



UNIVERSITI PUTRA MALAYSIA

***IMPACT OF TRADE OPENNESS ON ECONOMIC GROWTH, YOUTH
UNEMPLOYMENT AND POVERTY IN SUB-SAHARAN AFRICAN
COUNTRIES***

ADAMU PETER

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COUNTRIES**

By

ADAMU PETER

**Thesis Submitted to the School of Graduate Studies, Universiti Putra Malaysia,
in Fulfillment of the Requirements for the Degree of Doctor of Philosophy**

May 2017

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DEDICATIONS

First and foremost, I dedicate this work to God almighty for his infinite grace and mercies throughout my years of study. I also dedicate this work to my amiable wife whose supports are numerous and immeasurable.



Abstract of thesis presented to the senate of Universiti Putra Malaysia in Fulfillment of the Requirement for the degree of Doctor of Philosophy.

IMPACT OF TRADE OPENNESS ON ECONOMIC GROWTH, YOUTH UNEMPLOYMENT AND POVERTY IN SUB-SAHARAN AFRICAN COUNTRIES

By

ADAMU PETER

May 2017

Chairman : Shivee Ranjane Kaliappan, PhD
Faculty : Economics and Management

This study investigates the impact of trade openness on economic growth, youth unemployment and poverty in Sub-Saharan African (SSA) countries. Trade openness is largely viewed as a channel to boost economic growth for countries. However, the benefits embedded in free trade have not being visible for the SSA region because the economic growth is still low. Other regions where the environment for doing business are attractive to investors and operate relatively better institutions have benefitted immensely from trade openness but SSA have shown dismal performance over the years. Mixed findings have been largely reported in empirical literature for trade openness economic growth nexus but in recent times, the proxy for trade openness and methods applied in the past have been questioned. This suggests the application of new proxies and methods to investigate the trade openness-growth nexus for 40 SSA countries for the period 2000-2014. Similarly, the soaring youth unemployment problem in SSA was investigated on the basis of free trade in the region since international trade theory supports an employment gain for trading partners. The high rate of youth unemployment is worrisome in the face of poor institutions and difficult business environment in SSA. However, recent literature have suggested that goods institutions and business environment are channels through which trade openness can reduce unemployment and this situation was examined for 41 countries in SSA for the period 2000-2014. Despite the participation of SSA in world trade since the inception of WTO, poverty level have reduced only minimally. If trade openness is a poverty reducing arrangement, the poverty level in SSA should have fallen over the years but literature suggests that trade policies are to be complemented with sound policies if they must thrive. Consensuses as to whether trade openness reduces poverty have not been reached and this was investigated for 44 countries in SSA for the period 2000-2014.

The first objective of the study is to examine the impact of trade openness on economic growth by considering the role of institutional quality and business environment on the nexus using the threshold regression analysis. The threshold result revealed that trade openness is significant and positive in promoting economic growth up to a certain extent but this positive effect disappears beyond the threshold level because the p-value was found to be insignificant. This suggests that improving trade openness at an early stage of development is necessary to trigger economic growth up to a certain level of trade openness. In the case of institutional quality and business environment, threshold effects are insignificant. However, both domestic and foreign investments as well as human capital are veritable means to develop the SSA region as shown in the results.

Secondly, the issue of youth unemployment in SSA was investigated from the perspective of trade openness using the generalized method of moment (GMM) approach. The results revealed that good institutions are essential to reduce youth unemployment when free trade is practiced but poor institutions trigger an increase in youth unemployment in an era of free trade. More essential is a good environment for doing business for countries where trade openness policies are promoted but unconducive business environment can aggravate the problem of youth unemployment in the SSA region.

Lastly, the third objective of the study examine the effects of trade openness on poverty in SSA by considering the role of institutional quality and business environment utilizing generalized method of moments (GMM) estimation technique. Using an estimated index known as policy induced openness as a proxy for trade openness against the popular trade shares proxies, the result shows that trade openness aggravates the problem of poverty in SSA when considered directly. However, the indirect effect shows that business environment and institutional quality reduces poverty. Policies to encourage economic growth are necessary since growth reduces poverty and enrolments into schools are vital instruments to alleviate poverty in the SSA region as reported in this finding. Since the effects of trade openness on growth kicks in before trade openness reach a certain threshold, policy makers should improve mechanisms that promote openness such as reducing tariffs, abolishing quotas, and non-tariff barriers to explore the benefits of trade reforms in promoting economic growth in the region.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Doktor Falsafah

KESAN KETERBUKAAN PERDAGANGAN KE ATAS PERTUMBUHAN EKONOMI, PENGANGGURAN GOLONGAN MUDA DAN KEMISKINAN DI NEGARA-NEGARA SUB-SAHARA AFRIKA

Oleh

ADAMU PETER

Mei 2017

Pengeru : Shivee Ranjane Kaliappan, PhD
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Kajian ini menyiasat kesan keterbukaan perdagangan terhadap pertumbuhan ekonomi, pengangguran belia dan kemiskinan di negara-negara Sub-Sahara Afrika (SSA). Keterbukaan perdagangan sebahagian besarnya dilihat sebagai satu saluran untuk meningkatkan pertumbuhan ekonomi bagi sesuatu negara. Walau bagaimanapun, faedah dari perdagangan bebas tidak dapat dilihat bagi rantau SSA kerana pertumbuhan ekonomi masih rendah. Rantau lain di mana persekitaran untuk menjalankan perniagaan menarik kepada pelabur dan mengendalikan institusi yang lebih baik telah mendapat manfaat daripada keterbukaan perdagangan tetapi SSA telah menunjukkan prestasi kurang memuaskan sejak beberapa tahun lalu. Kajian empirikal ke atas tahap keterbukaan perdagangan dan pertumbuhan ekonomi melaporkan penemuan bercampur tetapi pada masa ini, proksi untuk keterbukaan perdagangan dan kaedah yang digunakan pada masa lalu telah dipersoalkan. Ini menunjukkan penerapan proksi dan kaedah baru untuk menyiasat perhubungan keterbukaan perdagangan dan pertumbuhan ekonomi bagi 40 negara SSA bagi tempoh 2000-2014. Begitu juga, masalah pengangguran belia yang melambung di SSA disiasat atas dasar perdagangan bebas di rantau ini memandangkan teori perdagangan antarabangsa menyokong keuntungan pekerjaan untuk rakan perdagangan. Kadar pengangguran belia yang tinggi adalah membimbangkan ketika menghadapi tahap institusi yang kurang memuaskan dan persekitaran perniagaan yang sukar di SSA. Walau bagaimanapun, kajian baru-baru ini telah mencadangkan bahawa institusi yang baik dan persekitaran perniagaan adalah saluran di mana keterbukaan perdagangan dapat mengurangkan pengangguran dan keadaan ini dikaji untuk 41 negara di SSA untuk tempoh 2000-2014. Meskipun penyertaan SSA dalam perdagangan dunia semenjak penubuhan WTO, tahap kemiskinan hanya telah berkurang sedikit. Jika keterbukaan perdagangan adalah untuk penurunan kemiskinan, tahap kemiskinan di SSA sepatutnya telah berkurang dalam beberapa tahun tetapi kajian lepas menunjukkan bahawa dasar perdagangan harus dilengkapi dengan polisi yang mantap untuk terus berkembang maju. Tiada ketetapan umum dicapai dalam hal sama ada keterbukaan

perdagangan mengurangi kemiskinan dan ini telah diselidiki untuk 44 negara di SSA untuk tempoh 2000-2014.

Objektif pertama kajian ini adalah untuk melihat kesan keterbukaan perdagangan terhadap pertumbuhan ekonomi dengan mempertimbangkan peranan kualiti institusi dan persekitaran perniagaan dalam perhubungan ini dengan menggunakan analisis regresi ambang (*threshold regression analysis*). Keputusan ambang mendedahkan bahawa keterbukaan perdagangan adalah penting dan positif dalam merangsang pertumbuhan ekonomi sehingga ke tahap tertentu tetapi kesan positif ini hilang di luar tahap ambang kerana nilai-p didapati tidak signifikan. Ini menunjukkan bahawa peningkatan keterbukaan perdagangan pada peringkat awal pembangunan adalah perlu untuk memacu pertumbuhan ekonomi sehingga ke tahap tertentu keterbukaan perdagangan. Kesan ambang adalah tidak signifikan bagi kualiti institusi dan persekitaran perniagaan. Walau bagaimanapun, kedua-dua pelaburan domestik dan asing serta modal insan adalah penting untuk membangunkan kawasan SSA seperti yang ditunjukkan dalam keputusan kajian.

Kedua, masalah pengangguran belia di SSA telah disiasat dari perspektif keterbukaan perdagangan dengan menggunakan pendekatan momen umum (*Generalized method of moment - GMM*). Hasil kajian menunjukkan bahawa institusi yang baik adalah penting untuk mengurangkan pengangguran belia apabila perdagangan bebas diamalkan tetapi institusi yang buruk mencetuskan peningkatan pengangguran belia dalam era perdagangan bebas. Lebih penting lagi ialah persekitaran yang baik untuk menjalankan perniagaan bagi negara-negara di mana dasar keterbukaan perdagangan dipromosikan tetapi persekitaran perniagaan yang tidak menentu akan memburukkan masalah pengangguran belia di rantau SSA.

Akhir sekali, matlamat kajian ketiga ialah menyiasat kesan keterbukaan perdagangan terhadap kemiskinan di SSA dengan mempertimbangkan peranan kualiti institusi dan persekitaran perniagaan dengan menggunakan teknik anggaran momen umum (*Generalized method of moment- GMM*). Menggunakan indeks anggaran yang dikenali sebagai keterbukaan yang disebabkan oleh dasar sebagai proksi untuk keterbukaan perdagangan berbanding proksi popular yang selalu digunakan iaitu saham perdagangan, hasil kajian menunjukkan bahawa keterbukaan perdagangan menimbulkan masalah kemiskinan di SSA apabila dipertimbangkan secara langsung. Walau bagaimanapun, kesan tidak langsung menunjukkan bahawa persekitaran perniagaan dan kualiti institusi mengurangkan kemiskinan. Dasar untuk menggalakkan pertumbuhan ekonomi adalah perlu kerana pertumbuhan mengurangkan kemiskinan dan pendaftaran ke sekolah adalah instrumen penting untuk mengurangkan kemiskinan di rantau SSA seperti yang dilaporkan dalam penemuan ini. Memandangkan kesan keterbukaan perdagangan terhadap pertumbuhan meningkat sebelum pembukaan perdagangan mencapai ambang tertentu, pembuat polisi perlu memperbaiki mekanisme yang meningkatkan tahap keterbukaan seperti mengurangkan tarif, memansuhkan kuota, dan halangan bukan tarif untuk meneroka manfaat pembaharuan perdagangan dalam merangsang pertumbuhan ekonomi di rantau ini.

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I certify that an examination committee has met on **date of viva voice** to conduct the final examination of **Adamu Peter** on the thesis entitled “**Impact of Trade Openness on Economic Growth, Youth Unemployment and Poverty in Sub-Saharan African Countries**” in accordance with the Universiti Putra Malaysia [P.U. (A) 106] 15 March 1998. The committee recommends that the student be awarded the Doctor of Philosophy.

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LIST OF ABBREVIATIONS

SSA	Sub-Saharan Africa
OECD	Organization for Economic Co-operation and Development
EAS	East Asia
ECA	Europe and Central Asia
LAC	Latin America
MENA	Middle East and North Africa
ECOWAS	Economic Community of West African States
SADC	South Africa Development Community
USA	United State of America
NAFTA	North American Free Trade Area
GATT	General Agreement on Trade and Tariffs
WTO	World Trade Organization
WDI	World Development Indicator
UNESCO	United Nations Educational, Scientific and Cultural Organization
FAO	Food and Agriculture Organization of the United Nations
WB	World Bank
IMF	International Monetary Fund
NGO	Non-governmental Organizations
OLS	Ordinary Least Square
ARDL	Autoregressive Redistributed Lag
GMM	Generalized Method of Moments
ECM	Error Correction Model
R&D	Research and Development
TFP	Total Factor Productivity
FDI	Foreign Direct Investment

GDP	Gross Domestic Product
H-O	Heckscher-Ohlin-Samuelson
FTAs	Free Trade Areas



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CHAPTER 1

INTRODUCTION

The 21st century came with Africa emerging as the poorest region in the world (World Development Indicators [WDI], 2000). Average per capita growth stood at about 1.2 percent at the end of the year 2002 which is less than the growth registered at the end of 1965 with 2.2 percent (Artadi & Sala-i-Martin, 2003). Sub-Saharan Africa (SSA) has largely been confined to a series of development problems. These problems include poverty, income inequality, high rate of youth unemployment and poor growth in income per capita. All of these challenges assert cost on the region more than any other region in the world. Since the 1980s, many countries in the region have made concerted efforts towards economic reforms such as trade and market liberalization aimed at encouraging the private sector to thrive. Successes have been recorded in recent times where some countries in the region form part of the world's fastest growing economies in the world with Ethiopia predicted to have GDP growth of 9.5 percent in 2015; Democratic Republic of Congo, 8.0 percent; Ivory Coast, 8.0 percent; Mozambique, 7.20 percent; Tanzania, 7.20 percent and Rwanda's GDP growth in the year 2015 stood at 7 percent (CIA World Fact book, 2015). Despite these economic progresses, most countries in Sub-Saharan African countries have not been able to overcome low household income level, deteriorating capacity, weak institutions and inadequate infrastructure.

Evidently, the classical trade theorist since the days of Adam Smith has attributed trade between nations to be beneficial to all based on the availability of resources in these countries. The establishment of the General Agreement on Tariffs and Trade (GATT) in 1947 paved way for eight rounds of multilateral trade liberalization, unilateral and regional trade liberalization all aimed at fostering a conducive trading environment in the world trading system to accelerate the level of economic growth across the globe. In 1995, the World Trade Organization (WTO) was established to assist in administering the growing body of multilateral trade agreements. The new order of trading has seen the developing countries increase their share of trading substantially. However, progress recorded in regions across the globe has been uneven in recent decades. A number of developing countries in Asia are doing very impressive and studies have attributed their success to greater openness to world trade. Latin American countries have also been doing very well in terms of progress recorded due to trade openness, however, the countries in Africa and Middle East seems to have benefitted less due to high barriers to trade (Tupy, 2005).

The classical economics provided a theoretical basis on which international trade can be beneficial to countries involved (Ricardo's Theory of comparative advantage). This principle as applied in the 16th and 17th centuries impacted greatly on the economies of most countries around the world especially, during the industrial revolution of the 18th century. Having noticed the benefits of trade across borders, most countries in the developing world have liberalized their trade and expects that the integration into the

global trade would stimulate economic growth in their countries (Frankel & Romer, 1999; Dollar & Kraay, 2004). However, the decision as regards subscribing to free trade or not, depends on trade policies implemented by the participating countries.

The issue regarding whether to adopt free trade or not have divided public debates on trade policy into two schools of thought. The first school of thought argues that free trade expands the export market as a result of increased demand for a country's product, increased domestic production and creation of more jobs. On the other hand, the second school of thought disregard these benefits and concludes that free trade will create unhealthy competition between foreign and domestic firms with a resultant negative effect on unemployment due to foreign dominance. These schools of thoughts have opened up an interesting debate in the area of international trade and empirical investigations have become necessary. This debate has been extended to various issues including unemployment and poverty in the developing countries. Trade openness and globalization have distributional effects but the extent to which trade reduces or increase unemployment and poverty is widely debated. Globalization and trade openness are expected to improve the standard of living of people in SSA but the story remains unexplained as the region is still battling with high unemployment, low level of income per capita, and a stagnating problem of poverty. These issues call for empirical studies to ascertain the effects of trade openness on economic growth, unemployment and poverty in SSA.

1.1 Background to the Study

Recently, the meaning of "trade openness" has been seen to be synonymous to the idea of "free trade" which is a system where all trade distortions are eradicated. Specifically, the New Economic Geography models (NEG)¹ defined international trade openness as low international trade cost which is an abstraction of transport cost, tariffs, subsidies taxes and non-tariffs barriers. Krueger (1978) argued that trade openness can be attained by implementing policies that lower the biases against the exports sector, for instance, subsidizing exports or encouraging exports schemes. However, Harrison (1996), suggested that trade openness could be synonymous with the idea of neutrality; the indifference between earning a unit of foreign exchange by exporting and saving a unit of foreign exchange through import substitution. Pritchett (1996) simply defines "trade openness" as an economy's trade intensity. However, Stensnes (2006) defined trade openness in relation to barriers to international trade imposed by governments.

Furthermore, to measure trade openness, the ratio of total foreign trade (i.e. ratio of exports plus imports to GDP) is widely used in empirical studies. Despite being clearly defined and measured, Rodrik, Subramanian & Trebbi (2002) challenged the valuation of trade ratio on whether it should be based on domestic or international prices. Another weakness of this measure of trade openness is that it does not tell the reason why some countries trade more than the others (Dowrick & Golley, 2004). This is

¹ Study on the location, the distribution and the spatial organization of economic activities across the world.

because a high trade ratio might be caused by a combination of trade openness policies, smooth and easy access to international market and the size of the domestic market (Dowrick & Golley, 2004). An alternative measure to capture these factors known as policy-induced trade openness was introduced by Frankel & Romer (1999), Combes & Saadi-Sedik (2009) and Musila & Yehiyis (2015).

To derive these indicators, the effects of factor endowment, size of a country, labour force are netted out. Leamer (1988) suggests that differences in the level of trade across countries could be expressed as an indicator of trade policy barriers if the countries in question are similar to a greater extent in terms of their factor endowment, size or population, technology, taste and preferences, and natural barriers or their effects are controlled for. Although some other factors that are potentials for trade openness are omitted, the estimated residuals from the regression can be used as a more reliable indicator for openness subject to only trade policy compared to the simple actual trade ratios (Eris & Ulasan, 2013; Musila & Yiheyis, 2015; Hakimi & Hamdi, 2016). A large value of residual would suggest that the country is more open to international trade if the sizes of the country and factor endowments are controlled for. Trade openness measures considered by Sachs & Warner (1995) and Wacziarg & Welch (2008) which adapts the dates of trade liberalization as the proxy for trade openness over the period 1960–2000 cannot be applied because of the unavailability of data for most of the countries in SSA. Also, using the date countries open up to trade would be problematic because the data on the actual dates for each country, especially, Sub-Saharan Africa countries for the period of study is difficult to find.

The integration of countries into the global economy is often regarded as an important determinant of differences in economic growth across countries and regions of the world. Specifically, international trade allow countries to realize economies of scale and scope; promote efficient allocation of resources; facilitate knowledge diffusion; foster technological progress and encourage competition in domestic and global markets for production process optimization and development of new products. However, the effect of trade policy on income and growth is more controversial (Grossman & Helpman, 1991; Rivera-Batiz & Romer, 1991; Barro & Sala-i-Martin, 1997 and Edwards, 1998). On the one hand, reducing trade barriers will likely foster international trade by lowering transaction costs with a resultant improvement in economic growth. Similarly, it is argued that the economies of developing countries or emerging market that are more open to the rest of the world have a greater potential to absorb technologies developed in more advanced nations. On the other hand, it is argued that some forms of protectionism, e.g., infant industry protection to develop certain industries or sectors or a strategic trade policy in key sectors, can be beneficial for economic growth and development in developing countries.

The empirical literature has extensively analysed both the impact of trade policies and trade volume on economic growth. Rodríguez and Rodrik (2001) argue that both effects are related as a matter of course but pose conceptually distinct questions and have different outcomes quantitatively. Trade policies can be viewed as responses to imperfection in market or rent seeking mechanisms. Restrictions in trade induced by such policies have a different impact on trade volumes than other constraints due to

transport costs or shifts in consumer preferences. Basically, the major constraints to analysing the effect of trade policy empirically have been to find adequate measures of trade restrictions and trade policy. The policy-induced trade openness which captures trade policy measure suggested by Combes & Saadi-Sedik (2006), Eris & Ulasan (2013) and Musila & Yiheyis (2015) was adopted in this study. In summary, trade openness (imports plus exports of goods and services as a percentage of GDP) is a combination of natural openness trade-policy induced openness and natural openness is computed by estimating the level of trade openness a country should have based on its structural characteristics. Therefore, trade-policy induced openness is the difference between the trade openness and the natural openness.

Before now, trade economists have paid only little attention to labour market frictions for a long time, the effects of trade openness on unemployment have featured more prominently in recent trade models. While unemployment is one of the most pressing economic problems in history, trade economists have generally neglected it discourse both in theoretical and empirical literature. Most trade models are full employment models with perfectly flexible wages (Dutt, Mitra and Ranjan, 2007). Implicitly, this suggests that trade economists do not believe that trade is one of the most important determinants of unemployment. However, in recent times, there exist a small but growing literature on the relationship between trade and unemployment. Aside the economics profession, there are people who believe that trade leads to jobs destruction, leading to significant unemployment. These people include some popular news media² which intentionally neglect the creation of jobs as a result of their participation in international trade (Dutt et al. 2009).

There is a significant disconnect between the traditional assumptions in economic models of international trade and the policy debate on the effects of trade policies on jobs. The policy debate focus specifically on whether changes in trade policy will create more jobs rather than destroy them, while the economic models used to evaluate these policy changes mostly assume that the economy is always operate at full employment and that total employment in the economy remains fixed. However, the assumptions in these economic models has been it in such a way that any destruction in jobs will be exactly offset by job creation, with no effect on unemployment rates. Davidson, Martin, and Matusz (1999) described this disconnect as follow:

The vast majority of public debate concerning trade policy centers on the impact of trade on employment. Those opposed to free trade argue that lower production costs and fewer regulations in other countries allow foreign firms to out-compete domestic producers. This, they argue, results in less domestic output and fewer domestic jobs. On the other hand, proponents of free trade

² A search of news articles in the New York Times since 1990, reveals a total of 275 articles on NAFTA as the primary subject. Out of this, 147 articles talk about job destruction in the US as a consequence of NAFTA. Davidson & Matusz (2004) suggested that out that most of the statements made in the House and the Senate during the NAFTA debate were about NAFTA's impact on jobs. They point out, that in sharp contrast, there is not a listing for unemployment in the index of the 4000 pages long Handbook of International Economics, primarily used by academic economists.

argue that free trade expands our export markets, resulting in a greater demand for our products, greater domestic production, and more jobs.

The vast majority of economists view both of these arguments as misguided and fundamentally incorrect. In fact, the debate about trade policy among economists almost always ignores the impact of trade on [a country's aggregate or total] employment.

Economic models that attempt to relate the effects of international trade on labor market outcomes have relied almost entirely on the assumption of full employment (Harrigan, 2011). Yet, the issue of unemployment is an undisputed fact of life, and net job creation is most often, a stated goal of international trade policies. Therefore, this call for not only theoretical researches but also rigorous empirical researches to investigate the impact of trade openness on unemployment, youth unemployment in SSA.

Theoretically, trade openness is likely to affect poverty through a number of channels: consumption, production, and the labour market (wages and employment) (Cali, Hollweg & Bulmer, 2015). The net welfare impact through consumption and production depends on whether an individual's net consumption and net production are of importable or exportable goods, while the net impact through the labour market channel depends on an individual's occupation and industry. These channels, in turn, are affected by the pass-through of price changes as a result of tariff reforms. Price change pass-through to local markets are determined by the condition of a country's transport infrastructure, distance from the nearest port, and the relative market power of international buyers, local retailers, and distributors (Cali, Hollweg & Bulmer, 2015). Increasing average income while holding income distribution unchanged should reduce the incidence of poverty (Mitra, 2016). Based on the Heckscher-Ohlin model, trade openness is expected to benefit unskilled workers which are the most abundant factor of production in developing countries with a resultant decrease in poverty rate. However, this impact can be truncated if labour cannot easily move across sectors. For instance, workers who are stuck in shrinking sectors will be adversely affected.

Generally, because most of these mentioned factors have heterogeneous effects, studies have considered net aggregate impact of trade openness on the poor and sometimes how the effects interact with regional or industry-specific characteristics. There exist a wide range of evidences on the effect of trade openness on poverty. The evidence comes from anecdotal country case studies (China and India), cross-country and country specific studies, and empirical general-equilibrium studies.

1.1.1 Role of Institutional Quality and Business Environment on Trade Openness-Growth-Unemployment-Poverty Nexus

The quality of institutions have been considered as a major determinant of long run economic growth in recent times and this is documented by a growing literature (see Hall & Jones, 1999; Acemoglu et al., 2001; Rodrik et al., 2004; Easterly & Levine, 2003; etc). Institutions explain a wide range of social structure that affects the outcome of economic activities. It captures the role of property rights, contract enforcement, investor protection and the political system which work together differently and collectively to promote a smooth economy or otherwise. Although, no consensus exists on the definition of institutions, it is conceptually viewed as a system of laid-down and prevalent social rules that structure social interactions in a society. The existence of institutions suggests the presence of restrictions and many other forms of constraints on the political and economic life of the people. However, such restrictions are likely to spring-up threat and opportunities that are beneficial to all. The dimension of institutions is multifaceted and might have different effects on the functioning of the economy (Slesman, Baharumshah, & Ra'ees, 2015). The relevance of institutions has made a number of organizations to develop indexes and measures to quantify the quality of institutions across countries of the world. The International Country Risk Guide, World Governance Indicator and Ibrahim Index for African Governance have all classified the measures of institutions based on political and economic divides.

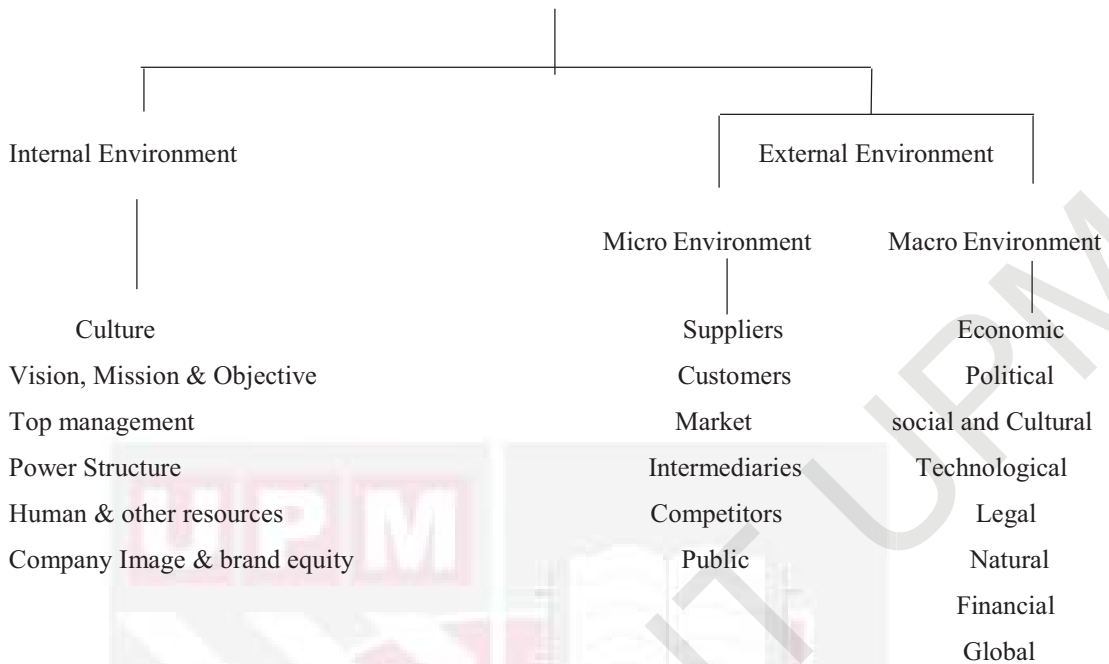
In the last 20 years, the role of regulatory environment in providing growth and development in a country have been emphasized by researchers, policy makers and international organization such as the World Bank and the International Monetary Fund (IMF). Economic institutions form part of a country's regulations and are shaped by its political institutions (Acemoglu, Johnson, & Robinson, 2000). Generally, the institutions of a country cover all arrangements that shape the political, economic and social interactions among the people. The major function of an institution is to reduce any form of uncertainty that emanates from information asymmetries and transaction cost (North, 1990). This would result to a smooth market interaction and a general importance in the functioning of the market. On the contrary, poor institutions increases the transaction costs of firms and restrain specialization and economic activities (Lee, 2008; Borrmann, Busse, & Neuhaus, 2006). The heritage house for economic freedom has documented a number of factors that brings about greater prosperity in countries across the world. They explain how governments across the world guarantees free movement of capital, labour, goods and services.

Although the traditional trade theory suggests that there are considerable welfare gains from market integration through trade, these welfare gains differ between countries because some countries are more likely to benefit more from trade than others. For instance, while a large proportion of countries in Southeast Asian countries have seen spectacular growth rates since the establishment of WTO and partly due to an aggressive export-oriented development strategy, several African and Latin American countries were less able to harness the benefits of trade. With this issue, it has become imperative to investigate the prerequisite for trade openness to improve economic growth, reduce unemployment rate and poverty. This prerequisite is the quality of institutions. According to North (1990), institutions can be defined as constraints

devised by people to structure political, economic and social interactions. Institutions exist to reduce uncertainties that might arise from incomplete information concerning the behaviour of other individuals in the process of interaction. In the field of economic interaction, institutions are to decrease information asymmetries by channelling information about market conditions, goods and participants (Borrmann, Busse & Neuhaus, 2006). With this, market actors become more coordinated and mutual cooperation is facilitated. Prominent among the proxy to capture institutional quality are: Property rights, contracts and the rule of the law (Rodrik et al., 2004). Therefore, if economic actors can trust the property rights or the rule of law of a country, transaction costs are reduced and this will result to the establishment of new businesses, facilitates the emergence and the functioning of markets and contributes to higher efficiency. All these will result to job creation, improvement in economic growth and poverty reduction.

Conceptually, business environment combines two words for its explanation. Business explains all activities related to trade, production, banking, finance, packing and many other related activities. Environment, on the other hand, is defined as all external factors that affect the business directly or indirectly. These factors that make-up the environment has the potential of becoming opportunities or threat to firms operating in a country. Even though many of such factors exist, prominent among them are socio-economic, technological, competitors and government. Business environment refers to the entire surrounding which harbours a number of opportunities and constraints for businesses with a direct and indirect bearing on their functioning. Generally, business environment refers to the aggregation of all forces and institutions that are external to the business and not easily controllable by the management. There are two categories of business environment, namely the internal and external environment. The internal environment captures factors existing within a business organisation and is under the control of the management. Meanwhile, the external business environment influences the performance of the business enterprises without being affected by the business enterprise. Since the internal environment is controllable by the business enterprises, this study focuses on external environment that affects the enterprises without the enterprises affecting it. For policy sequencing, the implication is that the countries that place excessive regulatory burden on the activities of the private sector must have a robust strategy in place to improve business climate before (or at least contemporaneously with) undertaking trade reform (Bolaky & Freund, 2004).

Type of Business Environment



(Source: Summarized from Kattookaran & Yakoob 2015).

There are a number of reasons to assume that trade openness is an important determinant of economic prosperity such as: promote economic growth, reduce unemployment and poverty rate but that would be somewhat restrictive variable for assessing the effects of economic policy on per capita income levels. It would be more ideal to have a measure of good economic policies that includes, but goes beyond, trade openness by capturing as many aspects as possible of how economic policies affect economic production.

Specifically, the theoretical and empirical literature have focused on five aspects of business environment: the regulatory environment, crime, corruption, access to infrastructure and financial development and how they together or individually affect output growth for employment generation and poverty reduction in countries across the world. Frictions in the financial sector or poor financial development can result to low Total Factor Productivity (TFP) and output (Greenwood & Jovanovic, 1990; Bencivenga & Smith, 1991). Low output implies poor economic growth and reduction in available jobs and increase in poverty rate. Also, Infrastructure services (transportation, energy and water) are used by firms in the process of production and delivery of good and services. Generally, it is agreed that adequate supply of infrastructure is beneficial to firms and increases productivity growth, create jobs and reduce poverty (Morisson & Schwartz, 1996). Empirically, Fan & Chan-Kang (2005) concluded that huge investments in roads in China have improved economic growth and it has substantially led to reduction in poverty in rural areas.

1.1.2 Sub-Saharan Africa Trade Openness and Economic Growth Performance

The region of Sub-Saharan Africa (SSA) as classified by the World Bank, is an area that is larger than China, the United States of America (USA) and India combined together. It is about five times bigger than 28 countries that made up the European Union (Olamosu & Wynne, 2015). The region is a combination of 48 countries that vary considerably in size and economic history. Sub-Saharan Africa at the beginning of the 20th century was characterised by shortages of labour and capital and nurturing an indigenous market activities. The shortage of labour in the 20th century has been attributed greatly to the slave trade that characterised that era. The period of slave trade (15th century) to 1850 witnessed a stunted growth in the population of the region. In contrast, however, the population of Europe grew more than four-folds in this period. By the end of the 19th century, Sub-Saharan Africa had suffered around 60 years of colonial destruction and economic plunder. This relegated the region to a continent of household-based agrarian economies with very limited long-distance trade. The colonialist imposed cash-crop production for export and mineral extraction, but placed an embargo on manufacturing.

The underdevelopment of the SSA's economy can be traced to a number of factors such as bad governance, poor infrastructure and colonialism, among others. The records shows that most countries can grow their economies and develop faster if leaders take sound decisions in the national interest (Mills, 2010). Colonialism has forced many of the countries to depend on monoculture exporters with strong dependence on imports for equipment, capital goods, consumer goods and technology. Primary production is still the bane of the export of Sub-Saharan Africa with the economies of many countries heavily depending on the export of one or at best two commodities. The over dependence on a monoculture export has over the years made SSA more vulnerable to external shocks than more diversified economies (i.e. countries that dependent on more than one product as source of foreign exchange). The result of global trade shocks from the late 1970s and late 2008 with the subsequent introduction of neoliberalism, explains the reasons behind the lingering problem of poverty and wide spread unemployment in the region.

In summary, the economy of SSA after most of the countries that make up the region became independent is divided into four sub periods. The period 1960-1980 saw the growth of many SSA countries at par with many other countries across other regions of the world, with an average annual GDP growth of 4.8 per cent. The period 1980-2000 documented the collapse of growth in many countries in SSA triggered by oil price shocks, a falling terms of trade and sudden surge in real interest rate, with an average annual GDP growth of 2.1 per cent. The period 2000-2007 was a re-awakening period of many SSA economies because the prices of primary products witnessed a significant increase and average annual GDP growth was 3.9 per cent. Lastly, the period 2008 to date has seen a number of countries (such as: Ethiopia, Democratic Republic of Congo [DRC], Cote d'ivoire, Mozambique, Tanzania and Rwanda) in the region growing very rapidly in recent times but this has not translated into poverty and unemployment reduction. Statistics made available by World Bank

Africa Development indicator (2001) has shown that only very negligible progress has been made to reduce poverty in the region.

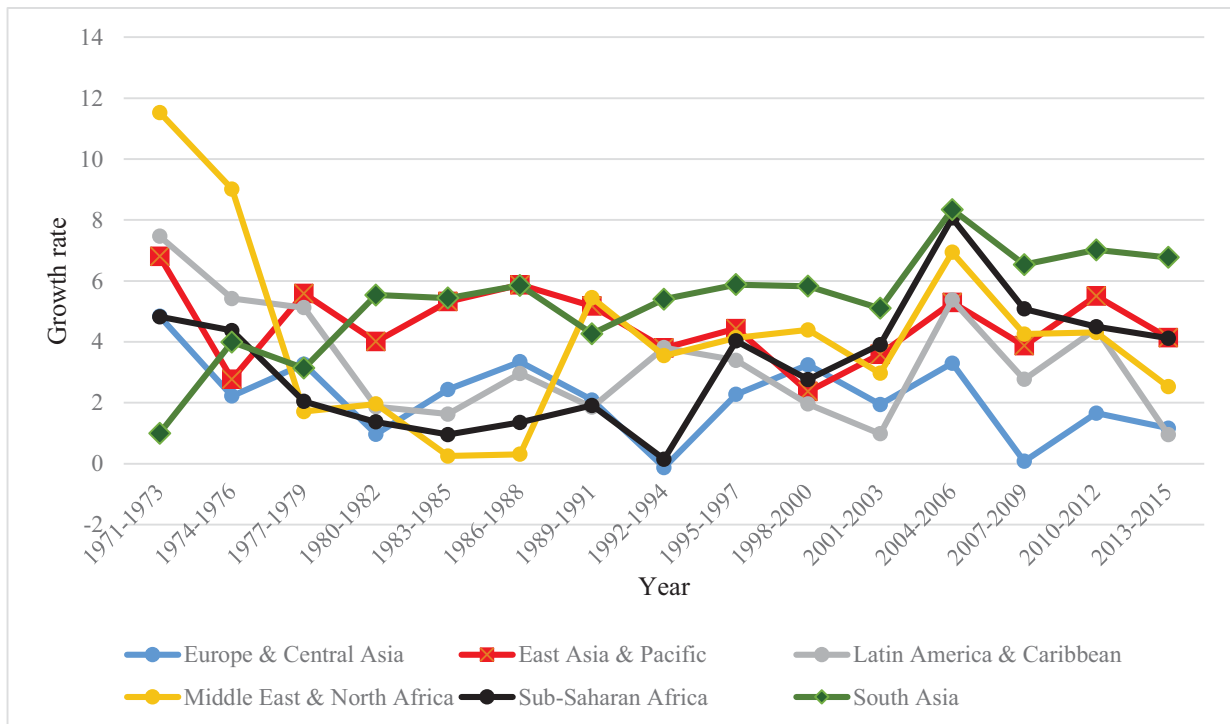


Figure 1.1 : Regional distribution of GDP per capita growth

(Source: Author's computation, data from World Development Indicators, 2015)

The theory of convergence as presented by the neoclassical growth model opined that poor countries grows faster than rich countries but this situation is not so for the region of SSA which has not shown any sign of convergence over the years except in recent times where few countries mentioned above have been performing well in terms of GDP growth. From Figure 1.1 above, the growth rate of Sub-Saharan Africa (SSA) has been poor over the years as compared to other regions. In fact, it was observed that growth has been below 2 per cent from late 1970s up to the 1990s. This is worrisome since economic growth has been seen as a medium through which poverty could be reduced and the income level enhanced.

The ambiguity in theory on the effects of trade openness on economic growth is reflected in the available empirical evidences. While some findings supports a strong positive effect³, others found a small positive effect⁴ but most notably are the conclusions of Harrison (1996) and Rodríguez & Rodrik (2001) who doubt the significance and robustness of the growth benefits of trade openness. They questioned the measurement of trade openness and the econometric issues prominent in literature

³ See e.g. Dollar (1992), Sachs and Warner (1995), and Edwards (1998)

⁴ See Lee et al. (2004).

as the likely reason for the mixed findings. Lately, the view that greater trade openness is associated with higher growth and vice versa seems to have gained attention amongst some policy makers. However, empirical evidence on this issue has been scanty. This suggests that a threshold level is possible for the trade openness-growth, especially for SSA countries.

In recent times, empirical literature has linked the performance of economic growth to the quality of institutions. Therefore, it could be suggested that the non-convergence of economic growth of SSA countries to the developed countries can be due to the differences in the quality of institutions. For instance, Aidt, Dutta, & Sena (2008) in their theoretical model explains that the differences in political institutions where people hold their policy makers accountable for their actions is a source of non-linearity in mapping the nexus between institutions and economic growth. Growth in the economy means that there is an expansion in the resource base from where policy makers derive their rent. Economic progresses make them want to hold onto power and this establishes a benign feedback loop between institutions and economic growth. Dollar & Kraay argued that countries with better institutions and trade more are likely to grow their economies faster. Again, this suggests that a trade threshold effect is possible in the trade openness-growth nexus based on institutions and business environment. According to Tupy (2005), SSA have benefitted less from free trade due to high barriers to trade. However, if trade share (i.e. $X+M/GDP$) adequately captures free trade, then, the SSA region can be said to be relatively opened to international trade compared to some regions across the world.

Figure 1.2 shows that from 1968-2014, SSA surpassed East Asia & Pacific (EAS)⁵, South Asia (SA)⁶ and Latin American (LAM)⁷. In fact, before 1982, trade share of SSA was higher than that of Europe and Central Asian region. In recent times, however, the EAS and Europe & Central Asia (ECA) have shown renewed effort to surpass the SSA region. Worthy of mentioned is the fact that EAS and ECA specializes in the export of manufactured products and import of primary products while the reverse is the case for the SSA region who depend solely on the export of primary products. The increased trade integration of the region has made it susceptible to external shocks and this is the current position of most countries. Even though the trade openness (ratio of exports plus imports to GDP) for SSA is greater than some regions like EAP, LAM and SA as shown in Figure 1.2, this does not necessarily suggest that the region trade more because the size of GDP for most countries in East Asia and Pacific is more than double that of the entire SSA countries put together. For example, the nominal GDP for China is 11199.15 U.S dollar in 2016 while the

⁵ Cambodia, China, Fiji, Indonesia, Kiribati, Korea, the People's Democratic Republic of Lao (Lao PDR), Malaysia, Marshall Islands, FS Micronesia, Mongolia, Palau, Papua New Guinea, the Philippines, Samoa, Solomon Islands, Thailand, Timor-Leste, Tonga, Vanuatu, and Vietnam.

⁶ Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan & Sri Lanka.

⁷ Antigua and Barbuda, Argentina, Aruba, Bahamas the, Barbados, Belize, Bolivia, Brazil, British Virgin Islands, Cayman Islands, Chile, Colombia, Costa Rica, Cuba, Curacao, Dominica, Cuba, Dominican Republic, Ecuador, El Salvador, Grenada, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Puerto Rico, Sint Maarten (Dutch part), St. Kitts and Nevis, St. Lucia, St. Martin (French part), St. Vincent and The Grenadines, Suriname, Trinidad and Tobago, Turks and Caicos Islands, Uruguay, Venezuela, RB & Virgin Islands (U.S.).

countries with the highest nominal GDP in SSA stood at 537.966 for Nigeria, 330.765 for Egypt and 266.213 for South Africa. If a single countries in East Asia and Pacific (i.e. China) has it average trade openness moved from 9% in 1960 to 37% in 2016, comparing the actual monetary value of trade and not just percentage of GDP would show that the value of trade of East Asia and Pacific more than double that of SSA countries. The figure 1.2 cannot be used to conclude whether a region participate more than other in international trade because it merely reveal percentage share of exports and imports to GDP and not the actual monetary value received from trade.

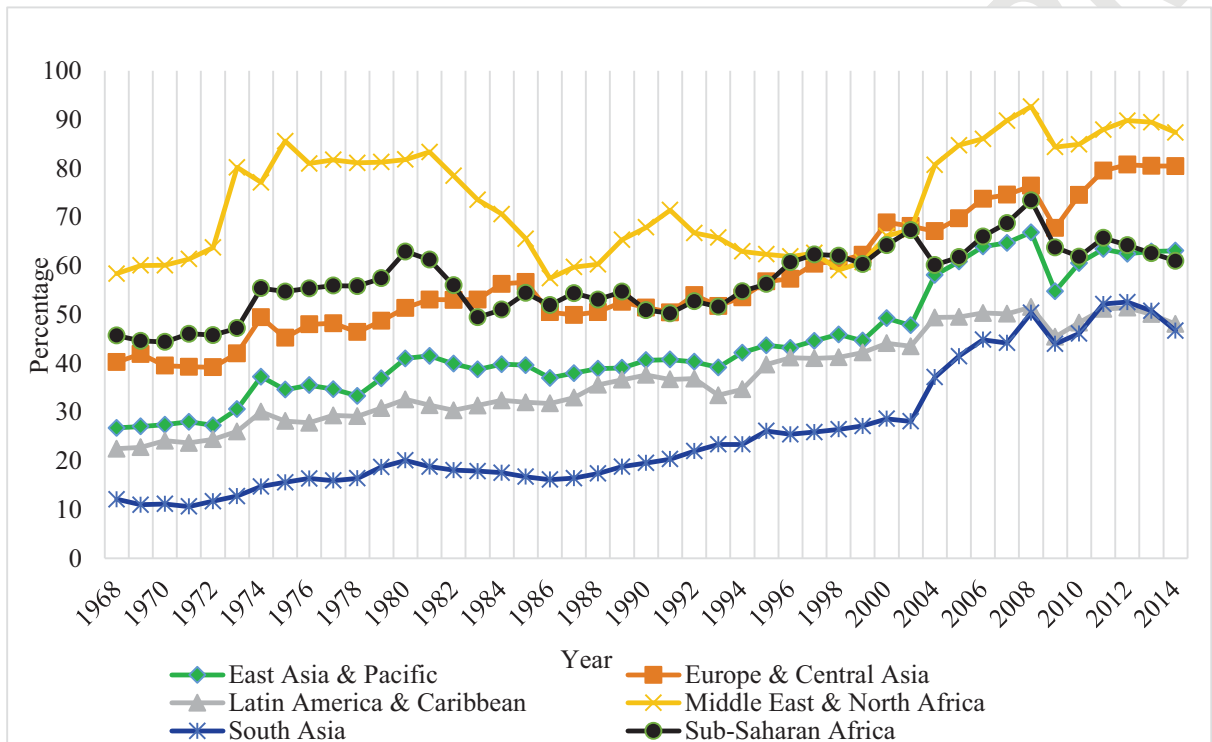


Figure 1.2 : Trade openness Trend for East Asia (EAS), Europe & Central Asia (ECA), Latin America (LAM), Middle East & North Africa (MENA), South Asia (SA) and Sub-Saharan Africa (SSA).
(Source: Author’s computation and data from WDI, 2015)

Although, the participation of Sub-Saharan Africa in global trade remain limited (see Tupy, 2005), trade to and from Sub-Saharan Africa has expanded significantly in recent times. In terms of openness to trade, the continent is one of the least opened regions in the world. Sub-Saharan Africa’s trade account for about 5.3 per cent in 1980 but drop to only 3.5 per cent of global exports and imports in 2013 (World Trade Organisation, 2013). Latin America countries have a share of 6 per cent while Asia account for 32 per cent of global exports and imports. In recent years, export from Sub-Saharan Africa countries has accelerated, widening annually on average of 2.6 per cent in the 1980s, 8 per cent in the 1990s and 15 per cent in early 2000s. More so, in 2011, the rate of increase in exports for Sub-Saharan Africa surpassed the world average. However, almost the same time, the average yearly growth rate of import for Sub-Saharan Africa reached about 17 per cent. The noticeable increase in exports and

imports for Sub-Saharan Africa suggest greater trade openness as measured by the ratio sum of total exports and imports of GDP but the level of staggering youth unemployment and poverty remain high.

In addition, trade openness in most countries in Sub-Saharan Africa started around the early 1980s and as of today, 42 countries in SSA are members of WTO since its establishment in 1995. The introduction of trade openness policies has not been reciprocated in terms of better access to markets for producers and manufacturers from the region in industrialized countries. Massive subsidies afforded to agricultural producers in some developed countries and other forms of protection have hindered Sub-Saharan Africa's efforts to upgrade capacities and alleviate poverty. Increasing agricultural exports in the context of oversupply with a corresponding lower prices in world markets is not rewarding for Sub-Saharan African countries. Most countries in the Sub-Saharan African region have drawn less benefits from their participation in the international trading system because the rate of poverty and unemployment are still very high. The agricultural support measures employed by developed countries need to be reviewed and simultaneously, provisions for preferential and differential treatment should be extended to Sub-Saharan African exports. For example, if tariff escalation is dismantled, there will be no duty or quantitative restrictions for imports of raw tropical products. Mobilizing the political support for constructive market reform will require seriously confronting the incentive dilemmas not only within Sub-Saharan African governments, but also within those of developed countries (FAO, 2008).

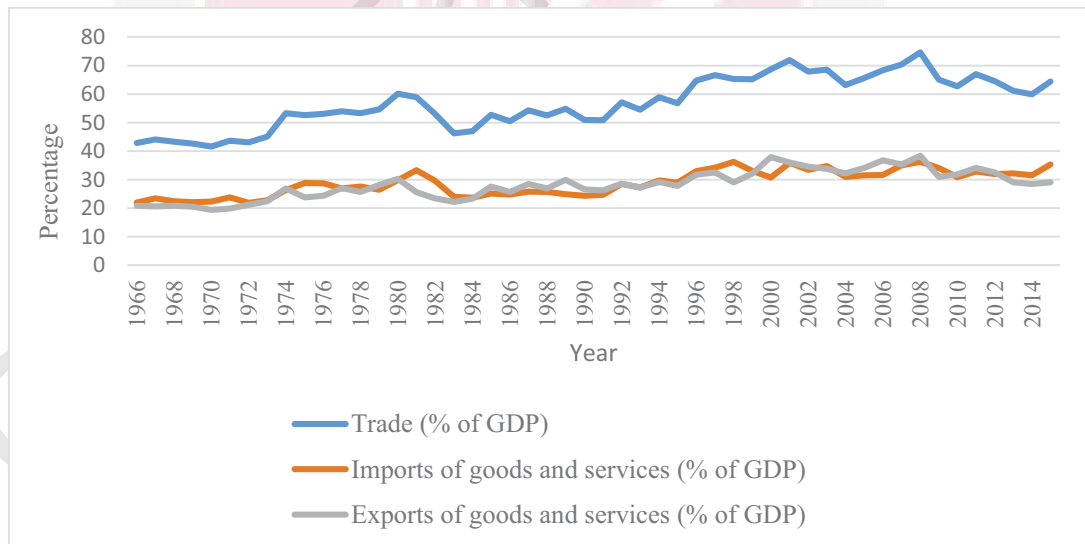


Figure 1.3 : Export, Import and Trade for Sub-Saharan Africa

(Source: Author's Compilation, Data from World Development Indicators 2015)

Table 1.1 : Exports and Imports for Selected Sub-Saharan Africa countries based on income classification

	Export % of GDP 1995	Import % of GDP 1995	Export % of GDP 2015	Import % of GDP 2015
Low Income Economies				
Benin	27.37	36.43	28.22	39.80
Burundi	12.93	27.28	6.05	29.73
Chad	21.93	33.77	29.83	37.32
Ghana	24.50	32.93	43.85	55.40
Guinea	21.12	24.53	26.81	51.30
Kenya	32.60	39.15	15.77	29.70
Mali	19.56	36.68	22.41	29.70
Mozambique	13.21	56.92	31.68	68.01
Lower Middle Income Economies				
Cameroon	23.58	17.79	19.53	30.10
Congo, Rep	64.70	63.61	69.28	96.37
Cote d'Ivoire	41.76	34.44	39.49	36.22
Nigeria	35.76	24.00	10.66	10.79
Upper Middle Income Economies				
Botswana	50.84	43.76	52.31	53.64
Gabon	59.39	35.75	46.13	28.26
Mauritius	58.66	66.08	49.04	58.91
Namibia	45.10	49.32	44.12	67.92
South Africa	22.14	21.48	30.72	31.73
High Income Economies				
Equatorial Guinea	68.53	286.45	59.69	45.12

(Source: World Development Indicators 2016)

Given the few reforms that have been implemented and the history of trade policy reversal in the SSA region, the quest to operate a free trade cannot be concluded even though the Figure 1-3 confirmed that the region have been involved in exports and imports and the trend has been inconsistent since the late 1960s. For the selected individual countries in the region, exports and imports have shown to fluctuate with time (refer to Table 1-1). For all the nine selected countries that fall within the categories of low income economies, their imports of goods and services when WTO was established in 1995 is more than their exports. The score card of a net importer of goods and services for the selected nine low income economies have continued over the years because the same trend was revealed in the year 2015. However, the selected countries in the lower middle income category are net exporters of goods and services in the year 1995 but in the year 2015, they became net importers with only Cote d'Ivoire maintaining its position as a net exporter in the year 2015. For the upper middle income economies, there have been fluctuations for the two periods (1995 and 2015). In the year 1995, Botswana, Gabon and South Africa were net exporters of goods and services but Namibia and Mauritius were net importers. In the year 2015, Botswana slipped to become a net importer while Gabon maintain its position as a net exporter and the position for Namibia as a net importer did not change. South Africa also slipped from being a net exporter of goods and services in the year 2015.

Considering import and export ratios to GDP, the trend since the 1960s to date has been in the same direction with import being slightly above export from the 1960s to the early 1980s for SSA. The early 1980s saw a raise in export slightly above import up to the early 1990s. Thereafter, the changes between import and export was less for short periods with import being slightly above export for few years and same for export as shown in Figure 1-3. This shows that neither import nor export dominate the SSA region trading with other regions since the early 1980s to date. However, it could be explained that their participation in trading activities is drawn from the endowment of natural resources, population size and other relevant factors that force them to trade with other countries⁸. Without netting out of these factors that compel countries to engage in international trade, it cannot be ascertained on whether the SSA region is actually operating free trade or not. This study corrected for these factors to obtain the actual trade openness measurement in the case of SSA region.

Theoretically, it is assumed that the integration of countries into the world economy is an important determinant of income and growth across countries. A number of channels have been identified through which trade impact on economic growth. Trade openness allows a country to realize economies of scale, facilitate the diffusion of knowledge, foster technological progress, and encourage competition both in domestic and international markets that leads to an optimization of the production processes and to the development of new products. The scatter plot (figure 1-4) shows the nexus between trade openness and economic growth in SSA countries. The figure involves 4 four periods ranging from 1995-2014 and divided on a five years basis. In the first and second periods, trade openness and economic growth shows a positive relationship but the third period reveal an almost zero correlation while the last period is almost a negative relationship. This graph explains only a bivariate relationship between trade

⁸ See (Eris & Ulasan, 2013), (Combes & Saadi-Sedik, 2006) and (Musila & Yiheyis, 2015)

and economic growth but other factors such as labour force, domestic investment, technological progress and recently, the role of institutions have not being incorporated to explain this relationship.

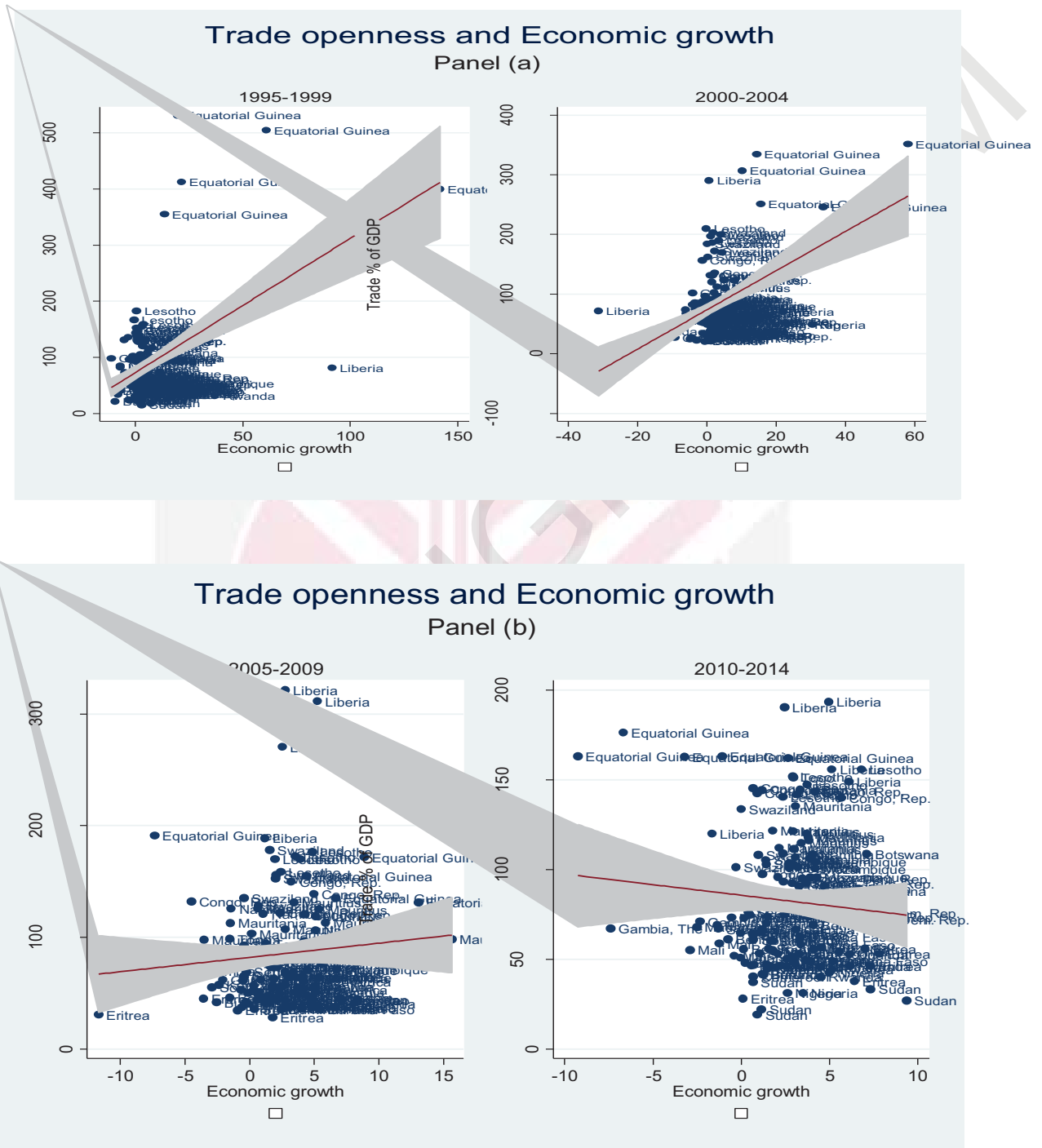


Figure 1.4 : Trade (% of GDP) and Growth of Gross Domestic Product Per Capita (representing 41 countries from 1995-2014)
(Source: Author's Compilation, Data from WDI, 2015)

Rodrik (1996) revealed four arguments in favor of trade openness. Firstly, openness to trade improves static efficiency based on the comparative cost advantage theory. Specialization tends to improve welfare in the trading countries as long as the autarky and world relative prices are different. Secondly, a dynamic relationship exists because trade promotes technical change, enhances learning and boosts the economy of the countries. Thirdly, shocks are quickly absorbed by countries that engage more in trade than closed ones and lastly, rent seeking activities are reduced as a result of trade openness. Rodrik (1996) argues that the extent of rent seeking in a country deals more with the “hardness” and “softness” of the government and has less to do with the type of economic policies embarked upon by the government. If a state is soft, bribery and corruption becomes rampant and rent seeking activities would persist. Importing and exporting firms cannot obtain license easily and this further promotes rent seeking activities. This is a typical situation in most countries in Sub-Saharan Africa where a number of countries have performed poorly in the ranking of governance by World Governance Indicators of the World (2014). On an average scale, the Sub-Saharan African region have performed poorly compared to other regions of the world as shown in Figure 1-5.

As clearly shown in Figure 1-5, the SSA region since the year 1996 to 2014 have not made any meaningful improvement in its quality of institution because on a scale of -2.5 to 2.5 (-2.5 indicate a poor institutional quality while 2.5 indicate the highest), the region have not obtained a score above -0.5. The score of institutional quality for South East Asia (SEA) regions have witnessed better improvement over time and this might explain the economic progress celebrated in this region. From the above mentioned phenomenon, it could suggest that the institutional quality of a country plays a role to smoothen the operation of international trade and this could be a source of non-linearity in the nexus between trade and economic growth because the quality of institutions varies from poor to good institutions and a certain level of quality of this institution is needed to accelerate economic growth. The arguments on the benefits of trade to economic growth was revisited by Rodriguez & Rodrik (2000) and Rodrigue (2007) when they observed trade share in GDP of many countries around the world have witnessed tremendous progress since the establishment of WTO in 1995 but yet, some countries have performed very badly. This suggests that some other supporting factors such as institutions could explain the relationship between trade openness and economic growth observed in literature.



Figure 1.5 : Average Institutional Quality for regions across the World

SEA=South East Asia, SSA=Sub-Saharan Africa, Europe=Europe & Central America, LAM=Latin America

(Source: Author's computation with data from World Governance Indicators, 2015)

Literature also have documented that economic progress of any nation is determined by both internal and external factors ((Bah & Fang, 2011). Among the external factors is the environment for doing business. Business environment plays a vital role for the benefit of trade to be felt (Gani, 2011 and Global Enabling Trade Report, April, 2013). A less restrictive business environment is arguably critical to accelerate trade⁹. This can be through easing the process of business formation, access to finance and ensuring that enforcement mechanisms are erected for business contracts and protection of investors. As shown in (Appendix A), the problems attached to doing business in Sub-Saharan Africa and North Africa are numerous. Poor infrastructure is seen to be higher in SSA compared to North Africa and this has increased the cost of doing business in the region because most of the businesses have to provide their power and other essential facilities which add up to the cost of operations.

The business environment in Sub-Saharan Africa has been somewhat unfriendly to investors and businesses (Bah & Fang, 2011). They further explain that about 33 percent of establishments in the region offer gifts to government officials to have things done (see Appendix A). Also, criminal activities serve as a cost because establishments have to pay hugely to safeguard their businesses. They spend close to 5.6 percent of their sales revenue on security. More so, the state of infrastructure in SSA is poor and very costly for businesses to thrive. Establishments spend an average of 5.5 percent of sales revenue on electricity supply and transportation. To access finance has been a major issue in Africa (Beck, 2004); even though, slight progress has been recorded in recent years. The trade openness-growth have been explained theoretically by Chea (2012) for SSA region, Onafowora & Owoye (1998) support trade openness using 12 countries in SSA and recently, Brueckner & Lederman (2015)

⁹ Ease of doing business report of the World Bank, 2016 attributes sound business environment to increased trade openness.

that found a short and long run growth trade openness. To the best of our knowledge, no study have considered the empirically investigation of this nexus in SSA on a non-linear basis.

1.1.3 Sub-Saharan Africa Trade Openness and Unemployment

The theory of international trade presented by Heckscher-Ohlin supports an employment gain for countries involved in the production of products on which they have comparative cost advantage in producing. However, empirical studies on the nexus between trade openness and unemployment remain mixed for developing countries. Reasons for this might range from wide variation in country characteristics such as population sizes and institutional arrangements to complementary economic policies (Srinivasan & Bhagwati, 1999). Bhagwati & Srinivasan (2002) believes that trade is beneficial to countries having abundant unskilled labour and since the unskilled labours are mostly found in developing countries which SSA is part of; trade openness is expected to benefit them more.

The problem of youth unemployment has witnessed considerable attention by researchers, policy makers and non-governmental organizations (NGO's) over the years. In relation to trade openness, tariff reductions induce displacements especially from exporters and employers in comparative-advantage sectors, and product tariff cuts substantively shrink hiring rates (Menezes-Filho & Muendler, 2011). Scholars as well as international organizations like World Bank (WB) and International Monetary Fund (IMF) suggests that reduction in trade restrictions could improve economic performance with a resultant decrease in the level of unemployment. Youth unemployment by definition range from the age bracket of 15-24. In Europe and more advanced countries, almost 100% of the youth at the age of 15 are in school (Eurostat, 2015). This is not the case for SSA region where the school enrolment rate of children at the age of 15 is low because new data from UNESCO Institute for Statistics (UIS) (2016) revealed that at least half of all those aged 15 to 17 in SSA are not in school and this is the highest proportion for any region in the world. However, unemployed people are those who report that they are without work and are available for work and that they have taken active steps to find work in the last four weeks (OECD employment outlook, 2016). In line with this definition of unemployment, it can be concluded that majority of the youth in SSA are unemployed and have searched for job without getting any over time. So many factors such as few job opportunities, lack of skills, demographic issues, economic structure, politics and globalisation have been mentioned as reasons for the high youth unemployment in the region (Fox, Senbet & Simbanegavi (2016). Therefore, if trade openness creates more job opportunities, it is expected that youth unemployment in SSA should be reducing over time.

Youth unemployment is one of the most serious problems facing the African continent in general and SSA in particular. In accordance with World Bank (1980), most of the Sub-Saharan African countries who applied the structural adjustment measures retrenched a large number of public and private sector workers. The situation of increasing unemployment in the region have been accompanied by demographic pressure, high graduate turn-out with a resulting high number of new entrants to the

labour market annually. Figure 1-6 shows that Sub-Saharan Africa is a region characterized as having the second highest level of youth unemployment rate in spite of the region's participation in international trade with the rest of the world over the years. Youth unemployment compared to total unemployment has almost doubled since the 1990s to date (refer to Figure 1-7). This is accompanied by rapid population growth and high rate of school completion rate both at the primary, secondary and tertiary levels even though data to show these figures officially are scanty. According to the president of Coca-Cola, Central, East and West Africa, almost half of the 10 million graduates churned out of the over 668 universities in Africa yearly do not get job (Africa Center for Economic Transformation, (ACET), 2016). Therefore, the problem of youth unemployment if not properly check might cause more harm than good for the SSA region.

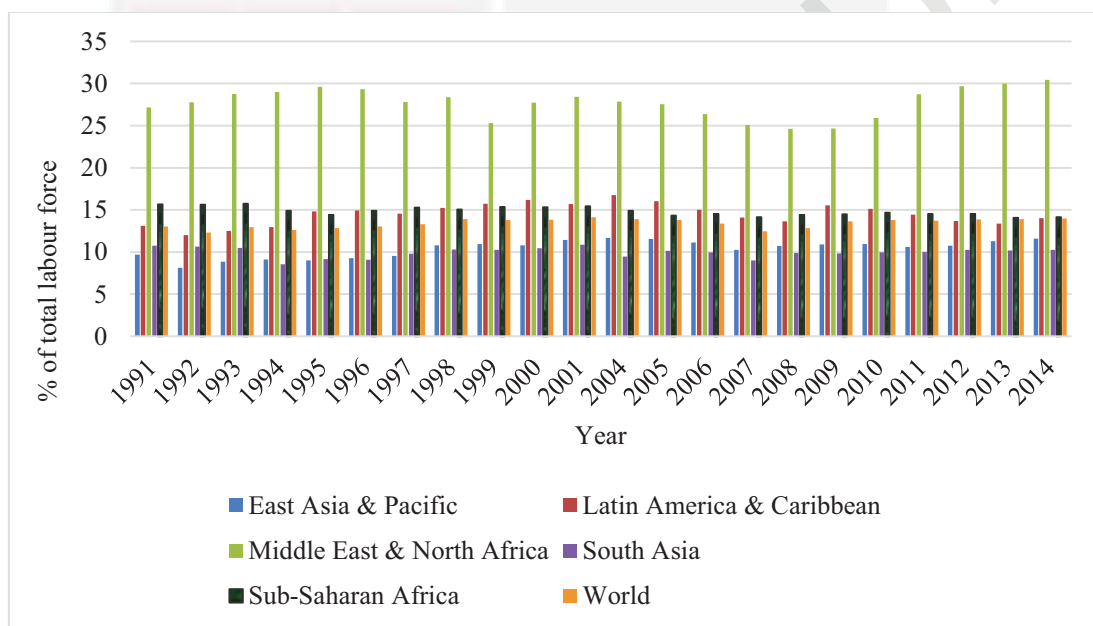


Figure 1.6 : Youth unemployment (% of total labour force) for regions across the world
(Source: World Development Indicators, 2015)

The continent of Africa is having the most youthful population in the world with the youth covering close to between 60% and 70% of the population (World Bank, 2012). This poses great threats to the strength and growth of Africa because the most productive labour force are not fully utilized. Though unemployment is seen manifested all over the world, the case of Sub-Saharan Africa is very dilapidating even amidst successes recorded by some countries in recent years. The level of openness maintained by SSA surpassed that of South Asia, Latin America and East Asia and Pacific since 1968 to date (Figure 1-2) but the economic situation in these regions seems to be better than that of SSA (World Bank, 2011). This therefore brings to fore the question on whether trade openness has impacted on the rate of unemployment in SSA or whether complementary policies are not in place to curb the increasing rate of youth unemployment in the continent.

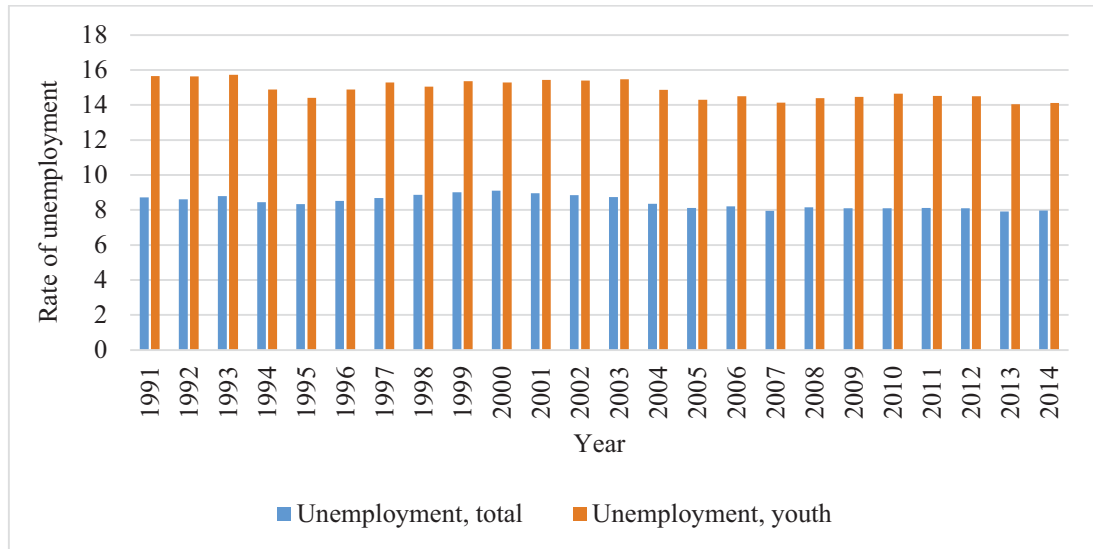


Figure 1.7 : Total Unemployment and Youth Unemployment for SSA
 (Source: Author’s computation, data from ILO, 2015)

A preliminary analysis was presented in Figure 1-8 in the form of scatter plot of trade openness and youth unemployment in selected countries in SSA for four different periods. In the period 1995-1999, the scatter shows almost a zero relationship between trade openness and youth unemployment in SSA. Same nexus is observed for the period 2000-2004 and 2005-2009 but the nexus witnessed a fairly positive trend for the period 2010-2014. The theory of international trade believes that trade is a means for job creation and unemployment reduction but this does not seem to be the case in SSA region where the scatter plot shows a slightly positive relationship for all four periods. It means that more openness is associated with more unemployment in the region but very minimally. However, the bivariate relationship between trade openness and unemployment might not adequately explained because some of factors such as the quality of institution of a country and business environment might play an intermediary role. Theoretical studies have suggested that good institutions and better business environment are essential ingredient for firms to expand their output and job creation. This relation can be better explained empirically when other factors such as institutional quality and business environment play a moderating role in the trade openness-youth unemployment nexus for SSA since the good institutions and better business environment have been suggested as a means to create jobs in a free trade regime.

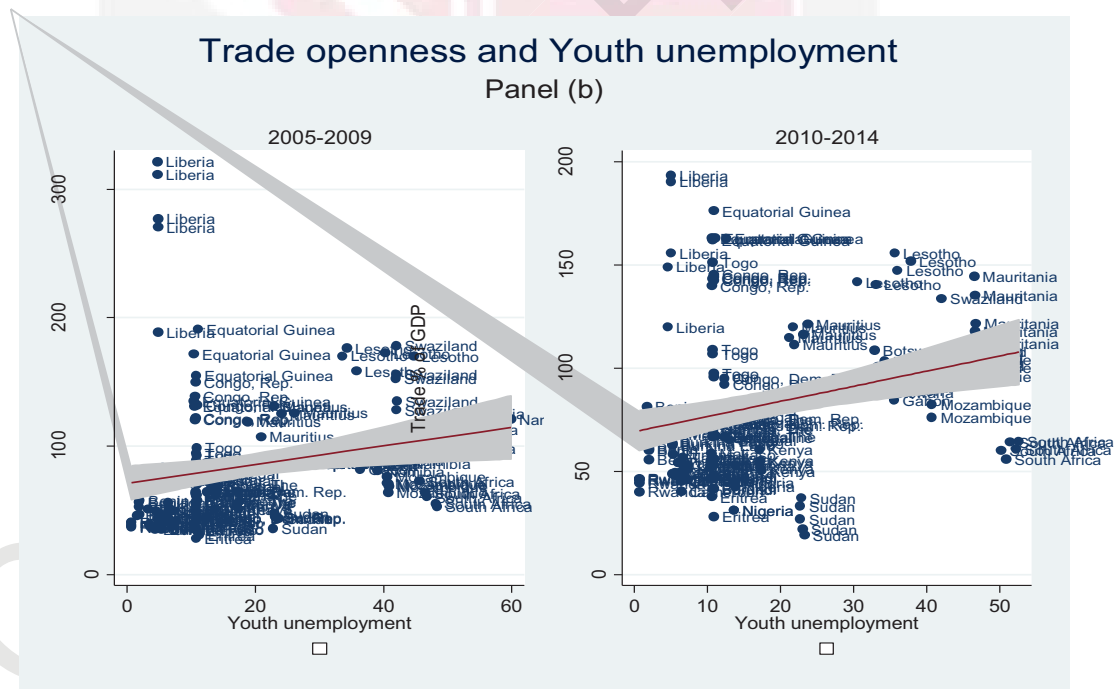
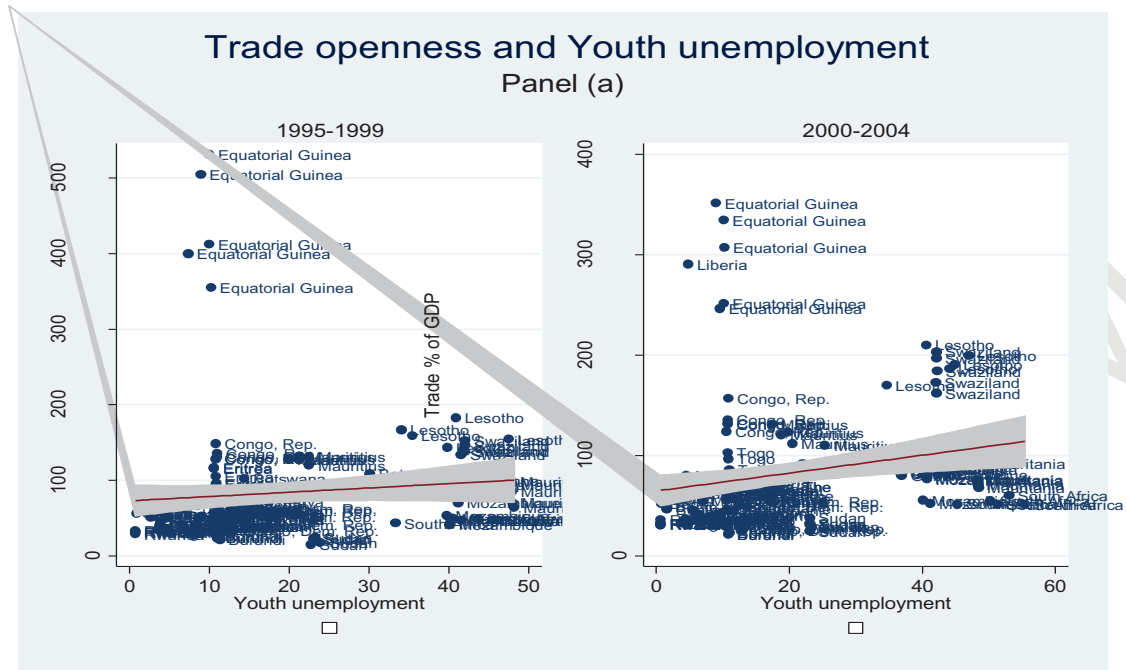


Figure 1.8 : Scatter plot of Trade openness and Youth Unemployment Nexus from 1991-2014 for 41 countries in SSA
(Source: Author's Compilation, Data from WDI, 2015)

1.1.4 Sub-Saharan Africa Trade Openness and Poverty

The direct theoretical link between trade openness and poverty rate is uncertain but a pool of economic literature have presented an indirect link between trade openness and poverty rate. According to Bhagwati & Srinivasan (2002), the theoretical and empirical analysis of the impact of freer trade on poverty in the rich and in the poor countries is not symmetric. Globalization is key to poverty reduction in developing countries according to Dollar & Misha, (2001) and Bergh & Nilsson, (2014). Dollar & Kraay (2001) gave example of India and China on how these countries have reduced poverty through the ability to integrate very fast into the world economy. Arguably, it is said that more opened economies have the tendency to do better than closed ones in terms of economic progress in the long run and this will translate to poverty reduction. A number of countries in Sub-Saharan Africa have reduced or even eliminated barriers to trade and accepted the ideas behind trade liberalization. However, it seems that the gains attached to opening up to international economic forces are limited in Africa, mostly the poor people (Le Goff & Singh, 2014). In the past, trade-poverty nexus have been reduced to theoretical studies with only a few empirical studies (Le Goff & Singh, 2014). However, Winter & McCulloch (2004) and Ravallion (2006) concluded that trade openness can be detrimental or favourable to the poor based on the level of economic growth and stability, household and market operations, wages and employment and government revenue. Since the recent emphasis on the importance of institutional quality and business environment in economic literature, this study investigates their indirect role in the trade openness-poverty nexus for SSA. Several researches using various approaches, whether intra-country or cross-country studies, have shown that international trade contributes to economic growth, and thus has the capacity to move many poor people out of poverty. However, the domestic environment is a means through which the poverty reduction benefits of increased trade can be achieved. Complementary domestic policies and institutional arrangements which are needed include: regulations that foster labor mobility, adequate financial development, good investment climate, government effectiveness and good public infrastructure.

A number of proxies to measure poverty have been suggested in literature. Poverty headcount, Gini coefficient and income per capita have been suggested but these proxies are not without problems because the dimensions of poverty such as deprivation in education, health and standard of living are not accounted for. Also, the data on poverty head count and poverty line measured in terms of United States Dollar (USD) was 1.25 a day between 1981-2011 but recently, this has changed to 1.90 USD averaged for the period of three years (See World Bank, 2016). Again, these data is only available for few countries and few years and this has made the usage of the other proxy for poverty rate was necessary. More reliable to measure poverty is data that captures ability to acquire basic necessities of life (see Woolard & Leibbrandt, 1999; Ravallion, 1992; Odhiambo, 2009). Poverty have always being measured in terms of income but the expenditure approach which have been adjudged to be more appropriately captures the ability of households to provide for their basic needs such as food, clothing and shelter. Some other studies have shown that household consumption per capita is more reliable and stable compared to income (Odhiambo, 2009). Therefore, this study utilizes the total final consumption per capita of household as a proxy for poverty reduction (see Quartey, 2005) and this measure tallies with the definition of poverty

according to the World Bank in 1990 as “the inability to attain a minimal standard of living” measured in terms of basic consumption needs.

Further, the distribution of extremely poor people across the regions in developing countries defined as people living on less than \$1.25 World Bank (2010) has changed significantly since 1981. East Asia and the Pacific were having the highest share of poor people. In recent times, East Asia and Pacific have succeeded in reducing the number of people living below \$1.25 but South Asia and Sub-Saharan Africa are lagging behind in terms of reducing poverty. Over the period of 25 years, East Asia and Pacific region has succeeded in reducing its share of global poverty to about 23 per cent by 2005. Contrary to this, South Asia and Sub-Saharan Africa increased their shares of worldwide poverty with (SA) increasing its percentage from 29 in 1981 to 43 in 2005 and SSA from 11per cent in 1981 to 28 per cent in 2005 (World Bank, 2010). From figure 1-9, SSA household consumption per capita has remained low from the 1990s to 2014 compared to other regions like Asia and Latin American who have made tremendous progress. It is obvious that SSA has lagged behind in terms of household access to basic necessities of life. Comparing different income groups across SSA as presented in figure 1.10, it is revealed that only two countries (Mauritius and Equitorial Guinea) has household final consumption per capita above the world average of 5000 USD per annum. Again, most of the countries presented in Table 1.10 have shown only little progress over the years in terms of their per capita consumption and this suggests the similar in the effort to move out of poverty by most countries in SSA. This suggests that a large percentage of countries that make up the SSA region are poor and this justifies the panel study of the SSA as a region.

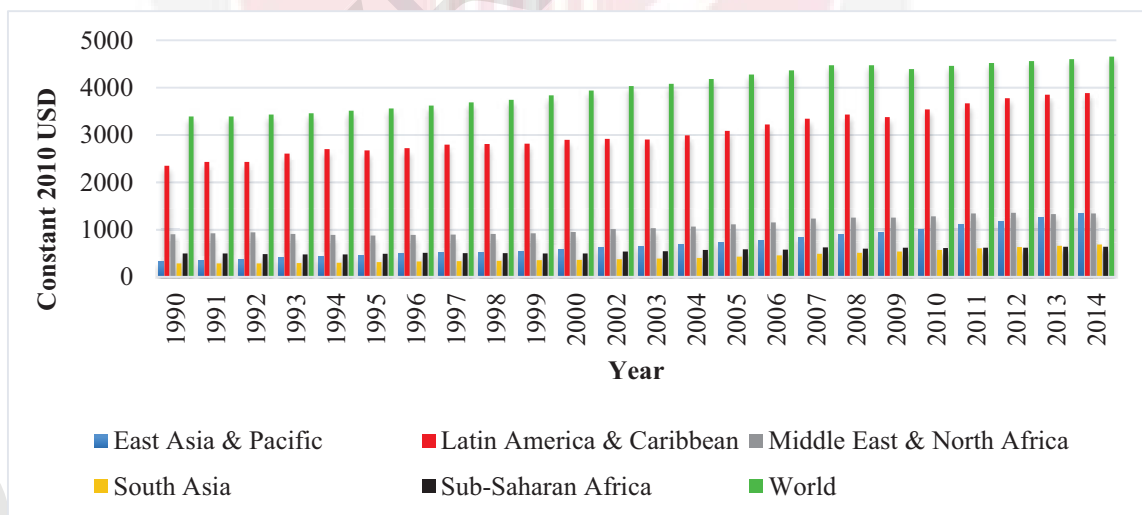


Figure 1.9 : Household final consumption expenditure per capita for regions across the world (measured in constant USD (\$))
(Source: World Development Indicator, 2015)

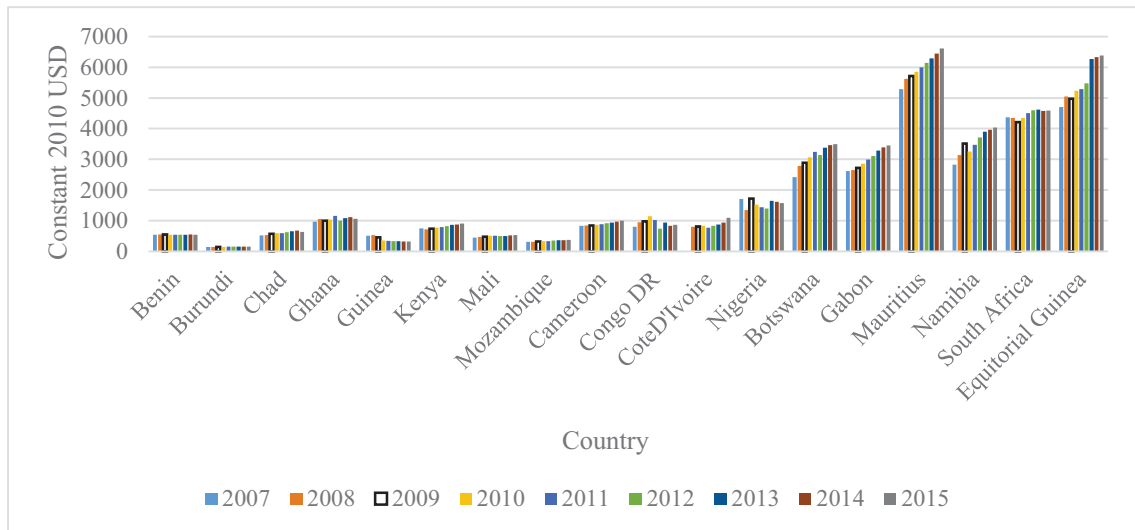


Figure 1.10 : Household final consumption expenditure per capita for selected countries in SSA (measured in constant USD (\$))
 (Source: World Development Indicator, 2016)

Theoretically, the relationship between trade openness and poverty is expected to be negative because a liberalized trade regime is arguably a means for relative factor prices to rise in favour of countries having abundance of unskilled labour (Le Goff & Singh, 2011). Based on the H-O theory, trade openness in developing countries is expected to benefit the poor who mostly unskilled labourers through various channels. These channels are: Production, consumption and labour market (employment). The impact of trade on production and consumption of the poor depends on whether they are net exporters or importers while it impact on the labour market depends on their occupation. These channels tends to be affected by the pass through of price changes because of tariff reforms. A scatter plot presented in Figure 1-11 describes a preliminary result in the case of SSA for a bivariate relationship between trade openness and poverty rate. It is noticed that the period 1995-2000, presented a slightly positive nexus between the variables under consideration but a steeper positive nexus was shown for the other three periods. This suggests that an increase an increase in trade openness is associated with a reduction in poverty since the household expenditure per capita increases. This conforms with the theory of international trade because trade is associated to improvement in the standard of living of the people depending on their endowment in terms of resources and factors of production. However, the empirical finding might reveal a more robust result when the complementary policies such as institutional quality and business environment quality are considered as indirect channels through which trade openness can affect poverty rate. Bhagwati & Srinivasan (2002) suggests that international trade can only lead to poverty reduction if complementary macroeconomic policies are put in place.

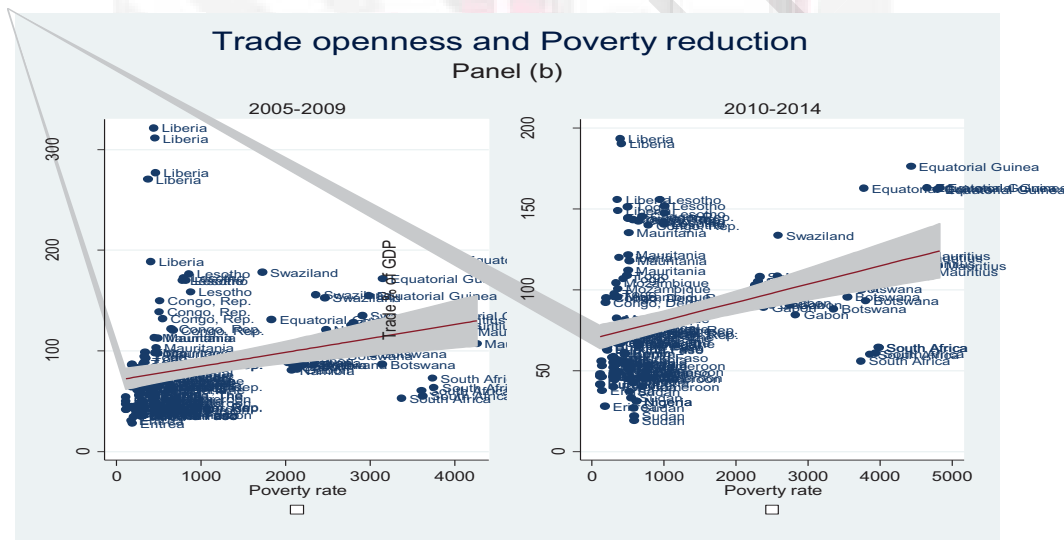
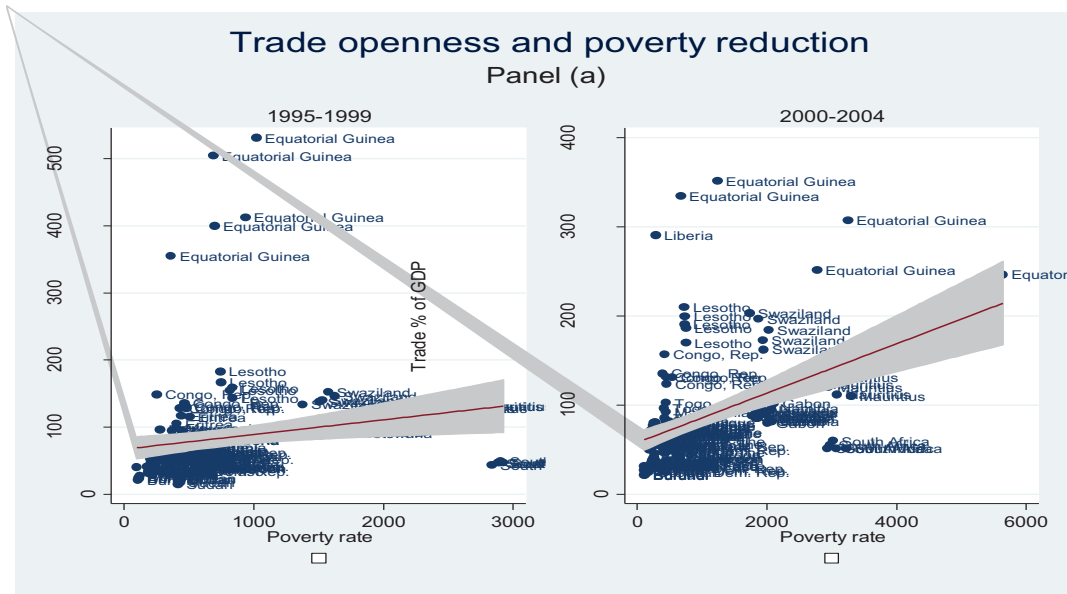


Figure 1.11 : Trade and Poverty Nexus for 41 countries from 1991-2014
 (Source: Author's Compilation, Data from WDI, 2015)

1.2 Statement of the Research Problem

The idea of free trade promoted by WTO has taken a new dimension in recent years with countries that have previously rejected its principles now have become members. As for SSA, a number of countries in the region are members in WTO but the outcome of trade openness in Sub-Saharan Africa has not been felt by many. It is very glaring from the average shares of trade in GDP of SSA countries as shown in Figure 1-2. It is observed that SSA countries have registered and maintained a reasonable level of openness compared to other regions such as Latin America, South Asia and East Asia & Pacific. The theories of international trade have asserted that more trade would lead to more economic growth, job creation and poverty reduction. Yet, this does not seem to have reflected in the growth of the SSA region because its growth performance in

the 1980s up to the mid-1990s was very disappointing (Figure 1-1). In recent times, empirical literature have connected the role of institutions to economic growth and trade openness. Generally, the performances of SSA in the quality of institutions and business environment are poor and this might be a reason for the poor economic growth, high rate of youth unemployment and increasing poverty despite its participation in international trade.

The first issue that the present study intends to examine is the link between trade openness and economic growth. Theoretically it is asserted that trade openness is beneficial to economic growth as shown in the Adam Smith and Ricardian trade models. Nevertheless, the debate has not being laid to rest despite the substantial empirical literature on trade openness and economic growth. Most empirical studies in the context of cross-country have offered inconsistent conclusions¹⁰. Again, it is argued that countries with good institutions benefit more from trade than those with bad institutions¹¹. However, the openness of trade in a country is not done at once. It takes time for it to arrive at a considerable level that will promote economic growth. The differences in growth rate across countries are mostly transitory¹², and explaining the levels is a paramount issue for economic development. These possibilities suggest a nonlinear relationship as against the linear assumption which is mostly found in empirical literature. This possibility might come in the form of U-shaped or inverted U-shaped depending on the empirical result. Moreover, the scatter plot (Figure 1-3) has shown different correlation for different time periods. For the periods 1995-1999 and 2004-2004, there is clearly a positive relationship but for the period 2005-2009, the plot suggests almost no correlation. Meanwhile, for the period 2010-2014, the relationship between trade and economic growth is slightly negative. For these periods, there exist a structural breaks in the relationship in terms of the level of economic growth. Therefore, these observations support the need to investigate the linear as well as the possibility for a nonlinear link between trade and economic growth for the SSA region.

The second issue that the present study proposes to investigate is the link between trade openness and youth unemployment. Although, total unemployment is high in SSA, youth unemployment is very much higher. The integration of young people into the labour market, their skills and education are essential to the realization of a prosperous, sustainable and equitable socio-economic environment worldwide (ILO, 2016). The United Nation defines youth as those aged between 15 and 24 years old as youths and this represent an important resource for society and account for over 18 per cent of the world's population as well as more than 15 per cent of the world's labour force. According to the International Labour Statistics, youth make up as much as 36% of the total working-age population in Africa (90% of African countries make

¹⁰ Rodriguez & Rodrik (2001) concluded that previous empirical literature on trade openness and economic growth have been plagued by so many problems such as misspecification of the model, poor data quality and choice of sample countries. Trade promote long run economic growth (Levine & Renelt, 1992 and Alcalá & Ciccone, 2004) while Kneller (2007) and Rigobon & Rodrik (2005) suggests that trade decrease long run economic growth.

¹¹ Countries with good institutions and are more open to international trade grow faster (Frankel & Romer, 1999).

¹² Easterly et al. (1993).

up SSA) and three in five of the unemployed are youth. This is accompanied by high rate of school dropouts at all levels of education and increasing population in the region. Therefore, to address the labour market and social challenges faced by youth is crucial, not only for the well-being of the young people but also to ensure sustainable and inclusive growth and improved social cohesion worldwide (ILO, 2016). Having an understanding of how certain and uncertain economic outlook such as openness to trade affects the youth in the labour market is paramount to shape the policy and institutional arrangements of affected countries because the wave of free trade experienced in the world are not beneficial to labour force in the region, especially, the youth.

The third issue that the present study attempts to examine is the link between trade openness and poverty. A heated debate still exists as to the impact of trade openness which manifests itself through the removal of tariffs and non-tariff barriers on poverty reduction in SSA. Empirical researches have sort to investigate the direct and indirect relationship between trade and poverty but has resulted in an unending debate but more of previous studies concluded that trade leads to poverty reduction¹³. Trade liberalization tends to harm the poor in the short run and even in the long run and moreover, successfully open economy might still leave some people behind¹⁴. In comparison with other regions of the world, SSA has really shown poor outing in terms of number of share of the total population living in poverty. SSA countries increased their shares of global poverty rate by 11 per cent in 1981 to 28 per cent in 2005 (World Bank, 2010). Although, the number of people living in poverty in SSA have fallen by 4 million with about 389 million living on less than 1.90 USD per day, this is scary owing to the fact that this number represents more than the poverty rate in all other regions of the world combined together (World Bank, 2013). Theoretically, the relationship between trade openness and poverty is expected to be negative. Although, from preliminary analysis, it is observed that the participation of SSA in international trade seems to have improved the rate of poverty (proxy by household consumption expenditure per capita) in the region (as shown in Figure 1-7) because for the division of the four periods, the relationship shows a slightly positive correlation. However, the situation on ground is different because the rate of poverty is still a big issue in the region. This calls for empirical investigation to include other relevant variables to reveal the actual relationship between trade openness and poverty in SSA.

1.3 Research Objectives

The general objective of the present study is to investigate the impact of trade openness on economic growth, poverty and unemployment in SSA in a dynamic panel framework. More specifically, this study intends:

¹³Participation in international trade is an essential engine for global poverty reduction (Bhagwati & Srinivasan, 2002; Dollar & Kraay, 2004).

¹⁴ (Winters, Mcculloch & Mckay, 2004)

- i. To examine the possible existence of non-linearity in the trade-openness nexus by using trade openness, institutional quality and business environment as threshold variables.
- ii. To investigate the impact of trade openness on youth unemployment by incorporating the mediating role of institutional quality and business environment on the nexus.
- iii. To examine the relationship between trade openness and poverty is contingent on the role of institutional quality and business environment.

1.4 Significance of the Study

There are several contributions that the present would make to the existing body of knowledge and policy implications. This study would be beneficial to researchers on trade and development economics because it offers new insights as to the reasons behind the persistent poverty, poor performance in terms of economic growth and increasing youth unemployment in SSA. Firstly, the present study contributes largely to literature on trade in terms of the measurement or proxy used to measure trade openness which is the trade-policy induced trade openness. The controversy as to the effects of trade openness was laid to rest from a different dimension. This study considers the weaknesses of previous studies as to the relationship between trade openness and economic growth and used the latest measure to provide new insights. To the best of our knowledge, this study serves as the only study to apply this measure to examine economic growth, unemployment and poverty based on the institutional quality and business environment in SSA.

Furthermore, most empirical researches have dwelled on the relationship between trade openness and growth using either trade shares or indices of trade openness¹⁵. Although this relationship has been extensively explored, different researchers have used different proxies for openness and rely on different methodologies¹⁶. Some have suggested the application of policy induced trade measures for accuracy. The policy induced openness (trade openness) data was obtained by netting out factors that are considered germane for countries to engage in international trade so as to arrive at the other factors that does not necessitate trade but should be given up by countries to allow for free trade. To date, no consensus has been reached as to the measurement of trade openness. This problem has made the trade openness-growth nexus open to debate.

Moreover, the interpretations of interactive models in literature have been questioned by Franzes (2008); Brambor (2006). This study adopted an updated method to interpret the interaction models specified in this study to show the relationships based on marginal effects by calculating new standard errors which supports a more robust

¹⁵For positive nexus between trade and economic growth see: Sachs & Warner (1995); Edwards (1997); Frankel & Romer (1999); Dollar & Kraay (2004); Lee, Ricci, & Rigobon (2004). Negative nexus are: Harrison & Hanson (1996); Edwards (1997); Irwin & Tervo (2002).

¹⁶Rodriguez & Rodrik (1999), Agenore (2002) and Ravillion (2004) challenged the main stream regression results on the grounds of endogeneity and misspecification.

outcome. It therefore means that, future researches in this area will benefit hugely from the outcomes of this study. Also, it is imperative to mention that the interpretation of the parameters of the interactive terms is completely different from that of the linear non-interaction models. Usually, in multiplicative interaction model such as in equation, the effects are assumed to be contingent on the factors considered and thus the marginal effect is considered. This study goes beyond the conventional interpretation of the interaction terms but to also capture different values of standard errors (minimum, mean and maximum) for each interaction term considered. This is a huge contribution to knowledge especially, the literature on trade economies.

Secondly, the proxy to measure poverty have always being in terms of income but this study applied the expenditure approach which more appropriately captures the ability of households to provide for their basic needs such as food, clothing and shelter. Future researches will also benefit from this as a more reliable proxy to measure poverty. Thirdly, in terms of methodology, this study contributes immensely to knowledge because a non-linear relationship method proposed by Hansen (1999) is applied to examine the possibility of a non-linear trade growth nexus for SSA as against the linear approach dominated in literature.

Fourthly, this study will assist in the policy direction of governments in Sub-Saharan Africa because the debates on the impact of trade openness has lingered for so long since the establishment of General Agreement on Tariffs and Trade (GATT) in 1947 and recently, WTO in 1995. Among the many policies to improve the welfare of its citizens, the decision to liberalize trade or not is paramount. The findings of this study will serve as a guide for the regional governments of Sub-Saharan African (SSA) on how trade policy changes affects the level of poverty and unemployment in the region. The findings of this study shows the performance of economies that make up SSA and how trade openness effort over the years adopted by these countries have influenced their level of economic growth and development.

Very importantly is the quality of institutions in these countries. Over the years, economies in this region have operated under poor institutions and this might have adversely affected their economic activities. The empirical results of this study would be useful to task the governments on the need to maintain high quality institutions capable of attracting foreign direct investment (FDI). Also, this research aims at providing a basis for policy formation that would revolutionize the domestic market through technological spillovers that comes with trade openness. The need to provide an enabling environment for businesses to thrive is very necessary. Boosting investor confidence is important and raising the morals of entrepreneurs through the provision of easy access to finance and improved infrastructure. The results of this study reveals the benefits of having trade openness in a conducive business environment.

1.5 Organization of the Chapters

This dissertation is structured into five chapters. Chapter one presents a detail background discussion on SSA's economic performance in terms economic growth, poverty and unemployment. This is followed by the highlights of research issues, research objectives and significance of the study. Chapter two provides a critical review on, both theoretical and empirical literatures, related to the three issues examined as well as theoretical foundations of the study. The research methodology adopted in this study is presented in chapter three; while chapter four discusses the results derived from the empirical estimations. Lastly, chapter five conclude the study by summarizing the findings and highlighting the policy implications. The chapter also includes discussion on the limitations of the study and some suggestions for future research.



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