ECONOMIC DEVELOPMENT IN AFRICA
2008

EXPORT PERFORMANCE FOLLOWING TRADE LIBERALIZATION:
Some Patterns and Policy Perspectives
This chapter discusses some specific policy proposals that could help strengthen Africa’s export performance. It is not exhaustive, but rather indicates some specific policy perspectives, which follow from the analysis of the previous chapters. This analysis shows that (a) to date, the benefits of trade liberalization for the agricultural and manufacturing sectors have been limited; and, (b) this is due, in part, to a lack of complementary policies addressing structural, institutional and socio-economic constraints that restrain African economies’ supply response to export opportunities.

The policy proposals presented in this chapter are founded on the view that export development requires more than trade liberalization, and that trade policy needs to be closely linked to sectoral development policies. Constraints on supply response are best addressed by specific sectoral policies, and not just macroeconomic policy reforms. Macroeconomic and political stability as well as policy predictability are necessary foundations for agricultural and industrial sectoral policies in Africa.

Each country’s priorities will also have to be set in accordance with the country’s specific circumstances. As a result, countries’ development strategies in the two sectors will have different policy combinations. The proposals provide a menu of some indicative lines of action from which specific policies can be chosen.

A. Agricultural exports

“Agriculture... offers great promise for growth, poverty reduction and environmental services, but realizing this promise also requires the visible hand of the State – providing core public goods, improving the investment climate, regulating natural resource management and securing desirable social outcomes” (World Bank, 2008b: 2).
The benefits of trade liberalization for the agricultural sector have been limited. This is partly because of the lack of a complementary policy package to address structural, institutional and socio-economic constraints that restrain agricultural supply response and exports. These issues are best tackled by specific sectoral policies and not macroeconomic policy reforms as such. However, it is important that sectoral and macroeconomic policies are mutually reinforcing. Given that some of the problems facing Africa’s agricultural exports have to do with conditions in global markets, the strategy to promote Africa’s agricultural exports must be based on polices by national Governments, working in cooperation with Africa’s development partners.  

The overall development strategies of countries should incorporate agricultural sector development strategies, which take into account the agro-ecological conditions of each country, and go beyond strategies for developing crop agriculture. The strategies should incorporate complementary programmes to develop off-season employment activities as a means of revitalizing the rural economy and addressing food security concerns within a holistic framework. Increased opportunities for year-round employment will also help to stem the flow of rural–urban migration of able-bodied young people who could be encouraged to take to farming as a profession and replace the growing population of ageing farmers. The agricultural sector development strategies should incorporate some or all of the following issues, depending on the development priorities and agro-ecological conditions of each country.

1. **Supply-side constraints**

These constraints should be addressed through an integrated programme of “supply-side measures” with two main objectives of tackling supply-side constraints critical to:

(a) Creating greater incentives to encourage investment in the agricultural sector, and to improve agricultural productivity and exports; and

(b) Enhancing the competitiveness of African agricultural exports vis à vis those of other developing regions.

The integrated programme of “supply-side measures” should have the following components:
(a) Incentive package

A comprehensive package of fiscal and other incentives to investors in the agricultural sector should be developed. The incentive package should be compatible with the Government’s macroeconomic objectives and tailored to its agricultural development priorities. For example, greater incentives and facilities could be provided to those investing in new market dynamic income-elastic products such as horticultural products and processed food. In this regard, the following steps should be taken:

(a) Set up an input subsidies programme, carefully designed and targeted at specific groups to improve agricultural productivity;

(b) Improve access to credit by enhancing the efficiency of the financial sector, including reducing segmentation between formal and informal sectors, and improving interactions between financial institutions and the private sector (for details see section B.3 below);

(c) Set up special export development and investment funds to provide financial resources in support of business ventures in agriculture. This could be supported by donors and contributions from the private sector, e.g. exporters’ associations and chambers of industry and commerce.

(b) Improving productivity

The State, perhaps in collaboration with private-sector agents, should increase the level of investment in technology, infrastructure (roads, irrigation facilities and post-harvest storage), extension services, supply of inputs, and research and development to improve productivity and quality of smallholder farms. It should also improve marketing systems. Considering the reduction in government expenditure allocated to agriculture in the past two decades, increased public investment in rural infrastructure, research, extension and improved marketing is critical. Governments should therefore endeavour to meet their commitment under the New Partnership for Africa’s Development’s (NEPAD’s) Comprehensive Africa Agriculture Development Programme to increase public expenditure on agriculture as a share of total government expenditure to 10 per cent by 2008.37 Specifically, increases in productivity and in agricultural supply response could be attained through doing the following:

(a) Design and implement “green box” policies,38 especially to support poor farmers in remote rural areas. These policies are classified as non-
trade distorting, and are not proscribed by the WTO Agreement on Agriculture;

(b) Provide health, water and educational facilities as a means of improving the overall quality of rural life.

(c) Reforming socio-economic institutions

In the medium-to-long term, Governments have to deal with socio-economic institutions that inhibit the efficient deployment of various factors of production — such as land tenure systems and associated inheritance systems — and gender relations governing the division of labour and division of income accruing from farming ventures. This will necessitate specific policies for:

(a) Land reforms; and

(b) Improving the property rights of women. This is important in view of the fact that women account for much of the agricultural production in sub-Saharan Africa but, most often, their role is not acknowledged in the design and implementation of agricultural policy interventions.

Engineering changes in the social structure of societies would be very difficult to accomplish. It may be necessary, therefore, that proposed changes to these socio-economic institutions be derived from the results of field research, including close consultation with various communities as so as not upset the delicate balance among them.

2. Diversification and value addition

Governments have to develop programmes that promote diversification towards higher value added products. These will enable African countries to increase their gains from agricultural production and trade. It will also permit Governments to reduce their vulnerability to commodity price volatility and to boom and bust cycles. Some possibilities include the following:

(a) Export promotion authorities in collaboration with exporters’ associations should launch programmes to collate and disseminate market information to producers;

(b) A “diversification fund” with support from development partners (i.e., within the context of the second window of the Common Fund for Commodities) should be set up.39
The opportunities for such diversification are influenced by the existence of health and safety standards in international trade, and the capacity of producers in African countries (especially small farmers) to comply with them. This draws attention to the need for programmes to promote market penetration and improved market access.

3. Market access

For African countries, improving market access entails the need to adapt to increasing global integration and its associated challenges of increased competition. A major implication of these challenges for African producers is that they must increase their participation in global value chains to be able to access the markets of developed countries and emerging economies. Participation in these chains gives producers access to information about markets and enables buyers to obtain information about, and develop confidence in, the supplier. For specific products, however, the entry of producers, processors and traders into the value chain depends on product characteristics, technical requirements, market structures and the organization of trade.

The determining factor in market entry is the capacity to upgrade and produce according to specific requirements relating to quality, health and environmental standards, as well as consumer preferences and tastes. Presently, some African producers encounter difficulties in meeting these standards. This notwithstanding, standards have an important and positive role to play in the development and expansion of world trade. For example, the compliance with sanitary and phytosanitary standards enables the effective management of risks associated with the spread of plant and animal pests and disease. Compliance with these standards also helps to stimulate value addition, innovation and product differentiation. With this in mind, the following should be considered:

(a) Governments, in collaboration with exporters’ associations, should set up capacity-building programmes to assist with trade standards compliance;

(b) Information bureaus should be set up to give information on requirements for participating in global value chains, to promote the use of opportunities in dynamic markets. Some of these programmes could be supported by donors bilaterally or within the framework of Aid for Trade (see below).
Total elimination of trade barriers in developed countries is critical for enhancing the benefits African countries derive from their participation in international trade in agriculture. Simulation exercises have shown that developing country benefits from eliminating agricultural support measures are relatively small if all trade barriers are not eliminated (Hoekman et al., 2002; Gayi, 2007). Concerning these issues:

(a) Liberalization of international trade in agriculture should go hand in hand with policies to ensure an objective application of various sanitary and phytosanitary measures, technical barriers to trade and environmental standards, which are increasingly being deployed as non-tariff barriers, even as tariffs are being eroded; and

(b) Ongoing agricultural negotiations in the Doha Round provide a legitimate framework within which to address the pressing market access problems of Africa’s agricultural exports. The speedy conclusion of the round in a manner that addresses the trade and development concerns of African countries will therefore send a strong positive signal to these countries that their priorities could be taken care of within a multilateral framework.

4. Private sector participation

A major challenge for new African entrants is how to identify market opportunities and meet the specific requirements for each market. This necessitates a constant examination of diversification opportunities, as areas of competitive advantage are dynamic and change constantly. Considering the weakness of the private sector in much of Africa, and the “public goods” nature of these services, they would have to be provided by Governments or in partnership with the private sector under public–private partnership arrangements, depending on country circumstances. In addition, the application of global value chains to agriculture means that private sector development in agriculture cuts across several policy domains, including improvements in the overall business environment and contract enforcement, and the development of business service providers. Exporters associations and producers cooperative should form partnerships with Governments to enforce contracts, including producing to meet specified standards.
5. Regional integration, South–South trade

Governments, in partnership with the private sector, need to promote regional economic cooperation, with the objective of overcoming the constraints of small domestic markets and diversifying away from traditional bulk primary commodities into market-dynamic products. Africa already has a variety of regional economic groupings at different stages of trade integration. However, a major problem for most of them is the weak implementation of trade protocols signed by members. Countries should comply with the obligations of all regional trade protocols they have entered into in order to promote intra-African trade in line with NEPAD priorities, which underscore regional economic groupings as “building blocks” for African economic integration.

The emergence of “Southern drivers” of the global economy suggests that Africa must rethink its existing trade and development strategies and reorient its external trade towards new growth poles in Asia, such as China and India, but also Brazil and the Russian Federation:

(a) Export promotion authorities and exporters’ associations should increase their participation in various South–South arrangements (e.g., Forum on Asia–Africa Cooperation in Export Promotion) with a view to identifying export market opportunities beyond oil and minerals in Asian/emerging markets; and

(b) Governments and the private sector should explore the increasing trade and financial links with China, India and other emerging economies by encouraging foreign direct investment (FDI) into their agricultural sectors. Oman, for example, is contemplating investing in food production in Africa, to be exported to the Middle East and Asia.

6. Aid for Trade, development partnerships

It is important to sustain the recent increases in aid to sub-Saharan African agriculture in view of the important role of ODA in funding public investments. However, greater coordination and harmonization of aid among donors and with recipient countries will be critical in ensuring its effectiveness (UNCTAD, 2006) in addressing the priorities of the agricultural sector in each country. African countries require technical assistance programmes to help them adjust to the new global environment, in particular the food and health standards enunciated in sanitary and phytosanitary and technical barriers to trade agreements, as
well as the private standards of supermarkets. These could be delivered with the framework of Aid for Trade and other trade and trade-related technical assistance, such as the Enhanced Integrated Framework.

A few such trade capacity-building programmes are already running and are excellent examples of bilateral cooperation between Africa and its trading partners in providing trade and trade-related infrastructure to facilitate market penetration. One such programme is the West Africa Trade Hub in Accra set up by the United States Agency for International Development, which provides technical assistance to investors who want to export to the United States. Second, in order to meet the sanitary requirements of developed countries, a new faculty exchange programme was instituted in August 2007 to enable African agricultural specialists to study at American universities. This United States–Africa Sanitary and Phytosanitary Capacity-Building Programme has established a partnership with African scientists and scholars to promote sound agricultural teaching and research techniques. These programmes could be replicated by the European Union (for African countries that benefit from the Everything But Arms initiative) and countries that have preferential trade arrangements for African countries.

During the round table discussion on commodities at UNCTAD’s quadrennial ministerial conference, held in Accra, Ghana, in April 2008 (UNCTAD XII), there was a consensus that the varying interests of producers and consumers would need to be reconciled through international dialogue and consensus-building on policy actions to deal with commodity problems and related issues. A three-pronged international policy action, including through the intergovernmental framework of UNCTAD, was identified as the way forward. These include:

(a) Integrating commodity policies into national, regional and international development and poverty reduction strategies in order to ensure the attainment of the Millennium Development Goals;

(b) Agreeing on trade-related policies and instruments for resolving commodity problems, including through the Doha Round; and

(c) Designing investment and financial polices for accessing financial resources for commodity-based development, including with respect to ODA, Aid for Trade and contingency financing, among others.

In conclusion, the complex characteristics of agriculture, its potential for poverty reduction and impact on the environment suggest that the sector does
not lend itself to simple policy solutions. Agricultural policies cannot realistically be formulated independent of other sectors and should therefore be an integral part of overall economic development policy. Governments have to make complex policy choices and carefully weigh the trade-offs before agreeing on any policy package to diversify and enhance agricultural exports. Such policy choices should take into account the intersectoral dimensions, bearing in mind various linkages between the agricultural, manufacturing and services sectors. In this context, it is propitious that NEPAD has identified agriculture as a priority for the continent. Its Comprehensive Africa Agriculture Development Programme\textsuperscript{42} launched in 2003 should provide some policy directions to Governments concerning the trade-offs entailed.

\section*{B. Exports of manufactures}

In view of the disappointing experience of commodity-based exports in Africa, one of the objectives of trade liberalization was to reallocate resources towards the production of exports, including manufactured products. However, as discussed in this report, trade liberalization has had a very limited positive effect on the production and export of manufactured products; Africa’s world market shares of manufacturing exports are negligible. The question now is what African countries should do to increase their participation in the international trade of manufactured products. As argued in this report, the key challenge is how to improve the microeconomic determinants of efficient manufacturing production that can compete in world markets. Three interrelated actions are proposed to strengthen the productive capacity of the manufacturing sector: increasing the competitiveness of manufacturing firms, helping the expansion of firm size and facilitating firm access to factors of production in order to invest and grow.

\subsection*{1. Increasing firm competitiveness}

Efficiency is arguably the most important factor that determines a firm’s competitiveness and participation in export markets. In Africa, the need to increase competitiveness through the overhaul of the current production and export infrastructure cannot be overemphasized (UNCTAD, 2007). Competitiveness must be built at the economy and firm level.
(a) **Competitiveness at the economy level**

Building competitiveness at the economy level has to deal with several issues:

(a) Overhauling the basic productive infrastructure to make production more reliable. Power generation, water supply and telecommunications are three key areas that need special attention. In addition, building a competitive manufacturing sector will require the strengthening of the support infrastructure needed for exporting, including roads, railways and port facilities. Some countries are confronting the infrastructure challenge head-on. For example, Nigeria is taking advantage of the recent surge in its oil revenue to modernize its energy sector, expand its railways network and upgrade its telecommunications infrastructure. The Democratic Republic of the Congo has also mobilized funds, through a bilateral loan, to finance an ambitious programme to overhaul its infrastructure sector. Over the next few years, the country intends to build (a) 3,200 kilometres of railways; (b) close to 4,000 kilometres of asphalt roads; (c) a highway linking the country to Zambia in the south; and (d) 31 hospitals, 145 health centers, 2 universities and 5,000 units of social housing. Angola is also implementing significant infrastructure projects.

(b) Helping the countries without their own resources to mobilize external capital for infrastructure finance from three sources:

- Allocating a bigger share of ODA to infrastructure development. For example, doubling the current share of ODA to GDP allocated to infrastructure would just bring the figure to its 1990s level. Hence, doubling the share of ODA allocated to infrastructure should be considered as a minimal objective;

- Using new private flows for infrastructure development in Africa coming from sovereign and other investment funds, particularly those from the Middle East;

- Capitalizing on international investors’ renewed interest in Africa’s economies by issuing sovereign bonds to mobilize resources for infrastructure investment. Ghana, for example, has recently mobilized $3.2 billion through such a mechanism, an amount four times higher than what the country had expected to raise.
Encouraging cross-border trade infrastructure. It is unlikely that the manufacturing sector in Africa will grow to a competitive level if it is limited to small domestic markets. The smallness of individual African markets and the difficulty for most firms to access the markets of industrialized countries suggest that in the short and medium term, the expansion of intra-African trade could offer the opportunity to widen markets outside national boundaries. In so doing, some key infrastructure projects could be executed at the regional level, taking into account regional economic complementarities. The NEPAD initiative on regional infrastructure could provide the basis for such cooperation. The African Development Bank has been identified as the leading institution in the mobilization of resources for infrastructure development, while NEPAD’s Medium- to Long-Term Strategic Framework (MLTSF) spells out the key modalities for the development of regional infrastructure in Africa.

**(b) Competitiveness at the firm level**

Firm competitiveness for exporting could be improved through three channels:

(a) Increasing labour productivity by promoting vocational training, on-the-job training and the sharing of best practices in production processes;

(b) Building firm-level technological capabilities so that they can upgrade technology to meet the standards and other norms required by the current trading system as well as export markets;

(c) Devising appropriate incentives to orient manufacturing production towards the export market in order to benefit from the efficiency gains and other advantages accruing to exporting. This could be done through an efficient export promotion agency tasked with providing information on market opportunities, standards and other export requirements. Given its “public good” nature, the creation of this agency should be sponsored by the State but, if necessary, managed privately. In the long term, efficiency gains from exporting could compensate for the eventual short-term cost of its creation.

It should be noted that the development of a reliable production and export system has important externalities that benefit the economy at large. Learning by exporting and creating linkages between both large and small exporting and
non-exporting firms — through, for example, subcontracting arrangements — create such positive externalities.

In short, it is expected that higher labour productivity, low indirect costs and better production and support infrastructure could help to create firms that are more efficient and bring about a competitive manufacturing sector in Africa.

2. The need for large manufacturing firms

Empirical evidence suggests that only large firms export in Africa. However, the continent’s size distribution in the manufacturing sector is heavily skewed towards very small firms, which raises an important policy issue: how to increase the number of large firms in Africa’s manufacturing sector in order to raise exports. There are two possible ways: (a) encourage the creation of large manufacturing firms, right from the beginning. The second is to create an enabling environment that helps young small firms to grow and become large (see next section).

Encouraging the creation of large firms

There are two ways through which African countries can encourage the creation of large firms:

(a) Encouraging FDI in the manufacturing sector: empirical evidence based on Africa’s manufacturing data shows that firms with foreign ownership export more than domestic ones, and they are on average larger. In Africa, FDI has tended to flow primarily into the extractive sector, with very few linkages with the rest of the economy. This helps explain why FDI has had a limited positive effect on key development indicators such as employment creation and poverty reduction. FDI flows in Africa’s manufacturing sector usually have a more positive effect on development indicators because of the labour intensity of the sector. The policies and actions needed to encourage such flows have been discussed in the 2005 Economic Development in Africa report (UNCTAD, 2005).

(b) Tapping domestic resources for investment in the manufacturing sector: there are African entrepreneurs who do not invest in Africa even when they are capable of mobilizing the required resources to start large firms. A number of Africans prefer to send their money abroad because they do not find the domestic environment conducive for business (UNCTAD, 2007). Such investors stay or return to Africa only if they find that the expected
risk-adjusted return on their capital is as high as in other economies. Hence, deepening political and economic stability and providing a predictable legal and regulatory framework would probably help to bring these potential investors back and contribute to the development of a dynamic manufacturing sector.

Encouraging the creation of large firms may appear to be an obvious recommendation but it poses a policy dilemma. In Africa, many firms are so small that growth and exporting is not their objective. The main (sometimes sole) objective is to sustain the livelihoods of their owners and their families; this is a very important socio-economic role which must be acknowledged. Therefore, if a country’s priority is to reduce poverty and ensure a relatively fair distribution of income, assistance should target the smallest firms. On the other hand, a viable export sector can only be created if assistance is concentrated on the needs of a relatively small number of large firms. Hence, if the policy objective is to create and sustain a vibrant export sector, the focus should be on the creation of large firms. In a world of limited resources, it is not obvious that these two objectives can be pursued simultaneously. As such, the development priorities of each country would determine the most relevant objective and the policy choices made to attain it.

3. **Facilitating access to credit to invest and foster firm growth**

One reason why African entrepreneurs start very small firms is their limited access to capital. Start-ups rely on the private resources of their owners since they cannot have access to credit or raise resources from the capital market in view of the weaknesses of the financial sector in Africa. Hence, the low level of income in Africa helps to explain why start-ups are generally very small. The question of start-up size would not be an issue if firms could easily access factors of production, particularly credit, in order to invest, grow and eventually reach the large size needed to be competitive in export markets. There are two key areas of focus: facilitating access to credit and fostering interactions between financial institutions and the private sector.

**(a) Access to credit**

Access to credit is among the most important determinants of firm performance. However, in Africa, small firms are credit-rationed, particularly because the traditional banking sector is not adapted to serving this market
segment; the transactions costs of processing such applications are simply too high. This problem can be alleviated in two ways:

(a) Developing informal and semi-formal credit institutions more adapted to the needs of the small firms that dominate Africa’s manufacturing sector. These institutions may have a role to play in the short term, but it is doubtful if they are the best long-term solution to the credit problem, given their limited resources. Therefore, modernizing the financial sector should be the long-term objective to create a deeper financial sector.

(b) Creating credit information bureaus could narrow, at low cost, the information asymmetry between small credit applicants and financial institutions. These institutions collect information on the creditworthiness of potential applicants and share it with lenders at relatively low cost. In view of the potentially high social returns to such an initiative, Governments could help the private sector in establishing such bureaus, through public-private partnerships. For efficiency, it would be desirable that the bureaus be privately managed.

(b) Creating a framework of interaction between financial institutions and the private sector

This could help to bridge the information gap between the demand for and supply of credit. In most African countries, these two entities work in isolation. Banks wait passively for clients while the latter complain of not having information on banks’ expectations and modus operandi. In addition, banks have credit application procedures that are sometimes so complex that potential credit applicants are discouraged from even attempting to apply. In this regard:

(a) Regular contacts should be organized between representatives of the private sector and the banking system, possibly through the chambers of commerce, to exchange ideas on issues of mutual interest.

(b) Commercial banks could consider opening in their agencies special windows dedicated to small enterprises, as this has been successfully experimented with in some countries. These windows go beyond the traditional loan evaluation functions. They also help small enterprises prepare their loan applications and provide some training in project management;

(c) Education programmes and outreach campaigns should be organized on a regular basis, to increase the awareness of private sector actors,
particularly small enterprises, on different business opportunities available to them. Helping small firms to invest, grow and participate in export markets would be beneficial to all.

C. Conclusion

The limited response of agricultural and manufacturing exports to the new incentive structure put in place by trade liberalization suggests that other actions beyond trade policy are needed to increase Africa’s exports of agricultural and manufacturing products. The challenge is how to enable African economies to make the best use of the new environment to seize export opportunities offered by the world economy. In order to mobilize domestic resources to help finance the policies discussed above and compensate for any short-term loss in revenue due to trade liberalization — for example, the loss of traditional revenue from trade taxes — African countries should identify “new” domestic financial resources. These include migrant remittances, efficiency gains in tax collection and use, and repatriation of capital flight (UNCTAD, 2007).

Trade liberalization should not be seen as an end in itself. As implemented in Africa, it has sometimes been conflated with a development policy strategy. Trade liberalization should be one of the means within a comprehensive development strategy through which African countries can achieve higher rates of economic growth. In this regard, “an international environment that supports a gradual approach to trade liberalization in Africa would be welcome” (Economic Commission for Africa and African Union, 2008: 13). It is time to shift the focus back to the development strategies consonant with the development challenges and priorities of African countries.
## Appendix table

### Trade liberalization and trade performance: Generalized Method of Moments econometric results

<table>
<thead>
<tr>
<th>Variable</th>
<th>Export equation</th>
<th>Import equation</th>
<th>Trade balance equation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Full sample</td>
<td>Africa</td>
<td>Non-Africa</td>
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<tr>
<td>Lagged dependent variable</td>
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<td>0.785**</td>
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<td></td>
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<td>[0.032]</td>
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<td>0.008**</td>
<td>0.009**</td>
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<tr>
<td></td>
<td>[0.002]</td>
<td>[0.003]</td>
<td>[0.003]</td>
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<tr>
<td>Change in terms of trade</td>
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<td>0.002**</td>
<td>0.002**</td>
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<td></td>
<td>[0.000]</td>
<td>[0.000]</td>
<td>[0.000]</td>
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<tr>
<td>Change in REER***</td>
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<td>-0.313**</td>
<td>-0.190**</td>
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<td>Trade liberalization dummy</td>
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<td>Lagged domestic growth</td>
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</tbody>
</table>

* Represents statistical significance at the 5% level. The numbers in brackets are robust standard errors.

** Represents statistical significance at the 1% level. The numbers in brackets are robust standard errors.

*** Real effective exchange rate.