from informal to formal or from small to medium or large. GRATIS through its Regional Technology Transfer Centres (RTTCs) should be able provide technological support to entrepreneurs to enable them improve on their productivity and accelerate their transformation process.

4. Conclusion

1Developing a strong rural economy in Ghana through the promotion of a vibrant MSEs requires pragmatic and holistic approach to address the challenges that this paper has identified. The study found out that low educational background of the entrepreneurs was a hindrance to even basic technology knowledge acquisition and adoption, innovation, competitiveness and growth in the MSE sector. Apprenticeship was the main source of skill acquisition while a majority of the trainers did not take advantage of National Vocational Training Institutes (NVTI) to upgrade their skills. A major constraint for the entrepreneurs was sourcing for funds to start or expand their businesses.

Access to institutional credit was a big problem and this revealed the ineffectiveness of the rural banks and the various micro-credit schemes to address the financial problems of the MSEs. Large number of disbursements has been made by the various micro-credit schemes but their impact had been minimal as only few of the respondents have acquired trade credit or loans from the banks. They therefore rely on personal saving, a situation that does not promote enterprise expansion and profitability.

Another important issue that should be addressed is the lack of market access of the MSEs. The study revealed that most MSEs have been confined to the markets in their localities. However, access to relative bigger markets would increase their profit margins, as well as their capability and visibility. It is important that REP intensifies its annual exhibition of the products of its clients in order to enable them to participate in the urban markets. It is concluded that MSEs have important role to play in the rural economy. Therefore, every effort must be made to ensure the growth of these enterprises as that will create and redistribute wealth and reduce poverty situations in the rural areas.

Acknowledgements

1 The authors are grateful to the Rural Enterprise Project, which funded the survey within the collaborative relationship with the Science and technology Policy Research Institute.

2 The government policy for micro and small business has been a draft since 2002. It is hoped that the policy will be finalised soon to enable the actualisation of the evolved strategies to develop the MSE.

3 The national minimum wage was equivalent to US$1.6 and translates to US$48 per month (see http://p4.hostingprod.com/@ghanationalcouncil.org/blog/2006

4 The Rural Enterprise Project is funded by the International Fund for Agricultural Development, African Development Bank and the government of Ghana. The underlining objective of REP is design specific interventions that will support the growth and expansion of informal MSEs in order to reduce poverty among vulnerable groups in Ghana.

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A Note on Intra-Firm Trade & Offshoring in Manufacturing and Services

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1. Introduction

Increasingly, the recent era of globalization has created key roles for both intra-firm trade and trade in intermediate products. Usually, these are topics that have been dealt with separately (see Feenstra and Hanson [1996] and Brainard [1997]). In this review, we take a brief look at their interaction and possible intersection viz. transnational intra-firm trade in intermediate inputs, both manufacturing and services. In the case of the US, a key phenomenon of interest has been intra-firm imports of intermediate products and services, also known as captive offshoring.

Low-cost offshoring has long attracted many firms in developed countries. Increasingly, however, cost issues, strategic, organizational and other considerations have motivated firms in developed countries to specialize in using imported inputs and intermediate services primarily from their majority owned affiliat

es abroad, instead of from arms' length suppliers. This process of unifying offshoring with intra-firm trade seems to be particularly intense in the case of high tech sectors. Indeed, one of the signal attributes of a manufactured high-tech product today is its extensive and elaborate value-chain, the proliferating number of its component intermediate products and services, and the global, fragmented, nature of the entire production process culminating in the final output, whether a good or a service. Progress in transportation, communications and standardization, as well as global institutional changes have significantly increased the geographically dispersed nature of production. The high-tech value-chain, in particular, is now a multilateral, multinational production mosaic, involving many countries but often just one firm or a group of affiliated firms.

The phenomenon of foreign outsourcing or offshoring is no longer restricted to the manufacturing sectors. Business services offshoring has now been going on for a decade, and jobs and occupations ranging from medical transcription, through payroll to stock market research are being offshored from developed to emerging economies, with a view to importing back the "intermediate services products". As with manufacturing, this kind of offshoring also encompasses both imports from third party firms, as well as from subsidiaries and affiliates in foreign countries. Increasingly, Research &Development and innovative activity is being offshored to captive R&D centers in India, China and East Europe.

The issue of intra-firm trade is inextricably linked to the study of multinationals and of foreign direct investment (FDI). For example, Wilamoski and Tinkler [1999] show that there was a rise in intra-firm trade between the US and Mexico as a result of US FDI in Mexico. Konan's (2000) theoretical model, in particular, shows that intra-firm trade in intermediate goods implies that vertical investment complements rather than substitutes for trade. Another branch of the intra-firm trade literature deals with its determinants. For example, Helpman [1984] develops a model that generates shares of intra-firm trade as a function of relative nation size and variations in relative factor endowments. A large literature also exists on transfer-pricing and taxation issues and their relationship with intra-firm trade (Taylor [2002]), Madan [2000]). Turning to outsourcing, Grossman and Helpman [2002] study the determinants of outsourcing locations in a global economy using a general equilibrium trade model. Bardhan (2009), and Bardhan and Jaffee (2009) deal specifically with captive offshoring in services and in R&D. The choice between captive offshoring and offshoring to third parties abroad is a complex one for both manufacturing and services firms. In an age of efficient inventory control, diversified sources of supply call for immense logistical precision and reliability. Large economies of scale and scope in modern component manufacturing mean that for some firms an affiliate operation is out of the question. Strategic considerations, quality monitoring imperatives and technology transfer constraints often imply that the more routinized, commoditized components, with low-value added get sourced from a foreign contract manufacturer. On the other hand, offshoring of high-end component manufacturing, or high-skill, customized services, such as financial and legal research, for reasons similar to those listed above, is usually carried out at an affiliated facility, and the product or service then shipped back to the home country in an intra-firm transaction.

2. Intra-firm Imports of Intermediate Manufactured Goods

Figure 1 can be helpful in clarifying the relationship between imported intermediate inputs and intra-firm imports (this section is based on Bardhan and Jaffee (2005), which quantifies the relationship between the two). The full 360-degree circle represents the total amount of goods imported by the home country. The right hemisphere (quadrants 1 and 2) show intra -firm imports, either from a foreign affiliate to a home country multinational or from a foreign one to its home country based affiliate. Intra-firm trade can occur in either intermediate inputs or final goods, represented by quadrants (1) and

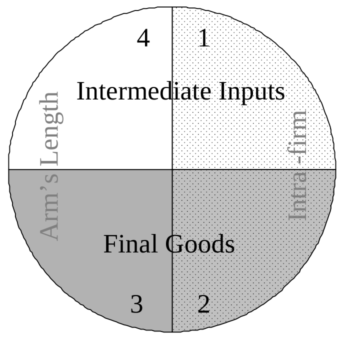
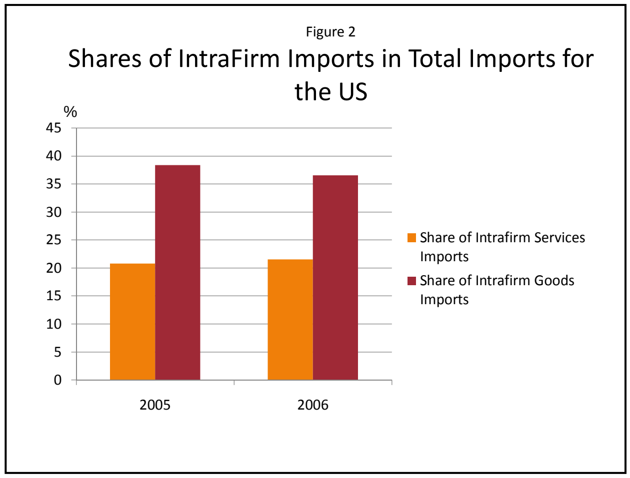


Figure 1. Total Imports into Home country, Classified as Intermediate Inputs or Final Goods and As Intra-Firm or Arm's Length Trade

(2) of the circle respectively. The left hemisphere (quadrants 3 and 4) represents imports from arms' length trading partners. Arms' length trade can also occur in either intermediate inputs or final goods (in quadrants 4 and 3 respectively).

However, the actual magnitude of the intersection of the two, i.e. the amount of imports of intermediates through intrafirm trade is not given by any dataset. The present authors in their 2005 piece mentioned above adopt a simple three step methodology under the premise that since aggregate data do not provide this information directly, data disaggregated by country of origin may be used to develop estimates. First, we compute imported intermediate inputs for the US by combining an input-output matrix based on the 1992 and 1997 US Census of Manufactures with industry import data. Import data by industry and country of origin are then used to estimate imported intermediate inputs by country of origin. Finally, we include intra-firm trade ratios for the US and its trading partner countries from the US Department of Commerce survey data supply and employ a gravity model to develop estimates for the US intra-firm imports of intermediate input products. The survey data shows that in 1997, 52 percent of all US imports were intra-firm imports and 48 percent were arms-length. Also, about 3/5 of all intra-firm imports were carried out by US multinationals, the remainder being imports by the US affiliates of foreign multinationals. More than 70% of the exports to the US from countries such as Japan are carried out through intra-firm trade, while at the other end of the spectrum, imports from Taiwan are primarily of an arms length nature.

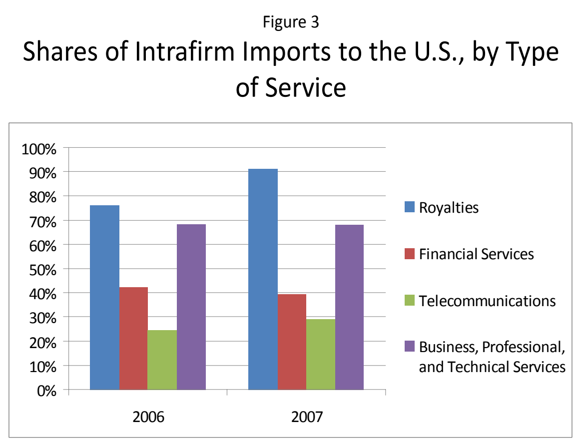
Using our first two steps, we estimate that in 1997, 38 percent of all US imports were intermediate goods and 62 percent were final goods. We then modify the standard gravity trade model, where the dependent variable is imported intermediate inputs, by including intra-firm and arms' length goods imports by country as additional explanatory variables. Our key results are: 1) Intra-firm imports were a relatively unimportant source of intermediate inputs as of 1992. Most US intermediate goods imports at that time were the result of arms' length trades.



2) By 1997, intra-firm trade, by both US and foreign MNEs had become very important as a source of imported intermediate inputs. However, arms' length trade also remained a significant determinant of US intermediate input imports. 3) Intra-firm trade (not arms' length transactions), and especially imports by US multinationals, were the key constituent of high-tech intermediate input imports, consistent with the view that offshoring has become especially important for high-tech US firms. Indeed, US firms were responsible for more than two-thirds of all imports of high-tech intermediate inputs into the US.

3. Captive Offshoring (Intra-Firm Imports) of Services

Technological advances have made possible the offshoring of jobs which do not require on-location customer service and a local presence in the high-cost developed country. Segments of the services value-chain , as well as white collar, service-oriented tasks in the manufacturing sector, such as accounting and payroll have migrated abroad, mostly to the English-speaking emerging economies, primarily India. Figure 2 shows the share of intrafirm imports in services versus goods for the US. Unlike for manufacturing we cannot carry out a similar exercise to estimate the proportion of intrafirm trade in intermediate services as opposed to final services. However, due to the distinctive nature of services listed below, there is reason to believe



that most of the intrafirm services trade is in intermediate categories.

Simple coding, testing for bugs, routinized software development, medical transcription, and similar, relatively low value-added activities were among the first activities to be offshored, and were often farmed off to arms length, third parties in India. In those cases, the possibility of complete contracting and writing-in of most contingencies, given the exhaustively known nature of the activity, its repetitive aspect and commoditization, meant that the parent firm could be secure in the knowledge of complete contractual fulfillment from the third party. The higher the activity is on the value-chain the greater the need for monitoring and control and a corresponding organizational and management solution, whether strategic alliances or joint ventures in the case of turn-key projects, systems integration for large corporate clients or captive R&D centers in the case of critical, proprietary research with potentially fragile

IP assets. Trade in increasingly complex activity dictated increasing internalization and vertical integration, and hence intrafirm trade.

As Figure 2 shows, the share of intrafirm trade in services is less than that in goods/manufacturing. A significant difference in the number and variety of inputs, and the structure of the value chain, which is not as extended as in goods production perhaps argues for less need for the intrafirm mode overall. Also, large segments of services trade are relatively recent. The growing importance of services worldwide, increasing tradability in services, and the opening up of services sectors in developing countries may alter things somewhat. It should be noted that in the four types of services recognized by the General Agreement on Trade in Services (GATS) only Mode 1 (cross-border supply) and partly

Mode 4 (supply through movement of natural persons, e.g. consulting) are compatible with intrafirm trade. The general conflation of production and consumption in the mode of delivery, customization and home country bias favor locally based sales, even if they are not generated by locally owned enterprises. For example, sales by US multinationals abroad have grown far more rapidly than exports of US services.

Figure 3 seems to suggest that the highest intrafirm shares are in those sectors, such as R&D, high-tech, consulting, information technology etc., where US multinationals have set up captive operations in Bangalore, New Delhi (in India), as well as in other cities in emerging economies, for provision of intermediate service "inputs".

Figure 4 corroborates the high level of intrafirm imports in "other private services", which include business, professional, and technical services, insurance and financial services. The high shares of intrafirm payments to India and China based affiliates reflects the intense importing activity carried out by parent firms from captive offshoring units set up by US companies in these countries. On the other hand, in the absence of disaggregated data one can surmise that the high intrafirm shares of payments to Japan and Germany are perhaps the payments of US based affiliates to parent Japanese and German multinationals headquartered there.

4. Intrafirm Trade in R&D or Offshoring of R&D and Innovative Activity

Intrafirm trade in R&D activity is the latest stage of intrafirm trade that started with manufacturing and then extended to services. In the more specific case of intrafirm imports of intermediates or offshoring, the process has climbed up the value chain, starting with offshoring of simple component production, going on to high-tech manufacturing and information technology enabled services activity, and thence to the creation of fully owned, operated and managed R&D centers of western multinationals in the relatively less costly and skill-abundant countries of East Europe, India and China.

As pointed out by Bardhan and Jaffee (2009), factors that determine the global distribution of corporate R&D activity are access to skilled labor, a functioning intellectual prop-

Figure 4

Shares of Intrafirm Trade, in Other Private Services, 2007

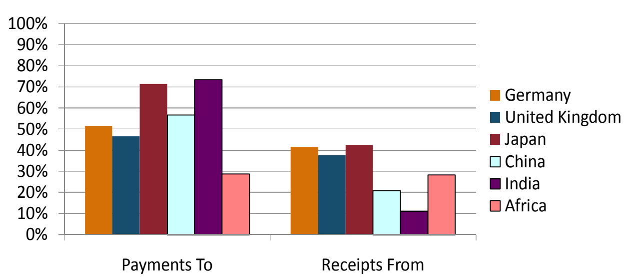
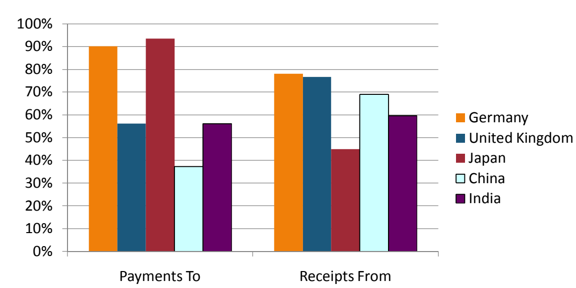


Figure 5

Shares of US Intrafirm Royalties and License Fees, 2007



erty rights regime (IPR), potential market size and sophistication in the potential target countries, and evolving business strategy of the parent firm. The organizational form of R&D trade and offshoring is determined by the critical nature of the activity performed and its uncertain returns. As both Figures 3 and 5 indicate (although intrafirm royalties and license fees may not accurately reflect intrafirm trade in R&D), wholly owned subsidiaries have been the organizational vehicle of choice for most US high tech firms engaged in product development, basic algorithmic research and research/design work of a fundamental nature. A significant number of R&D operations carried out by US firms in countries such as India, China and Russia, e.g. Intel, Microsoft, Google and others, particularly by large multinationals but also some specialized, niche high-tech firms, have been under the aegis of the parent firm, since carrying out R&D abroad under parent firm umbrella is meant to protect proprietary business secrets and intellectual property rights, thus allaying concerns of the shareholders and investors back home. Some vertical disintegration, however, has also taken place. In the case of offshoring of R&D to third parties on a contract basis, the key issues seem to be cost savings and relatively more clearly defined work at the marginal end of the innovation spectrum.

Intrafirm trade is alive and flourishing. Over the decades it has progressed from intrafirm trade in manufactured goods to intrafirm trade in services, and now in R&D. Of particular relevance have been intrafirm imports of intermediate goods and services by firms based in developed countries, or captive offshoring. They too have embraced ever more complex and high-value added activity. Indeed, technological advances and increased globalization seem to have given an added boost to cross-border investments, and increased the scale and scope of intra-firm trade.

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THE BENEFIT OF FREE TRADE AGREEMENT ON THE INTERFIRM TRADE: THE CASE OF THE JAPAN-MALAYSIA ECONOMIC PARTNERSHIP AGREEMENT

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2 Introduction

As one of the largest foreign direct investors in Malaysia, Japan has always been Malaysia's important economic partner. In turn, Japan is also an important destination of Malaysia's export products such as commodities, petrochemical, electronic and electrical products. In addition to trade relations, Japan and Malaysia have also enhanced their policy, social and cultural ties,since the introduction of the 'Look East Policy' initiative in 1982 by the then Malaysian Prime Minister Dr. Mahathir Mohamed..

The 'Look East Policy' mainly involves sending Malaysians to study and be trained in Japan, as an alternative to sending Malaysians studying and receiving training in western countries namely the United States and the United Kingdom. The Look East Policy was also used to change Malaysia's work culture and, at the same time, to further strengthen economic linkages by the signing Japan Malaysia Economic Partnership Agreement (JMEPA) on the 13th July 2006. The main purpose of the JMEPA is to scrap tariffs in all industrial goods and most forestry, agricultural and fisheries products within ten years from the date of the agreement.

The purpose of this article is to discuss the impact of the JMEPA on the intra-firm trade of Japanese companies who invest and have operations both in Malaysia and Japan. It will be examined to what extent such firms are drawing any benefits from the existence of JMEPA. The paper is divided into the following parts: Part II describes the economic relationship between Japan and Malaysia, Part III will discuss the JMEPA and Part IV will discuss the implications of JMEPA on the intra-firm trade. Part V will conclude the paper.

2. Japan-Malaysia Economic Relationship

The relationship between Japan and Malaysia has changed a lot since the Second World War. During the Second World War, the territories making up Malaysia then were under Japanese occupation, and history shows that people in Malaysia did not have a good memory of those years. The impact of the Japanese occupation in Malaysia left a lasting impression and often affected bilateral cultural relations..

However this has changed especially since the introduction of the Japanese Fukuda Doctrine in 1977 that proclaimed a transformation of the relationship between Japan and ASEAN member countries, including Malaysia, from unequal partners to equal partners. The Japanese rationale behind this shift was the insight that the development of the ASEAN region is also of crucial importance to Japan's security and economic prosperity. Historically, relations have evolved from a state of war to reconciliation and normalization, as well as from unequal cooperation to cooperation between strategic partners. Mahiwo (2008) observes that Japan's engagement in ASEAN in the last four decades shifted from selective engagement to comprehensive involvement. Mahiwo (2008) suggests that the contemporary relationship between ASEAN member countries such as Malaysia and Japan are subjected to the phenomenon of regionalism and globalisation.

In economic terms, ASEAN needs Japan as the source of investment while Japan needs ASEAN as the source of supply of certain materials to support Japanese economic growth. The pattern of key ASEAN exports to Japan indicates a highly complementary trading relationship. ASEAN is a key supplier of fuels and commodities, with shipments of Liquified Natural Gas, crude oil, wood and rubber accounting for nearly 24% of total exports in 2003. Intermediate electronic components and machine parts bound for Japanese factories accounted for another 20%, underscoring ASEAN's complementary role in the value chains of Japanese MNCs (Toh, 2007).

From the Japan-Malaysia perspective, according to the figure released by the Malaysian Industrial Development Authority (MIDA) there are more than 1,400 Japanese enterprises operating in Malaysia, and these Japanese companies have provided a broad manufacturing base in Malaysia and significantly contributed to economic growth and further development of this country. In 2006 and 2007, Japan was the No 1 investor to Malaysia. Japanese enterprises continue to be very much committed to upgrading or expanding manufacturing facilities in Malaysia. Since 2000, Japan has always been among the top three investing countries together with the United States and Singapore (see Figure 1).

A major investment area is electronic products and transportation equipment. On top of such traditional in-

Figure1: Investment to Malaysia

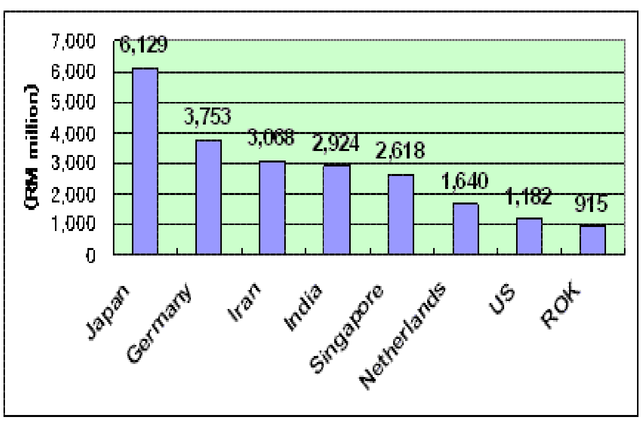
(RM million)

2000	2001	2002	2003	2004	2005	2006	2007 (10 月現在)
①US 13,849	①US 15,788	①US 7,940	①Singapore 6,249	①Singapore 3,020	①Singapore 3,958	①Japan 11,195	①Japan 6,129
②Japan 3,613	②Japan 5,315	②Singapore 5,623	②US 4,765	②Japan 2,558	②US 2,878	②US 3,077	②Germany 3,753
③Germany 3,378	③Singapore 4,462	③Japan 4,146	③Japan 4,685	③US 1,904	③Japan 2,067	③Singapore 3,015	③Iran 3,068
④Hong Kong 1,798	④Netherland 772	④UK 679	④Hong Kong 2,768	④Hong Kong 1,765	④Germany 1,593	④Germany 1,735	④India 2,924
⑤Singapore 1,746	⑤UK 677	⑤Netherland 423	⑤Saudi Arabia 810	⑤Germany 1,136	⑤Hong Kong 1,170	⑤Hong Kong 1,381	⑤Singapore 2,618
⑥UK 836	⑥Germany 384	⑥Germany 411	⑥UK 589	⑥UK 736	⑥UK 942	⑥Canada 1,238	⑥Netherland 1,640

(Source: MIDA)

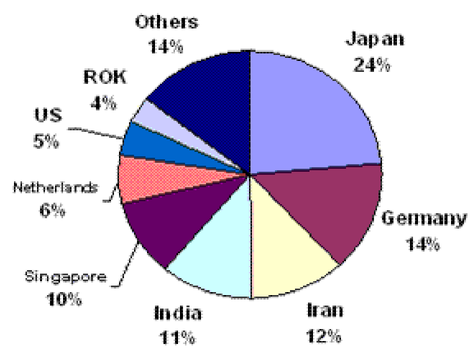
vestment in manufacturing sector, Japanese investment in various services has also been increasing; recent projects include retail sector and logistics, such as AEON and Jusco Supermarket. According to MIDA (Malaysian Industrial Development Authority) Japan's investment approved in manufacturing sector, has reached 6.1 billion Malaysian Ringgit, or 1.75 billion in US dollar in 2007 (Figure 2). The figure is 39% larger compared to the figure in 2006. Japanese investment projects, approved by MIDA, consists 24% or one-fourth of total manufacturing investment into Malaysia.

Figure2: Approved Investment in Malaysia (January-October 2007)



(Source: MIDA)

Figure3: Share of Approved Manufacturing Investment in Malaysia (January- October 2007)



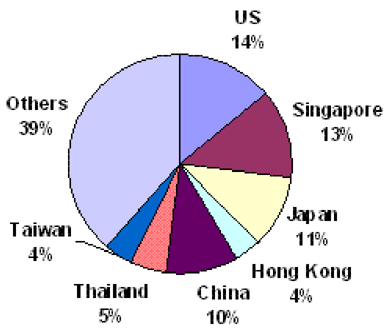
(Source: MIDA)

Regarding bilateral trade between Malaysia and Japan, Japan is the third largest trading partner for Malaysia. Bilateral trade between the two countries makes up 11% of total trade volume of Malaysia (Figure 4).

(Total of Export and Import, January-September 2007)

Throughout the last several years, Japan has been the third largest export market for Malaysia and Japan has also been the top import source for Malaysia.

Figure 4: Malaysia's Major Trading Partners



(Source: Department of Statistics, Malaysia)

3. Japan Malaysia Economic Partnership Agreement

The economic relationship between Japan and Malaysia was further strenghtened by the signing of the Japan-Malaysia Economic Partnership Agreement (JMEPA) in 2005 that came into force in 2006. The signing of the JMEPA is part of Japan's change of focus from multilateralism to bilateralism.. Japan's change in focus to bilateralism is due to several factors such as the slow progress of the multilateral trade negotiations, especially the slow progress of the Doha Development Agenda and other issues such as the multilateral negotiations under the General Agreement on Trade in Services and the slow progress or non acceptance of the Singapore Issues which include investment, competition and government procurement by certain countries. Japan's change in focus is also due to the need to balance the interest of Japanese trade against the greater interest signalled by trading powers such as the US and the European Union (EU) to focus on bilateral trade agreements.

In 1997, in response to Japanese corporate concern regarding discrimination in the Mexican market arising from NAFTA and the EU-Mexico FTA, the Japan External Trade Organization (JETRO) embarked on a joint study with Mexico on the feasibility of a Japan-Mexico FTA which then became Japan's first bilateral trade agreement.. Furthermore, in 1999, JETRO-IDE (Institute of Developing Economies) decided to start a joint study with the Korean Institute of International Economic Policy (KIEP) on a Japan–South Korea FTA, and official FTA-related negotiations commenced in 2002. In the meantime, Japan signed an economic partnership agreement with Singapore in January 2002, representing Japan's first departure from multilateralism. Japan's Task Force on Foreign Relations, in its report to Prime Minister Koizumi Jun'ichiro in November 2002, recommends that Japan's economic strategy be defined by a closer partnership with ASEAN, to serve as a counterbalance to the emerging economic presence of China.

In December 2002, Malaysia proposed JMEPA. Negotiations started in January 2004, and in May 2005, both parties agreed in principle on the major elements of JMEPA, including a free trade agreement. Japan and Malaysia signed the JMEPA on 13 December 2005. The scope of JMEPA includes trade in goods and services, investment, customs procedures, movement of natural persons, intellectual property, competition policies, and bilateral cooperation in the fields of agriculture, forestry, fisheries and commodities, education and human resource development, information and communications technology, science and technology, small and medium enterprises, tourism, and environment.

JMEPA includes the ambitious goal of eliminating import tariffs on goods within 10 years. For Japan, the agreed modality for tariff reduction and elimination of tariff lines are categorized into two categories: A - custom duties will be eliminated on the date of entry into force of this agreement, that is July 2006 R - custom duties will be renegotiated on the occasion of the general review of the JMEPA. For Malaysia, the agreed modality for tariff elimination will follow the following categories: A - custom duties will be eliminated on the date of entry into force of this agreement, that is July 2006 B7 - custom duties will be eliminated in 8 equal annual instalments from the base rate to zero, starting from the date of entry into force of the Agreement.

4 JMEPA and the Japanese intra firm trade

Cross-border trade within multinational companies and their affiliates, often referred to as "intra-firm" or sometimes "related party" trade, accounts for a large share of international trade in goods. Intra-firm trade accounts for around one third of goods exports from Japan and one-quarter of all Japanese goods imports (OECD, 2002). Much intra-firm trade between high-income countries is probably of nearly finished goods destined for affiliate companies that are mainly involved in marketing and distribution with little additional manufacturing processing taking place. There are, however, some middle-income countries where intra-firm trade with rich countries accounts for a high share of their bilateral trade. The primary role of the foreign affiliates located in such countries is more likely to be manufacturing to produce goods that are destined for other markets, including the country of the parent company.

A large part of intra-firm trade is of finished goods with foreign affiliates mainly engaged in marketing and distribution activities. Nevertheless, the increasing importance of foreign direct investment flows, particularly to low- or middle-income countries from the most advanced economies, and the increasing number of supertrading economies, together suggest that the trends in intra-industry and intra-firm trade also partly reflect the increasing importance of the internationalisation of production. Japanese companies are very much involved in outsourcing of parts and components especially in the electronic and automotive sector.

Many East Asian and Southeast Asian developing countries have encouraged multinational affiliates to enter their markets through foreign direct investment (FDI) (ADB 2006). These multinationals are also involved in the production sharing and the rise in production sharing, where different countries contribute towards the production of different components of an end product has become particularly noticeable since the mid-1980s. For example, developing Asia's share of world trade in parts and components rose from 16% in 1992 to 32% in 2003, exceeding the share of the North American Free Trade Agreement (NAFTA) and equaling the share of the EU in 2003 (Athukorala and Yamashita 2005). Despite the significant volume of trade in parts and components within developing Asia, the ultimate destination for most final assembled products remains outside the region, chiefly in the markets of the EU and US. In fact, recent empirical research demonstrates that developing Asia is growing more, not less, dependent on these large markets for final consumption of the outputs of the Asian production networks (ADB 2006).

It can be argued that the free trade agreement has little impact on the decision by firms whether to increase investment (ADB 2006) or to increase the intra-firm trade. In some cases, the margin of preference offered by tariff concessions in a free trade agreement has been too small to compensate firms for the costs of complying with the rules of origin that are necessary to enforce these agreements.. Rules of origin normally is a prominent part of a regional or free trade agreement. Rule of origin is specifically covered in the JMEPA and also the AJCEPA. For example, less than 10% of all intra-ASEAN trade is under the ASEAN Free Trade Area's common effective preferential tariff (CEPT) scheme (*The Economist* 2004). Obtaining an AFTA certificate of origin is apparently difficult in terms of paperwork and costly because it necessitates face-to-face meetings with customs officials, so many ASEAN businesses just chose to pay the MFN tariff (ADB 2006).

However the free trade agreement may have an impact on the intra-firm trade in high-tariff sectors such as automobile as it is worthwhile to obtain the certificate of origin but this is not the case in sectors where tariffs are low or duty drawback is available for imported inputs that are used to produce products for export (e.g., electronics and office equipment) (ADB 2006).

This argument is backed by a study by Kinoshita et al (2004). Kinoshita et al (2004) finds that a free trade agreement had not visible impact in the intra-firm trade and investment decision in the electronic industry and petrochemical industry among Japanese firms in Malaysia. In the electronic industry there are two layers of productions, finished products and components.

However the free trade agreement has an implication on the automobile industry (Kinoshita et al 2004) where, companies produce specific items in specific countries which are exported to every other country in ASEAN. Japanese automobile-related industy will also use AFTA as they are engaged in the intrafirm trade not only on components but also on finished automobile units. The potential impact of the FTA on the automobile industry is not insignificant. It will have a greater impact on the automobile industry than the electronic or the petro-chemical industry.

One of the most significant outcomes of the JMEPA negotiations is that Malaysia has agreed to eliminate tariffs on knocked-down auto parts for Japanese carmakers in Malaysia, which are basically cars that is later assembled in the importing country, and to completely eliminate tariffs on Japanese finished cars by 2015, starting first with the high-end larger car market segment. Since the domestic car market has long been protected by Malaysia, this can be seen as a positive step in liberalizing this sector. The JMEPA will allow Japanese carmakers direct entry into one of ASEAN's largest car market.

5. Conclusion

In conclusion JMEPA is an important instrument for both Japan and Malaysia to increase both the trade and also the investment between the two countries. It is still too early to predict the effectiveness of the free trade agreement on the flow of trade between the two nations or the usability of the free trade agreement by the exporters in the two countries. However it is predicted that the free trade agreement has little impact on the firms' investment decision as it has little impact on the intra firm trade apart from the automobile industry. Nevertheless one could be worried that the increase in the intra- firm trade would result in the lesser benefit from the FTA like JMEPA as firms may avoid more investment and trading in order to avoid technology spill overs into the local economy.

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CARIFORUM-EU EPA: THE LIBERALISATION OF FINANCIAL SERVICES AND IMPLICATIONS OF THE FINANCIAL CRISIS

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Cariforum**-EU EPA: The Liberalisation of Financial Services and Implications of the Financial Crisis

1. Introduction

As the champions of free trade resort to protectionist and other trade distorting measures, including government bailouts of companies in trouble, attention is once again drawn to the controversial signing of the Economic Partnership Agreement (EPA) between the CARIFORUM states and the European Union which is requiring liberalization of various sectors including sensitive ones like financial services. The financial crisis has shown how greed, recklessness and slack lending standards led to the collapse of prominent banks, resulting in the collapse of global stock markets, the shrinking of world trade, the loss of many people's life savings, the plummeting of demand, increased unemployment and a decrease in production as factories shut down. The financial times reported that the US economy lost more than half a million jobs in January for the third month running.

This brief examines the chain of events that led to the financial crisis and looks at the financial services chapter of the CARIFORUM – EU EPA pointing out problematic provisions in the context of the global financial crisis and the ability of countries to retain a financial sector that contributes to economic development.

2. The Overall Economic Context Related to the Financial Crisis

2.1 The subprime mortgage issue

Subprime lending involves financial institutions providing credit to borrowers who have a heightened perceived risk of default, such as those who have a history of loan delinquency, those with a recorded bankruptcy, or those with limited debt experience and encompasses a variety of credit types, including mortgages, auto loans, and credit cards. The term "subprime" under mortgage lending in the U.S, is applied to non conforming loans, defined as those that do not meet the guidelines of the two government-backed mortgage institutions namely: Federal National Mortgage Association (**Fannie Mae**) or The Federal Home Loan Mortgage Corporation (**Freddie Mac**), using the criteria aforementioned.

However, in 2006 the *Wall Street Journal* reported that 61% of all borrowers receiving subprime loans were eligible to qualify for prime conventional loans, alleging that some lenders engaged in unorthodox lending practices such as deliberately targeting borrowers who may not have fully understood the terms of their loan, or lending to people who were never likely to afford the interest payments in the long-run. Many of these loans included exorbitant fees and hidden terms and conditions, and they frequently led to default, seizure of collateral, and foreclosure. In other situations, borrowers eligible to buy a house at the beginning when the variable interest rate was low, later failed to pay the required down payment, in the stipulated timeframe, as a result of dishonest/greedy bankers wanting to make higher returns through raising the variable interest rate. This also led to pre-mature default, seizure of collateral and foreclosure.

3. The Financial Services Chapter Of The Cariforum -EU EPA

For the Signatory CARIFORUM States, notwithstanding the initial request by the EC, the financial services sector was one of the few sectors where there was limited liberalization since it was deemed sensitive. The sectors liberalized reflect the de facto position or are sectors chosen by government to be in need of further investment. In this regard it can also be noted that with the exception of Belize all other CARIFORUM States have made GATS commitments/offers in this sector, therefore in the EPA to meet the demand of the EC, Belize scheduled a commitment in actuarial services.

Since the CARIFORUM states used the GATS format for scheduling commitments under the EPA, it is important to first understand what financial services are and the key provisions that govern them.

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** *CARIFORUM comprises the 14 independent states of Caribbean Community (CARICOM), the Dominican Republic and Cuba negotiating the Economic Partnership Agreement (EPA) on behalf of the region with the European Community.*

4. Financial Services In The GATS Context

The GATS Annex on Financial Services defines Financial Services as "....any service of a financial nature offered by a financial service supplier of a Member," with the exclusion of state-owned or state controlled entities. Examples of Financial Services include banking, insurance and insurance related services, advisory services providing financial information, asset management, brokerages, to mention but a few.

Under the GATS, trade in Financial Services is governed by the obligations of Transparency, the MFN principle the Annexes on financial services (which by annexure to the GATS, are integral parts thereof and as laid out in the Articles on Market Access and National Treatment.

Liberalisation under the GATS is determined by the scope of sector specific commitments scheduled by each individual Member on the basis of provisions on Market Access and National Treatment, subject to limitations scheduled. It is important to note however that many developing countries have situations where de facto market access is more liberal than what they have bound under the GATS (which gives them room to retain policy measures that may not be consistent with the core rules mentioned here below especially as they relate to specific commitments. It is also worth noting that the recently signed CARIFORUM - EU EPA also imposes GATS PLUS obligations-which creates obligations over and above those in the GATS.

5. Core Rules, Regulation And Sector Specific Commitments of the Financial Services Chapter of Cariforum – EU EPA

The core rules of the Agreement include the Market Access (MA), National Treatment (NT) and Most Favored Nation (MFN) principles. The principle of MA requires the parties to accord to each other treatment no less favorable than that provided for in their schedule of specific commitments. In addition, similar to the GATS, it also sets out measures which either party shall not maintain or adopt unless specified in their schedules.

In accordance with Article 68 and 77 of the EPA, the Parties are required to grant National Treatment in sectors where Market Access has been scheduled. This is subject to the conditions and qualifications set out in the schedule. Therefore in all sectors scheduled, unless the Parties have regulations which discriminate in favor of their nationals and have inscribed them in its schedule, they will have to give the same treatment to non-nationals. On reading of the schedule one can see that in many cases the Signatory CARIFORUM States scheduled UNBOUND to give them the flexibility to continue to regulate the activities under the financial services sector. However, the vagueness of the term "like" within the definition of National Treatment in Article 68 can create confusion in practice as it is unclear what level of similarity the Article contemplates – for example,. It is not clear if even micro finance insitutions would be treated as 'like' banks for purposes of this article, even though they provide different services but are also majorly involved in the practice of lending money to consumers. This would widen the scope to unknown proportions.

As it pertains to the MFN principle in the EPA, the EC is to provide no less favorable treatment to the Signatory CARIFORUM States than they accord to any third country that they conclude an economic integration agreement with. The Signatory CARIFORUM States too are to provide no less favorable treatment to the EC than they may accord to any major trading economy that they conclude an economic integration agreement with. This has strong implications for potential south south trade in services as many major developing countries would be included in the mentioned thresholds.

In Chapter 5 of the EPA, which addresses the issue of regulatory framework, there are requirements similar to the GATS obliging the Parties to establish enquiry points to respond to requests on information and measures which pertain to or affect the Agreement. Also, Article 87 of this section states that where authorization is required, the competent authorities shall within a reasonable time after the submission of a complete application, inform the applicant of the decision concerning the application. This will no doubt introduce a human resource burden on the Signatory CARIFORUM States, and to Africa and Pacific if they sign on to similar Agreements and so the need for technical and financial assistance to alleviate this burden is urgent.

Specific to the regulatory framework on financial services, section 5 of the EPA goes beyond the GATS by adding provisions on effective and transparent regulations, new financial services, data processing and specific exceptions. Article 105 of the EPA, calls for effective and transparent regulation, requiring Parties to endeavor to provide in advance to all interested persons any measure of general application. In addition the Parties shall also endeavor to implement and apply internationally agreed standards for the regulation and supervision of financial services. As Sauvé and Ward put it, the provision stays a best endeavor clause 'only as CARIFORUM countries perceived it as an attempt to regulate their financial services industry through the backdoor by making them comply with OECD country standards in this area. This issue remains a sensitive one in the region owing to past tensions between some CARIFORUM states and the OECD over matters of tax policy, offshore financial market regulation and money laundering". Africa and Pacific negotiations can draw on this to ensure that the regulatory requirements that they are not in a position to adopt remain best endeavor language, giving them the regulatory space that will be needed to develop their own required regulations.

The EC was the demander for further liberalization in Financial Services, particularly in new products hence the inclusion in the text of New Financial Services. Their level of liberalization though is inconsistent with their requests as new products such as futures and derivatives essentially require a Mode 1 commitment and all EC Member States have scheduled UNBOUND. Unlike the CARIFORUM States, the EC have an obligation to the implementation and application of the OECD regulations and therefore may have scheduled such limitations in Market Access to avoid having to grant automatic National Treatment requirements. It must also be noted that in accordance with Article 107 of the EPA, Parties are required on adoption of adequate safeguards measures to permit financial service supplies to transfer information for data processing where required. This must be taken considering that there is, like the GATS, a prudential carve-out, which allows the Parties to maintain regulations for prudential reasons and not to disclose any confidential or proprietary information in the possession of public entities.

For CARIFORUM only 7 Signatory States scheduled commitments in life, accident and health insurance services, and services auxiliary to insurance, with limitations of UNBOUND for Modes 1 and 2 in three (3) States and NONE in the other four (4). Similarly for Mode 3, there are three (3) Signatory States with no limitations and four (4) with limitations. Similar to all other CARIFORUM scheduling for most of its commitments, Mode 4 is UNBOUND except for key personnel and graduate trainees. The other areas under insurance services where there are commitments are actuarial and consultancy services.

Under banking and other financial services activities, with the exception of money broking service, Signatory CARIFORUM States have made commitments. In regard to non-life insurance services, there are seven (7) Signatory States with commitments. For Mode 1 there are four (4) Signatory States with UNBOUND and three (3) have no limitations. For Mode 2 there are (3) Signatory States with UNBOUND and four (4) with no limitations. With the exception of Dominica where it is UNBOUND and NONE from 1st January, 2018 and Jamaica where there is a regulatory requirement, Mode 3 is open. Mode 4 is as stated above in the discussion on life insurance services. The activity of Reinsurance and Retrocession is where all Signatory States, with the exception of Belize, have commitments. In this regard it must be noted that all other Signatory CARIFORUM States with the exception of Guyana and St. Kitts & Nevis have commitments/offers in this activity under the GATS.

An examination of the EC commitments in the financial services sector shows that the markets of the EC also still remain fairly closed. For Mode 1 in Insurance and Insurance related services, with the exception of Estonia, all other EC Member States have scheduled limitations. In Mode 2, twenty-four Member States have also scheduled limitations. As it pertains to Mode 3 while there are only (12) Member States with specific limitations in Insurance and Banking services, there is an EC wide limitation for Banking and Other Financial Services. In Mode 4 only Key Personnel are allowed with limitations in only 5 Member States. In particular, when one considers the limitation on residency and nationality which requires that persons participating in these activities must either be a resident or national of an EC Member State, the lack of access is blatant. This must be considered in light of the fact that in accordance with Article 60 on objective, scope and coverage it is clearly stated that the Agreement does not apply to measures regarding citizenship, residency or employment on a permanent basis. It is therefore to the discretion of the Member states to allow access on these terms.

6. Policy Actions Taken By Developed Countries in Response to The Financial Crisis and Implications Thereof.

The report by the Director General of the WTO on trade and the financial crisis warned that even though members have not resorted to full fledged protectionism during the ongoing economic turmoil, they eventually will through raising new trade barriers to protect domestic industries, even while respecting their WTO commitments. Therefore, Governments that are trying to shield their domestic producers from the brunt of the economic crisis by closing their borders to competing markets might in due course stifle trade and serve to aggravate and prolong the economic crisis, as was evidenced by the rapid rise of protectionism in the 1930's that transformed what started as a recession into the deepest economic depression of the 20th century. Almost all developed countries have adopted policy measures to deal with the effects of the crisis to their economies – measures which will eventually restrict or distort trade as elucidated above and that also discriminate against developing countries that cannot afford to provide domestic producers support at that level.The measures taken range from nationalisation of banks and lowering lending rates, to participation in guarantee and recapitalisation schemes. A few detailed examples are listed below:

The United Sates has expended the greatest amount of relief. The most well known of these measures was the Troubled Asset Relief Program (TARP), which allowed for the Secretary of the Treasury to purchase troubled assets from nearly any financial institution, with US$ 700 billion available pending additional approval. Rescue packages were issued to lending giants Fannie Mae and Freddie Mac as part of the larger Housing and Economic Recovery Act of 2008, as well as to American International Group. In return for assistance and recapitalisation totalling over US$ 120 billion, the US received an 80% stake in AIG. Financial aid was made available to GMAC, and a capital injection / guarantee scheme for troubled assets was provided to Citicorp in the amount of approximately $US 326 bn. Additionally, an expansion of the TARP program under former President Bush allowed for relief to the ailing American auto industry. Currently, the Congress has approved the American Recovery and Reinvestment Act of 2009, an US$ 819 billion program aimed to provide economic stimulus in the form of money for infrastructure projects to inject cash back into local economies and stimulate job creation. The US has additionally lowered key lending rates and pressured banks to pass on low rate loans to consumers. An important feature of some of the conditions attached to these bailouts are their accessibility only to American companies. This would raise a national treatment question-which if applicable in a sector where specific commitments have been made, would be problematic. An important consideration for countries engaged in the EPA negotiations.

The EU has moved largely towards municipal rule of regulation, with individual countries taking action to enable lending, while borrowing to sustain economic growth:

⇒ Belgium benefited the KBC Group with a recapitalisation scheme of €3.5 billion, as well as a state guarantee for the Fortis Bank. Belgium also participated in a joint guarantee scheme for the Dexia financial group with France and Luxembourg.

⇒ France instituted a recapitalisation scheme capped at €21 billion, nearly half of which has already been used to recapitalise the top six French banks. Furthermore, France assisted authorised banks, including foreign subsidiaries, with credit refinancing in the amount of €265 billion. The program will specifically issue State-backed securities to promote lending to credit institutions against collateral. In February 2009, the French government proposed a €26 billion economic stimulus plan designed to make expansive improvements to French infrastructure and educational facilities.

⇒ Germany instituted wide ranging relief, including recapitalisation and guarantee schemes, as well as a temporary acquisition of assets totalling €500 billion for approved banks, insurers, pension funds, stock and derivative exchanges and investment companies.

⇒ Italian response to the crisis included both a recapitalisation of fundamentally sound banks and a guarantee for solvent banks authorised in Italy, including foreign subsidiaries.

⇒ In the Netherlands, the states response was the nationalisation of Fortis Bank Nederland and ABN AMRO Bank Nederland. Recapitalisation was provided to Aegon N.V., SNS REAAL, as well as to ING Groep N.V. in the cumulative amount of nearly €14 bn. The Netherlands also created a guarantee scheme for all solvent financial institutions with significant activities within the nation, including foreign subsidiaries.

Trade analysts have warned however that protectionism can manifest in various forms, one being through retaliatory actions by Members at the WTO, instigated as a result of their trading partners selling their exports at artificially low prices (an action known as dumping) through the introduction of export-subsidies during this period of turmoil. This observation was also made in the statement of the CAIRNS group to the WTO in which they call on the EU to repeal its decision to offer subsidies for diary products leaving the EU, stating "Increasing trade-distorting measures and protectionism in a time of a crisis carries a very high price....[and is]... likely to drive international prices down to artificially low levels and, at the very least, prolong the current downturn''

7. Linking EPA Services Provisions and the Regulatory Interventions Adopted By Developed Countries in Response to The Financial Crisis

The ability of developing countries entering into an EPA to modify or withdraw their commitments in the financial services sector as a means or consequent to a policy response to a financial crisis is anchored on provisions in the agreement justifying such modification or withdrawal. In this case, Article 105 on the 'Prudential Carve-out' is the most relevant provision. While a similar provision in the GATS has been generally interpreted by the WTO Membership as having a very broad and comprehensive scope such that practically any type of measure applicable to the financial services sector is deemed encompassed by the carve-out, it remains an open question whether a similar interpretation will be accorded to the 'Prudential Carve-out' by the parties to an EPA. If a GATS-type interpretation is mutually agreed, then developing countries can seek cover under the provision when taking measures which may be inconsistent with their financial services commitments. Otherwise, such inconsistent measures may be susceptible to dispute.

The EPA could also have a negative effect on financial stability in developing countries. As mentioned above, Article 106 imposes an obligation to allow the entry of EU suppliers of new financial services if CARIFORUM states allow their own financial service suppliers to do so. This erodes a countries ability to provide preferences through favourable domestic regulation to domestic providers of new financial services, forcing them to compete with already established entities in the developed world and could also stagnate the domestic infant growth of such service providers in the CARIFORUM states. If a new financial service is made available in a Caribbean country, the country must also allow European financial institutions to supply the new service in the Caribbean country, if this finance service activity had been liberalised in the EPA. This is particularly concerning in a situation where new financial services consists of heavily complex processes that regulators in the most efficient of jurisdictions have failed to catch up with. Africa and the Pacific where regulation is only being developed would do well to think carefully about their capacity to oversee these new financial services prior to considering the liberalisation of financial services in the EPAs.

The financial services chapter also allows for the mandatory free movement of capital and current payments and the definition of the term *financial services* also covers a wide range of activities, in insurance and banking, including trade in foreign exchange, derivatives including futures and options, exchange rate instruments, securities and asset management. All these areas have financial service activities that have been liberalised. These provisions put the onus on developing countries to undertake obligations, in market access and rules, in areas such as Government Procurement, Competition Policy and Investment, which are necessary for the development of strong regulatory rules for the financial sector and also to avoid the problem of instability that new financial services may generate. It is important to note that Government Procurement, Competition policy and investment were rejected as negotiating topics in the WTO since developing countries felt that rules in these areas would infringe on their sovereignty and the right to regulate.

Since Title II governs the provisions on Investment as well as trade in services, the fact that this EPA creates a legally binding agreement which locks in establishment rights and national treatment for foreign investment and investors is damaging to the development interests of developing countries Also, the reservations listed by the EC where commitments were made, impose barriers to CARIFORUM financial services suppliers seeking market access in the EU.

The financial crisis itself is a lesson on the dangers of deregulation and liberalisation and the section above, which elucidates the chain of events that led to the financial crisis, shows the dangers that resulted from big economies like the U.S introducing and failing to regulate new financial services and instruments such as credit derivatives and securitised debt, as well as other activities practised by financial institutions. If a CARIFORUM country that had liberalised financial services in the EPA were for example to newly allow a hedge fund activity domestically, it would have to allow hedge funds from EU countries to enter and introduce similar services. Since the European institutions are much larger than the domestic hedge fund, the risks to the economy by this liberalisation would increase manifold.

The safeguards contained in the CARIFORUM- EU EPA in regard to financial liberalisation are not sufficient either, as they are limited to enforcement during periods of crisis. For example, they cannot be used to limit the movement of current payments unless there is also a balance of payments crisis At this juncture one can only advise on the importance of regulation for the financial sector, the necessity of sequencing liberalisation undertaken and the need for countries to design and develop strong policies based on their individual economic growth index.

8. Learning from the Crisis – Lessons for Ongoing ACP Negotiations

While monetary policy, e.g., interest-rate setting, are not necessarily the subject of trade liberalization commitments in the financial services sector, the entry of foreign financial institutions as a result of such liberalization can contribute to the exacerbation of some of the negative effects of undue expansionary monetary policies. For example, foreign financial institutions establishing commercial presence must generate revenue by using the capital at their disposal. In a climate of expansionary monetary policy, this translates to increased money supply being made available at easy credit terms, thus fuelling consumerist behaviour. This consumerist behaviour may of course be curbed if the regulations governing access to credit were well thought-through or even exist in the first place. If these regulations do not exist or are not yet well-developed, as is the case with many African and Pacific countries, and the establishment of commercial presence occurs under a bound commitment, the host government will have difficulty imposing regulations governing credit unless these are imposed on a non-discriminatory basis, i.e., on both domestic as well as foreign financial services suppliers.

The related experience of some countries with 'housing bubbles' provides useful lessons. In the U.S. and United Kingdom for instance, where State policies have generally encouraged home ownership, a mix of policy tools including facilitating access to credit for purposes of purchasing real property led to a situation where credit-unworthy individuals were able to obtain loans from a deregulated home mortgage industry. The ease with which housing loans could be obtained fuelled a demand for more housing and increased housing prices, thus creating the illusion of (artificially) inflated housing values. In the U.S. especially, homeowners became brazen and took out second mortgages to fund non-productive expenditures such as vacations, cars and similar consumerist spending. Translated into the context of a bound liberalized regime for the mortgage industry, re-regulating the industry may result in an inconsistency with bound commitments.

Among developing countries such as Thailand which experienced analogous 'housing bubbles' in the past, such as that which contributed to the Asian financial crisis in the 1990s, there remains a strong reluctance to make binding commitments (in WTO negotiations) in the relevant sub-sectors under financial services because of a desire to retain the regulatory flexibility which came in handy in re-regulating and reforming the financial services sector as a way out of the crisis. Therefore, where a country has bound the existing liberalized regime without having put in place the necessary regulatory framework, or has not anticipated the harmful effects of expansionary monetary policy, the ability to regulate is restricted in the sense that any regulation must then be imposed on a non-discriminatory basis. Domestic financial institutions are then arguably disadvantaged if they have not attained a certain level of competitiveness. These domestic service suppliers for instance may have less capital and resources to cope with regulatory requirements which other, well-capitalised and resourced institutions, such as foreign financial institutions, tend to have.

Regulatory frameworks also have to allow for a certain degree of flexibility to accommodate changes in both the domestic and global business climate. This should allow revisions to regulations to be made and indeed for new regulations to be put in place. Such flexibility must however be balanced with greater transparency in the regulations in and of themselves and in the way these regulations are formulated. Often, the much-maligned element of 'consultation with interested parties' pushed by developed country trading partners in negotiations actually have significant value-added in the context of unilateral domestic policy-making and rule-making. Africa and Pacific countries engaged in EPA negotiations should therefore be cautions not only of the need to develop regulatory capacity, but also to ensure adequate flexibility within regulations so as to allow for room to respond to unforeseen circumstances such as those we see in the context of the financial crisis-a situation which seems opposed to the notion behind a full national treatment commitment for example.

The need for a degree of flexibility in regulatory formulation has a tangible example in laws dealing with securitization. Securitization provides a creative way of raising financing through collateralization of future, relatively consistent income streams. In the United States and Europe, this has allowed for instance financial institutions to raise capital through the issuance of commercial papers based on the future inflow of mortgage repayments by home buyers. Derivatives of these commercial papers are subsequently issued to raise further capital. Not only does this result in layers of financing being raised on the basis of a common income stream, but as it turns out, absence of a proper assessment of the investment risk underlying the commercial papers or securities. Increasingly, there are calls for greater regulation of these financial instruments, including rules on transparency in terms of the risk and calculation of the risk involved. This trend is one that countries engaged in services negotiations including on financial services in the EPAs need to be cognizant of, since Europe's push for new commitments in financial services seems oblivious to this reality.

In the case of developing countries which have followed or intend to follow the developed country path towards raising financing as described above, the question arises as to whether sufficient regulation exists. Indeed if, as we have seen above, developed countries erred in regulating or lacked regulatory oversight in the issuance of these financial instruments, how much more vulnerable are developing countries in committing similar regulatory errors when they have not had the same long experience as their developed country counterparts? Or when the actual reality for most of their financial regulatory systems is that they follow the institutions as opposed to the other way round. If financial services are fully bound in multilateral or bilateral agreements, then a necessary consequence may be that the regulatory flexibility of developing countries to introduce new regulation to prevent repeating the negative experience of the U.S and Europe may be curtailed.

Financial services liberalization allows not only for the establishment of commercial presence by foreign financial services suppliers but also for the introduction of financial instruments used or practiced by these institutions in their home jurisdictions. Liberalization may for instance allow for the supply of services through establishment of commercial presence by hedge funds. Hedge funds typically generate revenues through 'shorting' or selling of stocks or securities which the fund does not as yet own, in anticipation that the price of these securities will decrease in the future, thus allowing the fund to buy the securities at a lower price vis-à-vis the price at which it sold the securities previously. This practice not only entails a lot of risk for investors, but also has the potential to de-stabilise markets or at least prices of securities that are being 'shorted.' The practice could have such egregious effects especially in times of financial volatility that even the U.S. prohibited the practice in the last quarter of 2008 in regard to financial institutions.

Viewed in the context of the push in the EPAs for new financial services, the negative implications of this are clear. In the case of developing countries, undertaking binding liberalization commitments in financial services could potentially open the door for hedge funds or similar institutions which bring in practices that may have destabilising effects on securities markets. Given the greater susceptibility of financial markets in developing countries, (in terms of knock on effects on the entire economy) it would seem that an even stronger argument is made for having appropriate regulations in place or a degree of regulatory flexibility through carefully structured liberalization commitments.

9. Conclusion

To quote the economist Aaditya Matoo, 'Good regulation is a precondition for efficient competitive markets' and the economic measures being undertaken, as a result of the financial crisis, by both central banks and governments of developed countries have assumed record-book proportions proving that the forces of demand and supply alone do not suffice in regulating markets in the real economy.

Most economies of developing countries are relatively small, have weak regulatory frameworks and a lot of the economic activity is centralised in specific industries or commodities. As a result, it is difficult for these economies to spread-out risk and absorb shocks to their financial systems. Governments therefore have an important role to play in developing effective policy for financial regulation to be able to cope with the challenges that come with liberalisation of the sector.

Many economic studies show that liberalising trade in financial services does have its advantages. For example, it reduces the unit cost through increasing competition, facilitating economies of scale and reducing price mark ups, while also raising managerial efficiency. The World Bank report of 2002 also showed that increased foreign entry to the EU, by acceding Members, acted as a catalyst for improved regulation to the domestic financial sector framework. One must however question whether this would be true for ACP states which have weak regulatory structures or none at all. One must also question whether these benefits could not be obtained by the unilateral, autonomous services liberalisation existing in these small economies without committing it in an EPA context and bringing therewith the attendant risk and obligations. During a time of financial upheaval, unilateral/autonomous services liberalisation seems a safer option for developing countries if they want to obtain the benefits mentioned above, and still retain the policy space to react to changing financial circumstances because they have not bound it in an EPA.

In the CARIFORUM - EU EPA, the right of the CARIFORUM states to regulate has been infringed and narrowed further than the GATS, the latter providing countries the lee-way to pursue domestic national policy objectives through necessary regulation and macro-economic policy, where the former would not. The MFN clause contained within the EPA is also controversial as it might restrain future ACP FTAs with other emerging economies like India, Brazil and China, that are potential future markets for CARIFORUM services providers - a fact not lost on the EU as evidenced by Commissioner Michel's explanation for the MFN clause *'... it's also a question of sovereignty for Europe.... It is difficult to say that Europe should let our partner countries treat our economic adversaries better than us. We are generous but not naïve''*. ACP negotiators should therefore keep in mind that Europe has adopted a mercantilist attitude in the negotiations of the EPA's and must therefore practise caution in the percentage of liberalisation undertaken and the leverage they are giving Europe over their economies. ACP countries that already have ample market access through preference schemes which are the ones where their export potential is most credible (i.e trade in goods) should ensure that the constraints being faced in accessing those markets are first addressed before getting into services liberalisation specifically in sensitive sectors like financial services where necessary domestic regulatory frameworks are at best only growing.

The impact of the crisis will probably differ in magnitude among the ACP countries, based on their production rates, export structures, exposure to the international financial system and their potential to cushion the negative effects of the crisis. Since most of these countries, in particular the least developed amongst them are not exposed to the sub-prime markets in developed countries, disruption to the domestic credit markets might not be as grave. However, if multinational banks begin to withdraw funds from their subsidiaries – in a damage control mechanism (as the trends seem to show that they are-the impact would be huge since the percentage of foreign owned banks exceeds the domestic ones in a majority of these states. Other potential impacts for developing countries will be (i) negative effect on exports from developing countries due to decreased demand in industrial countries affected by the crisis (ii) inability to import capital and inputs needed for production in the domestic market (iii) low investments due to increased pressure on the exchange rate (iv) increased unemployment as companies go bankrupt and no jobs are created The Global Economic Prospects 2009 report of the World bank also predicts that 'Export opportunities for developing countries in 2009 were likely to fade rapidly because of the recession in high income countries and of shortages in export credits and the increased cost of export insurance'

The present global financial crisis has shown the importance of the finance sector, as well as the need for proper regulation. Introduction of new financial products such as credit derivatives or collateralized debt obligations and trading methods such as short selling of stocks and currencies or allowing the entry of financial agencies such as hedge funds and investment banks can destabilize a developing country's financial sector and economy. It would be prudent for the ACP countries to focus, now more than ever, on the need for and development of efficient regulation, prior to making any commitments in the EPAs. The 1990's show how many developing countries liberalized their financial systems under the IMF and World Bank conditionalities in the hope that this would reap huge development benefits. Instead, these countries experienced lack of growth and limited access to financial services. The major factor responsible for this was the inadequate sequencing of liberalisation reforms. At a time of negotiation of an Agreement grounded on similar principles, lessons from_ history should not be forgotten.

The road to the Financial Crisis - Chain of events

Triggers	Explanatory note
Increased consumerist spending because of easy access to credit, especially with the credit card culture and the facility to re-mortgage	This was caused by expansionary monetary policies pursued by banks forcing the lending rates down as a result of the industrial crisis of 2000/2001 that led central banks to believe that deflation might set in. this resulted in enormous liquidity for banks and financial markets
House buying bubble was facilitated by minimal or no down payment on housing loans and the low interest rates made the real estate market more attractive.	Spending beyond the budget cycle becames unsustainable due to greater uncertainty on the ability of borrowers to re-pay at a future date. The first cracks began to show through foreclosure and seizure of property
Policies setting criteria for availing of credit through Fannie Mae and Freddie Mac (hereafter referred to as FNMA's) were encouraged. Government wanted to promote the residential markets which they felt was more attractive with low risk and huge returns	Since this was coupled with de-restricting the lending market to private sector banks and mortgage companies, it resulted in competition with the government based FNMAs, with the private companies zoning in on subprime borrowers
The practise of creative financing to clear such loans from banks' balance sheets by securitising them and selling them on the global capital market through investment banks evolved as a way to raise capital	Since the securities were structured with supposed safeguards against default by individuals, they earned the good credit rating enabling the banks' use of mortgages as collateral to back up issuance of commercial papers. Banks also began the use of derivatives of these Commercial Papers as further means of raising capital.
The prices of U.S homes rose to above average rates making banks more willing to lend, while the existence of loose rules on leverage allowed investment banks and other investment entities to purchase these attractive-looking instruments at a higher value than the actual available capital	The result being that credit availability was illusory as it was based on layers of Commercial Papers and derivatives whose actual foundation in many cases was in future cash flows, with a value that was a fraction of the present credit made available
Subprime mortgage repayments became problematic resulting in lenders to the housing market experiencing cash flow problems	The value of Commercial Papers and derivatives issued on the basis of subprime mortgages became unstable and resulted in huge actual losses for holders of these instruments
Quarterly multi-billion write downs of losses for US and non-US investment banks resulted in more cash flow problems	The credit default swap market at this point picked up the signals and the effect was a further erosion of the value of Commercial Papers, derivatives and assets held by these banks. The other huge impact was job-layoffs. With the collapse of the housing market, people were also made homeless since their homes had to be sold as collateral of the mortgage. Consumerist spending also took a nose dive.
Shorting by hedge funds of stocks of banks continued to erode the value of these banks' assets, therefore stock issuance as a way of raising financing proved impossible	This led to the collapse of Bear Stearns and Lehman Brothers. Merrill Lynch got bought by Bank of America while Goldman Sachs and Morgan Stanley got capital infusion from China.
FNMA's falter was to the brink of collapse since their bonds were securitized on future cash flows and issued to raise more funds for the housing market. They were then fully nationalised	This resulted in loss of confidence among depositors. Increased anticipation of bank runs led to banks refusing to lend to one another in a bid to safeguard their own liquidity and they refused to extend the credit line for companies, which then went bankrupt. This situation is the meaning of the term 'the credit crunch'.

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1. Programme Officer Services Trade and Dispute Settlement at the International Centre for Trade and Sustainable Development. The views expressed in this publication are attributable to me and do not express the views of ICTSD.
2. Most of the measures being proposed by governments as 'rescue packages' constitute either a form of state aid or subsidy which in the long term may have negative spill-over effects on other markets or introduce distortions to the rules of competition
3. The World Banks in its report Global Economic prospects 2009 forecasts a drop in global export volumes of -2.1 percent , the first decline since 1982.
4. Financial Times dated 6th February estimates the number of jobs lost in January in the U.S to have reached 598,000, while the unemployment rate - 4.4 per cent before the credit crisis - jumped to 7.6 per cent in January.
5. U.S. Department of Treasury guidelines issued in 2001.
6. Fannie Mae's purpose is to purchase and securitize mortgages in order to ensure that funds are consistently available to the institutions that lend money to home buyers
7. Freddie Mac was created to expand the secondary market for mortgages through buying mortgages on the secondary market, pooling them and selling them as mortgage-backed securities to investors on the open market
8. Rick Brooks & Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy: As Housing Boomed, Industry Pushed Loans To a Broader Market", Wall Street Journal, December 3, 2007
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10. In 1998, the Federal Trade Commission estimated that 10% of new-car financing in the U.S. was provided by subprime loans, and that $125 billion of $859 billion total mortgage dollars were subprime – source Wikipedia
11. Expansionary monetary policy in this regard refers to situations when the Federal Reserve lowered the Funds rate to increase the money supply, thus causing mortgage rates to decline, consumers to borrow and spend and businesses to grow, which in turn led to hiring more workers who consumed even more – source http://useconomy.about.com.
12. Leverage being the ability to control a large amount of any financial instrument like a currency or stock using only a small amount of capital – source http://useconomy.about.com
13. These are financial instruments used as hedge and protection for debt holders from the risk of default. It became evident that those providing the insurance would have to pay and this heightened uncertainty across the system, as investors wondered which companies would be required to pay to cover mortgage defaults – source Wikipedia
14. A technique used by brokers/hedge funds who try to profit from a falling price of a stock through borrowing from another lender with the hope of buying the product low and reselling it at a higher value, thus retaining the profit made on the initial borrowed fee – source http://www.investorguide.com
15. UBS, the biggest private bank in the world in terms of managed assets, also got a capital injection from the Swiss Government.
16. Most -Favoured -Nation principle which prohibits Members from discriminatory practices among their trading partners – whatever treatment is accorded to one member must be extended to all.
17. GATS Article XVI
18. GATS Article XVII- defined as treatment no less favorable than that accorded to domestic services and services suppliers.
19. These are (a) limitations on the number of commercial presences whether in the form of numerical quotas, monopolies, exclusive rights or other commercial presence requirements such as economic needs tests; (b) limitations on the total value of transactions or assets in the form of numerical quotas or the requirement of an economic needs test; (c) limitations on the total number of operations or on the total quantity of output expressed in terms of designated numerical units in the form of quotas or the requirement of an economic needs test; (d) limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding or the total value of individual or aggregate foreign investment; and (e) measures which restrict or require specific types of commercial presence (subsidiary, branch, representative office)11 or joint ventures through which an investor of the other Party may perform an economic activity. As it pertains to cross border supply of services conditions (d) & (e) are not included.
20. A "major trading economy" is defined in Article 69 (4) as any developed country, or any country accounting for a share of world merchandise exports above one (1) per cent in the year before the entry into force of the economic integration agreement referred to in paragraph 1, or any group of countries acting individually, collectively or through an economic integration agreement accounting collectively for a share of world merchandise exports above one and a half (1,5) per cent in the year before the entry into force of the economic integration agreement referred to in paragraph 1. This calculation is based of official data by the WTO on leading exporters in world merchandise trade, excluding intra-EU trade.
21. Article 86, Transparency.
22. Article 105 of the CARIFORUM-EC Economic Partnership Agreement.
23. Article 106 supra.
24. Article 107 supra.
25. Article 108 supra.
26. The EC –CARIFORUM Economic Partnership Agreement: Assessing the outcome on Services and Investment' by Pierre Sauvé and Natasha Ward available at http://www.ecipe.org/the-ec-cariform-economic-partnership-agreement-assessing-the-outcome-on-services-and-investment/PDF
27. An analysis of the implications of inclusion of these new financial services comes in the following chapters.
28. This section draws on reports from CNN, BBC, CNBC, Channel 4 news, the Financial Times, Wikipedia, The Economist and the report to the TPRB from the Director General of the WTO on 'the Financial and Economic Crisis And Trade Related Developments' dated 26 January 2009-
29. The report to the TPRB from the Director General of the WTO on 'the Financial and Economic Crisis And Trade Related Developments' dated 26 January 2009-
30. BRIDGES Weekly Trade News Digest, Volume 13, number 3.
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34. http://money.cnn.com/2009/01/28/news/international/australia_export.reut/index.htm - Reuters, January 28th 2009.
35. Article 106, 2 B.
36. Professor Jane Kelsey's analysis in her preliminary draft paper on the development implications of the CARIFORUM-EU EPA, available at http://www.lawstaff.auckland.ac.nz
37. Supra at 33.
38. Under the Insurance sub-sector, for Mode 4, reservations have been listed by Austria, Estonia, Spain, Italy and Finland. Under the banking sector, Belgium, Finland, Italy, Lithuania and Poland also list reservations. No commitments were made by the EU under the categories of independent professionals and contractual services suppliers.
39. Even Article 240, which is the supposed exception, stipulates that there must be a balance of payment crisis.
40. Aaditya Mattoo's overview in the book 'Services Trade and Development: The Experience of Zambia', 2007.
41. Cecchini Commission Report 1988.
42. The Annex on financial services to the GATS, paragraph 2 (a).
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44. IMF Global Stability Report, October 2008.
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Intra-firm trade and Africa's competitiveness in the global professional services

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(ATDF)

Abstract

Many African countries have improved their legal and regulatory regimes over the last two decades to attract and retain investment to increase their participation and integration in world trade. Despite these efforts, Africa's competitiveness in trade in services remains limited. This overview highlights some of the key connections between intra-firm trade and Africa's development and competitiveness in the global economy. It shows that Africa's trade in services is small but growing while its trade in professional services is limited by the type of FDI it has been attracting. This paper uses a number of examples to highlight alternatives that could enable African countries to participate in the growing trade in business and professional services.

1. Introduction

Competitiveness may be seen as the ability of a country to achieve a sustained high rate of growth in gross domestic product (GDP) per capita or the degree to which a country produces goods and services which meet the test of international markets, while simultaneously sustaining and expanding the real incomes of its people over the long-term in a free and fair market. In a way, competitiveness is the ability to generate sustainable and relatively higher revenues from a country's investments in production of goods and services while achieving a steady rise in living standards of most of its citizens.

There are many aspects that may determine the competitiveness of a country. For instance, the World Economic Forum's Global Competitiveness Index (GCI) focuses on 9 pillars: 1) institutions, 2) infrastructure, 3) macroeconomy, 4) health and education, 5) higher education and training, 6) market efficiency and 7) technology readiness, 8), innovation and 9) business sophistication.

The first seven are thought to account for about 90% of most developing countries' competitiveness (less than $9000 per capita). Most African countries fall within this group of countries and they compete in the global market place on prices of basic commodities. According to the WEC Global Competitiveness Report 2007-2008, 19 of the 24 countries in SSA included in the assessment are among the 25 least competitive economies largely attributed to poor infrastructure, low levels of higher education and inadequate technology preparedness.

While it is acknowledged that a country's competitiveness is determined by its technological infrastructure, sophistication of its domestic demand and inward foreign domestic investment, there is some evidence that export performance in services is determined by different comparative advantages. A recent publication showed a number of developing countries (e.g. India, Egypt, Mexico and Pakistan) enjoy similar or higher comparative advantages in some service sectors than developed countries. One of the recent observations has been the rapid growth in the export of services and the globalization of business and professional services once thought to be the preserve of the headquarters of transnational corporations (TNCs).

The competitiveness of countries in professional services may be based on criteria such as:

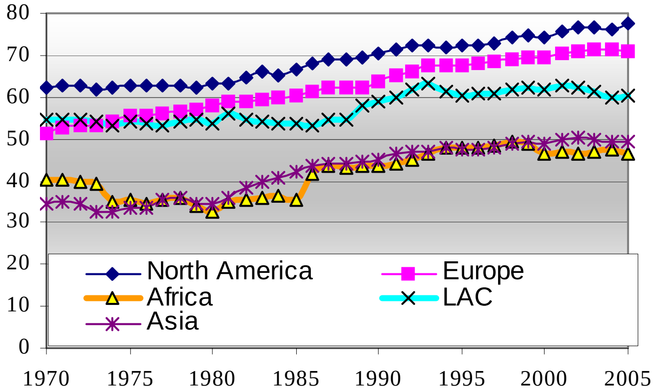
- ⇒ The ability of professional services firms to set global standards and promote good corporate governance
- ⇒ The skill levels across the economy that benefit both professional service firms and their client companies
- ⇒ A tradition for quality and expertise with flexible working practices to deliver innovative products and services and global attraction for international professional services firms
- ⇒ Exploitation of opportunities for synergies with other major professional services centres, particularly in emerging markets
- ⇒ Capacity to develop an open and constructive relationship with government.

Table 1. Comparison of key global competitiveness index scores

	N. Africa	SSA	LAC	Asia
Institutions	4.13	3.65	3.69	4.08
Infrastructure	3.53	2.45	3.25	3.12
Macro economy	4.57	4.00	4.2	4.61
Health & basic education	6.44	4.04	6.51	6.3
Higher education	3.69	2.84	3.92	4.09
Market efficiency	4.03	3.86	4.13	4.64
Technology readiness	3.03	2.71	3.42	3.3

Source: WEF (2006) Africa Competitiveness Report 2007, World Economic Forum.

Figure 1. Services as percentage of GDP (1970-2005)



Source : UNCTAD Handbook of statistics

2. Services and Africa's competitiveness

2.1 Defining services

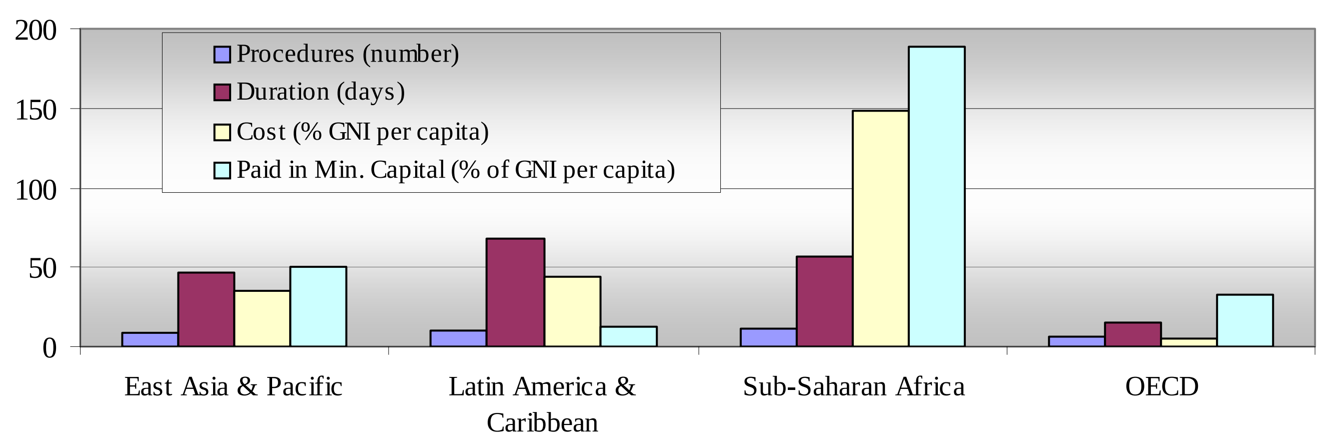
The Manual on Statistics of International Trade in Services defines services as "heterogeneous outputs produced that typically consist of changes in the condition of the consuming units realised by the activities of the producers at the demand of the customers. By the time their production is completed they must have been provided to the consumers." Services include wholesale, retail, hotel, transport, postal, telecommunication, financial, insurance, real estate, computer-related, research, professional and marketing.

Services already account for a substantial proportion of the global GDP (about 50%). Europe has seen the contribution of services to its GDP increased from about 51% to 70% between 1970 and 2005 while that of the United States increased from 62% to 78% over the same period (See figure 1). Africa and Asia are the only regions where the contribution of services to their GDPs is the lowest but has generally increased steadily from about 34% to 50% between 1970 and 2005.

The low contribution of services to GDP of Asia and Africa may be linked to the openness to FDI in the services. It was noted that restrictions on FDI in the service sectors are higher in Africa and Asia than in Latin America and the Caribbean. For example, foreign ownership limits are common in services such as banking, communication, energy and transport. In addition, many developing countries did not allow private participation, either domestic or foreign, in a number of services such as insurance, telecommunications, electricity and transportation until the privatization and liberalization movement of the 1990s. Take together, the services sector remains under-invested and uncompetitive.

It has been noted that regulatory barriers could influence the structure and concentration of industry. Firms may prefer to expand the acquisition of existing firms rather than develop independent ones in sectors or countries where regulatory entry barriers are high. Many of these are related to government services such as registration, export and import, taxation, land acquisition, licensing and judicial procedures, among others. The number, complexity and efficiency at which these services are delivered by government departments, such as revenue and company registration authorities, could increase the cost of doing business or producing goods and services (see Figure 2). Improving these services may not involve a huge investment. For instance, Mozambique now permits company registration to take place online. Such a move could also provide extra business for specialized internet cafés that could help individuals conduct name search, fill-in company forms on-line, decongest company registration offices, facilitate company formation, increase access, provide extra internet content and build confidence in information technology. With minimal investment, the cascade of benefits may be huge.

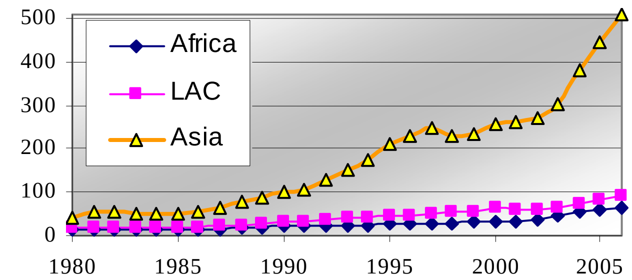
Figure 2. Starting a business: Procedures and costs



Source : World bank's Doing Business database

Services offer a helping hand to other sectors of the economy. For instance, equity financing and stock markets play a key role in raising cheaper capital for mergers and acquisitions, development of new products and the creation and expansion of enterprises. Insurance and pension schemes, in addition to helping individuals and firms to recover from disasters, provide an essential reduction of uncertainty necessary for risky investment decisions in new and emerging technologies. Furthermore, services develop the skills, knowledge and resources needed to make projects work, broker deals, protect investments and technologies, design and develop capital-intensive investment projects. Moreover, they offer employment to a large proportion of the total work force.

Figure 4. Trends in export of services ($billions)



Source: UNCTAD Handbook of

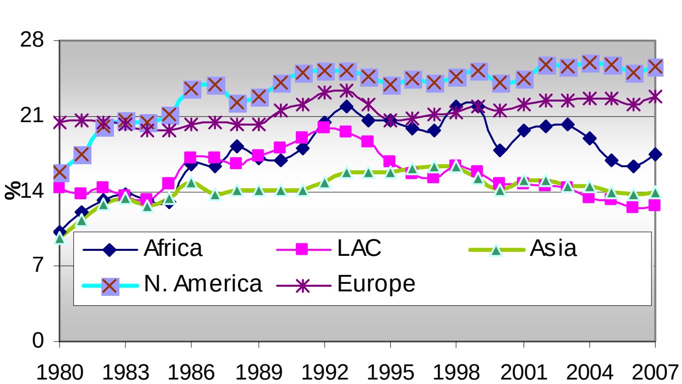
3. Competitiveness in trade in services

3.1 Trends in global trade in services

At the global level, exports of services have grown from $391 billion to $2,735 billion between 1980 and 2006 and its share of global exports of goods and services has increased from about 17% to 22% over the same period, according to UNCTAD database. At the regional level, Europe accounts for about 50% of global services exports, developing Asia 18%, Canada and the United States 17%, LAC 3% and Africa 2%. Regarding the percentage of total trade in goods and services for the regions, exports of services have grown faster for North America (Canada plus United States) and Africa (see figure 3) in the 1980s and 1990s. However, North America and Europe are the major exporters of services.

In terms of value, Asia spectacular growth in trade in services parallels its growth in exports of manufactured products. Between 1980 and 2006, Asia's exports of services have increased 10-fold from $49 billion to $509 billion (see figure 3) while that of merchandise exports increased about 6-fold (from $365 billion to $2,384 billion). Asia's share of global services exports increased from about 10.8% to 18.6% over the same period while that of Africa declined from about 3.4% to about 2.4%.

Figure 3. Exports of services as a percentage of total exports of goods and services



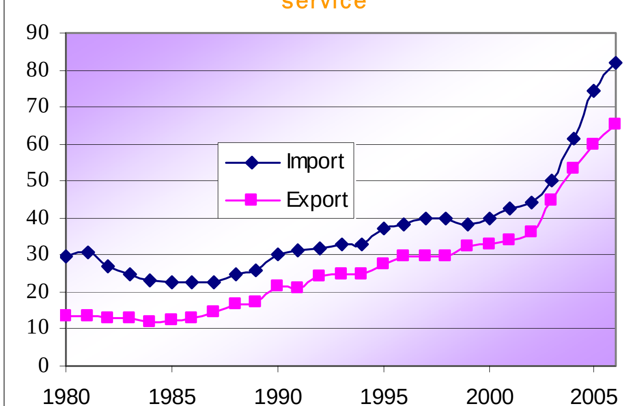
Source: UNCTAD Handibook of Statistics

Africa's trade in services is however growing fast, especially in the last five years. Exports and imports have almost doubled between 2002 and 2006 (see figure 4). There is also some relationship between growth rates of the economy in general and trade in services. More interestingly perhaps, the share of services in exports of goods and services for Africa has increased from about 10% in 1980 to about 16% in 2006 and peaked in 2002 at nearly 20%. In simple terms, Africa's export of services has grown faster than exports of goods until the last 4 years (when the commodity boom drove goods exports much faster).

The poor economic performance of most African economies in the 1980s and the limited international investment flows may have affected the service sector. The increased economic growth rates and increased liberalization in Africa's service sector in the last decade seem to have provided a stimulus for service growth and exports. Africa may have to look at services as another way of diversifying exports.

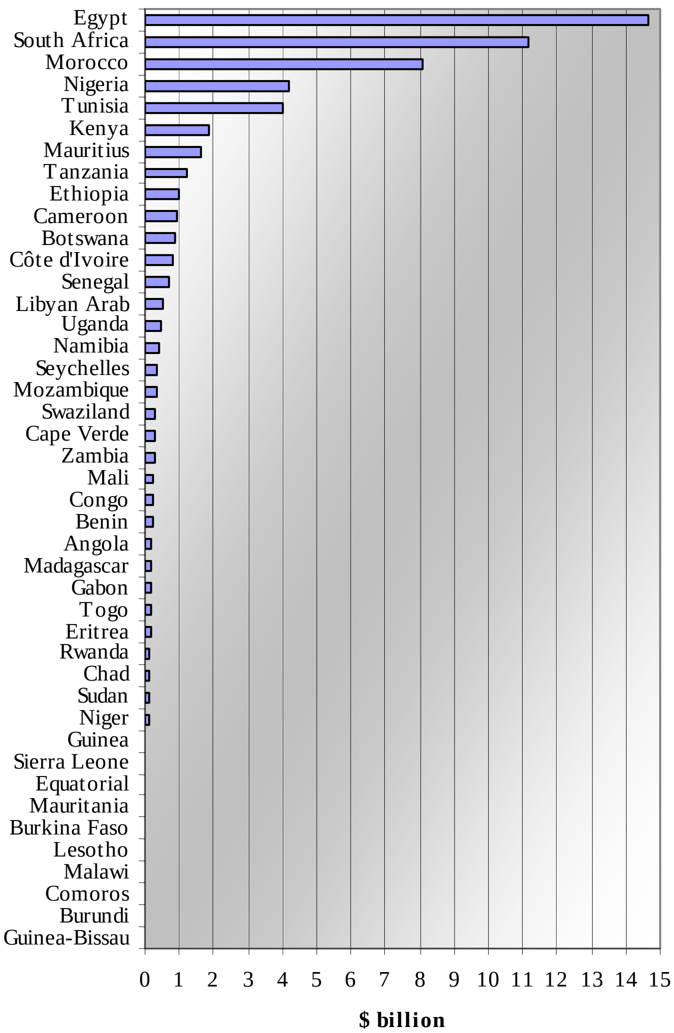
It may be important to breakdown the services exported by country and by category. At the national level, the top service exporters in Africa include Egypt, South Africa,

Figure 5. Africa: Trends in trade of service



Source: UNCTAD

Figure 6 Exports of services



Source : UNCTAD

Morocco, Nigeria and Tunisia that together account for over 70% of the continent's exports of services. There are roughly ten countries whose annual export of services is above $1 billion (see figure 5). The rest of the countries are yet to realize their full potential in trade in services.

The composition of traded services varies widely from one country to another but there are some general similarities. Here we compare two African countries (Egypt and South Africa) and two Asian countries (China and Singapore) at different levels of technological advancement and manufacturing capabilities (see table 2). In general, travel and transportation services account for over 40% of service imports and exports. All four countries are net importers of insurance, computer and information services, intellectual assets and government services.

There are wide differences too. Egypt and South Africa are net exporters while China and Singapore are net importers of services. Travel services constitute about 65% of South Africa's export of services but only 11% of Singapore's exports. In addition, South Africa and Singapore export more financial services than the other two. Royalties and licensing fees make up a larger proportion of Singapore's services imports than the other three. These differences may reflect the differences in economic, industrial, technological and financial bases of the four countries.

3.2 Trade in professional and technical services

Professional and technical services include architecture, engineering, consulting, installation, research, development, management, operational leasing, financial and

Table 2. Comparision of the composition of trade in services of selected developing countries

	Egypt		South Africa		China		Singapore	
	Imports	Exports	Imports	Exports	Imports	Exports	Imports	Exports
Transportation	37.2	28.3	42.6	14.6	34.0	19.3	35.6	36.2
Travel	15.7	43.1	30.6	65.3	26.5	41.2	19.2	11.2
Communications	*2.8*	*2.9*	*1.4*	*1.9*	*0.7*	*0.7*		
Construction	*2.1*	*2.9*	*0.0*	*0.3*	*1.9*	*2.4*	*0.5*	*1.2*
Computer and information	*0.3*	*0.2*	*0.8*	*0.9*	*1.7*	*2.6*	*0.6*	*1.0*
Insurance	*7.3*	*0.3*	*3.8*	*1.1*	*8.5*	*0.6*	*4.4*	*2.8*
Financial services	*0.3*	*0.5*	*1.4*	*4.4*	*0.2*	*0.2*	*1.3*	*5.3*
Royalties and licence fees	*1.3*	*0.7*	*8.6*	*0.4*	*6.2*	*0.4*	*15.7*	*1.1*
Other business services	*25.8*	*19.6*	*5.9*	*5.7*	*19.3*	*32.0*	*16.4*	*35.4*
Personal services	0.2	0.5	0.0	0.9	0.2	0.1	0.5	0.4
Government services	6.9	1.1	2.6	2.5	0.7	0.6	0.4	0.2
Total $ billions	**8.0**	**14.2**	**1.0**	**9.7**	**7.2**	**6.2**	**5.0**	**4.7**

Source: UNCTAD

ATDF Journal Volume 5, Issue 3/4

Table 3 Trends in the United States' international trade in business and professional services (in US$ millions)

	Receipts		Payments	
	2001	2004	2001	2004
Intra-firm	30,744	37,236	20,966	28,218
Inter-firm	28,169	33,773	9,452	12,519
Total	58,913	71,009	30,418	40,737

The United States' international inter-firm trade in business and professional services by region (in US$ millions)

	Receipts			Payments		
	1986	1996	2004	1986	1996	2004
NA (Canada)	335	1,637	3,305	283	727	2,873
Europe	1,203	6,005	13,474	467	2,634	5,224
Africa & Middle East	680	2,677	3,383	29	342	1,047
Asia and Pacific	1,319	5,929	9,170	334	1,625	2,320
Latin America & Caribbean	807	2,916	4,396	70	342	1,055

Source: US Bureau of Economic Analysis
NB: Data for trade in services between affiliated firms is available only from 2001.

analytical testing services, among others. These services may be required to upgrade skills, get the most out of capital goods imports, stay abreast with the next generation of technological developments and improve the efficiency of running a business. More importantly, services play a role in the transfer of tacit knowledge and organizational systems that are often not easy to acquire.

However, it is difficult to monitor the flows in these classes of services globally as most national governments do not seem to breakdown the import and export of services to a level where one can discriminate those that have very little to do with technology (e.g. advertisements and travel) to those likely to play a role in technology development (e.g. industrial engineering services). However, one can use the trends in the leading exporters of business and professional services to monitor emerging trends.

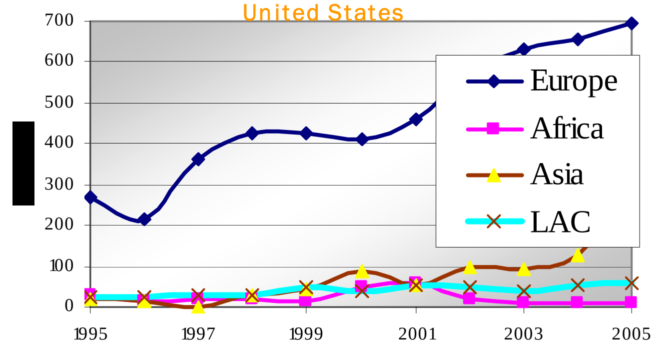
The top five exporters of global services are the United States, United Kingdom, Germany, France and Japan (in order of value of exports). The United States accounted for about 15.2% of global services exports in 2004 followed by the United Kingdom (8.1%). Though a poor proxy for several reasons (e.g. 15.2% is a small fraction, trade links could skew observations and geography can play a major role), it is perhaps one of the few sources likely to have complete information in professional services.

Trade in business and professional services between the United States and the rest of the world had grown at varying speeds, as shown in table 3. LAC's share of payment to the United States has decreased from about 18% in 1986 to about 13% in 2004 of the total, while that of Europe has increased from 28% to 40% over the same period. Similarly, the share of business and professional services provided to the United States (i.e. payments by the United States to other regions) has increased from 2.5% in 1986 to 8.4% in 2004 for Africa and the Middle East, and from 5.9% to 8.4%, over the same period, for LAC. Asia and Oceania's share has declined both in terms of exports and imports.

However, it is important to note that only business and professional services provided to or by unaffiliated firms (inter-firm) is broken by country or region, and it constitutes about 48% for receipts and 31% for payments of their respective totals. This perhaps explains why trade in services between Asia and Oceania, given the high growth of investment flows over the last 3 decades, may have declined between unaffiliated firms but is likely to have increased between affiliated firms, especially in terms of payments.

Another service that seems to be growing rapidly is trade in research, development and testing services. Although

Figure 7. Payment for research, development and testing services by the United States



Source: US Bureau of Economic Analysis

data is still emerging, there is some evidence that Asia is emerging as a major supplier of research, development and testing services while Africa and LAC are lagging behind (see figure 6). Although a lion's share of trade in such technology services is concentrated in developed countries, it offers developing countries with the basic technological foundation a chance to learn and become global suppliers.

4. Options for improving Africa’s competitiveness

4.1. Filling the skills gap to compete in services

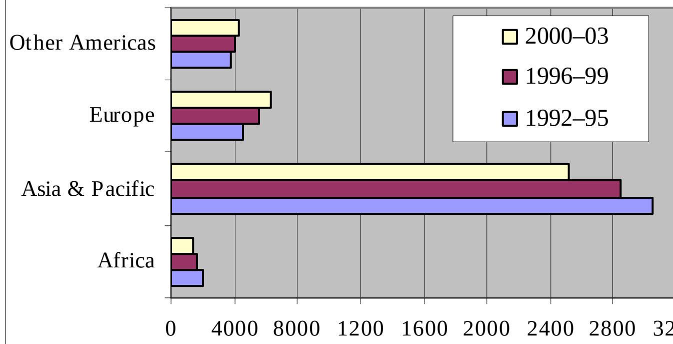
Africa's competitiveness in providing business and professional services is quite low at present as it lacks the skills and technologies needed to participate in this growing trade. Asian countries, such as China and India, have openly declared education, science and technology as the strategic engines for economic and social development. China and India have attracted the world’s major corporations and their investments, expanded post-graduate training and are specializing in knowledge-intensive services. For instance, the number of science and engineering doctoral degrees awarded by China increased from about 1,000 in 1991 to 8,000 in 2001.

In addition, China, India and Taiwan are benefiting from professionals trained or worked abroad, especially in the United States, returning home or serving home country facilities. The movement of such professionals bring business and technological alliances and understanding of global markets. Such professionals may also serve as local contacts. In the case of Taiwan Province of China, the number of returnees increased from an average of about 400 in the 1970s to about 2800 in 1990 and peaked in 1994 at about 6500. Such numbers are higher than many African countries could graduate a year.

International foreign students could also play a role in skills development in Africa. They may acquire emerging skills, develop relations and understand both home and host country barriers, among others, that could facilitate diffusion of knowledge, industrial development and promote trade and investment. For example, Africa Online, one of Africa's largest Internet Service Providers (ISP), was developed by three Kenyan students at the Massachusetts Institute of Technology (MIT) in 1994. One of the students returned to Kenya in 1995 to establish and manage the first local office, and its first major investor was an American ISP. It now operates in about eight African countries.

As the gaps between basic and applied research and experimental development narrow in some knowledge-intensive fields, international students in higher education institutions could serve as technology transferors as well as facilitators of business deals and development. Currently, about 25% of foreign students are registered in the United States, 11% in the United Kingdom, 10% in

Figure 8. Foreign recipients of United States science and engineering doctoral degrees



Source : NSF, science and engineering indicators, 2006

Germany, 9% in France and 8% in Australia, and the remainder are hosted in 126 countries. [] According to United States data, about 80,000 science and engineering doctorates were issued by its universities to Asian students between 1992 and 2003 compared to about 5,000 to African students over the same period. CHowever, current trends suggest that the number of foreign students awarded PhDs in science and engineering in the United States has been falling for Africa and Asia but has increased for Europe and the other Americas (See figure 7).

There may also be a need to carefully assess the need for foreign skilled workers (see box 1). Unlike manufacturing, services tend to be skills and knowledge intensive. While academic qualifications may provide prestige, they may not always equip its holders with the technical knowledge skills and experience that are required by financial, insurance, investment and communication firms, among others. Allowing foreign experts to take up temporary positions or promoting attachments abroad could be useful. Several developed and developing countries have developed such policies.

Box 1. Examples of policies on recruitment of international migrants.

Malaysian skilled worker program:

Malaysia plans to attract 5,000 skilled workers a year as part of their knowledge-economy master plan for 2001 (Wong 2000).

South Africa loosening restrictions

The government plans to make immigration laws less restrictive, hoping to address the difficulty of getting short-term work permits for skilled foreign workers.

Canadian permanent skilled worker targets

In the 1990s, Canada raised the number of immigrants and those admitted for certain skills to more than half the inflow. Now it plans to target skilled immigrants and workers from China, India, Pakistan, Philippines and South Korea.

Source: Lowell B. L, (2001) Policy responses to the international mobility of skilled labour, International Migration Papers 45, ILO, Geneva

To promote skills development, Africa may also rethink its cooperation with other countries. It could request that a proportion of its assistance aid be provided in the form of places in the partner country's MSc, PhD and post-doctoral programmes in science and engineering and bringing its university up to acceptable international standards, whether private or public. If targeted, such programmes could enable more African countries to leverage their national efforts and raise the necessary skills.

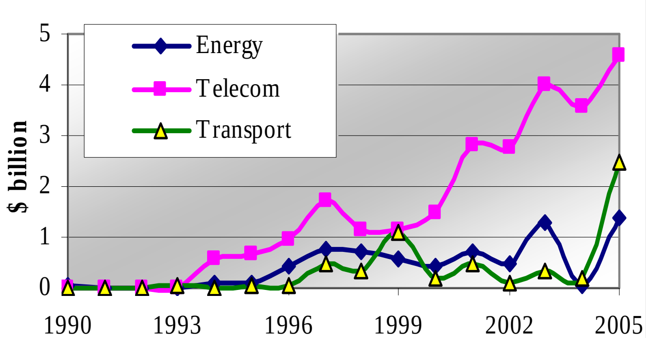
4.2 Filling the infrastructure gap

There are several ways of filling the Africa's infrastructure gap. The most important is for government to provide strategic direction in all the key service sectors. This could be achieved by developing clear policies and guidelines on investment in infrastructure, especially if the private sector is to participate. Experience of the last decade reveals that private sector participation in telecommunication has increased from about 20 million in 1992 to $4.6 billion in 2005. The existence of clear and predictable, though not necessarily the best, policies has had a profound effect in attracting private sector investment for the growth of telephone services (see figure 9) and in making Africa one of the fastest growing mobile phone markets.

A recent study outlined some of the key aspects that have to be addressed even in developed countries if private sector investment is to be attracted for infrastructure projects:

- ⇒“Identifiability: The object to be financed should be clearly identifiable in geographic and economic terms to allow for efficient risk sharing between the private and public sectors;
- ⇒Stable demand: Given the long service life of infrastructure investments –investors will expect reliable long-range planning of demand for the relevant infrastructure;
- ⇒Low risk of substitution: Investors become interested in infrastructure projects when risks related to introducing competing solutions and technologies remain low across the entire duration of the project;
- ⇒Flexible contract design: Contracts governing public-private partnerships should be based directly on the requirements of the individual project rather than on standardized stipulations;
- ⇒A low risk of "politicization". Private investors generally shun projects with infrastructure solutions that may become election campaign tools”

Figure 9. Infrasturcture projects in SSA with private sector participation



Source: World Bank PPI database

It is, therefore, possible to attract investment into other infrastructure projects if the regulations take into account the needs and risks involved. In the energy sector, the unbundling of vertically integrated electricity monopolies is a necessary step to enable potential independent power producers (IPP) to emerge and promote competition. This is important as electricity cannot be produced, stored and sold a few days later. Unbundling will also induce retailers to focus on connecting new customers and ensure that distributors deliver enough power to the retailers and producers on generating enough energy to meet the demand. The same applies to ports and airports where competition could be created within the facility to improve efficiency.

For instance, the leasing of the container terminal at the port of Dar es Salaam (Tanzania) to the Hong Kong-based Hutchison Whampoa has improved efficiency and increased business opportunities for hotels, banks, insurance, consulting and clearing and forwarding firms. About US$7 million has been spent in modernizing the facility and the number of ships visiting the port has increased from 30 to 50 and the number of containers cleared has increased from 100,000 per year to 165,000 per year since the lease was finalized in 2000.

However, public investment in infrastructure will remain the main stay for meeting most of the challenges. Countries could cooperate in developing expensive infrastructure. The Namibia-Zambia (Katima mulilo inaugurated in 2004) bridge may not be very attractive to the private sector but has already resulted in increased use of Walvis Bay port by Congo, D.R. and Zambia. However, most of the traffic to and from South Africa is passing through Botswana and plans to build another bridge across the same river are underway. Again, this project may not be attractive to the private sector because the current heavy traffic may fall once Zimbabwe is back on its feet (fuel and foreign currency shortage is forcing truckers to avoid the more direct route).

As private investment in telecommunications and energy picks up, resources that are saved may have to be directed to transport, basic and higher education, health and industrial parks or zones, especially in peri-urban and rural areas where there is little knowledge about the complexity involved in setting up a business in the formal sector. In addition to the bilateral projects, Africa may also need to address some of its infrastructure needs at a regional level. The design of power pools should be extended to the sharing of telecommunication networks and co-management of infrastructure.

The scientific and technological infrastructure needed to survive and compete in the knowledge economy may also need significant attention. Many African universities, research centres, technical colleges and secondary schools as well as science parks and incubators may require investment. Just like bridges and airports, they serve as the breeding and testing grounds for new technologies. Currently, they are not providing the products or knowledge that stimulate the increasingly sophisticated businesses.

The idea that African R&D centres could somehow focus on "second-grade" (often term *appropriate*) technologies relevant to the poor presupposes that the poor will not need a cell phone but rather a mail-man. Above all, it does not make any sense to build a road for ox-carts if the people prefer buses and railways or the country seeks to catch up with the rest of the world. Some R&D centres and universities may increasingly be alienated if existing and developing industries do not find them useful.

Along with infrastructure, trade logistics services are indispensable to the international competitiveness of countries (see table 3). As more businesses and services rely on just-in-time models of production and real time monitoring of business activities, logistics support services become critical. Currently, Africa is not performing well as measured in international logistics performance index (LPI). Singapore is ranked top in the world while South Africa (top in Africa) is ranked 24 and Rwanda (worst in Africa) is at position 148, two places from the bottom. Some of the key services that need to be addressed, such as tracking and tracing, competence and timeliness could be provided by domestic firms on behalf or support of government or independently, just like infrastructure.

4.3 Improving the performance of institutions

Although often seen as legal entities, government institutions are actually administrative agencies. There is a growing volume of evidence within Africa that professionalizing the key institutions that provide services to firms is perhaps easy or at least possible. For example, Zambia restructured its tax authority in 1993/94, created a new administration whose board included accountants, lawyers, bankers and members of industrial associations and government. Tax revenues that had fallen from 30% (11% from mining firms) of GDP to 13% between 1970 and 1990, have risen to 18% of GDP despite the huge tax incentives given to large mining firms. More importantly, the tax authority has, in general, consistently surpassed the revenue targets set in the national budget.

This achievement has been attributed to simplified procedures, elimination of taxes that contribute very little but are expensive to collect, and to the autonomy the tax authority now enjoys. Similar efforts in Kenya and Nigeria have resulted in substantial increases in revenue collection in the last few years. Other institutions, such as patent and company registration offices that are autonomous, have reduced the number of procedures, improved their efficiency and continue to expand their facilities to other locations. The establishment of one-stop boarder posts, investment centres, company registration services and regional cooperation should help cut down costs.

Cutting the number of procedures and elimination of unnecessary ones may help but is not the end. For example, overzealous and corrupt police, veterinary and immigration personnel could undo any gain achieved by one-stop-border posts. Similarly, the company registration may take one week but obtaining a bank account and municipal certificates may take a longer time. A general improvement in all institutions may be necessary.

Improving the performance of R&D institutions may be required. Enabling or making some of their funding conditional to partnering with private sector and working with the community may improve their performance in the long run. Simple as it sounds, evidence seems to suggest that for government-industry-academic relationship to be sustained, some level of autonomy is necessary, the management must be clearly committed, political support is needed and a common problem/interest to be addressed identified. It is these

Table 4. International Logistics Performance Index 2007 of selected economies

Country (Rank)	LPI	Customs	International shipments	Logistics competence	Tracking & tracing	Domestic logistics costs	Timeliness
Singapore (1)	4.19	3.9	4.04	4.21	4.25	2.7	4.53
Netherlands (2)	4.18	3.99	4.05	4.25	4.14	2.65	4.38
South Africa (24)	3.53	3.22	3.56	3.54	3.71	2.61	3.78
Rwanda (148)	1.77	1.8	1.67	1.67	1.6	3.07	2.38
Regional comparison							
East Asia & Pacific	2.58	2.41	2.64	2.54	2.53	3.04	3.01
LAC	2.57	2.38	2.55	2.52	2.58	2.97	3.02
SSA	2.35	2.21	2.36	2.33	2.31	2.98	2.77

Source: World Bank 2009

common challenges or opportunities that keep them interested in working together until solved.

In addition, clear regulations on sharing of any benefits and royalties resulting from the collaborative work may have to be clearly spelt out. Institutions that wish not to compensate entrepreneurial individuals may just discourage them from working within their institutions. In Kenya and Uganda, some universities takes additional self-sponsored students and those departments that teach them get compensated. In Zambia, the main referral hospital allows its doctors to admit private patients and then share the fee. In a way, it helps keep the doctors and lecturers within the institution and the institutions gets more out of the arrangement in terms of services. The same mechanisms should be adopted in encouraging knowledge generation, technology commercialization and industrial arrangements.

4.4 Deepening Africa's financial markets

African financial markets are growing at a fast rate and can no longer be dismissed. Although they are still small in size compared to the top world markets in London and New York, they are substantial with respect to the GDP of their countries. For example, the assets of the Kenyan pension fund is estimated to at about US$4 billion or about 26% of GDP. Insurance and equity financing institutions as well as banks have mushroomed since the 1990s

African stock markets were initially dismissed as too small even in percentage of GDP or in comparison to large ones. The Zambian stock market grew from less than 5% of GDP to over 32% of GDP in the last 3 years. More importantly, the growth is not driven by stock from the mining sector but rather manufacturing, agriculture and services. There is general excitement as the lucrative mobile firms near their contractual obligation to list on the local markets (e.g., Safaricom in Kenya and Celtel in Zambia). There is little wonder a recent Forbes article headlined *African Stock Safari* has noted that "Africa's stock markets outperformed world averages in 2006… Sub-Saharan Africa is growing faster than most of Asia *(without China and India)*".

African banks that were notoriously rigid in lending money are now beginning to play their rightful role. As African government bonds and treasury bills become less attractive, they are turning to entrepreneurial activities. For the first time, three Zambian banks provided a syndicated loan to a private local airline company to purchase 2 Boeing 737-200 aircrafts. Confidence is returning and the financial institutions are beginning to become drivers of industrial growth.

However, with few exceptions (e.g. Kenya and South Africa), the number of people investing in the stock markets remain a small fraction of the total population and, in value terms, foreign portfolio investors remain the key movers of trades. Most African firms are family-owned and managed. Most investors prefer public firms (not as in state-owned) to family-managed ones. Finally, the stock markets are tailored for reasonably large firms while most African firms are small and medium-sized. These challenges may have to be addressed.

5. Conclusion

There is a growing realization that the service sector is a major source of employment and a key contributor to GDP and exports. The rapid diffusion of mobile technology, growth of supermarket chains and expansion of financial services in Africa has been impressive and created many opportunities. For instance, the rise in supermarkets has been associated with investment in construction of modern shopping malls. South Africa, for example, is one of the main sources of investment in supermarket chains. Well established names such as Shoprite and Game have expanded to several countries in Eastern, Southern and Western African countries.

Intra-firm trade is particularly common in the service sector. For example central sourcing of goods for supermarket chains ensures that quality is maintained by all the shops belonging to the chain. This presents many challenges: small scale farmers may not achieve and assure a constant supply of the desired volumes and quality of good needed by large supermarkets. On the other hand, supermarkets also serve as export channels for emerging firms.

African countries may have to develop comprehensive strategies for growing and expanding their service sectors if they are to successfully compete in the growing trade in services. Some of the areas where Africa may have a comparative advantage in commercial services include transport, travel, financial and business services. To realize this potential, significant investment and policy interventions may be required. This will also require the development and emergence of entrepreneurial, efficient and reliable private sector. This is particularly important if Africa will have to participate in the global value chains of knowledge intensive products.

Africa has an emerging contract research and manufacturing market especially in field and clinical trials and in information and communications. The chances for countries such as Egypt and South Africa to compete in contract research and manufacturing with established destinations such as India and China will depend on the levels of investment in human, institutional and enterprise development.

Africa may also have to encourage their firms to adopt international manufacturing standards if they are to integrate in the global production networks. Such a push could help firms maintain manufacturing excellence needed to partner with globally reputable firms. For instance, AMANET, an NGO based in Tanzania, is playing a key role in helping selected R&D institutions to meet

Good Clinical Practice (GCP) standard for undertaking vaccine clinical trials in malaria (http://www.amanet-trust.org/). A number of the centres have already achieved this status and are participating in clinical trials. There is no reason why governments cannot help or at least push pharmaceutical firms, for example, to meet the basic international standards.

Services are important to the development of Africa especially given its location from major markets in the North. If Africa has to become a manufacturing base, it will have to quickly fill the education, health, financing and infrastructure gaps. Of these, infrastructure and higher education restrain undermine Africa's competitiveness not only in commercial services, especially professional services.

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The Challenges of increasing productivity in agriculture: the case of cassava in Zambia

Constantine Bartel (ATDF)

1. Introduction

Despite concerted efforts by different international and national organizations to promote food security and reduce poverty by introducing improved crop and animal breeds and stimulate trade, Africa remains food insecure and farming communities remain some of the poorest societies compared to those engaged in manufacturing and services. While this generalization is the big picture, small and successful cases have been implemented. Among them are horticulture and cotton. In these sectors, partnerships and intra-firm trade has played a central role. This note looks at increasing productivity which is one aspect in the long list of barriers to intrafirm trade.

What makes the case of Cassava production in Zambia an interesting one is not about the NGOs per se. The role of the NGOs could be substituted by other institution, but rather the type of model used, in this case the provision free of charge or subsidised agriculture inputs to farmers and its implications to market development and export opportunities of the outputs. The cassava case involved small scale food enterprises and millers, traders, the breweries industry, stock feed processors.

2. Effective partnerships

One of the common approaches to identifying effective and profitable partnerships is through outgrower schemes such as those in the flowers and fresh vegetables as they present new ways of bringing together producers and agribusiness, they establish and enforce grades, standards and regulations, improve the investment climate and provide essential public goods such as rural infrastructure. These have the potential to support equitable and sustainable development as they recognize the market, socioeconomic, cultural and management aspects of rural farmers and link these to public policy and good institutional settings aimed at sustainable and profitable agriculture.

As processors, millers and traders need enough quality farm produce, subcontracting arrangements in agribusiness is another model of partnerships that has been used to promote production. In this case, companies provide technical assistance, materials and/or financing to local farmers with an agreement by the company to purchase the products is being revived. An important aspect of this model is that it builds local supply chains of raw materials.

Another way to raise small-farm income is by delivering technology and market information to small farmers and incorporating them into remunerative new markets through contract farming. Critics of contract farming see it as a means by which agribusiness firms take advantage of the unequal bargaining relationship to pass production risk to farmers (Sachiko Miyata 2007). This could also favour larger farmers. Another is stimulating demand and improving productivity through targeted support such as in the case of cotton where training, credit, market development and agriculture inputs are made available

All of these models pose Africa with a strategic dilemma when it comes to making the choice of promoting food security and market development. On the one hand, input-led efforts to deal with the food crises often hamper the prospects for local market development for inputs, while investments and policies supporting market development do not easily translate into increased input use for poor, food insecure farmers who need inputs the most (Valerie Kelly, et al 2003)

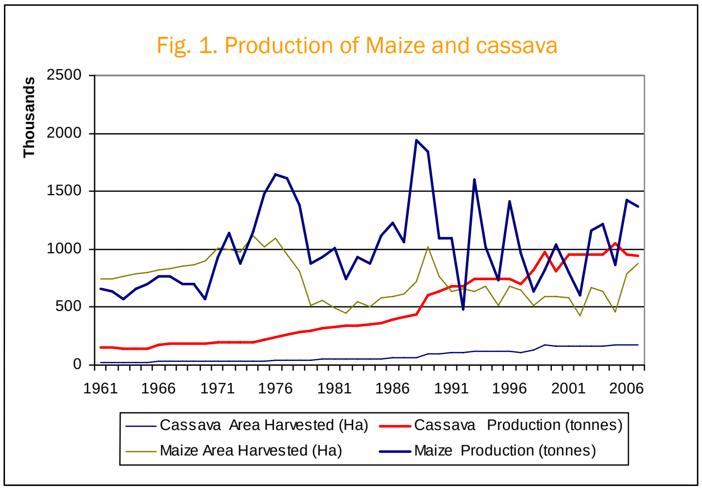
To identify the right intervention is not without costs. One has to know whether or not inputs are economically or financially profitable. Subsidized distribution programs often use inputs as a vehicle to increase food security and reduce poverty. Problematically, though, such programs increase risk and uncertainty for the emerging commercial sector.

This involves understanding of input and transaction costs. Agribusinesses constraints to increasing agricultural productivity in developing countries range from pricing policies, poor market access and marketing efficiency. Farmer's access to agricultural credit is low and is reflected by the low use of fertilizer. Land tenure insecurity, land degradation and low investment in agricultural research, coupled with the lack of good infrastructure, recognised standards to determine product value and capacities to enforce contracts with large numbers of small-scale farmers.

For example fertilizer subsidies should only be considered when fertilizer use is economically profitable (i.e., there is a strong enough crop response that fertilizer use remains profitable when price distortions from subsidies and taxes are removed). These considerations are true when identifying areas for technology research or off the shelve technologies including the choice of target group of farmers.

3. The Zambia Cassava Task Force Approach

Cassava, the staple food crop in northern Zambia saw rapid production growth over the past decade and a half (Figure 1) overtaking maize, Zambia's other staple food. Source: FAOSTAT



Source: FAOSTAT

Besides the increased growth of cassava, groundnuts, cotton, tobacco and horticultural products also increased.

In Zambia, the two-pronged approach to commercial promotion of agricultural supply chains was undertaken to accelerate the production of cassava. This is because understanding the key opportunities and constraints up through the value chain is imperative to sustain smallholder growth. The analysis revealed five distinct supply channels linking cassava producers with various final markets (Table 1).

Table 1. supply channels linking cassava producers

Channel	Description
Supply channel 1	Channel one is composed of self-sufficient cassava-producing households who consume the bulk of their own production and accounts for about 85% of all cassava production in Zambia (van Otterdijk 1996).
Supply channel 2	This involves farm households selling surplus production in fresh form to nearby markets for human consumption. The fresh sales account for no more than 5% of total production (van Otterdijk 1996; Tembo and Chitundu 2000; Langmead and Baker 2003).
Supply channels 3, 4, & 5	These channels link rural cassava producers to potentially vast urban markets by supplying a cheap carbohydrate to substitute for the wheat- and maize-based products that currently predominate among Zambia's food, feed and industrial processors. These three channels account for 5% to 10% of total cassava production.

Source: Chitundu, Droppelmann and Haggblade 2006

The stakeholder taskforce deal with bottlenecks that constrain growth in the supply channels such as the absence of trading standards, poorly coordinated market information, long distances, small volumes and consequently high marketing margins. At the top of each channel are innovators or "channel captains". These are "innovative players who develop markets for products that incorporate cassava-based carbohydrates into their products, expand demand for cassava roots and chips, generating demand to which the rural producers have shown they are likely to respond" Chitundu, Droppelmann and Haggblade 2006.

The initial focus on Channel 1 which represents a supply-led strategy of promoting food production by focusing on subsistence households and providing inputs to the farmers (in this particular case by NGOs) was a complete failure. Some donors are now known to discourage the use of free or subsidized input distribution. The argument however is not the distortions that it creates, but rather that it is a financially unsustainable approach. Likewise some African governments and donors still underscore the importance of input subsidies as a tool to address food security issues.

The Zambian approach or demand-led strategy which focused on market development in both trade and upstream processing industries instead yielded the desired results. This experience revealed that successful value chain interventions require identification of sizeable and broad-based commercial opportunities. This is important to mobilize broad interest and support from all stakeholders. In the Zambian cassava case, it was found that the commercial potential could easily sustain a 50% increase in national cassava production. The multiplier effects of such an increase included on farm income gains, opportunities for increased value added upstream including significant spin-offs in terms of improved household food security, reduced costs of feed and livestock products, and potentially lower protein costs for consumers.

The cassava case presented significant spin-offs for many firms, households and institutions suggesting that the most significant opportunities for growth lie in commercializing cassava for use as a low-cost carbohydrate in processed foods, livestock feed and industrial cassava derivatives.

4. Conclusion

In general the constraints of the traditional supply-driven model are bourn out of funding requirements or approaches that do not take advantage of indigenous knowledge of farmers. Access by women and coverage in remote areas by the supply driven model is more limited than is the case under demand-driven approaches

The Zambian experience advocates an approach which marries together value chain analysis with a stakeholder taskforce that ensure that analysis of opportunities and constraints gets translated into actions that will facilitate commercial growth. The increase in Cassava production is also attributed to the introduction of new cassava varieties by research stations in northern Zambia. These improved cassava varieties are tolerant to disease and pests, early maturity and yields up to triple those of most local varieties. The other important factor is the removal of maize subsidies and the implementation of an innovative approach.

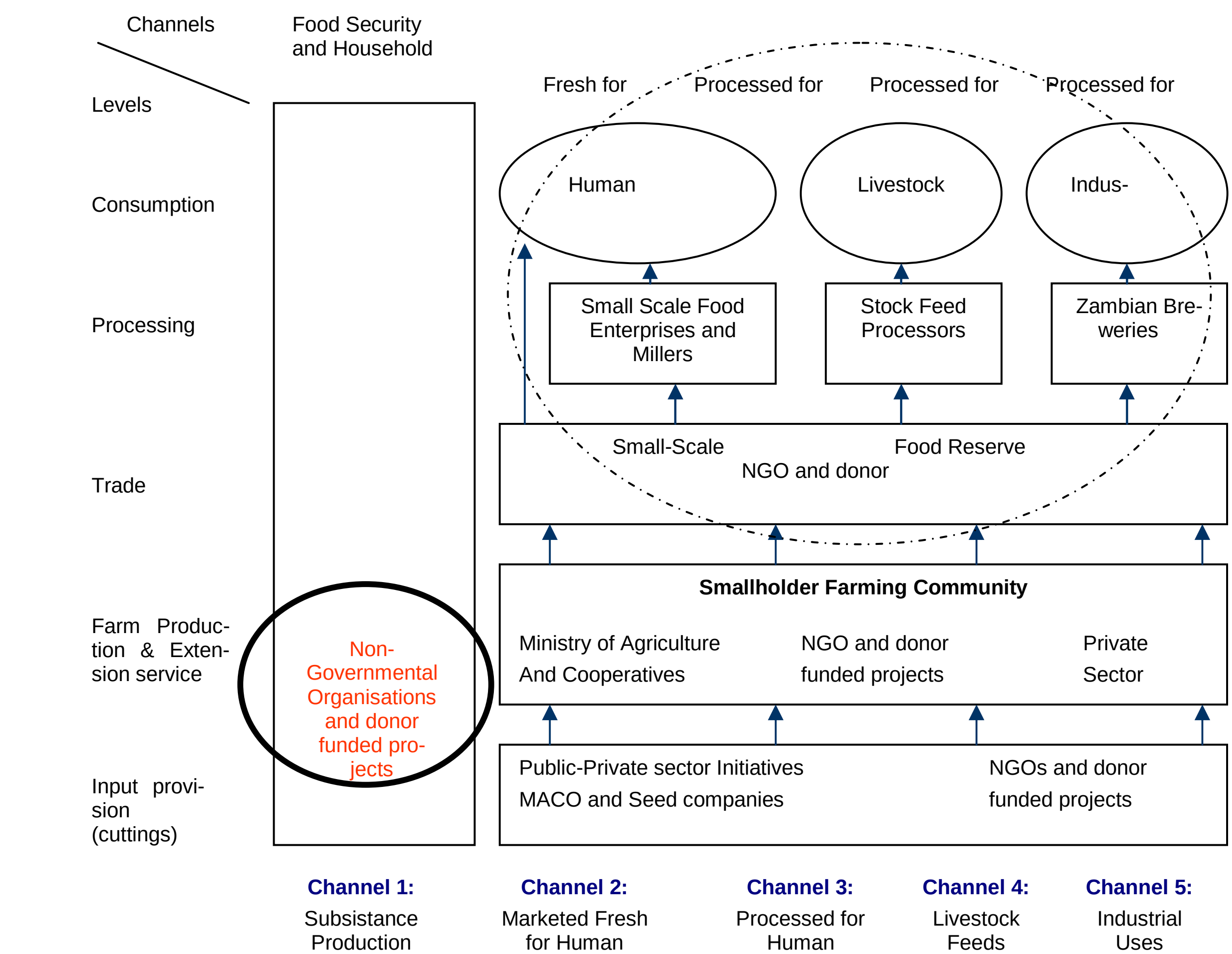
Box 1. Intra-firm trade in agriculture

There has been very little intra-industry or intra-firm trade in food and agricultural products compared to intra-firm trade in manufactures, especially in semi-processed products which has benefited from the division of labour within companies that are operating in different continents. The fact that Agriculture is lagging behind reflects the nature of agricultural trade, which is often largely determined by different agro-ecological conditions and at the same time has put up with traditional trade and investment barriers. According to the FAO, where these barriers have declined, the exchange of processed and semi-processed agricultural products has increased considerably and brought about levels of intra-industry/intrafirm trade close to levels observed for non-agricultural products. Much of this trade has been stimulated by the activities of global food companies and traders, but has also involved retailers and small food exporters exploiting niche markets.

References

1. World Agriculture: Towards 2015/2030. An FAO perspective...
2. Because cassava roots contain about 70% water, and because root quality deteriorates within 48 hours after harvesting, most fresh sales travel no more than about 50 kilometres from field to final market. For this reason, Channels 1 and 2 are well established in northern Zambia but offer limited expansion potential elsewhere, until consumption patterns change appreciably.
3. Chitundu M, Droppelmann K, Haggblade S, A Value Chain Task Force Approach For Managing Private-Public Partnerships: Zamiba's Task Force On Acceleration Of Cassava Utilization Working Paper No. 21 Food Security Research Project Lusaka, Zambia December 2006
4. Dr Benjamin Chege the National Horticultural Centre based at the Kenya Agricultural Research Institute (KARI) Thika
5. Stakeholders include Agricultural Research Institutes, Plant Health Inspectorate Services (i.e. regulating TC banana seedling production), farmer associations, traders, nursery owners and Horticultural Development Authority should collaborate to set up standards for the industry
6. Ashok Menon: Private Investment in the Agriculture Sector in Mozambique; Mozambique Trade and Investment Project, Associates Inc. November 2008

Figure 2. Cassava Value Chain and Stakeholders



= Concentration of early promotional efforts from 1990 – 2005; = New focus of promotional efforts by the task Force from 2005