

# Industrializing through trade



ECONOMIC REPORT ON AFRICA



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2015

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# CONTENTS

List of figures, tables & boxes	vii
List of abbreviations used	x
Acknowledgments	xii
<b>FOREWORD</b>	<b>xvi</b>
<b>EXECUTIVE SUMMARY</b>	<b>xviii</b>
<b>KEY FINDINGS</b>	<b>xxi</b>
<b>POLICY RECOMMENDATIONS</b>	<b>xiv</b>
<b>CHAPTER 1:</b>	
<b>RECENT ECONOMIC AND SOCIAL DEVELOPMENTS</b>	
<b>IN AFRICA AND MEDIUM-TERM PROSPECTS</b>	<b>1</b>
<b>AFRICA'S GROWTH PERFORMANCE</b>	<b>5</b>
Expansion is set to continue	5
Private consumption and investment are the key growth drivers	7
Growth is expected to increase across all economic groups	9
Growth varies between subregions	9
Employment is yet to pick up	11
Inflationary pressure stays subdued	12
Most African currencies will continue to depreciate	15
Fiscal deficits are narrowing	18
The falling oil price will affect current accounts	21
International reserves among oil exporters remain high but are deteriorating	22
Private inflows are rising	24
Private equity is an opportunity	27
African countries with higher savings make fewer domestic investments	29
Risks and uncertainties	30
<b>AFRICA'S TRADE PERFORMANCE</b>	<b>32</b>
The merchandise trade boom is tapering off	32
Services trade is changing its composition	36
Net—Africa exports goods but increasingly imports services	41
<b>CONCLUSIONS</b>	<b>42</b>
References	43
End Notes	44

<b>CHAPTER 2: STRUCTURAL CHANGE AND SOCIAL DEVELOPMENT</b>	<b>45</b>
<b>GROWTH AND STRUCTURAL CHANGE UNDER SHIFTING POLICY PARADIGMS</b>	<b>48</b>
<b>SOCIAL DEVELOPMENT AND STRUCTURAL CHANGE: A BI-DIRECTIONAL LINK</b>	<b>56</b>
Poverty and inequality	56
Demography and urbanization	58
Africa’s rapid urbanization without industrialization	59
Building an educated and healthy workforce	60
Constraints of primary education	61
Improved secondary education, but not enough for the labour market	63
Transition from school to work	63
Progress in health is essential for labour productivity and industrialization	63
Potential productivity gains stymied by weak education and health care	64
Employment in manufacturing and services as an outcome of structural change	64
Employment-to-population and participation ratios increase in Africa	66
Weak labour productivity is curtailing Africa’s employment prospects...	66
... which can fuel economic and social instability	66
Informality still drives jobs	66
<b>TRADE AND EMPLOYMENT</b>	<b>68</b>
<b>CONCLUSIONS</b>	<b>68</b>
References	69
Appendix 2.1	71
End Notes	72
<b>CHAPTER 3: THEORIES AND EXPERIENCE</b>	<b>73</b>
<b>THEORETICAL UNDERPINNINGS OF TRADE’S BENEFITS IN INDUSTRIALIZATION</b>	<b>74</b>
<b>A SELECTIVE TRADE POLICY FRAMEWORK</b>	<b>76</b>
Keeping up with the leaders	80
Regional integration is still a triumph of hope over experience	81
Towards a coordinated and harmonized trade for industrial development in Africa: United we stand, divided we fall	82
<b>TRADE POLICY COHERENCE AND SELECTIVITY IN A SHRINKING POLICY SPACE</b>	<b>84</b>
Coherence needs to be beefed up	84
Getting everyone on board: the political economy of trade policy reform	86
Policy space is narrowing	88
<b>CONCLUSIONS</b>	<b>91</b>
References	92
Appendix 3.1: Key elements of trade and industrial policy in 10 countries	94
End Notes	96

<b>CHAPTER 4: REPOSITIONING AFRICA IN GLOBAL VALUE CHAINS AND FACILITATING TRADE IN INTERMEDIATES AND SERVICES</b>	<b>97</b>
<b>GVCS AND INDUSTRIALIZATION</b>	<b>98</b>
<b>STRENGTHENING PARTICIPATION IN VALUE CHAINS</b>	<b>101</b>
African countries show high participation in GVCs, though at low rungs	101
Regional chains are a much-needed step towards global chains	102
The development and promotion of local and regional agro-food chains are very promising and lucrative agro-business ventures	105
Intra-African trade in intermediates offers broader scope for regional chains to emerge	109
Countries have shown their determination to join value chains	110
<b>THE PERSISTENCE OF BARRIERS TO TRADE</b>	<b>113</b>
Key supply-side constraints	113
Trade policy constraints	115
<b>AFRICA'S TRADE IN INTERMEDIATE PRODUCTS</b>	<b>118</b>
Imported intermediates have surged but without boosting Africa's competitiveness	118
Intermediate exports have increased vigorously, but remain dominated by mining and resource-based manufactures	121
<b>SERVICES IN AFRICA'S STRUCTURAL TRANSFORMATION</b>	<b>125</b>
Services provide essential inputs to most other businesses	125
The services sector can attract much needed foreign investments and private equity finance into Africa	125
Services have the potential to be an engine of job creation	125
Across Africa, growth in services is strongly correlated with growth in GDP and growth in manufacturing value added	126
Services are increasingly important in African economies	126
Some African services subsectors have seen a particularly strong growth, though not always being translated into better services for local firms	129
The services sector is an avenue for economic transformation, as not all countries have a competitive edge in manufacturing	129
<b>CONCLUSIONS</b>	<b>133</b>
References	135
Appendix 4.1 Correspondence between OECD and bilateral trade database by end-use category and other trade classification	137
End Notes	138

<b>CHAPTER 5: GETTING TRADE AGREEMENTS TO ADVANCE AFRICA'S INDUSTRIALIZATION</b>	<b>141</b>
<b>FAILURE OF PREFERENTIAL SCHEMES TO BROADLY ENHANCE INDUSTRIALIZATION</b>	<b>143</b>
Economies offering trade preferences have absorbed a large share of Africa's exports, but such schemes have done little to help Africa industrialize	143
Reducing exclusion lists and finding a balance between productive capacity and rules of origin	146
Trade preferences alone cannot build RVCs, though they can support a favourable environment	148
<b>REINFORCING TRADING RELATIONSHIPS WITHIN THE CONTINENT AS A STRONGER BASIS FOR INDUSTRIALIZING</b>	<b>149</b>
The TFTA would not exclusively stimulate industrial production of big players	149
Boosting intra-African trade and its industrial content through CFTA	151
CFTA must be accompanied by ambitious complementary reforms, notably trade facilitation	151
Enhancing intra-industry trade and opportunities to move up the value chain through CFTA	152
<b>NEED FOR AFRICA-WIDE STRATEGIC TRADE POLICIES WHEN OPENING TO THE REST OF THE WORLD</b>	<b>155</b>
Initial asymmetric protection structures in the economic partnership agreements lead to uneven gains	155
Africa must be strategic in setting its common external tariff (CET) structures to avoid undermining its regional integration process and Africa's industrialization	156
To what extent is trade policy space limited by trade agreements?	156
<b>IMPORTANCE OF "SMART SEQUENCING" OF TRADE AGREEMENTS</b>	<b>159</b>
Africa is likely to be hurt by mega-regional trade agreements...	159
... unless it gets CFTA going	160
CFTA must be accompanied by bold reforms	160
<b>CONCLUSION</b>	<b>163</b>
References	165
End Notes	166
<b>CHAPTER 6: TOWARDS A SELECTIVE TRADE POLICY FRAMEWORK FOR INDUSTRIALIZING AFRICA</b>	<b>169</b>
<b>KEY THEMES</b>	<b>170</b>
Translating the gains from the recent past into the foundations for a sustainable future	170
Getting trade and other policies to work together	171
Joining global and regional value chains	171
Reversing the wrong-way trend in trade in intermediates	173
Trade in services: more important for some countries than others	173
Using trade agreements to Africa's advantage	173
<b>POLICY RECOMMENDATIONS</b>	<b>174</b>
End Notes	178

# LIST OF FIGURES, TABLES & BOXES

## CHAPTER 1

### Boxes

Box 1.1: The world economy in 2014 and impacts on Africa	2
Box 1.2: Defining structural transformation	4
Box 1.3: The impact of oil price decline on Africa	8
Box 1.3 figure 1: Crude oil price, January 2000–December 2014 (US\$/barrel)	8
Box 1.4: GDP rebasing and analysis of structural change	10
Box 1.5: EBOLA's negligible economic effects on Africa	10
Box 1.6: Domestic financing—diaspora bonds and sovereign wealth funds	26
Box 1.7: Home player advantage?	31

### Figures

Figure 1.1: Growth in emerging and developing regions, 2010–2016	5
Figure 1.2: Africa's growth performance and components of growth, 2013–2015	6
Figure 1.3: Growth performance and components of GDP growth by African economic group, 2013–2015	6
Figure 1.4: Africa's growth performance and components of growth by subregion, 2013–2015	7
Figure 1.5: Employment-to-population ratios in emerging and developing regions, 1991–2012	11
Figure 1.6: Inflation rate by economic group, 2010–2016	12
Figure 1.7: Inflation rate and real effective exchange rate by resources endowment, 2000–2014	13
Figure 1.8: Inflation by subregion, 2010–2016	14
Figure 1.9: Real effective exchange rate and sectoral share in value added, 2000–2012	16
Figure 1.10: Average budget balance by subregion, 2010–2015 (% of GDP)	18
Figure 1.11: Average budget balance by economic group, 2010–2015 (% of GDP)	19
Figure 1.12: fiscal deficits and the real exchange rate, 2000–2014	20
Figure 1.14: International reserves by economic group, 2010–2015 (% of GDP)	22
Figure 1.15: International reserves by subregion, 2010–2015 (% of GDP)	23
Figure 1.16: Inflows of external finance, 2010–2015 (\$ billion)	24
Figure 1.17: Inflows of FDI as a share of GDP, by economic group, 2005–2015 (%)	25
Figure 1.18: Net foreign debt by economic group, 2005–2015	27
Figure 1.19: African savers and investors, 2000–2010	28
Figure 1.20: Africa's domestic financing gap, by economic group, 2000–2011	29
Figure 1.21: Manufacturing intensity, by main destination of Africa's exports, 2005–2010 (%)	36
Figure 1.22: Shares of goods and services in exports, by country and region, 2013 (%)	37
Figure 1.23: Africa's exports of commercial services, by category, 1980–2012 (\$ million)	37
Figure 1.24: Shares of Africa's exports by top three exporting countries in 2012, by category	38

## Chapter 1 (cont)

Figure 1.25: Africa's share of world's services exports, by category, 2000–2013	39
Figure 1.26: Africa's imports of services, by category, 1980–2012 (\$ million)	40
Figure 1.27: Africa imports and exports of goods and services, 1980–2013 (\$ million)	40
<i>Box 1.7 Figure 1: Accuracy of Africa's economic forecasts-Kenya, 2009–2013</i>	31
<i>Box 1.7 Figure 2: Accuracy of Africa's economic forecasts-Morocco, 2009–2013</i>	31

## Tables

Table 1.1: Growth in world merchandise trade, by region, 2005 and 2013 (%)	32
Table 1.2: World trade and Africa's trade, by region, 2013	33
Table 1.3: Share of manufactures in total merchandise trade by region, 2013, percentage	33
Table 1.4: Africa's top 20 merchandise exports to the world, 2011–2013 (\$ billion)	34
Table 1.5: Africa's top 20 imports from the world, 2011–2013, \$ billion	35
Table 1.6: Average annual growth of Africa's services exports, 2000–2013	38
Table 1.7: Africa's trade balance in services, 2012	41
<i>Box 1.4 Table 1: Share of GDP (at basic prices) by sector, Ghana, 2006–2010 (%)</i>	10

## CHAPTER 2

## Boxes

Box 2.1: Importance of good macroeconomic policies for productivity growth	55
Box 2.2: The african social development index (ASDI)	57
Box 2.3: Africa's demographic transition—a dividend that must be encashed	58
Box 2.4: Decongesting cities	59

## Figures

Figure 2.1: GDP composition by sector, Africa, 1961–2012	47
Figure 2.2: Sectoral share of value added in Africa, 1970–1979	49
Figure 2.3: Sectoral share of value added in Africa, 1980–1999	50
Figure 2.4: Sectoral share of employment and value added in Africa, 1991–1999	51
Figure 2.5: Sectoral share of employment and value added in Africa, 2000–2012	52
Figure 2.6: Industrial and manufacturing growth rate by subregion, 2000–2012	53
Figure 2.7: Average manufacturing contribution to industrial growth, 2000–2012	54
Figure 2.8: Education and structural transformation	60
Figure 2.9: Learning levels in selected african countries	61
Figure 2.10: Unit cost of primary school in 2010, at constant price ppp terms	62
Figure 2.11: Employment by sector in selected regions, 2000–2013 (% change)	65
Figure 2.12: Employment by sector in Central, Eastern, Southern and West Africa, 2000–2013	65
Figure 2.13: Size of the informal sector, selected countries	67
<i>Box 2.2 Figure 1: Trends in exclusion in Morocco by social group, 2001–2011</i>	57
<i>Box 2.2 Figure 3: The ASDI in zambia by subregion, 2006–2013</i>	57
<i>Box 2.2. Figure 2: decomposition of the asdi in morocco by dimension and subgroup of population, 2010–2012</i>	57



*Chapter 2 (cont)***Tables**

Table 2.1: Overall and sectoral GDP growth (% per year)	47
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**CHAPTER 3****Boxes**

Box 3.1: Master it—or it will master you	75
Box 3.2: Protecting infant industries: import tariffs, import quotas and production subsidies	79
Box 3.3: Successful non-African experiences of industrializing through trade	81
Box 3.4: Some regional industrial initiatives in Africa	82
Box 3.5: Framework for industrial development in Nigeria	86
Box 3.6: The Nigeria Industrial Revolution Plan	87
Box 3.7: Some flexibility still in WTO agreements	89

**Figures**

Figure 3.1: A selective trade policy framework	76
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**Tables**

Table 3.1: Trade policy measures and possible effects on GVCs	78
Table 3.2: basic information on the selected African countries	85
Table 3.3: Coherence issues in trade policy design	85
Table 3.4: WTO dispute settlement cases relating to industrialization, 1995-2005	89
Table 3.5: Trade policy instruments, WTO	90

**CHAPTER 4****Boxes**

Box 4.1: Holding the chain	100
Box 4.2: How to measure “participation” in GVCs	100
Box 4.3: Taking stock of COMESA’s leather value chain	105
Box 4.4: Building linkages in extractive industries— Mozambique and Nigeria	123
Box 4.5: Services may be undercounted	127
Box 4.6: Even though booming, Mozambique’s finance sector targets mainly large mining projects, leaving local firms credit constrained	129
Box 4.7: Services as an alternative to manufacturing-led development in Rwanda	131

**Figures**

Figure 4.1: GVC participation by sector, backward and forward integration, 2011	101
Figure 4.2: Country participation in RVCs, backward and forward integration, 2011	102
Figure 4.3: Participation in RVCs, backward integration, 2011	103
Figure 4.4: Continental value chains by sector in 2011	104
Figure 4.5: Africa’s exports of intermediates by main sector and destination	110

## Chapter 4 (cont)

Figure 4.6: GVC participation by country, backward and forward integration, 1995 and 2011	111
Figure 4.7: Africa's merchandise trade by end-use	118
Figure 4.8: Africa's imports of intermediate goods by country and main sector, 2010–2012	119
Figure 4.9: Africa's imports of intermediate goods by sector, 2010–2012	120
Figure 4.10: Exports of intermediate goods by country and main sector, 2010–2012	121
Figure 4.11: Africa's exports of intermediate goods by sector, 2010–2012	122
Figure 4.12: Africa's trade in cotton and cotton fabrics	124
Figure 4.13: Average annual growth in services by region, 2000–2012	127
Figure 4.14: Africa's exports of services by category, 2013	128

## Tables

Table 4.1: List of the top 20 global food and beverage companies in the world, value in billions (B)	106
Table 4.2: Production cost and profitability along the maize value chain segments in Benin in 2013–2104	108
Table 4.3: Matrix of trade complementarity indices by region, 2012	113
Table 4.4: Classification of non-tariff barriers	116
Table 4.5: Selected growth correlations, 2000–2012	126
Table 4.6: Top ten African countries by services as percentage of GDP, 2013	130

## CHAPTER 5

## Boxes

Box 5.1: Latest developments in the multilateral trading system and implications for Africa	142
Box 5.2: Lesotho's apparel industry driven by agoa and its third-country fabric rule of origin provision	146
Box 5.3: Large impacts from few products	147
Box 5.4: Challenges ahead for harmonizing CET structures at country level (Botswana) and subregional level (ECOWAS)	157
Box 5.5: Africa must take advantage of the transitional period offered under EPAS to hasten regional integration	162

## Figures

Figure 5.1: Evolution of LDCs' exports to top five destinations outside Africa, 2000–2002 versus 2010–2012 averages (\$ billion)	144
Figure 5.2: Evolution of US imports of agoa-eligible products from AGOA-eligible countries by main sector, 2001–2013 (\$ billion)	145
Figure 5.3: Evolution of us imports of AGOA-eligible textile, apparel and leather products from AGOA-eligible countries, 2001–2013(\$ million)	148
Figure 5.4: Changes in intra-african trade, following implementation of cfta alone versus CFTA along trade facilitation measures, by main sector, 2022 (\$ billion)	152
Figure 5.5: Share of intra-african trade versus share of regional value added in intra-regional trade, by main region, 2011 (%)	153
Figure 5.6: Changes in bilateral EU-Africa (ECOWAS+ESA) trade, post EPAS, by sector, 2040 (\$ billion)	156

*Chapter 5 (cont)*

Figure 5.7: Export changes—MRTAS alone versus mrtas plus CFTA, by main region, 2020 (%)	160
Figure 5.8: Gain in intra-african trade—EPAS with CFTA, with and without trade facilitation, by sector, 2040 (\$ billion)	161
<i>Box 5.3 Figure 1: AGOA-eligible countries' exports to the us, following extension of AGOA under several scenarios of possible expansion by product eligibility, 2025 (\$ million)</i>	147

**Tables**

Table 5.1: Shifts in industrial production after implementation of tfta reform, percent change compared to a situation without tfta in place	150
<i>Box 5.5 Table 1: ECOWAS tariff liberalization schedule under its EPA with the EU</i>	162

# LIST OF ABBREVIATIONS USED

ACET	African Center for Economic Transformation
ACP	African, Caribbean and Pacific
AfDB	African Development Bank
AGOA	African Growth and Opportunity Act
AIDA	Accelerated Industrial Development of Africa
AIDS	Acquired immune deficiency syndrome
ASDI	African Social Development Index
ATA	Agriculture Transformation Agenda (Nigeria)
ATC	Agreement on Textiles and Clothing
AUC	African Union Commission
B2B	Business-to-business
BWP	Better Work Programme (Lesotho)
CAADP	Comprehensive African Agricultural Development Program
CET	Common external tariff
CFTA	Continental Free Trade Area
COMESA	Common Market for Eastern and Southern Africa
DFQF	Duty-free quota-free
EAC	East African Community
EBA	Everything But Arms
EC	European Commission
ECA	United Nations Economic Commission for Africa
ECOWAS	Economic Community of West African States
EEPRI	Ethiopian Economic Policy Research Institute
EIU	Economist Intelligence Unit
EPA	Economic Partnership Agreement
ERA	Economic Report on Africa
ERP	Effective rate of protection
EU	European Union
EVD	Ebola virus disease
FDI	Foreign direct investment
FMITI	Federal Ministry of Industry, Trade and Investment (Nigeria)
FTA	Free trade area
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GSP	Generalized System of Preferences
GVC	Global value chains
HCP	High Commission for Planning (Morocco)
HIV	Human immunodeficiency virus
HS	Harmonized Commodity Description and Coding Systems
ICT	Information and communications technology
IDE-JETRO	Institute of Developing Economies (Japan)
IGAD	Intergovernmental Authority on Development
ILO	International Labour Organization
IMF	International Monetary Fund
ITC	International Trade Centre

ITPO	Industrial and trade policies organization
KILM	Key Indicators for the Labour Market
LDC	Least developed country
LLPI	Leather and Leather Products Institute
MDAs	Ministries, Agencies and Departments
MFN	Most-favoured nation
MRTA	Mega-regional trade agreements
NGO	Non-governmental organization
NEPAD	New Partnership for Africa's Development
NES	Not elsewhere stated
NICs	Newly Industrialized countries
NIRP	Nigeria Industrial Revolution Plan
NSI	North-South Institute
NTB	Non-tariff barriers
ODA	Official development assistance
OECD	Organisation for Economic Cooperation and Development
OPEC	Organization of the Petroleum Exporting Countries
PIDA	Programme for Infrastructure Development in Africa
R&D	Research and development
RCEP	Regional Comprehensive Economic Partnership
REC	Regional economic communities
RVC	Regional value chain
SACU	Southern African Customs Union
SADC	Southern African Development Community
SAP	Structural adjustment programme
SAR	Special administrative region
SME	Small and medium-sized enterprise
STEM	Science, technology, engineering and mathematics
TFTA	Tripartite Free Trade Area
TRALAC	Trade Law Centre for Southern Africa
TRIM	Trade-Related Investment Measures
TVET	Technical and vocational educational training
UEMOA	West African Economic and Monetary Union
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UN-DESA	United Nations Department of Economic and Social Affairs
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific and Cultural Organization
UN OSAA	United Nations Office of the Special Adviser on Africa
US	United States
WACIP	West African Common Industrial Policy
WEFM	World Economy Forecasting Model
WDI	World Development Indicators
WEO	World Economic Outlook
WFP	United Nations World Food Programme
WTO	World Trade Organization

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## FOREWORD

Africa's recent growth performance only reinforces the call for urgent structural transformation. The continent's strong growth is projected to continue in the medium-term due to increasing domestic demand, driven mainly by the rising middle class, improving regional business environment and macroeconomic management, increasing public investment, especially in infrastructure, a buoyant services sector and robust trade and investment ties with emerging economies.

Africa, however, needs more than marginal growth. The continent requires a great leap in economic performance that will be sustainable, inclusive, and transformative. Structural transformation of the African economies through industrialization is imperative. The current merchandise export structure, dominated by raw and unprocessed commodities, is not conducive to the envisaged level of development. This fact was clearly established by several past editions of the Economic Report on Africa (ERA). This edition builds on ERA 2013 and 2014, as they advocated commodity-based industrialization and stressed the important role of industrial policy in the structural transformation.

This edition's entry point is the symbiotic relationship between trade and industrialization. It emphasizes the role and place of trade and trade policy in the industrialization process. Trade can, under certain conditions, promote industrialization. Needless to say, trade can—on the other hand—lead to de-industrialization. Thus, the central message of this Report is that trade-industrialization virtuous link is not automatic: it requires appropriate policy.

This Report draws attention to the structure of African exports and the need to add value to exports through processing and other industrial activities. It identifies roles for trade policy in promoting trade in intermediates: joining, creating, and upgrading along value chains. This direction is important in order to incorporate the dynamics of modern industrial production and trade in tasks and activities, in addition to final products.

Effective participation in global value chains (GVCs) requires investments in sector-specific skills and human capital, as well as infrastructure, financial services and a conducive policy framework. Based on the level of development of these parameters in most African countries, intra-African trade and regional value chains (RVCs) are identified as a platform for learning and enabling economies of scale, thereby facilitating Africa's industrialization and eventual entry into GVCs. The pivotal role of services value chains, and the consequent need to enhance trade in services, is an important feature of modern production and trade.

This Report also examines the flurry of trade negotiations and agreements that African countries currently engage in. It notes with concern the role assigned to industrialization in this process. The Report underscores the need for Africa to ensure that its industrialization goal is not compromised by these negotiations and agreements. As a step forward in the quest for industrialization through trade, African countries should audit various agreements they have signed, to take advantage of the embedded flexibilities. This process may entail renegotiating the agreements or seeking waivers



and concessions. However, an enduring strategy is for African countries to develop capacity (to negotiate, implement, comply with obligations and defend rights) to articulate smart choices within the various trade agreements they have signed.

Another important recommendation in this direction is the need for appropriate sequencing if trade is to effectively foster industrialization of the continent. This Report shows clearly that sequencing of trade policy reforms does matter considerably for Africa's industrialization. There is powerful evidence indicating that a Continental Free Trade Area (CFTA) should be put in place before other trade agreements are fully implemented by African countries with the rest of the world.

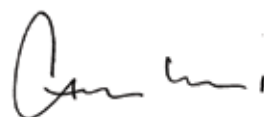
The analysis and findings of this Report are based on an extensive review of issues and 10 country case studies that were directed at gauging the trade policy-making process, especially in relation to industrialization. Selectivity of trade policy as an essential prerequisite for trade-induced industrialization was examined. Coherence between national development strategy and trade policy, on the one hand, and between trade policy and industrial policy, on the other hand, was particularly emphasized.

The need to adopt and strengthen a highly selective trade policy that is based on rigorous empirical analysis and carefully designed to promote efficiency of matured firms, protect budding industry, avoid negative policy externalities and put industrial development over and above other objectives is an important step in the trade-induced

industrialization. The implementation of such policies must be time-bound, have to progress towards the set objectives, and must regularly monitor and evaluate benchmarks.

Trade policy alone is not a panacea for Africa's industrial development, notwithstanding its important place and role in the industrialization process. There are important roles for complementary policies that are coherent with trade and industrial policies. African countries have already committed to implementing action plans under the Action Plan for Boosting Intra-Africa Trade (BIAT), where most of the policies are clearly identified.

Finally, as there is no one-cap-fits-all model, this Report provides a robust framework for African countries to reassess their trade policy with a view to identifying the best route to structural transformation and also tailor trade policy to achieve the desired goals. It is my hope that the African vision, African countries, regional economic communities and other stakeholders will take the message of this Report to the next level in the promotion of trade-induced industrialization.



**Carlos Lopes**

United Nations Under-Secretary-General  
and Executive Secretary of UNECA

## EXECUTIVE SUMMARY

Africa's growth continued to increase rising from 3.7 per cent in 2013 to 3.9 per cent in 2014. The performance was underpinned by improved macroeconomic management, diversified trade and investment ties with emerging economies among other factors. Africa's social development indicators reveal the weakness of the observed economic performance: high unemployment and poverty coexisting with robust growth. This is a paradox.

### **Trade continues to play a vital role in Africa's economic growth performance and it has potential to promote trade-induced industrialization**

Industrialization promises to address this paradox by promoting economic diversification, inclusive growth, efficient utilisation of abundant physical, mineral and human resources and in the process eliminate poverty and hence structurally transform Africa economies.

Trade continues to play a major role in Africa's economic growth performance and it has potential to promote trade-induced industrialization of the continent provided it is deliberately directed at industrialization. For this purpose, trade policy must be consciously designed, effectively implemented and managed with regular monitoring and evaluation. Such a policy must recognise and key into developments in the global production system especially internationalisation of production system with a view to promoting value addition through processing and manufacturing. Finally, the goal of

trade-induced industrialization must also guide the conduct, negotiations and implementation of trade and investment agreements and arrangements.

### **ISSUES IN INDUSTRIALIZING THROUGH TRADE**

Two but related challenges facing the continent are to maintain the strong economic growth and to transform it to productivity-induced sustainable, inclusive, employment-generating, poverty-reducing, and environmentally-friendly growth. The greatest deficiency of the current growth episode is its inability to promote structural transformation of the economies of the region. Rudimentary agricultural practices and provision of services dominate the structure of African economies. This overt dependence on traditional agriculture and services sectors can only support limited growth. Industrialization with its capability to generate direct and indirect employment, strong forward and backward linkages with other sectors of the economy including external sector not only promises to transform African economies but also to ensure that growth translates into sustainable development.

No doubt, Africa's industrialization should take advantage of its abundant and diverse resources including agricultural and mineral resources. Thus, as advocated in previous editions of the Economic Report on Africa (ERA), the continent should exploit its comparative advantage in commodity-based industrialization and add-value to these resources using its abundant human capital. Finally, continuous upgrading, a hallmark of modern industry, is important for sustainability of Africa's industrialization. In all this, industrial policy has

an important role to play so that industrialization is responsive to the yearnings of the continent especially in the promotion of inclusive and transformative growth.

Trade and industrialization are basically two sides of the same coin. A bi-directional relationship: industrialization facilitates trade, and trade also facilitates industrialization. Industrializing through trade emphasizes the role and place of trade in fostering industrial development and upgrade. Basically it involves analysis of the structure of exports and the role of trade policy in the production, imports and exports.

Based on this strong association between trade and industry, this Report, Economic Report on Africa 2015 examines how trade can serve as an instrument of accelerated industrialization and structural transformation in Africa. It also examines the challenges and opportunities for Africa to industrialize through trade in the context of the rapidly changing regional and global economic environment. In specific term, it attempts to answer the following three main questions:

- **When and how trade policies benefit or harm industrialization?**
- **What are the prospects for Africa to industrialize by tapping into global value chains?**
- **What are the current status of national and regional trade policies in Africa and what are their implications for the continent's industrial aspirations?**

This Report is a follow-up to the previous editions of Economic Reports on Africa especially ECA and AUC (2013), ECA and AUC (2014) and ECA and AUC

(2004). These Reports did not only focus on the role of industrialization in structural transformation of Africa by critically examining and analysing commodity-based industrialization and industrial policies in Africa but they also laid the foundation for the current Report as they emphasised the role of trade in fostering industrialization, both at regional and global level, and underlined the importance for Africa of implementing strategic trade policies aimed at overcoming market and institutional failures that hinder export competitiveness. They outlined the key factors constraining Africa's trade which include the continent's narrow production and export base dominated by low-value products such as raw materials and primary commodities, very high trade costs, tariff and non-tariff barriers to intra-African trade and Africa's access to international markets. This Report delves into greater depth on the relationship between trade and industry in Africa, and specifically the role of trade in supporting Africa's industrialization.

The theme of this Report is justified on many grounds and two of them are highlighted here. First, Africa is marginalised in the world trade. The continent's share in the global exports increased marginally from 4.99% in 1970 to 5.99% in 1980 and has continued the downward trend since then. It was 3.3% in 2010 and 3.3% in 2013. The share of African manufactures in total merchandise exports was 18.5% in 2013. Based on Africa's abundant physical,

**ERA 2015 delves into greater depth on the relationship between trade and industry in Africa, and specifically the role of trade in supporting Africa's industrialization.**

natural and human resources, the continent has potentials to significantly increase its share in the global exports.

Second and closely related to the first, empirical evidence shows that the newly industrialised countries (NICs) were able to catch-up with the developed countries through highly selective trade policies. This is evident in the fact that East Asia share in the global exports increased from 2.25% in 1970 to 17.8% in 2010 coupled with the fact that manufactures constituted between two-thirds and four-fifths of the region's total merchandise exports. Africa may not be able to replicate the feat performed by East Asia by towing the same or similar route due to the dynamics in the global trade and industrial production. However, it is also important to note that Africa is capable of surpassing the East Asian miracle by carefully designing trade and industrial path that takes into consideration lessons from experience as well as the current and future developments in the global environment.

Hence, for effective trade-induced industrialization in Africa, structural transformation of industrial production and trade is a basic pre-requisite. Three critical issues are: (1) production and trade in intermediates; (2) establishing, joining and upgrading along national/regional/global value chains; and (3) increasing role of services in (1) and (2) and in trade in general. Africa must imbibe the change from trade in products to trade in tasks and activities and promote the increasing role of services in the process.

Finally, and perhaps more important, trade policy is critical for effective trade-induced industrialization. National trade policy architecture and the flurry of activities in bilateral, regional and multilateral trade negotiations across the length and breadth of the continent must consistently give priority to industrialization.

**Global value chains are an important feature in today's global economy and African countries seeking to develop exports and grow their economies need to take them into account**

## KEY FINDINGS

The key findings of this Report presented in the following paragraphs are based on the foregoing background; an analysis of extensive review of issues; and ten country case studies. The case studies were directed at gauging the trade policy-making process especially in relation to industrialization.

Both theory and existing empirical evidence suggests that trade, under certain conditions, can be a veritable tool to promote industrial development and structural transformation in Africa. Trade policy, on one hand, through promotion of competition, innovation and efficient utilization of resources can enhance the dynamic efficiency of matured firms and thus foster industrialization. On the other hand, trade policy which exposes infant industries to competition can lead to de-industrialization. A critical factor for trade policy to promote industrialization is the appropriate balancing between promotion of relatively matured sectors and simultaneous protection and support of fragile sectors. No doubt, this is not an easy task but a feasible one that has been successfully performed by most industrialized countries.

A pre-condition for trade policy to foster industrialization is that it must be highly selective. This condition is necessary at least from two perspectives: First, trade-induced industrialization involves huge resource costs, and second, it requires an effective implementation, monitoring and evaluation. While recognizing the role and place of horizontal industrial policies, the vertical (i.e., selective) policies are important in the process of developing dynamic comparative advantage. The hallmarks of an effective selective trade/industrial policy are: it is based on rigorous studies that inform identification of the sectors, it has monitoring and evaluation mechanism in place; and it is insulated from political hijack. However, most countries

are not fully engaged in effective selective trade policies for promoting industrialization based on the various policies instituted and implemented.

Trade-induced industrialization is not automatic; it requires concerted efforts at least at two levels. First, integrated and coherent trade and industrial policies, diligently crafted and implemented, carefully and regularly monitored and evaluated is a pre-requisite. Such policies must be tailored towards the overall goals and objectives of a country's national development strategy and plan while recognizing and incorporating challenges and opportunities offered by the external environment. Second, various stakeholders must be on board. An effective method is consultations with various stakeholder groups to ensure that most their concerns are addressed. The evidence from the country case studies suggests the need to step-up coherence between trade policy and the national development strategy and between trade policy and other policies especially industrial policy.

Regional and global trade and production networks open new potential opportunities for Africa's industrialization. Instead of industrializing bottom up, segmented value chains offer the scope to engage in international trade at a specific stage of the production process, thereby harnessing more efficiently one's comparative advantage. In this context, the services sector has come to play a fundamental role in the value addition that takes place at each step along the supply chain, whilst foreign direct investments have emerged as a driver of international trade expansion. For trade policy to effectively foster Africa's industrialization, it must respond effectively to developments in the global production architecture, especially production of intermediate goods rather than just the finished goods, and participation in one or two activities along a value chain instead of all the activities

in the chain. Thus, trade policy that promotes trade in intermediates, trade in tasks and trade in services (as services are important components of internationalization of production process), is an essential pre-requisite of modern day industrial development.

Consistent with global trends, intermediate products accounted for the bulk of Africa's merchandise trade, accounting for about 60 per cent of Africa's total merchandise imports and over 80 per cent of its exports. In addition, intermediates represent the most dynamic component of Africa's merchandise trade, increasing fourfold over the last decade; yet Africa only accounts for 2-3 per cent of the global figure. Imports of manufacturing intermediates have expanded remarkably, yet this has largely failed to reverse Africa's premature de-industrialization, and spur the emergence of viable regional supply chains.

Africa's exports of intermediate goods are dominated by mining products and resource-based manufactures such as basic metals or chemicals and fuels; this is consistent with a forward integration into global value chains, but merely as exporter of raw materials and other intermediates embodying limited value addition. Despite its limited size, intra-African trade in intermediates is significantly more diversified than the corresponding trade with the rest of the world. The scope for incipient emergence of regional value chains, particularly in the manufacturing sector, is however still largely untapped due to an array of structural and policy constraints. The shallowness of regional supply chains can be gauged by the fact that Africa sources 88 per cent of its imported inputs from outside the region. Effective participation in GVCs requires investments in sector-specific skills and human capital, as well as infrastructure, financial services and a conducive policy framework. Based on the level of development of these parameters in most African countries, intra-African trade and regional value chains (RVCs) are identified as a platform for learning and enabling economies of scale, thereby facilitating Africa's industrialization and eventual

entry into GVCs. This is similar to infant industry argument.

Although manufactured products represent the bulk of imported intermediates, there is little evidence to support the claim that improved access to imported inputs has led to decisive progress of Africa's industrialization. This trade pattern suggests that African producers are increasingly connected to GVCs, but mainly as suppliers of raw materials or other low-end products. The subdued role played by exports of manufacturing intermediates – in particular light manufacturing inputs – concurs with the evidence of persistently limited weight of intra-industry trade in the region, and points to the low level of integration into international production networks, be they regional or global. African countries show high participation rates in GVCs, though at a very low level of the chains. While backward integration has been increasing in many African countries, the larger share of Africa's GVCs participation is still due to forward integration driven by exports of raw materials. This illustrates the fact that African firms operate at the lowest rung of the ladder in GVCs. In the same vein, participation in GVCs per se does not guarantee structural transformation: Africa needs to focus on improving backward integration. Intra-regional trade in processed goods is the first opportunity for African firms to move up the chain. So far, only few firms are driving the growth of Africa's backward integration. GVCs linkages need to be expanded to other firms and areas of the economy.

Global value chains (GVCs) are an important feature in today's global economy and African countries seeking to develop exports and grow their economies need to take them into account. At the same time, the growing importance of information and communications technologies (ICTs) enables African countries to enter several value chains without having to develop the whole production process. Participation in GVCs and competitiveness is linked to having access to priced intermediate imports, with border costs, import tariffs and customs procedures being important factors.

Services play an important role in Africa's economic transformation. They are key inputs to most other businesses, make a direct contribution to GDP and job creation, attract investments into local businesses and are a magnet for FDI. Across African countries, growth in services value added is strongly linked to growth in manufacturing value added. The strong growth of some services sub-sectors in Africa has not always translated into better services for local firms. In many African countries, banks have positioned themselves to lend to large mining projects of foreign investors while local SMEs remain credit-constrained. The services sector can be itself an avenue for economic transformation, particularly for small countries and island states. Not all African countries can develop through manufacturing. The service sector plays an increasingly important role in international trade. Services contribute 50 per cent to Africa's total trade in value added. The term "Servitization" is coined to emphasize the important link between services and participation in value chains.

Preferential schemes have generally been helpful in supporting Africa's trade with preference-giving countries but they have failed to broadly enhance Africa's industrialization so far. Although they remain quite useful and important for Africa looking forward, unilateral trade preferences alone can hardly enable the conditions required for the development of regional value chains.

Fast-tracking the implementation process of Africa's integration, and specifically establishing an African Continental Free Trade Area (CFTA), could go a long way in supporting Africa's industrialization. A CFTA would help increase both intra-African trade and its industrial content; the adoption of trade facilitation measures on top of CFTA reform would considerably enhance further the positive expected outcomes. The level of ambition for Africa's regional integration should be elevated with particularly greater attention given to the development of regional value chains largely untapped within the continent.

The sequencing of trade policy reforms does matter considerably for Africa's industrialization. There is powerful evidence to support that a CFTA should be put in place before other trade agreements are fully implemented by African countries or by the rest of the world (e.g., mega-regional trade agreements<sup>1</sup>) which would not only preserve the anticipated benefits from these agreements but also offset most –if not all– their costs to Africa as well as its

**African countries need to leverage on the progress that has been made and continue to build robust institutions that maintain and improve the business environment, economic governance and macroeconomic management.**

industrialization.

No one-cap-fits-model: From country case studies, different levels of development and the fact that African countries are quite diverse in many dimensions, but most especially in term of endowments, there is no single model that will address issues regarding the trade-industrialization nexus of African countries. It is on this premise that each country or region as the case may be should first determine its best route to structural transformation, if industrialization is favoured and justified by rigorous analysis; the second level entails the determination of the role and place of trade and trade policy. In this vein, individual countries should adopt a trade policy strategy that best suits its initial conditions. However, the diversities create synergies that are yet to be tapped and are only realizable within an effective regional framework.

Gradual approach to industrialization and upgrading: Lessons from experience of industrialized

and emerging countries and from African countries' previous attempt at industrialization, suggest that a gradual approach to upgrading and industrialization is practicable and highly recommended. The flying geese model of catching-up process of industrialization, suggests that African economies

should start from labour-intensive sectors and upgrade to medium- and high-technology sectors. Since, African countries are at different levels of industrial development, some will have to start with labour-intensive sectors while others should be upgrading.

## POLICY RECOMMENDATIONS

Africa needs to translate the current growth into sustainable and inclusive development. In addition to sustaining and improving business environment, good political and economic governance and management, social development strategies that are consistent with the needs of the industrial and modern sectors are required. Conducive socio-economic conditions, peace and security as well as political will are equally important to ensure Africa structural transformation can effectively take place. African countries need to leverage on the progress that has been made and continue to build robust institutions that maintain and improve the business environment, economic governance and macroeconomic management. This will in turn boost investors' and consumers' confidence and further strengthen the continent's future growth prospects. There is the need to ensure that growth is sustainable and inclusive, and the sources of growth are diversified to reduce vulnerability of African economies to internal and external shocks such as droughts, global consumption shocks, and financial, economic and debt crises. In this regard, appropriate policies that promote inclusive growth, productivity and structural transformation through industrialization, value addition, export diversification, and regional integration remain paramount.

Human capital is central to innovation. Technical and technological progress and entrepreneurship linked to knowledge creation and the educational system is the kernel of a social development strategy aligned to a structural transformation agenda. A social development strategy is necessary, anchored within long term planning processes, strengthening the productive capacities of the labour force through high quality, equity-based education and health policies, complemented by investments in research and development focused on driving industrialization, modern services and structural transformation.

The demographic dynamics and urbanization processes currently in force in Africa present a mixed picture of challenges and opportunities, and the factoring of these social phenomena in a structural transformation agenda is important. Africa needs to strategically take advantage of rising wages in China and other parts of Asia and the imminent relocation of labour intensive industries. This calls for education, training and human development of both the skilled and unskilled labour.

A highly selective trade policy that is based on rigorous empirical analysis, carefully designed to promote efficiency of matured firms and protect budding industry, avoid negative policy externalities



and put industrial development over and above other objectives is an important step in the trade-induced industrialization. The implementation and management of such a policy is as important as its design. The implementation must be time-bound, progress towards the set objectives and benchmarks are regularly monitored and evaluated and the process carefully managed to avoid political hijack.

African countries need to rethink trade policy as a means to promote industrial development in order to achieve structural transformation that will promote inclusive, stable and sustainable growth; reduce poverty and generate employment. This message calls for deliberate actions that must permeate all levels of trade and investment negotiations as evidence clearly shows that each successive bilateral, regional and multilateral trade negotiations have reduced and constrained the use of traditional trade policy instruments that were once used by developed countries to promote industrialization. African countries should identify and deploy possible alternative instruments within the world trading system that can be invoked to foster industrialization (i.e., coping strategies). The point is that the world will not wait for African countries to catch up with industrialization, rather African countries need to be smart, interrogate the system and deploy trade policy instruments that will foster their industrialization aspirations. Indeed, this is the path towed by late comers in industrial development especially the newly industrialized countries (NICs). African countries should stop negotiating agreements as if industrialization does not matter. African countries should stem the trend in policy-space erosion especially when negotiating any form of trade and investment agreements by insisting on the need to use such policy instruments to promote industrialization of their economies.

In terms of sequencing of trade policy reforms, deeper and bolder regional integration should be followed by gradual opening-up of African economies with the rest of the world as African countries would then be in a better position to

compete internationally. Thus, the use of gradual opening and smart protectionism to promote the emergence of regional value chains as a launching pad for development of industry/high value activities is a right step in the right direction.

## **Trade policy requires complementary policies and various institutional structures to deliver on industrial development**

Given that African countries depend on international markets for both inputs and outputs, for the purpose of promoting industrialization trade policy instruments must be carefully selected in order to avoid “negative policy externalities”. A thorough thinking-through the process is required to avoid inadvertent effects. Such a policy must promote dynamic efficiency of matured firms and at the same time promote efficiency of infant industry through a temporary shield from the fierce international competition. In the case of infant or budding industry, relative tariff protection combined with different activities directed at developing competitiveness of firms in the industry must be carefully designed and implemented to address the source of externalities. Targets must be set and respected.

Most African countries have embraced development strategies and efforts are being made to ensure that national (including trade and industrial) policies relate very well with the overall national goals and objectives. African countries need to strengthen the links among national development strategies, industrial policy and trade policy. For most African countries, industrial development is just one of the objectives of trade policies. In order for trade policy to foster industrialization, industrial development must be the core objective of trade policy. Thus, for this purpose and to a reasonable extent, coherence between trade and national development strategies are expected to be very high<sup>2</sup>. In

addition, the expected sequence is for industrial policy formulation to precede that of trade policy formulation and the latter to aim at promoting the goals and objectives articulated in the former. However, where this sequence is not feasible then a mainstreaming exercise may be required.

Looking at intra-African trade, the weight of manufacturing intermediates is far greater than in the continent's exports to the rest of the world, suggesting a considerable scope for regional supply chains to support Africa's industrialization. Nonetheless, regional value chains are still poorly exploited, and only 12 per cent of Africa's imported intermediates is sourced from the region. A strong production network on the national as well as on the regional level will provide a platform for learning and realizing economies of scale. The leading firms control and set product standards in their value chains that constrains the possibility of local firms to step into higher stages of global value chains. A regional production network should therefore receive greater attention.

Moving up the value chain in agriculture is profitable and needs to be put on the national and regional development agenda. An expansion in these labour-intensive industries generates new jobs that bring a social upgrading. However, given the dominance of leading giant firms in the food value chains, policies need to invest massively in rural industrial clusters development under commodity based industrialization.

Establishing services hubs and regional value chains can help African countries exploit each other's capabilities and boost competitiveness.

African countries should revisit all the various rules of origin (RoO) with a view to relaxing the constraints they imposed on preference utilisation and productive capacity development. Indeed, preferential schemes (e.g., AGOA) can surely support Africa's trade; including in manufacturing sectors if the usually stringent rules of origin are relaxed to be adequate and in line with often limited productive

capacity of African economies. A more integrated African market can enable the necessary conditions to upgrade productive capacity required to fostering the development of solid regional value chains, and facilitate diversification. The harmonization of rules of origin within the continent and possibly beyond will also be essential in making sure those obstacles to trade as well as to moving up the value chains within the continent are further reduced, thereby strongly supporting Africa's industrialization.

Opening-up Africa's market through reciprocal agreements can also deliver positive benefits to many African countries. Nevertheless, their impact on Africa's industrialization highly depends on initial protection conditions. Africa should, however, seize the opportunity of the economic partnership agreements (EPAs) between some regions and the European Union to strategically determine its external protection structures (e.g., facilitating imports of intermediates to be used in the production of industrial products) with both African and non-African partners. This is critical in rendering more systematic industrialization benefits from bilateral agreements and guaranteeing that regional integration and industrialization efforts are not diluted.

As noted earlier some trade policy instruments that were once used by developed countries to develop their industrial sectors are no longer permissible and new ones have been created. A smart move by African countries desiring to promote industrial development is to audit various agreements that they have signed, with a view to taking advantage of the embedded flexibilities. This process may entail renegotiating the agreements or seek for waivers and concessions. However, an enduring strategy is for African countries to develop capacity (to negotiate, implement, comply with obligations and defend rights) to take advantage of the various trade agreements they have signed. There is no doubt that tariffs are the easiest trade policy instrument to implement and in addition, they also generate revenue for the government. However, other trade policy instruments including para-tariff measures

(tariff rate quotas, (TRQs), subsidies (for export and for research and development), contingent trade protective measures (anti-dumping, countervailing, and safeguard measures) are veritable trade policy instruments. Of course, the implementation of these other trade policy instruments is more demanding than that of the tariff measures. Technical capacity needs to be built and appropriate institutions need to be established and rule and regulations need to be enacted in order to invoke them. For trade, to effectively promote industrialization, African countries need to move away from tariff measures only and develop capacity to fully engage in modern trade policy.

The current situation where African countries are more open and accessible to the rest of the world than to themselves is inimical to regional trade and creation and effectiveness of regional value chains. It is therefore imperative to remove remaining tariff and non-tariff barriers not only by consolidating existing RECs, but more broadly across the whole continent, thereby supporting the emergence of viable regional supply networks. This action will also help to fully exploit and maximize the advantage in the diversities of the continent.

Regional trade agreements (RTAs) have the potential to serve as building blocks of the multilateral trading system. While they can complement multilateral trading systems, they cannot substitute it. However, from an empirical point of view, there is powerful evidence to support the fact that sequencing of trade policy reforms matters considerably. To that end, regionalism can be a truly beneficial component of African nations' trade policy reforms. Nevertheless, not all forms of regionalism have the same impact on Africa's trade and industrialization.

The relatively higher freedom in policy options available and expected from South-South engagements than from North-South partnerships, suggests that African countries would gain more by reinforcing trade ties with developing partners. However, opening-up Africa's market should be

progressive and ideally intensified once regional integration has considerably deepened across the continent.

Indeed, regional integration seems to show the most convincing outcomes to supporting vigorously industrialization of African economies. Boosting intra-African trade can be achieved rapidly – though the formation of an African mega-regional trade agreement, namely the CFTA– by removing all tariff barriers on goods still remaining within Africa and tackling those related to services as well.

However, it should be emphasized that trade policy alone cannot deliver on industrial development. Complementary policies and various institutional structures are required for trade policy to optimally foster industrialization and structural transformation. African countries should make efforts to mainstream trade policy into development strategies and ensure coherence among all the national policies especially between trade and industrial policies.

Trade policy alone is not a panacea for Africa's industrial development notwithstanding its important place and role in the industrialization process. There are important roles for complementary policies that are coherent with trade and industrial policies. The scope for complementary policies appears limitless as any policy and or action that promotes industrialization in addition to trade policy is qualified. Perhaps, there is need for a strong consistency between macroeconomic policy especially exchange rate policy and trade policy.

In light of Africa's disproportionately high trade-related costs, trade facilitation issues warrant specific attention to reduce the burden of time-consuming and costly administrative and custom procedures. These groups of red tapes acquire an even higher relevance in the context of GVCs, since goods are likely to be exported and imported several times along the value chains.

Addressing Africa's inadequate physical and virtual infrastructural provision (roads, railways, ports, ICTs) and boost its energy production and distribution networks, to close the competitiveness gap faced by African firms is an important undertaking in the process of making trade and trade policy promote industrialization. Policy initiatives at the sectoral level that improve infrastructure and linkages among firms in the value chain (e.g., Mozal project in Mozambique) can increase Africa's backward participation in GVCs. The poor connection between successful sectors and other areas of the economy is a huge constraint for Africa to exploit the full potential from GVCs. Hence, policies need to focus on establishing production networks within the African economies.

Establishing special economic zones (SEZs), trade zones and export processing zones including a national production network or industrial clusters to include more SMEs/SMIs and promote increased linkages to other areas of the economy is an important step in technological transfers, which could be further expanded to neighbouring countries. While many African countries have established SEZs, their operations, especially the link with the rest of the economies, are less effective to promote the required spillover effects to rest of the economies.

National policies have to be complemented by strong regional policies including regional infrastructure, ICTs, logistics and convergence in regulatory policies. National policies have to focus on labour-intensive sectors and should give a higher weight to the agriculture sector in order to bring a social upgrading rather than only an economic upgrading.

# ENDNOTES

1 Mega-regional trade agreements (MRTAs) are profound integration partnerships between countries often from different regions; each MRTA usually accounts for a significant share of world trade and GDP.

2 The observed high coherence is attributable to at least two efforts namely: (1) UNDP's mainstreaming trade project and (2) Enhanced Integrated Framework (EIF). The objectives of these efforts emphasize the need for trade policy to be pro-poor.



**Part 1: Economic Growth, Structural Change and Social Development**

CHAPTER



**RECENT ECONOMIC AND SOCIAL  
DEVELOPMENTS IN AFRICA AND  
MEDIUM-TERM PROSPECTS**

Global growth of gross domestic product (GDP) increased marginally from 2.4 per cent in 2013 to 2.6 per cent in 2014, thanks to the positive growth registered in most developed economies for the first time since 2011. Yet the worldwide expansion remains at risk, mainly owing to (a) virtual stagnation in the euro area, (b) slowing growth in the major emerging economies (notably China, Russia and the large emerging economies in Latin America) and (c) Japan's stumble into recession in the second half of 2014. Growth in the United States (US) has continued to recover since 2012, reaching

5 per cent in the last quarter of 2014, although US economic growth is vulnerable to contagion from elsewhere (box 1.1).

Africa's growth accelerated from 3.7 per cent in 2013 to 3.9 per cent in 2014, which was slower than had been forecasted in the 2014 edition of this report. East and South Asia is the only region that grew faster than Africa, at 5.9 per cent (figure 1.1). The growth was underpinned by private consumption and gross capital formation, supported by improved governance and macroeconomic management;

## BOX 1.1: THE WORLD ECONOMY IN 2014 AND IMPACTS ON AFRICA

### Moderate recovery is occurring in global growth, but recovery in key emerging economies is subdued

Global GDP growth edged up from 2.4 per cent in 2013 to 2.6 per cent in 2014 (UN-DESA, 2014b),<sup>1</sup> supported by the prolonged recovery from the global financial crisis but dampened by emerging geopolitical tensions in West Asia and the Crimea. The outlook is slightly more positive, with growth projected to accelerate to 3.1 per cent in 2015.

In developed economies, growth picked up from 1.2 per cent in 2013 to 1.7 per cent in 2014, driven by stronger performance in the major European economies. The European Union recorded growth of 1.3 per cent, up from 0 per cent in 2013, and its recovery is expected to continue, although slower than the October 2014 forecasts, with annual growth projected at 1.2 per cent in 2015 and 1.4 per cent in 2016<sup>2</sup>.

The US economy grew by 2.3 per cent in 2014, a marginal lift from 2.2 per cent in 2013, and should climb a little higher to 2.8 per cent in 2015. That change resulted from faster business investment and higher consumer confidence, which is largely driven by improved job figures: the unemployment rate declined by 0.2 percentage point to 5.6 per cent in December 2014 and 1.1 percentage point from 6.7 per cent in December 2013<sup>3</sup>. In Japan, growth slid to 0.8 per cent from 1.5 per cent in 2013 as a result

of the imposition of a higher consumption tax in April 2014, which caused a surge in growth in the early months of the year but subsequently put downward pressure on private consumption. Growth is expected to pick up a shade, to 1.2 per cent, in 2015.

GDP growth in emerging and developing countries slowed to 4.4 per cent in 2014 from 4.7 per cent in 2013, and it is expected to remain stable at 4.3 per cent in 2015. That stabilization is mainly the result of lower growth in China and its implications for other developing countries, geopolitical tensions in Russia, and continued decline of oil and other commodities. Regionally, growth was strongest in South Asia, where it edged up to 5.9 per cent from 5.8 per cent in 2013, and is expected to nudge further up to 6.0 per cent in 2015, largely mirroring stronger investment and economic activity.

Economies in transition also witnessed a slowdown, with real GDP growth of 0.7 per cent, hurt by dampened growth in Russia resulting from the Crimean crisis (and associated sanctions imposed by the US and European Union) and the tumbling oil price since midyear. Growth in Russia reached only 0.5 per cent in 2014 compared to 1.2 per cent in 2013, and it is expected to remain unchanged in 2015. The aftermath of that crisis poses a threat to the economic

performance of Russia's trading partners, too, including large European economies such as Germany. China's growth is expected to have decelerated to 7.3 per cent in 2014 from 7.7 per cent in 2013, as the government holds its course towards a more service- and consumption-oriented economy.

### Labour market performance does not reflect economic recovery

Despite the marginal pickup in global growth, global unemployment marginally declined, from 6.0 per cent in 2013 to 5.9 per cent in 2014<sup>4</sup>. Unemployment remained high at 7.8 per cent in developed economies, despite slightly improved economic conditions in the euro area. Unemployment also stayed high in Africa and in Latin America and the Caribbean, with average rates of 10.1 and 6.6 per cent, respectively, in 2014. Youth are particularly affected, with their global unemployment rate reaching 13.0 per cent in 2014 and expected to increase to 13.1 per cent in 2015. The unemployment rate in all regions is expected to remain largely unchanged in 2015 and 2016.

### Inflation is declining in developing countries, but deflation is a risk in some developed economies

World inflation in 2014 was unchanged at 3.1 per cent versus 3.0 per cent in



continued urbanization; a still-rising middle class that is driving aggregate demand; diversified trade and investment ties with emerging economies; and tighter regional integration and trade partnerships in the region.

Inflation for the region slipped in 2014 and is expected to continue declining as a result of prudent monetary policies, decreasing global prices for oil and other commodities, and recent good harvests. Over the medium term, oil-importing countries will be the major beneficiaries of reduced inflation.

Inflation due to currency depreciation in some countries—especially frontier market countries—has been a concern though, prompting tighter monetary policy.

Africa's fiscal deficit continued widening in 2014, owing both to expansionary fiscal policies, as countries continued to spend on infrastructure, and to lower revenues from oil and other commodities. Several countries—notably Nigeria, Senegal and South Africa—took measures to curb public waste, minimize corruption and inefficiencies, and cut

2013 and is forecast to be 2.9 per cent in 2015. Inflation remains low in developed countries, particularly in the euro area, where it declined to 0.7 per cent from 1.5 per cent in 2013. Low inflation was driven mostly by a weak economic recovery but also by shocks, such as falls in food and energy prices, particularly oil. Low inflation in the euro area, alongside persistently high unemployment, presents a risk of deflation. In developing economies, inflation fell to 5.7 per cent in 2014 from 5.8 per cent in 2013 with, in South Asia, a steep fall to 9.2 per cent from 14.7 per cent. Inflation in developing countries is expected to fall further to 5.4 per cent in 2015 due to declining global commodity prices and tightening monetary policies in developed economies.

#### **Commodity prices are subdued**

Despite the decline in commodity prices in 2014, most of them are still relatively high, which benefits the resource-rich countries in Africa. The index for all commodities stayed at 180–185 until August, when it started to fall, reaching 130 in 2014 (IMF, 2015). The world crude oil price index rose from 193 in January 2014 to a peak of 204 in June before starting to fall steeply and reaching 114 in December 2014, largely reflecting the shale supply boom in the US and slowing demand in, primarily, China. The price of food and

agricultural raw materials did not greatly change from 2013, although the price index for beverages rose steeply from 151 in January 2014 to 185 in April (due to strong global demand for cocoa, low production of cocoa in the Côte d'Ivoire and Ghana, and the impact of droughts on coffee prices in Brazil) before declining sharply and reaching 160 in December. Metal prices decreased continuously in 2014, reaching 149 in December, despite a slight increase prompted by reduced supply in July and August.

#### **Trade growth is sluggish**

Growth in world trade stayed unimpressive in 2014, as export growth fell to 3.3 per cent from 3.8 per cent in 2013, despite improved export growth in developed economies. Export growth is expected to rise to 6.8 per cent in 2015 on a rebound in developing regions, particularly in South Asia and in Latin America and the Caribbean. Current account balances remained quite stable in the major economies in 2014 relative to 2013. In 2015, surpluses are expected to strengthen in Japan and the euro area, whereas the US account deficit is set to widen, driven by a strong US dollar (IMF, 2014). Growth in global foreign direct investment (FDI) was unchanged at 2.7 per cent of GDP (EIU, 2015), although FDI inflows to emerging economies have been

on a slide, owing to improved business confidence and recovery in advanced economies.

#### **The medium term carries risks and uncertainties**

The outlook for 2015 is generally positive, with growth accelerating globally and recovering in Latin America and Europe to 2013's rates. Whereas recovery in the major export markets of the European Union and the US is moderate, it is positive for African countries. Yet the outlook is uncertain, given the fragility of recovery in the euro area, declining growth in China and Russia, and weakening commodity prices. The political tensions in the Crimea and Western Asia present a risk to the world economy and may have indirect consequences for Africa through reduced demand from trading partners. The consequences of the "tapering" of quantitative easing measures in developed countries also remain uncertain. For example, mooted increases in interest rates in the US recently have led to capital outflows from and currency depreciation in developing countries, as investors returned to safer assets (UN-DESA, 2014b).

allocations to non-essential expenditure. Revenue mobilization is expected to improve as some countries, including Ethiopia and Rwanda, continue to improve tax policy and collection. Africa's fiscal deficit is likely to improve in 2015 and 2016 (UN-DESA, 2015).

The continent's current account deficit widened in 2014 because of declining export earnings and rising imports of capital goods; the latter usually is a marker of increased industrial activities. Global demand for agricultural and mineral commodities weakened over the period, as supply rose. That trend is expected to persist in the medium term. With continued strong growth in infrastructure investment and increasing private consumption, imports are set to keep rising, with a slight offsetting effect from weakening currencies in most African countries.

Private capital inflows are expected to remain strong—and even increase—in 2015 resulting from enhanced investor confidence combined with an improved business climate and better economic management. FDI and remittances are expected to remain the dominant sources of private capital inflows, although they are outweighed by huge illicit financial outflows.

Despite the continent's medium-term risks—lower oil and commodity prices, slow recovery or decelerating growth, tighter global monetary policy, the Ebola outbreak (box 1.5), weather-related shocks and, in some countries, political instability—

its prospects are strong. Africa has enhanced productivity through structural transformation (see box 1.2), associated with its strong growth performance (ECA and AUC, 2013). Expanded intra-African trade; increased export diversification from agricultural commodities, minerals and oil through value addition; and steps to promote industrialization and structural change should help consolidate its growth.

To translate that growth into sustainable, inclusive development, Africa has to keep improving its business environment, political and economic governance, and economic management to enhance productivity in sectors where it has a comparative advantage. That improvement entails addressing deficits in infrastructure, technology and human capital by mobilizing domestic resources innovatively. Such a feat can be accomplished by, for example, improving public sector management, combating tax evasion and illicit financial flows, deepening financial systems, issuing infrastructure bonds, and developing sovereign wealth funds. Finally, Africa should accelerate regional integration and adopt the Continental Free Trade Area to boost its internal trade in manufactured goods (which are more important for intra-African than for external trade; see chapters 4 and 5).

### **BOX 1.2: DEFINING STRUCTURAL TRANSFORMATION**

Structural transformation is the defining characteristic of the development process. It entails the allocation of resources—especially new investments—from low- to high-productivity activities within and across sectors, especially the agriculture, industry and services sectors. Timmer et al. (2012) stress that it is both the cause and the effect of economic growth, and they outline four quite relentless and interrelated processes that define the structural transformation process: (a) a declining share of agriculture in gross domestic product (GDP) and employment, (b) the rapid process of urbanization as people migrate from rural to urban areas, (c) the rise of a modern industrial and service economy, and (d) a demographic transition from high to low rates of births and deaths. The final outcome of structural transformation is an economy and society in which agriculture as an economic activity has no distinguishing characteristics from other sectors, at least in terms of the productivity of labour and capital or the location of poverty.

# AFRICA'S GROWTH PERFORMANCE

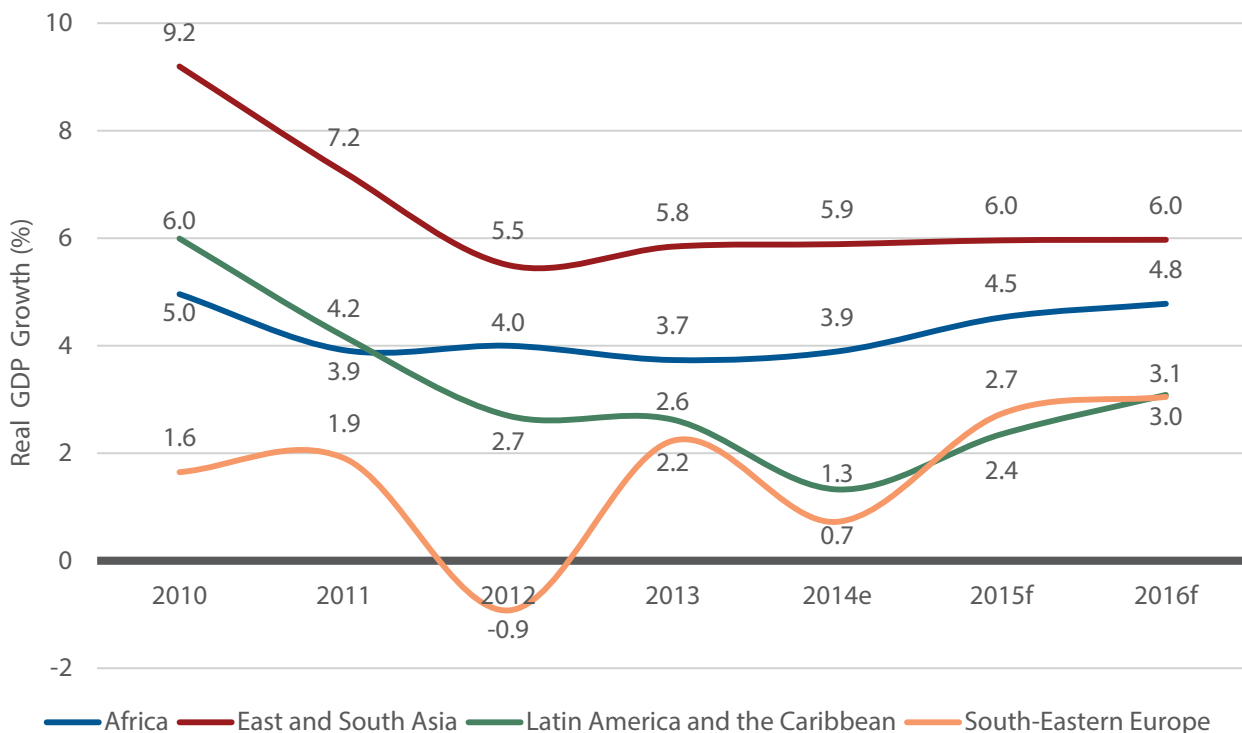
## EXPANSION IS SET TO CONTINUE

Africa's growth edged up from 3.7 per cent in 2013 to 3.9 per cent in 2014, which was slower than had been previously estimated in the 2014 edition of this report.<sup>5</sup> Only the East and South Asia region grew faster, at 5.9 per cent (figure 1.1). Africa's GDP growth rate is expected to increase to 4.5 per cent and 4.8 per cent in 2015 and 2016, respectively. That growth is expected to be only slightly lower than that of the East and South Asia region, whose growth is expected to moderate to approximately 6.0 per cent over 2014–2016 (figure 1.1).<sup>6</sup> Despite uncertainty in the global economy and weakening commodity prices, growth momentum is set to

continue—underpinned by increasing domestic demand, coupled with improving regional business environment and macroeconomic management, increasing public investment—especially in infrastructure, a buoyant services sector and increasing trade and investment ties with emerging economies.

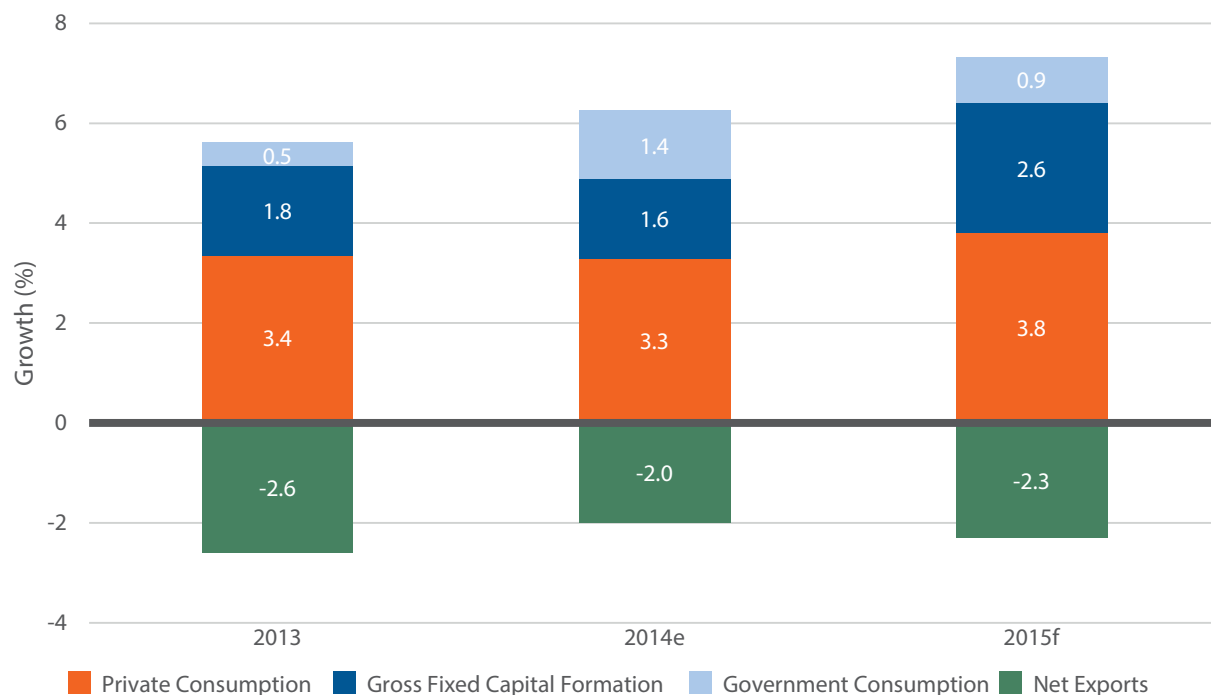
**At 3.9 per cent growth in 2014, East and South Asia are the only region that grew faster than Africa, at 5.9 per cent**

**FIGURE 1.1: GROWTH IN EMERGING AND DEVELOPING REGIONS, 2010–2016**



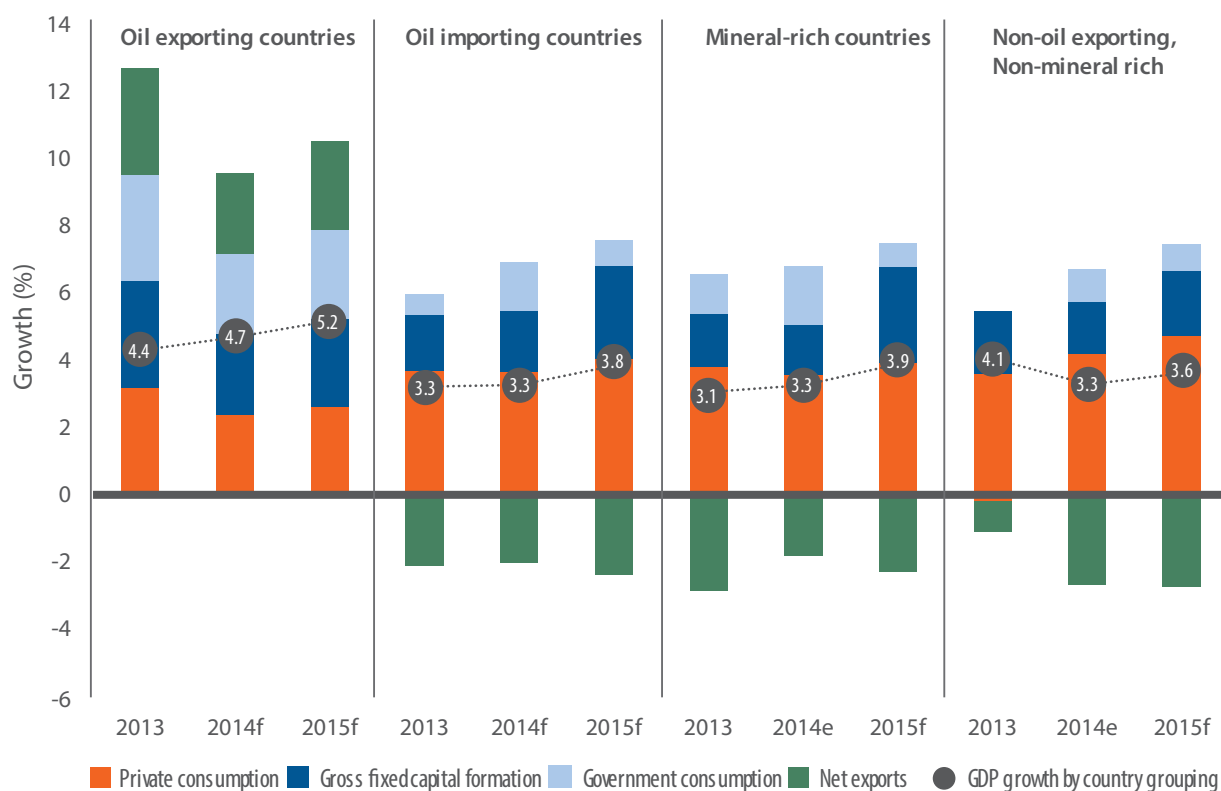
Source: Calculations based on UN-DESA (2014b); data for Africa exclude Libya.  
 Note: e = estimate; f=forecast; GDP = gross domestic product.

**FIGURE 1.2: AFRICA'S GROWTH PERFORMANCE AND COMPONENTS OF GROWTH, 2013–2015**



Source: Calculations based on UN-DESA, 2014b, and EIU, 2014.  
 Note: e = estimate; f = forecast.

**FIGURE 1.3: GROWTH PERFORMANCE AND COMPONENTS OF GDP GROWTH BY AFRICAN ECONOMIC GROUP, 2013–2015**



Source: Calculations based on UN-DESA, 2014b, and EIU, 2014.

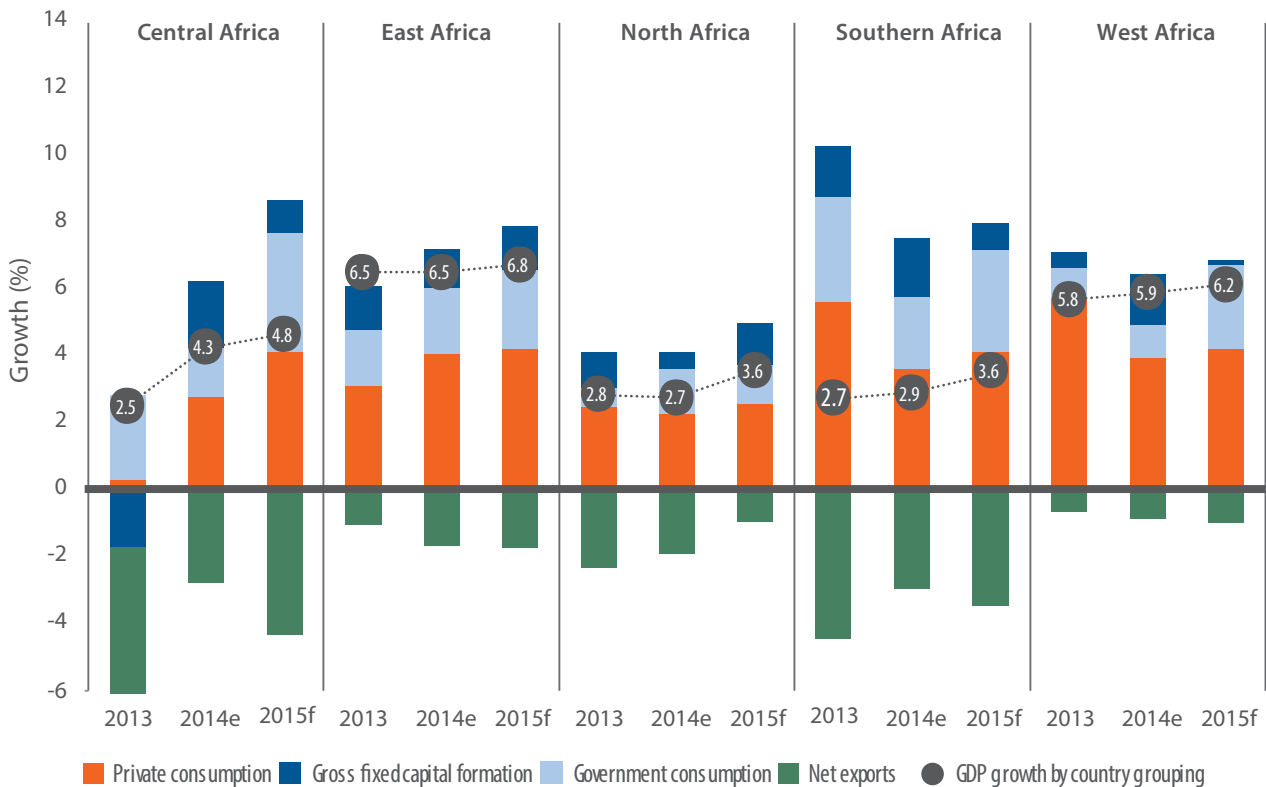
Note: e = estimate; f = forecast. Oil importers and exporters are net importers and net exporters as defined in the Statistical Note. Data on growth for oil-exporting countries exclude Libya.

## PRIVATE CONSUMPTION AND INVESTMENT ARE THE KEY GROWTH DRIVERS

African growth had a moderate contribution from private consumption and investment, which grew at 3.3 per cent and 1.6 per cent, respectively, in 2014, down from 3.4 per cent and 1.8 per cent in 2013. Growth in private consumption and investment (gross fixed capital formation) is expected to continue to drive growth, increasing from 3.3 per cent and 1.6 per cent in 2014 respectively, to 3.8 per cent and 2.6 per cent in 2015, respectively (figure 1.2). Growth in the former is underpinned by greater domestic demand due to increased consumer confidence and an expanding middle class. Investment is driven mainly by an improved business environment and lower costs of doing business in, for example, Burkina Faso, Burundi, Côte d'Ivoire, Ghana, Kenya, Mauritius, Rwanda, and the United Republic of Tanzania (Tanzania).

Government consumption (expenditure on infrastructure and wages) also was an important driver in 2014, at 1.4 percentage points, up from 0.5 percentage points in 2013 (see figure 1.2). Its contribution is expected to decline to 0.9 percentage points in 2015 resulting from fiscal consolidation measures, mostly in Central, Southern and West Africa. Net exports will continue their negative contribution, despite a slight improvement in 2014, because the value of the region's exports—mainly commodities—is outweighed by industrial imports, with governments increasing infrastructure investments and private consumption staying strong. The contraction in net exports of oil-importing countries is expected to accelerate from 2.0 per cent in 2014 to 2.4 per cent in 2015 (figure 1.3). The continued decline in oil prices and the expected depreciation of Africa's currencies are expected to underpin that decline, underlining the need to add value to exports and diversify them.

**FIGURE 1.4: AFRICA'S GROWTH PERFORMANCE AND COMPONENTS OF GROWTH BY SUBREGION, 2013–2015**

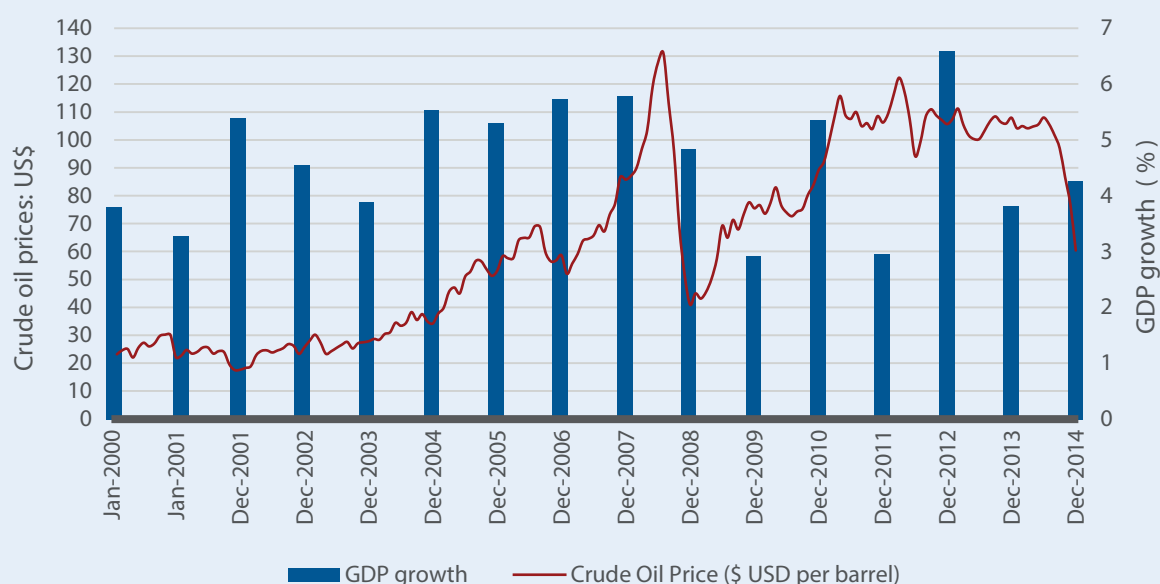


Source: Calculations based on UN-DESA, 2014b, and EIU, 2014.  
 Note: e = estimate; f = forecast. Data on growth for North Africa exclude Libya.

### BOX 1.3: THE IMPACT OF OIL PRICE DECLINE ON AFRICA<sup>7</sup>

Since January 2000, world prices for crude oil have generally risen steeply, despite a sharp decline between July and December 2008, caused by the global economic slowdown (box figure).

BOX 1.3 FIGURE 1: CRUDE OIL PRICE, JANUARY 2000–DECEMBER 2014 (US\$/BARREL)



Source: IMF primary commodity price monthly data. <http://www.imf.org/external/np/res/commod/index.aspx> (accessed 23 January 2015).

Note: GDP = gross domestic product.

This oil-price decline had only a marginal positive impact on GDP in Africa's oil-importing and mineral-rich countries—0.01 per cent and 0.02 per cent—and a marginal negative impact on its oil-exporting countries—0.17 per cent, emphasizing that the continent's current growth comes from non-oil sectors due to improved macroeconomic management and effective fiscal policies<sup>8</sup>. The economic recovery (in western countries, China and India since 2009), the decline in production of crude oil resulting from conflict in the Middle East and Africa, and production cuts by the Organization of the Petroleum Exporting Countries (OPEC) in response to the recession pushed up crude oil prices up until mid-2014. Then prices declined by 29 per cent between June and December 2014

as a result of weak global economic activity, a growing use of other fuels, and the US shale-energy boom coupled with the decision by OPEC to not reduce production.

The impact of the recent decline on Africa's growth is found to be marginal (contributing 0.03 per cent to GDP)<sup>9</sup>, although local currencies in, for example, Angola, Ghana and Nigeria will depreciate. Growth will not be significantly affected if the price continues declining at an average of 8.0 per cent a month (the rate of decline from June to December) or less. A significant impact is likely only if oil prices sink to \$33.75/barrel, which might happen in July- through August 2015 if the price continues tumbling at the current rate.

The marginal effect on Africa may be attributed to growth in the non-oil sectors of the African economy and also the ability of African countries, especially oil-exporting countries, to minimize shocks because they hedge themselves against the volatility of the crude oil price. They save more when the prices are higher and use their savings to attenuate the impact of a decline in crude oil prices on their economies.

Source: Analysis based on ECA calculations, based on IMF 2015 and EIU 2015 data.

## **GROWTH IS EXPECTED TO INCREASE ACROSS ALL ECONOMIC GROUPS**

Moderate growth is expected in all the economic groups in 2015. Oil-exporting countries (excluding Libya) grew fastest, by 4.7 per cent, in 2014, from 4.4 per cent in 2013 (figure 1.3). Despite falling oil prices, growth in those economies as a group is expected to rise to 5.2 per cent in 2015. The recovery of growth in consumption and investment in 2015 will counter any further potential slowdown in growth in oil-exporting countries.

Growth of oil-importing countries is expected to move up a little to 3.8 per cent in 2015, after stagnating at 3.3 per cent in 2013 and 2014. Growth will be supported by low oil prices and continued consumer and business confidence. Growth in private consumption and investment is expected to increase to 4.1 per cent and 2.8 per cent, respectively, in 2015 in those economies.

Despite the steep drop in global oil prices, the overall impact on Africa has been very small, unlike the oil price shock felt in 2008 (box 1.3).

Mineral-rich countries are expected to build on their growth momentum and accelerate from 3.3 per cent in 2014 to 3.9 per cent in 2015, mainly because of increased investments and new mineral discoveries in Angola (coal), Botswana (copper, coal and diamonds), Ghana and Liberia (gold), Namibia (uranium and diamonds), Sierra Leone (iron ore and diamonds), and Zambia (copper). Growth across all economic groups will be supported by an increase in private consumption and investments (see figure 1.3), but growth in net exports and government consumption will continue slowing.

## **GROWTH VARIES BETWEEN SUBREGIONS**

Subregional growth variations are expected to continue in 2015 (figure 1.4). GDP growth in Central Africa is expected to rise from 4.3 per cent in 2014 to 4.8 per cent in 2015. Strong public spending on capital intensive infrastructure in Cameroon and

the Congo and new oil and gas developments in Cameroon and Chad are expected to drive growth. However, political instability in the Central African Republic and labour unrest and worsening problems with the sole refinery in Gabon are challenges.

Growth in East Africa is expected to increase from 6.5 per cent in 2014 to 6.8 per cent in 2015, driven by Djibouti, Kenya and Uganda. Growth in Kenya, the subregion's biggest economy, will benefit from rapid expansion of banking, telecommunications, urbanization, and investment in infrastructure, particularly rail. Uganda's growth will be supported by increasing activity in construction, financial services, transport and telecommunications.

Growth in North Africa (excluding Libya) is expected to climb to 3.6 per cent in 2015 from 2.7 per cent in 2014, as stability consolidates in the subregion's largest economy, Egypt. Growth is also expected to be supported by government spending on infrastructure, underpinned by improving political stability in Egypt and Tunisia, and strong growth in private consumption and investment. Weak commodity prices; tight monetary policies in Algeria, Egypt, Morocco and Sudan; and political instability in Libya may upset those forecasts.

Southern Africa's growth is expected to accelerate from 2.9 per cent in 2014 to 3.6 per cent in 2015. Angola, Mozambique and Zambia will stay the fastest-growing economies. Growth will be driven mainly by investment in the non-diamond sector in Botswana, recovery in private consumption in South Africa, increased investment in mining and natural gas exploration in Mozambique, and generally by private consumption. A continued slowdown in oil and mineral prices may derail those forecasts, as two thirds of those countries are mineral rich or oil-exporting.

West Africa's growth is expected to increase from 5.9 per cent in 2014 to 6.2 per cent in 2015, although forecasters are wary of political instability in Mali and Nigeria—whose economy was recently rebased (in the process of replacing present price structure (base year) to compile volume measures

### BOX 1.4: GDP REBASING AND ANALYSIS OF STRUCTURAL CHANGE

Africa's GDP growth increase reflected GDP rebasing primarily in Nigeria but also in Ghana, Kenya, Tanzania, Uganda and Zambia. Rebasings also reduced their debt-to-GDP ratios, which improved their capacity to borrow on domestic and international markets and helped to lift investment in their productive sectors. And as rebasing also helps to better assess economic sectors with potential to grow, resources targeted to those sectors could boost productivity in those countries.

Regular GDP rebasing is central to evaluating an economy's growth and its share in world GDP. In Africa, the number of countries with outdated base years outnumber those with updated base years, so rebasing GDP figures is long overdue for many countries. The six countries mentioned at the beginning of this box have rebased their GDP in recent years. Identifying previously unregistered activities through rebasing of the countries' GDP in the informal sector and the telecommunications and entertainment subsectors provides a better idea of their relative importance in the economy. Changes after rebasing are illustrated in the table below for Ghana.

**BOX 1.4 TABLE 1: SHARE OF GDP (AT BASIC PRICES) BY SECTOR, GHANA, 2006–2010 (%)**

Year	Old series			New series (rebased)		
	Agriculture	Industry	Services	Agriculture	Industry	Services
2006	38.8	28.3	32.9	30.4	20.8	48.8
2007	37.6	28.2	34.2	29.1	20.7	50.2
2008	37.0	28.3	34.7	31.0	20.4	48.6
2009	37.7	27.2	35.1	31.7	18.9	49.5
2010	35.6	28.3	36.1	30.2	18.6	51.1

Source: Adapted from Table 4 of Ghana Statistical Service 2010, Information Paper on Economic Statistics: Rebasings of Ghana's National Accounts to Reference Year 2006, November 2010.

Rebasing in Ghana leads not only to an overall expansion but to a structural shift towards services, as the shares of agriculture and industry decline. The growing evidence of structural change in Africa indicates the need for African countries to rebase their GDP to better understand that change. Other important effects of rebasing include a decline in tax- and debt-to-GDP ratios, and growth in Africa's share in world GDP. Overall however the impact of rebasing on growth generally is small and depends on the number of years between revisions.

Source: ECA analysis and calculations based on specific country reports.

### BOX 1.5: EBOLA'S NEGLIGIBLE ECONOMIC EFFECTS ON AFRICA

The three EBOLA-affected countries of Guinea, Liberia and Sierra Leone will suffer GDP loss, but because in 2013 the three countries accounted for 2.4 per cent of West Africa's GDP and only 0.7 per cent of Africa's GDP, the economic effects on West Africa will be minimal; on the continent, miniscule.

Under the LINK/WEFM (World Economy Forecasting Model), EBOLA in both 2014 and 2015 will for West Africa take off

0.1 percentage point from GDP growth and for the entire continent a mere 0.02 percentage point (for West Africa, the forecasts are nudged down from 5.9 per cent in 2014 and 6.2 per cent in 2015; for Africa as a whole, from 3.37 per cent and 4.61 per cent).

An alternative simple projection forecasts less optimistic but broadly similar figures. ECA (2014a) assumes a benchmark scenario in which all three countries register growth

of 0 per cent in 2014 and 2015, whereas projected growth rates for the other African countries remain unchanged. The model finds that growth projected for West Africa decreases by 0.19 percentage point in 2014 and by 0.15 percentage point in 2015; for Africa as a whole, the loss will be 0.05 percentage points in 2014 and 0.04 percentage points in 2015.

Source: ECA 2014a.



of GDP with a new or more recent base year (box 1.4)—and, to a small degree, the outbreak of Ebola virus disease (EVD) (box 1.5).

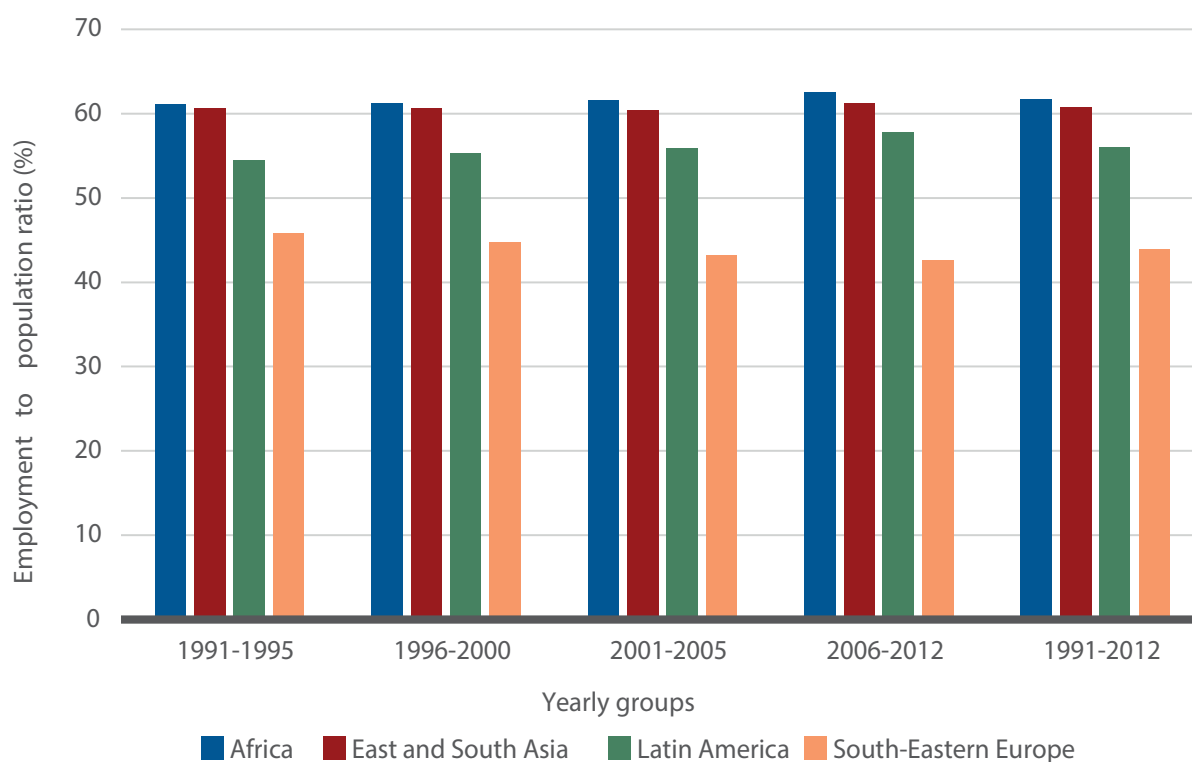
## EMPLOYMENT IS YET TO PICK UP

Africa's high growth during the past decade has not created the many jobs needed for its growing working-age population. Its limited ability to generate well-paying jobs in the formal sector and its low labour productivity have made Africa less competitive because of the weight of informal employment. Structural change (the shift of resources from low- to high-productivity sectors of the economy, i.e. productivity resulting from cross-sectoral rather than within-sector resource allocation) is believed to be the key to moving African economies towards higher productive sectors, thereby boosting job creation and reducing the informal sector. The bulk of the labour

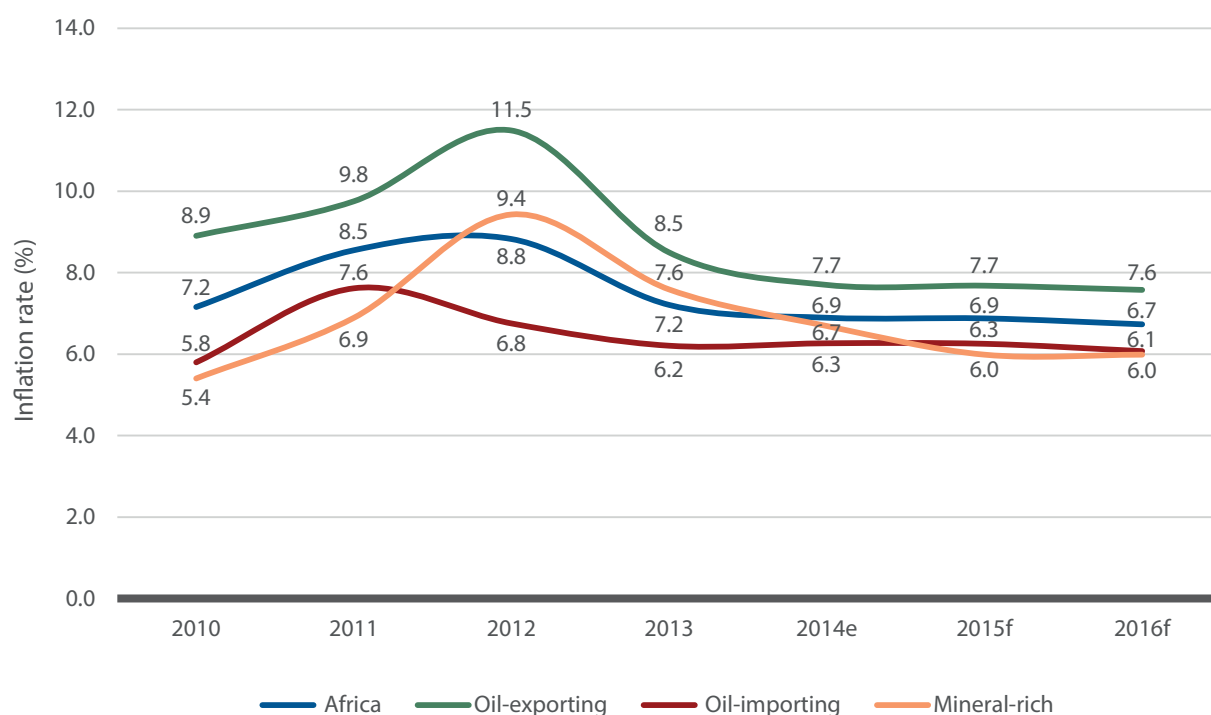
force has moved from agriculture to industry and services over the past decade, but that change has not occurred quickly enough to reduce youth unemployment (which most of South-East Asia accomplished). Still, the labour market shows some progress: Africa's employment-to-population ratio is among the highest globally, second only to East and South Asia (chapter 2).

Employment in Africa grew at an annual average of 2.9 per cent from 1991 to 2012, higher than in other emerging and developing regions, such as Latin America and the Caribbean (2.5 per cent); East and South Asia (1.4 per cent); and South-Eastern Europe (0.9 per cent). Moreover, the employment-to-population ratio rose from 61.3 per cent in 1991–1995 to 62.6 per cent in 2006–2012 in Africa, the biggest increase among the regions except Latin America and the Caribbean (figure 1.5).

**FIGURE 1.5: EMPLOYMENT-TO-POPULATION RATIOS IN EMERGING AND DEVELOPING REGIONS, 1991–2012**



Source: Calculations based on ILO, 2014.

**FIGURE 1.6: INFLATION RATE BY ECONOMIC GROUP, 2010–2016**

Source: Calculations based on UN-DESA, 2014.

Note: e = estimate; f = forecast.

## INFLATIONARY PRESSURE STAYS SUBDUED

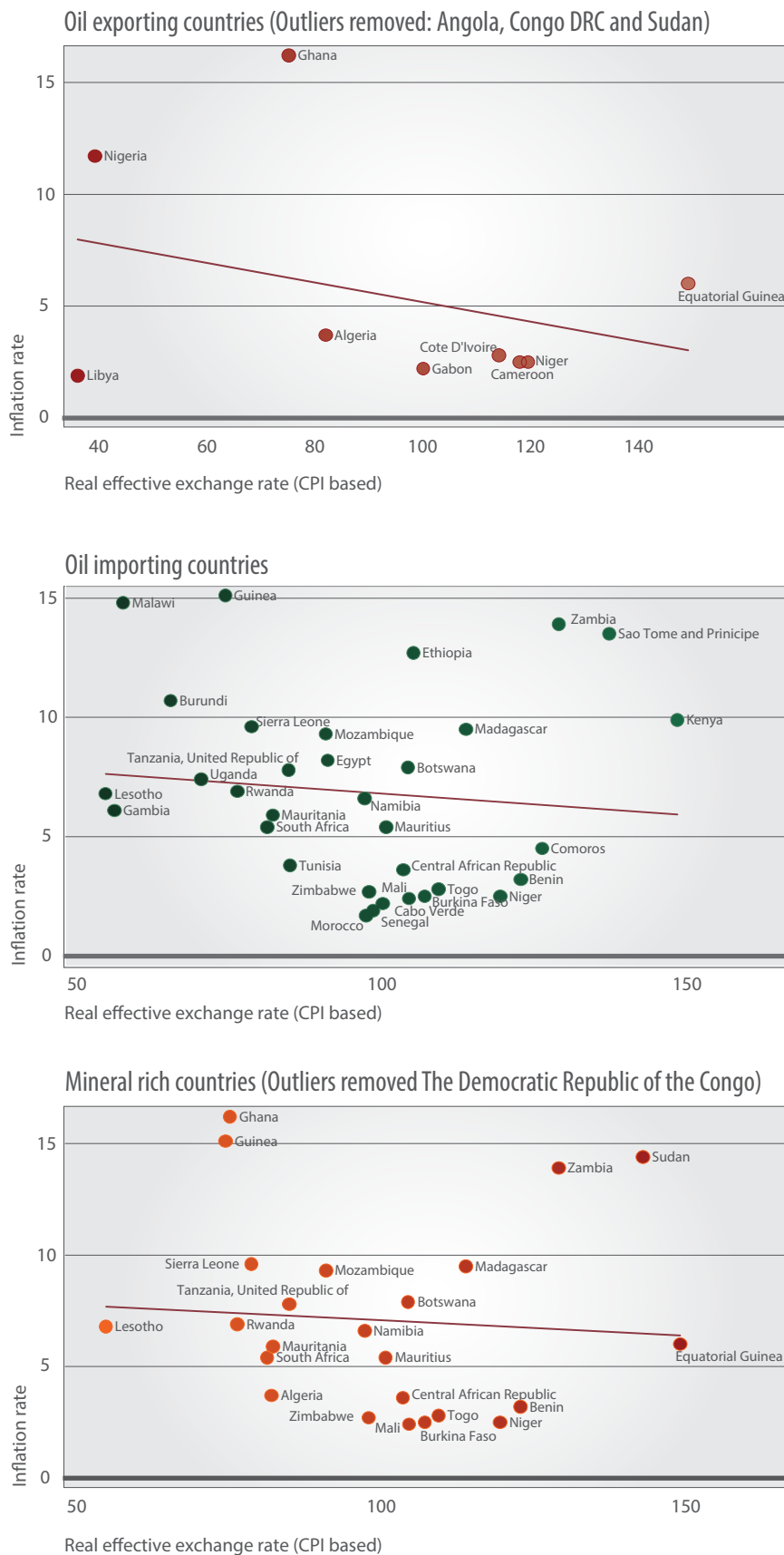
Inflation in Africa is expected to continue on its downward trend since 2012, stabilizing at 6.9 per cent between 2014 and 2015 and decelerating to 6.7 per cent in 2016 (figure 1.6).

Oil-exporting countries are expected to experience an increase in inflation in 2015 before the rate tips down a little in 2016. Exchange rate depreciation is observed to be the main driver of rising inflation among oil-exporting countries with marginal effects on oil-importing and mineral-rich countries (figure 1.7), which could be attributed to the effects of the deteriorating oil and commodity prices on the global market. However, the effect is more pronounced in oil-exporting than mineral rich countries with a mild impact on oil-importing countries.

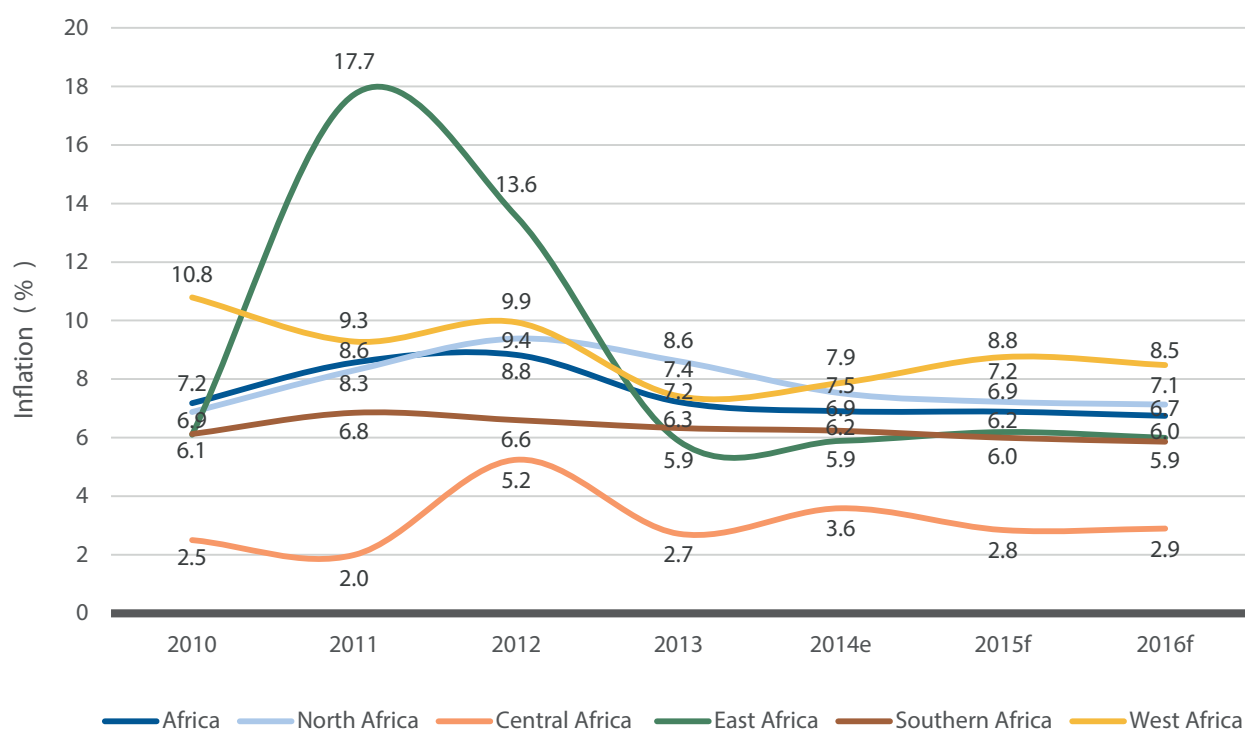
At the subregional level, Central Africa is expected to experience the lowest inflation, mainly because of the common monetary policy in most of its countries (their common currency, the CFA franc, is pegged to the euro) (figure 1.8). In Southern Africa, inflation is projected to edge down from 6.2 per cent in 2014 to 6.0 per cent in 2015, mainly as a result of lower oil and global food prices, as well as the improved domestic food supply in Malawi and Zambia, a tight monetary policy in Lesotho and South Africa, and appreciation of local currencies in Botswana and Zambia.

In East and West Africa, inflation is forecast to increase from 5.9 per cent and 7.6 per cent, respectively, in 2014 to 6.1 per cent and 8.8 per cent in 2015. In Kenya—East Africa's largest economy—inflation will be driven by the outcome of the rainy season, and in Tanzania by a weakening shilling and rising electricity prices. Kenya's central bank has kept rates unchanged since 2012 but is expected to raise

**FIGURE 1.7: INFLATION RATE AND REAL EFFECTIVE EXCHANGE RATE BY RESOURCES ENDOWMENT, 2000–2014**



Source: Calculations based on EIU 2014 and UN-DESA 2014b.

**FIGURE 1.8: INFLATION BY SUBREGION, 2010–2016**

Source: Calculations based on UN-DESA, 2014.

Note: e = estimate; f = forecast.

them by 50 basis points by mid-2015 to counter the inflationary effects of the tighter monetary policy in developed economies, such as the US.

Nigeria—Africa's largest economy after rebasing the country's GDP—is expected to be the key driver of West African inflation, with fiscal expansion in the run-up to the 2015 elections, growing consumer demand and exchange rate depreciation. In Ghana, increases in water and power tariffs, sanctioned by the government in July 2014, and the effects of the depreciating Ghanaian cedi will be sources of inflationary pressure in the first quarter of 2015.

North African inflation is expected to decline a shade further, from 7.2 per cent in 2014 to 7.1 per cent in 2015 (see figure 1.8). Egypt is expected to be the most inflationary, with a rate of 10.1 per cent in 2015, fed by disruptions in the supply chain due to political challenges, raised minimum wages for government employees and currency instability. The central bank raised its policy rate by 100 basis points in July 2014 to counter pressures. In Algeria

and Mauritania, where food and commodity prices constitute the largest proportion of the countries' inflation basket, inflation will be subdued. Morocco is expected to have very low inflation because of moderating domestic demand and mild currency appreciation against the US dollar. In Libya, disruptions in supply chains resulting from political challenges and increased housing prices are concerns. Inflation in Sudan is expected to continue to slow down, reflecting a weak currency and decreasing oil prices. Further, the Central Bank of Sudan has also pledged to limit its credit to the government and slow down the purchase of gold, in line with its agreement with the IMF (EIU, 2014b).

**Inflation in Africa is expected to continue on its downward trend thanks to prudent monetary policies and recent good harvests**

## **MOST AFRICAN CURRENCIES WILL CONTINUE TO DEPRECIATE**

Declining oil and commodity prices, tightening of monetary policies in developed countries, and large trade and fiscal deficits will continue to drive exchange rate depreciation in most African countries.

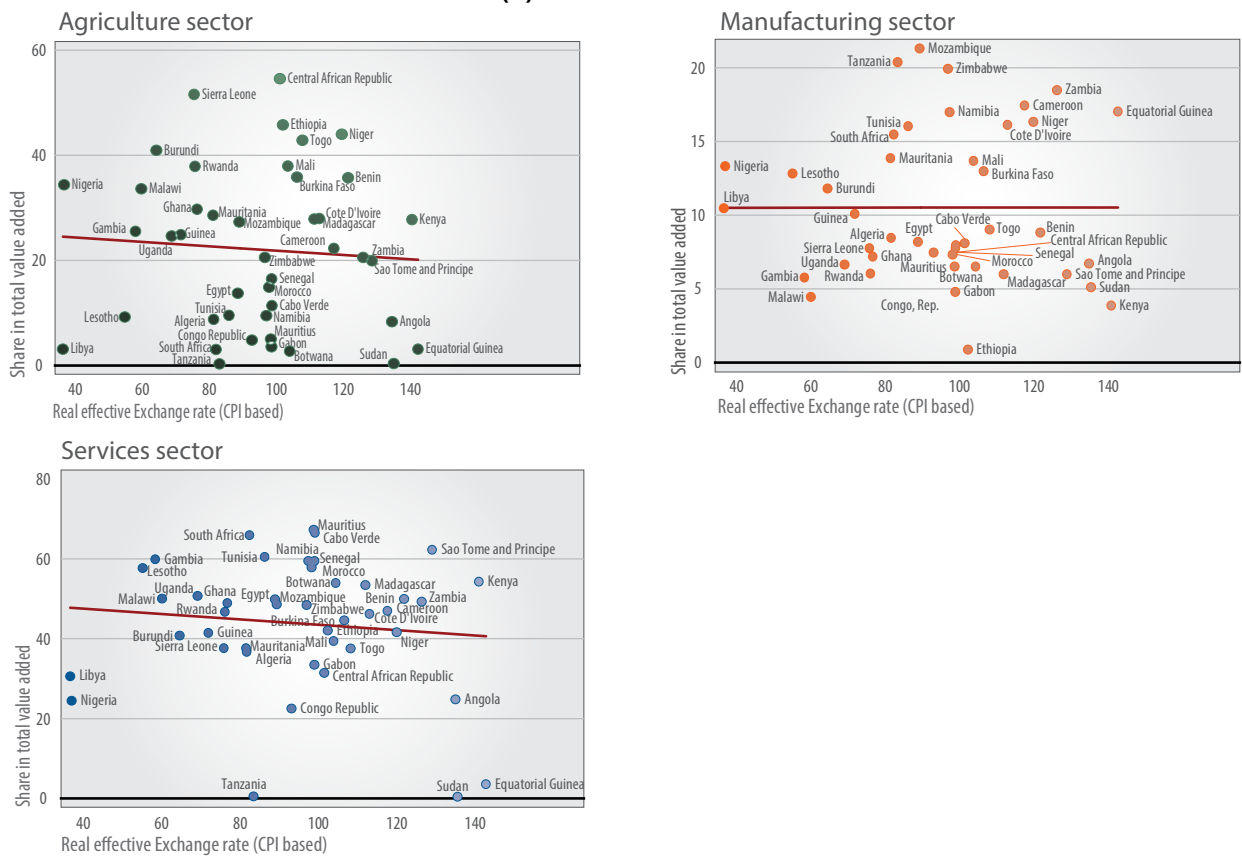
Looking at the continent's largest economies, South Africa's currency is expected to pick up by 1.2 per cent to 10.66 rand per US dollar in 2015, although perhaps staying volatile (the rand is the most heavily traded African currency). The Central Bank of Nigeria, despite being under political pressure to maintain the naira at an overvalued rate in 2014, devalued it in November to minimize erosion of foreign currency reserves and raised the monetary policy rate by 100 basis points to 13 per cent. The Kenyan shilling depreciated in 2013 and 2014 because of weak tea prices and low tourist inflows resulting from security concerns. The shilling is expected to slide further in 2015 as global monetary policies tighten. In the West African Economic and Monetary Union (UEMOA) region (of which most West and Central African countries are members), where the CFA is pegged to the euro, the CFA appreciated against the dollar in 2014 but is expected to depreciate in 2015.

As noted by Rodrik and McMillan (2011) that an overvalued exchange rate can impede the development of tradable sectors, particularly modern manufacturing. Using the real effective exchange rate compiled by EIU (an increase denotes appreciation of the currency), Figure 1.9 shows that appreciation of the currency is associated with an increase in manufacturing value added and a decrease in agriculture and services value added in the oil-exporting countries. While currency appreciation leads to a decline in manufacturing value added and an increase in services value added in oil importing countries. However, real exchange rate appreciation is associated with a significant decrease in the services sector in the mineral-rich countries.

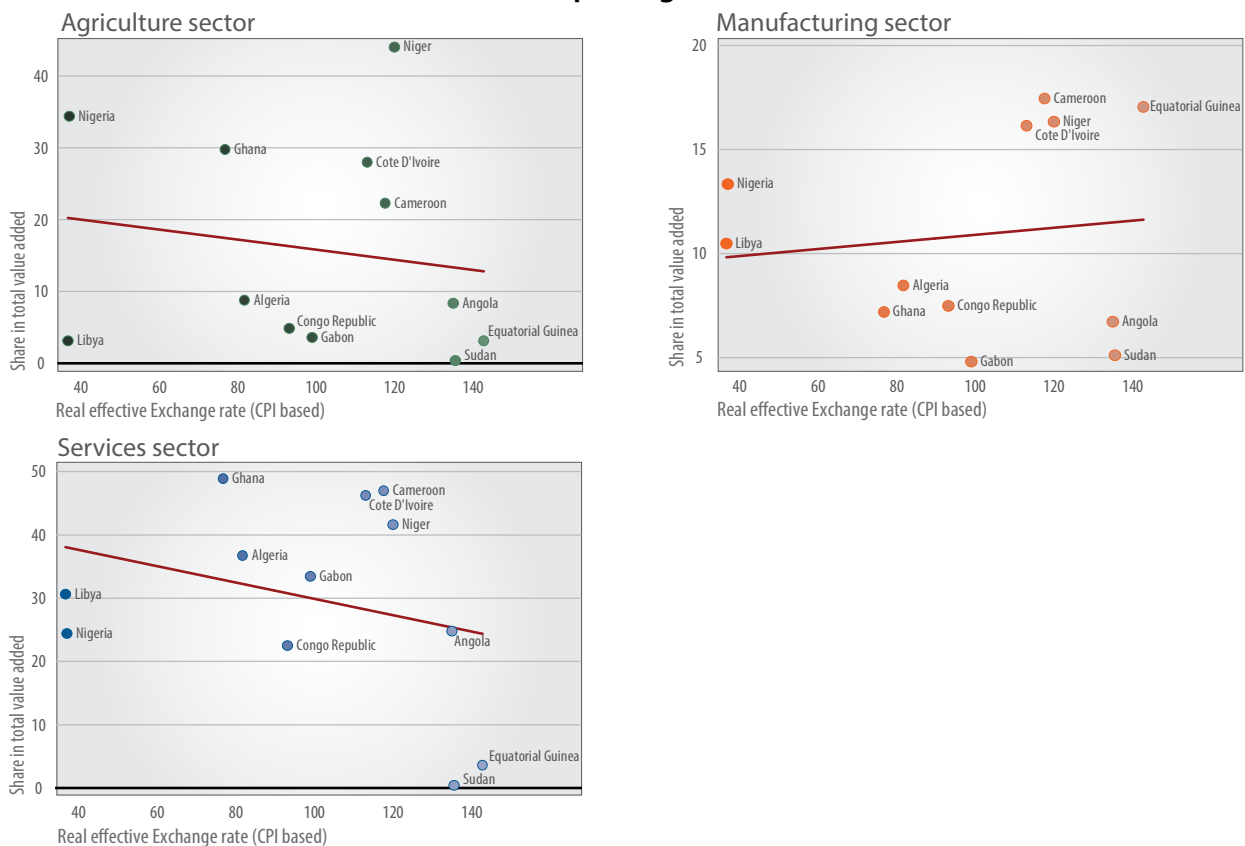
**Exchange rate in most African countries will continue to depreciate due to declining oil and commodity prices, tightening of monetary policies in developed countries, and large trade and fiscal deficits**

**FIGURE 1.9: REAL EFFECTIVE EXCHANGE RATE AND SECTORAL SHARE IN VALUE ADDED, 2000–2012**

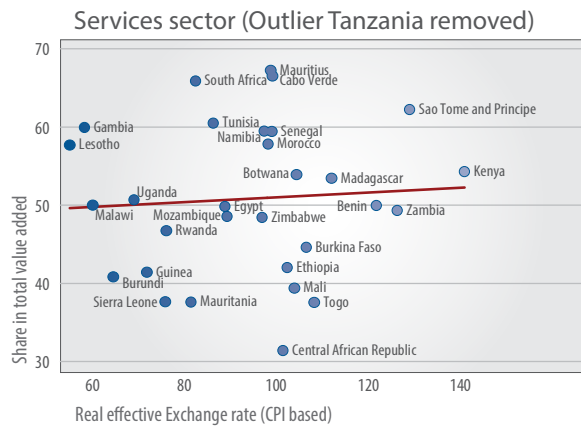
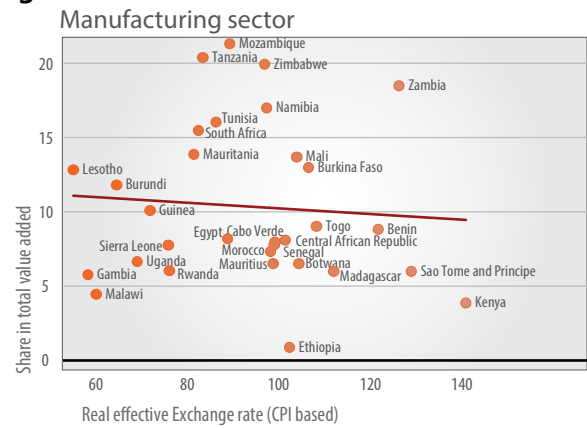
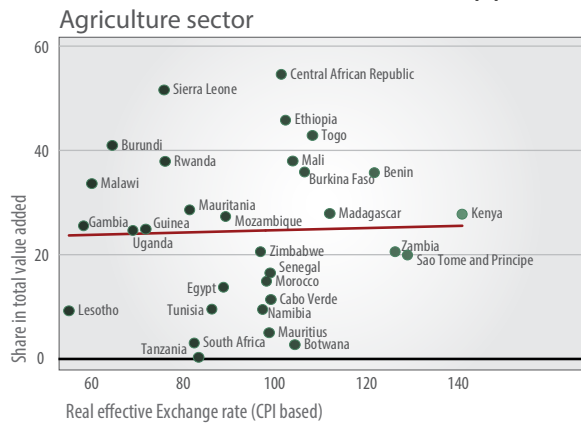
**(a) All African countries**



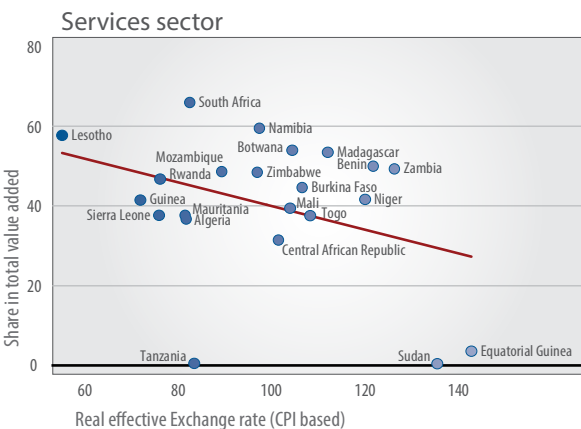
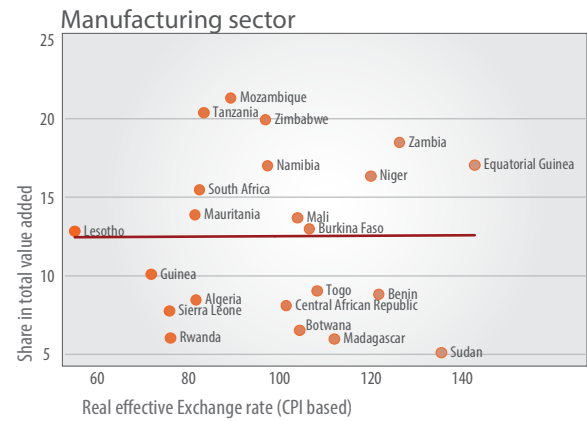
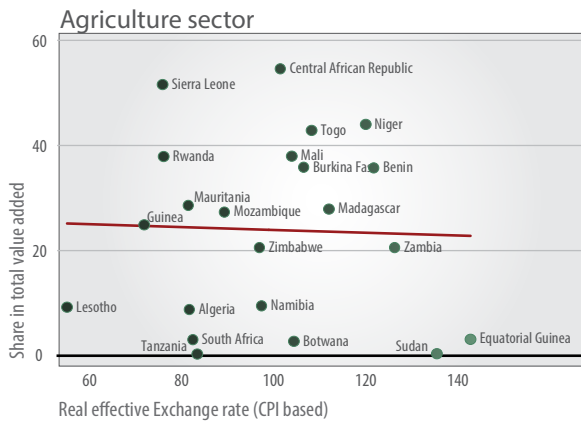
**(b) Oil exporting countries**



**(c) Oil importing countries**



**(d) Mineral rich countries**



## FISCAL DEFICITS ARE NARROWING

Subregional fiscal balances are set to remain negative but are generally improving (figure 1.10).

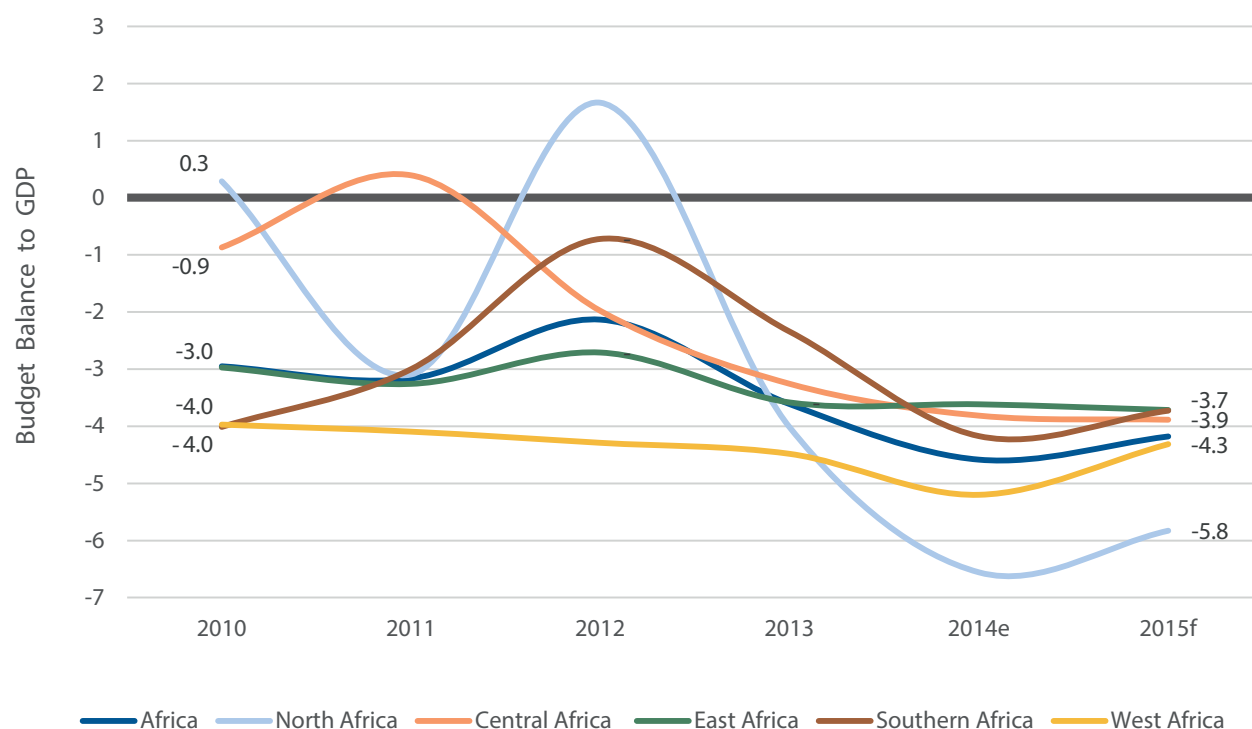
The region's average fiscal deficit widened from 3.6 per cent of GDP in 2013 to 4.6 per cent in 2014, but the deficit should narrow to 4.2 per cent in 2015, tracking decreases in North Africa (from 6.6 to 5.8 per cent), Southern Africa (4.2 to 3.7 per cent) and West Africa (5.2 to 4.3 per cent).

In South Africa, the fiscal deficit is expected to narrow from 4.4 per cent of GDP in 2014 to 3.7 per cent in 2015, as fiscal authorities take steps to address corruption and inefficiencies and cut allocations on non-essential expenditures. In Botswana, buoyant revenue from mineral taxes, income and value-added taxes, and the Southern African Customs Union (SACU) revenue-sharing scheme will improve the fiscal surplus from 1.2 per

cent of GDP in 2014 to 1.5 per cent in 2015. Nigeria's fiscal deficit is expected to widen by 0.1 percentage point to 2.1 per cent of GDP in 2015, mainly because of low oil revenues, instability in its oil-producing region, and increased expenditure in the lead-up to 2015's elections. In Senegal, the fiscal deficit is expected to improve from 5.1 per cent of GDP in 2014 to 4.1 per cent of GDP, as authorities minimize non-productive spending. Egypt, Ghana and Tanzania however could face sustainability issues, as their deficits are expected to average 8 per cent, 10.7 per cent, and 7 per cent, respectively, of GDP over 2014 through 2016.

In East and Central Africa, the deficit is expected to slightly widen to 3.7 per cent of GDP and 3.9 per cent, respectively. Burundi, Tanzania and Uganda will be the drivers of the deficit increase for East Africa, Burundi's underpinned by high spending on military and civil servant salaries and public spending on imported goods. In Tanzania,

**FIGURE 1.10: AVERAGE BUDGET BALANCE BY SUBREGION, 2010–2015 (% OF GDP)**



Source: Calculations based on EIU 2014 data.  
Note: e = estimate; f = forecast.



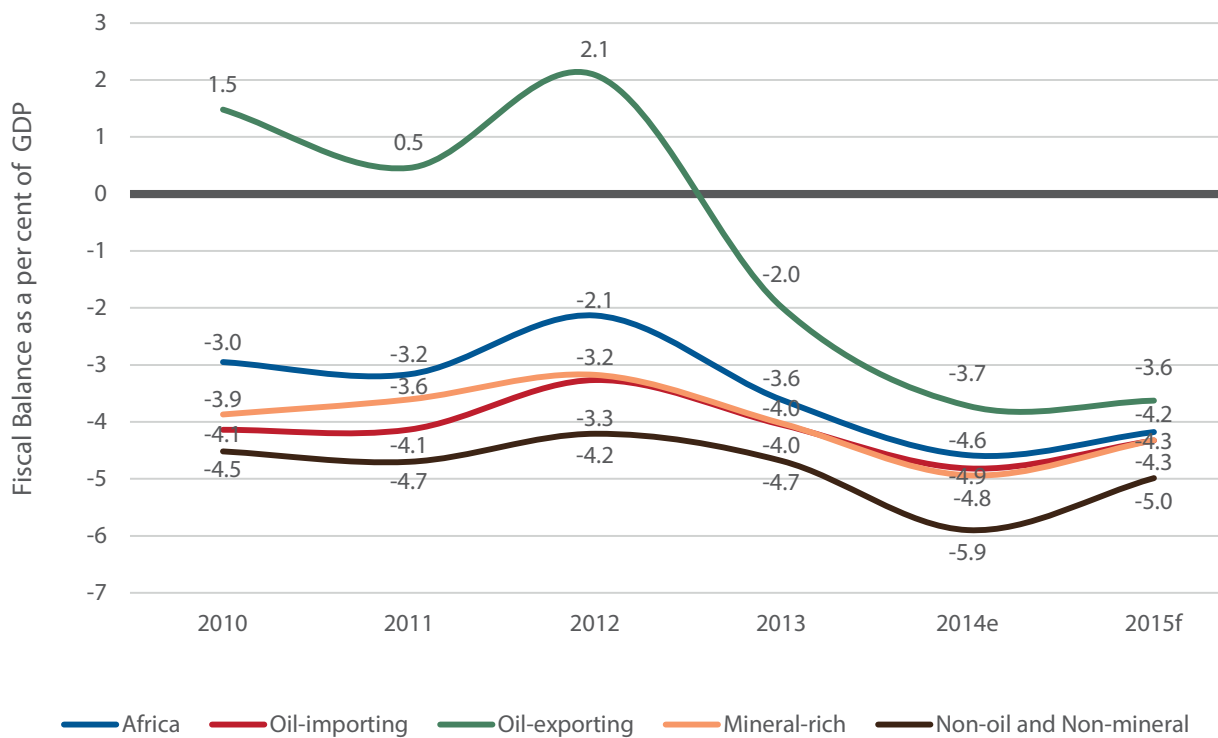
expansionary policy before the 2015 elections and weak fiscal management are behind the increase, whereas in Uganda the deficit will be driven by infrastructure investment, weak public spending controls and deteriorating relations with foreign donors. In Kenya, the fiscal deficit is expected to decrease mainly due to revenue and fiscal reforms. The key driver of fiscal deficit increase in Central Africa—where large economies are major oil exporters—is deteriorating oil prices, as well as fuel subsidies and infrastructure spending in many countries.

Although real exchange rate depreciation is associated with an increase in fiscal deficits in oil-exporting and oil-importing countries, the opposite is true in mineral-rich countries (figure 1.12). However, the relationship is more pronounced in oil-exporting than oil-importing countries. Other factors contributing to better fiscal balances include fiscal consolidation, the emergence of new sources of revenue, and innovative resource mobilization in, for example, Botswana, Cameroon, Republic of Congo, Ethiopia and South Africa (box 1.).

Oil-importing, mineral-rich and non-oil and non-mineral countries are expected to experience the largest gains of 0.5, 0.6 and 0.9 percentage points, respectively, in 2015 as a result of lower oil prices (oil-importing countries include some mineral-rich and non-oil and non-mineral countries) (figure 1.11).

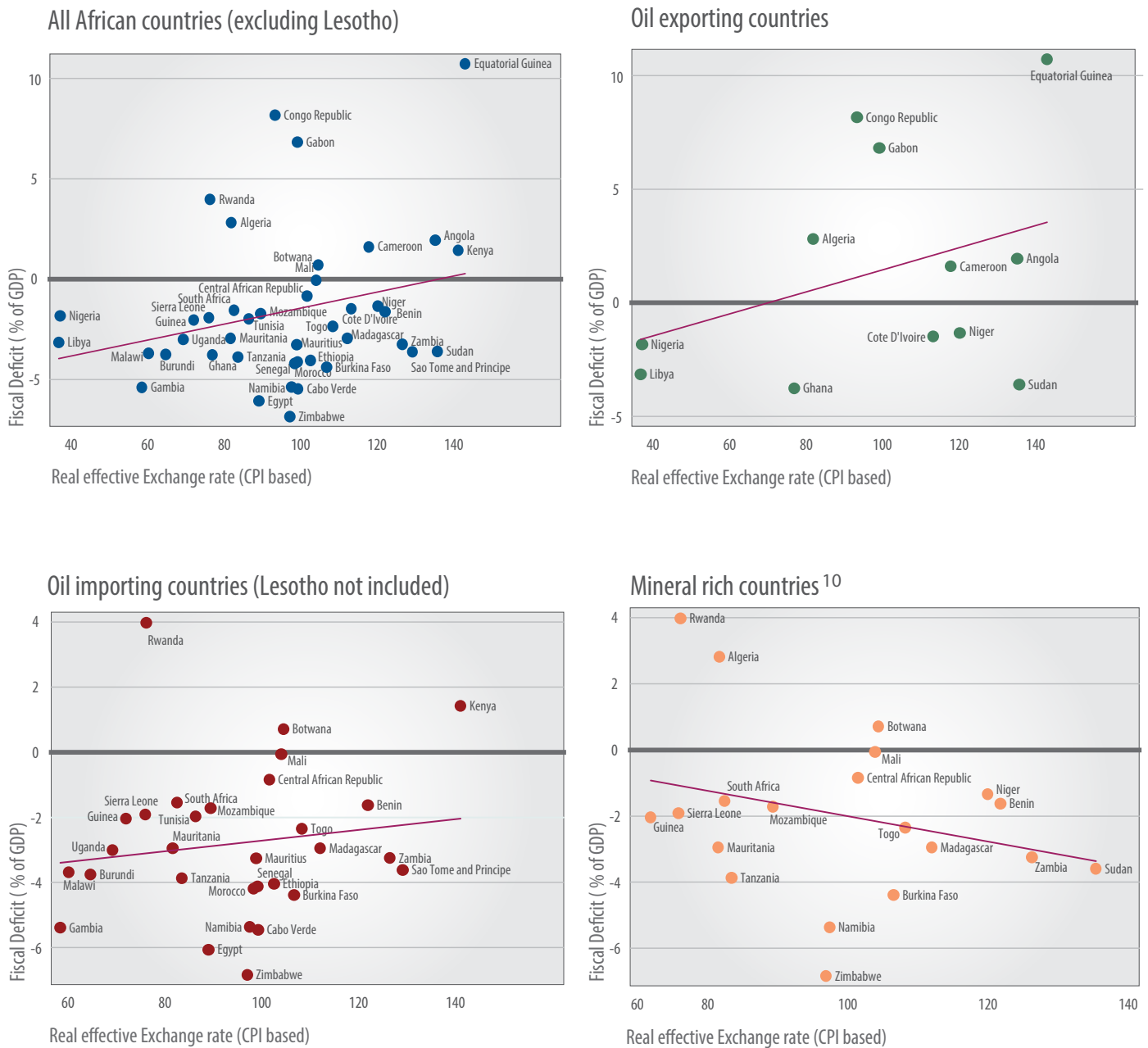
### Africa's overall current account deficit will continue because of trade deficits and increased demand for capital goods

**FIGURE 1.11: AVERAGE BUDGET BALANCE BY ECONOMIC GROUP, 2010–2015 (% OF GDP)**



Source: Calculations based on EIU data.  
Note: f = forecast.

**FIGURE 1.12: FISCAL DEFICITS AND THE REAL EXCHANGE RATE, 2000–2014**



Source: Calculations based on EIU (2014) database.  
 Note: e = ECA estimate; f = forecast.

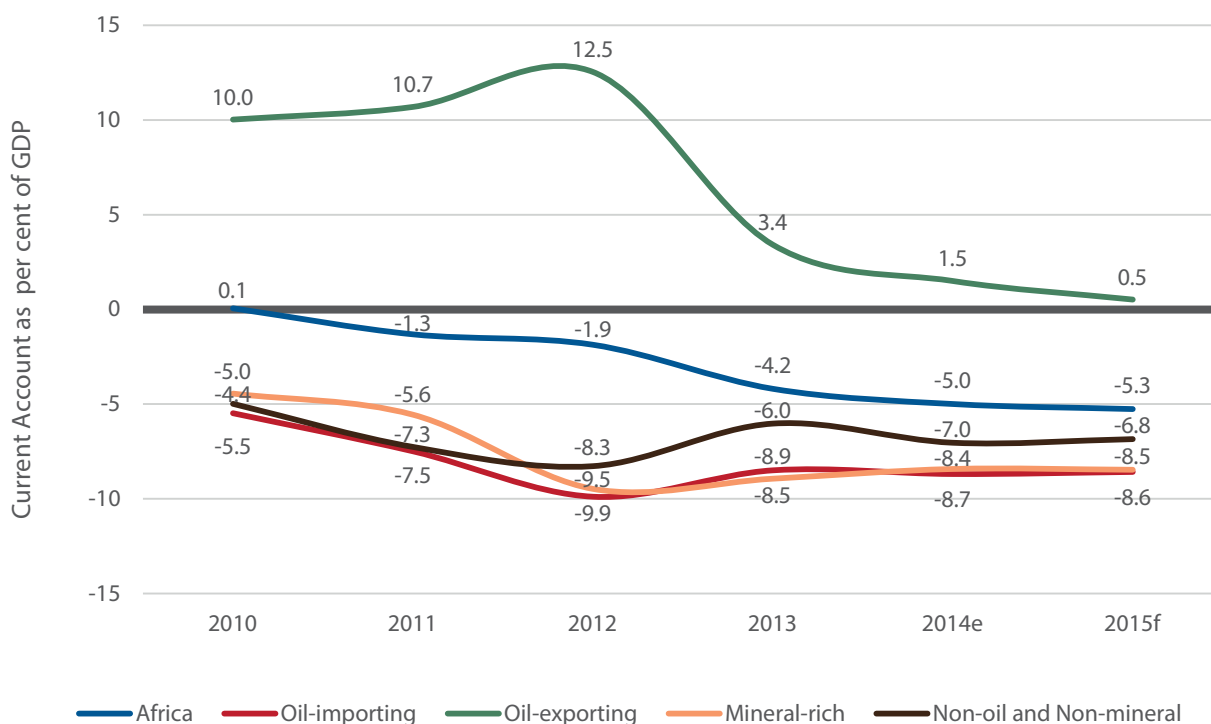
## THE FALLING OIL PRICE WILL AFFECT CURRENT ACCOUNTS

Africa's overall current account deficit will continue because of trade deficits and increased demand for capital goods. Oil-exporting countries will keep their current account surpluses, but they will be much lower in 2015 than they were in 2013 and 2014, whereas current account deficits will persist in other economic groups (figure 1.13).

More specifically, in 2014 the current account deficit of oil-importing countries deteriorated by 0.2 percentage point to 8.7 per cent of GDP, a deficit expected to improve in 2015 to 8.6 per cent. Mineral-rich countries will maintain large current account deficits because of their reliance on imported services and their structural deficits on the income account, as multinational companies (which dominate their mining sectors) continue paying external debts and repatriating profits (EIU,

2014). After improving by about 0.5 percentage point in 2014, the current account deficits of those economies are expected to deteriorate by 0.04 percentage point to 8.5 per cent of GDP in 2015. Non-oil-exporting and non-mineral-rich countries will have the largest current account deficits, mainly because they have limited access to foreign currency reserves.

**FIGURE 1.13: CURRENT ACCOUNT BALANCE BY ECONOMIC GROUP, 2010–2015 (% OF GDP)**



Source: Estimations based on EIU 2014 data.

## INTERNATIONAL RESERVES AMONG OIL EXPORTERS REMAIN HIGH BUT ARE DETERIORATING

Africa's total international reserves decreased by 3.9 per cent, from \$561.4 billion in 2013 to \$539.6 billion in 2014, and are expected to decrease further to \$533.5 billion in 2015, mainly as a result of weakening reserves among oil-exporting countries (figure 1.14). Oil-exporting countries have the largest external reserves, despite falling from 57 per cent of GDP in 2013 to 50 per cent in 2014. They are expected to fall further to 45.8 per cent in 2015. International reserves as a share of GDP for countries in three of the four economic groups averaged just above 14 per cent during 2012–2014.

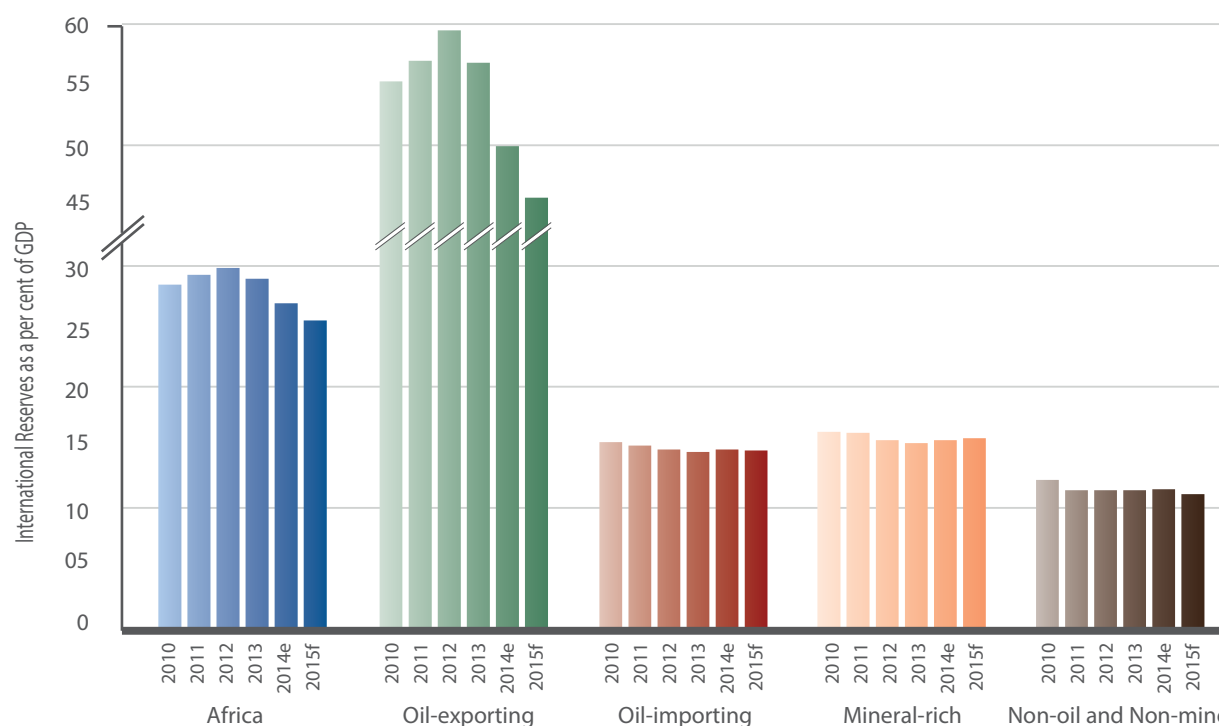
At the subregional level, North Africa has the largest international reserves, driven mainly by oil-exporting economies, notably Algeria and Libya. East Africa has the second-largest reserves, mainly because of high reserves in Burundi, the Comoros and Tanzania (figure 1.15). However, they are

expected to decrease slightly in 2015, as countries such as Ethiopia prefer to spend resources on development rather than build up more reserves.

In West Africa reserves are expected to fall to 12.6 per cent of GDP in 2015, while reserves for Central Africa are expected to increase to 10.9 per cent of GDP in 2015, Gabon driven mainly by the oil-exporting economy, Gabon. Reserves for Southern Africa are expected to be flat. Despite the decrease in Angola, and an increase in all the major economies in the subregion mainly influenced by the decreasing oil-prices.

**Africa's total international reserves decreased by 3.9 per cent, in 2014, and are expected to decrease further as a result of weakening reserves among oil-exporting countries**

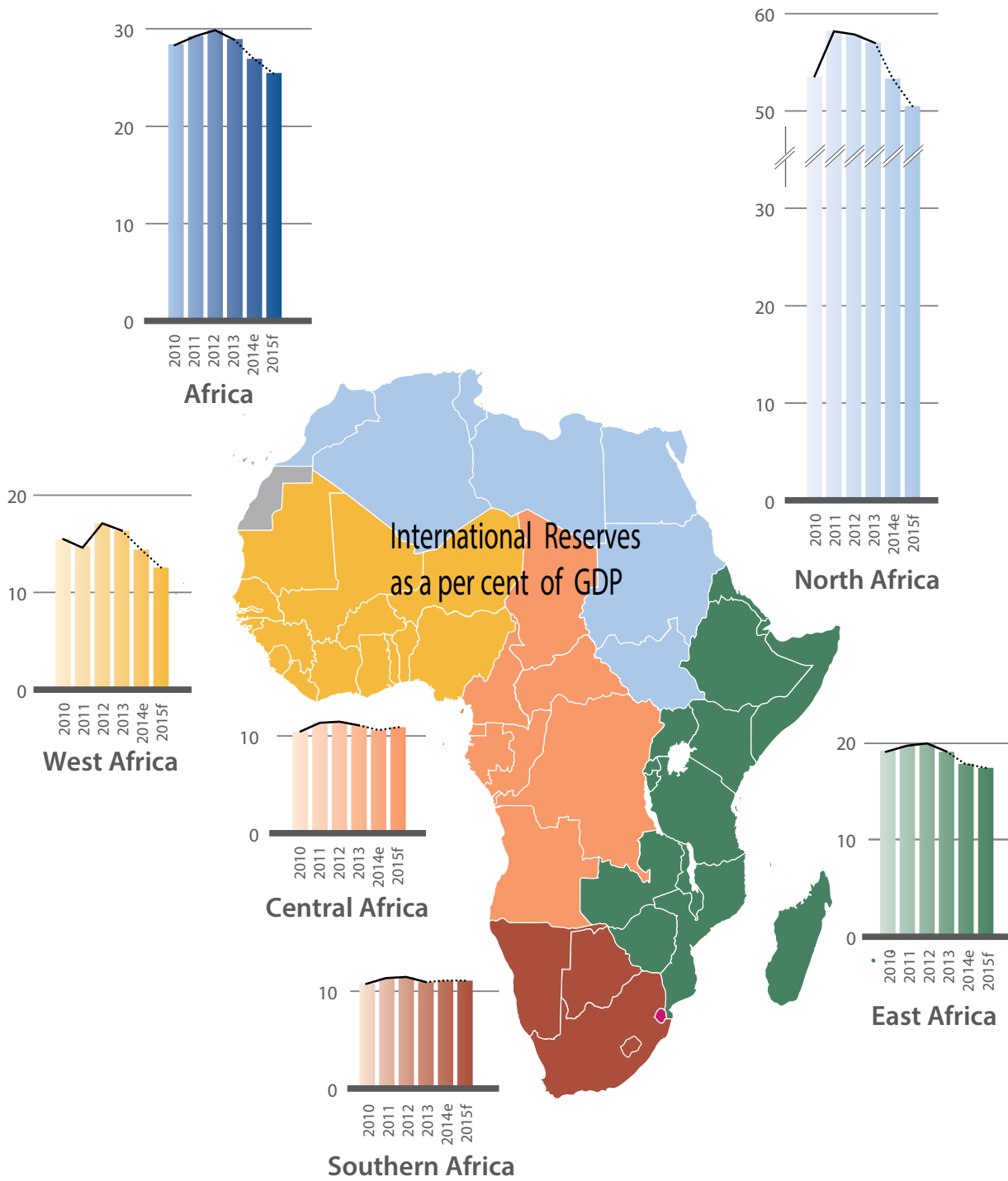
**FIGURE 1.14: INTERNATIONAL RESERVES BY ECONOMIC GROUP, 2010–2015 (% OF GDP)**



Source: Calculations based on EIU (2014) database.

Note: e = ECA estimate; f = forecast.

**FIGURE 1.15: INTERNATIONAL RESERVES BY SUBREGION, 2010–2015 (% OF GDP)**



Source: Calculations based on EIU (2014) database.  
 Note: e=estimate; f=forecast.

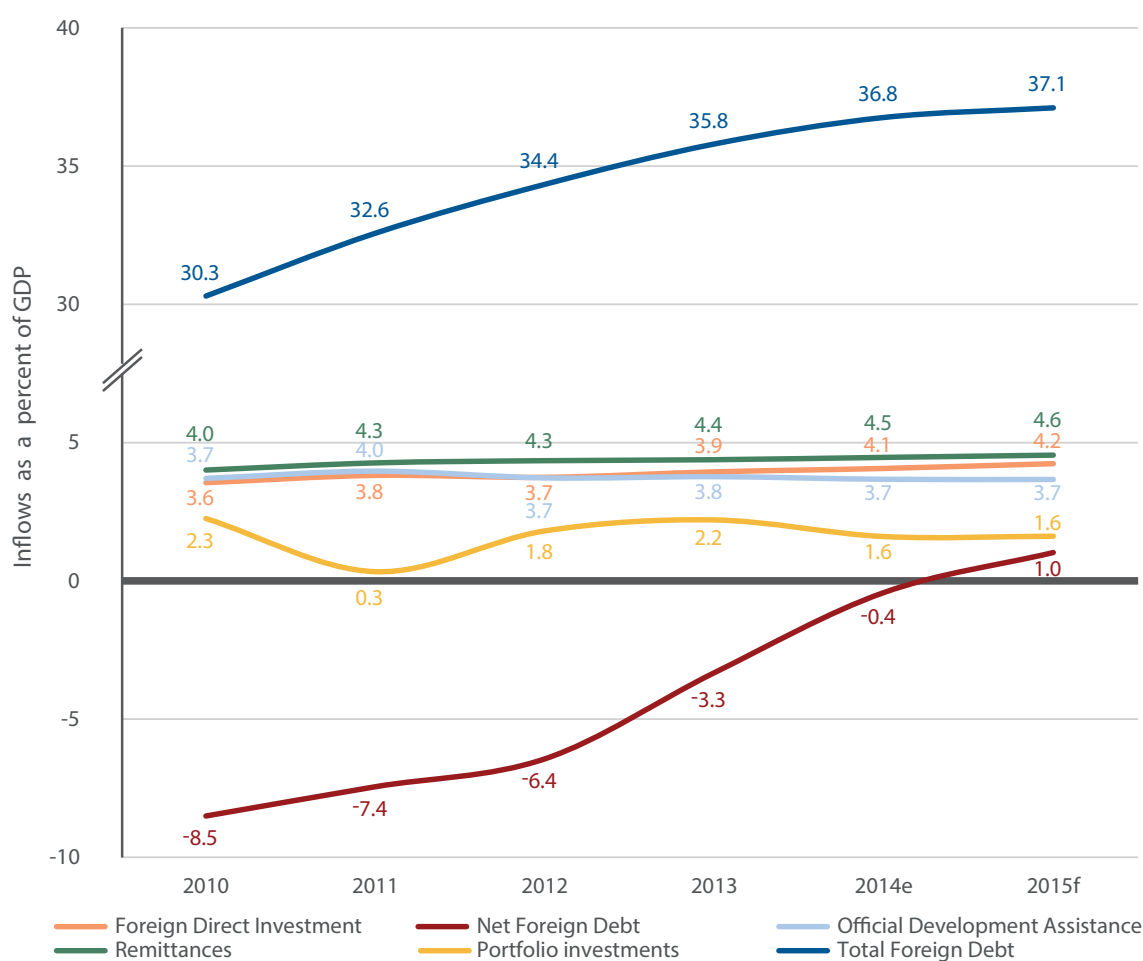
## PRIVATE INFLOWS ARE RISING

Africa continues to attract private capital because of its improved business environment and increasing positive corporate sentiment ratings such as the “Doing Business” regulatory improvements observed in Mauritius and Rwanda<sup>11</sup>. FDI is a large external source of finance but was surpassed in 2010 by remittances (figure 1.16), which also are the most stable source of external financing. Remittances nudged up from 4.4 per cent of GDP in 2013 to 4.5 per cent of GDP in 2014, and they are expected to further increase to 4.6 per cent of GDP in 2015, as more African expatriates seek to invest in their home countries. In absolute terms, remittances for 2013, 2014, and 2015 translate to \$62.9 billion, \$67.1 billion and \$71.8 billion,

respectively. To leverage increasing remittances, the continent must decrease the cost of sending them back and develop financial instruments to channel them towards developmental programmes.

FDI is the second largest source of external private equity inflows. FDI increased from \$56.6 billion in 2013 to \$61.1 billion in 2014 and is projected to increase to \$66.9 billion in 2015, equivalent to 3.9 per cent, 4.1 per cent and 4.2 per cent, respectively, of GDP. Portfolio flows averaged about 1.6 per cent of GDP over 2010–2015, and they remain volatile because they often are influenced by global monetary policy stances and the political outlooks of developing and emerging countries. Portfolio flows decreased from \$31.6 billion in 2013 to \$24.1 billion

**FIGURE 1.16: INFLOWS OF EXTERNAL FINANCE, 2010–2015 (\$ BILLION)**



Source: Calculations based on UNCTADstat (2014).  
 Note: e = ECA estimate; f = forecast.

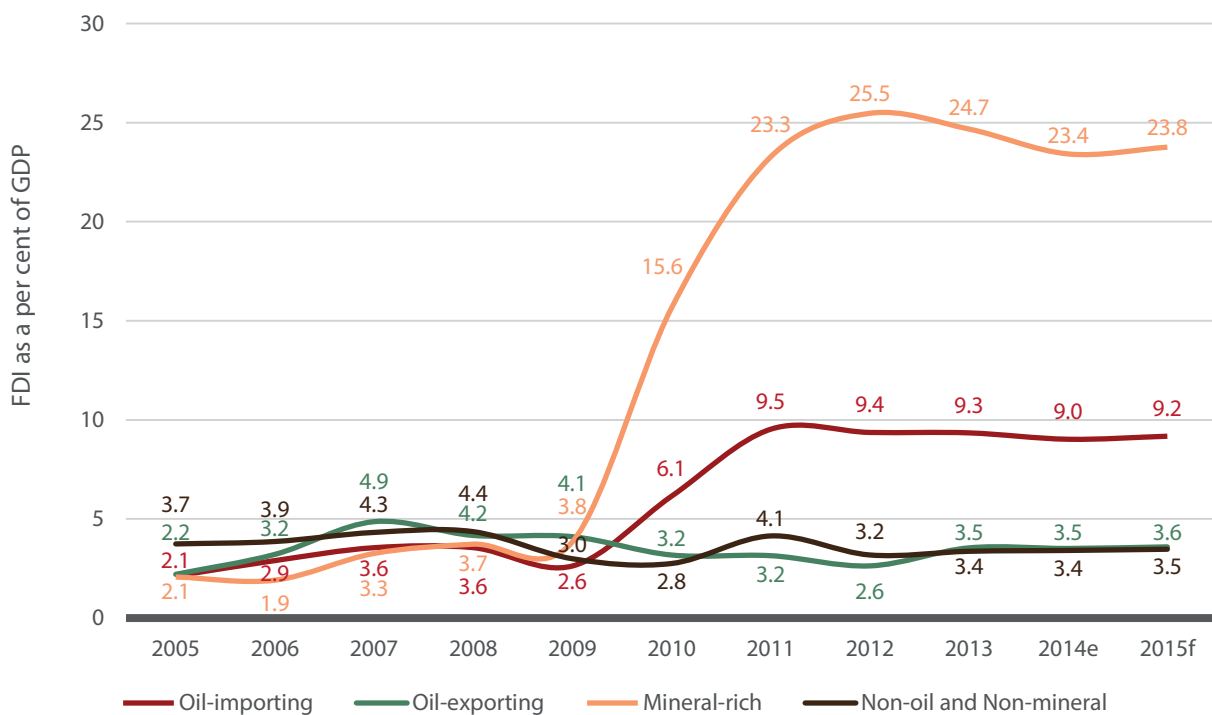
in 2014 but are projected to increase to \$25.5 billion in 2015. Despite the slow recovery in developed and emerging economies, both FDI and portfolio equity flows are expected to continue increasing, underscoring the global private sector’s appetite for the continent’s opportunities. Frontier markets are key in attracting foreign private capital, bringing in 25.1 per cent and 26.3 per cent, respectively, of Africa’s total FDI inflows in 2013 and 2014, and 90 per cent and 63.2 per cent of its portfolio flows during those years. In 2015, frontier markets are expected to attract 27 per cent and 59 per cent, respectively, of total FDI and portfolio flows.<sup>12</sup>

Since 2010, mineral-rich countries have been by far the largest recipients of FDI inflows (figure 1.17)

although those inflows gradually decreased from 24.7 per cent of GDP in 2013 to 23.4 per cent in 2014. Whereas FDI to resource-rich countries has the potential to improve efficiency by bringing technological and management spillovers, the resource-rich sector could develop at the expense of other sectors. Exports from the sector also could put pressure on the local currency, resulting in “Dutch disease”<sup>13</sup> and limited economic diversification.

Illicit financial outflows through trade mispricing also are widespread in resource-rich economies, estimated at close to \$60 billion a year and growing at 32.5 per cent over 2000–2009. Cumulatively, the outflows over that period were equivalent to nearly all the official development assistance (ODA)

**FIGURE 1.17: INFLOWS OF FDI AS A SHARE OF GDP, BY ECONOMIC GROUP, 2005–2015 (%)**



Source: Calculations based on EIU(2014).  
 Note: e = ECA estimate; f = forecast.

received by Africa during that time (ECA, 2014d). Policy interventions through tax incentives and close monitoring could help curb illicit financial outflows.

ODA will remain a key source of external public finance for many countries. In 2013 and 2014, ODA constituted 3.8 per cent and 3.7 per cent of Africa's GDP, respectively. The ebb and flow of ODA, though, is tied to (often short-term) priorities of development partners that can be driven by non-

developmental concerns, including geopolitics, strategy and security. That is why Africa must prioritize financing and mobilize resources to achieve structural change. The continent must encourage savings in industry, particularly manufacturing and mechanized agriculture; some African countries have made a good start (box 1.6).

Total foreign debt has been higher than 30 per cent of GDP in Africa since 2010 and is expected to rise to 37.1 per cent of GDP in 2015, although net

### **BOX 1.6: DOMESTIC FINANCING—DIASPORA BONDS AND SOVEREIGN WEALTH FUNDS**

The importance of domestic ownership to successful development has led to an emphasis on domestic resource mobilization, as a complement to external resources, such as FDI and remittances.

In the short term, the greatest potential resource is taxation, but that will require upgraded technology in national tax bureaus, improved tax collection (including faster collection time) and higher compliance rates, although some narrowly based progress has been made (almost all recent gains have come from taxes and other revenues collected from the natural resource sector).

Some governments have sought to tap into private finance for developmental projects. One example is the issuance of "diaspora bonds," which if well structured can be a stable and cheap source of finance, as they have been for Ethiopia (2008 and 2011), Ghana (2008), Rwanda (2012) and Zimbabwe (2014). Such bonds are not, however, suitable for all countries; they are appropriate for high-income countries with large diasporas<sup>14</sup>. (Most African national diasporas remain on the continent.)

Africa's resource-rich countries are setting up sovereign wealth funds. Botswana set up the Pula Fund as far back as 1994. Taking its income mainly from diamond exports, the Pula Fund is managed by the central bank, and had about \$5.4 billion in August 2014<sup>15</sup>. The fund invests only in foreign currency-denominated assets of developed countries. It runs a stabilization fund to finance fiscal deficits and a savings fund to help achieve intergenerational equity. The success in raising such an amount of funds by the Pula Fund is attributed to the government's establishment and

adherence to a sustainable fiscal policy backed by an oversight framework, underpinned by the strategic delinking of fiscal expenditure from natural, resource-driven revenues.

In the past two years, Angola, Ghana and Nigeria have also established that type of fund; Kenya, Liberia, Mauritius, Mozambique, Senegal, Zambia and Zimbabwe are expected to follow suit.

Governments in Africa will have to balance the goals of intergenerational equity and current economic priorities. For that reason, Angola's new sovereign fund aims to support sectors that contribute to regional integration, such as infrastructure, agriculture, water, energy and transport, while also investing in emerging markets, commodity markets and priority investment sectors in Africa. Nigeria's fund focuses on intergenerational equity, exogenous economic shocks and infrastructure. Senegal's fund is intended as a "strategic co-investor in business capital" (particularly for small and medium enterprises), along the lines of a private equity fund. The key policy and institutional drivers are in government hands, but the private sector is of course more important in generating revenues.

**Some governments have sought to tap into domestic financing such as diaspora bonds and sovereign wealth funds mainly for developmental projects**



foreign debt as a share of GDP will be only 1 per cent of GDP (see figure 1.16), having been negative since 2006 because of high international reserves in oil-exporting economies (figure 1.18). Net foreign debt (total debt minus reserves) as a share of GDP in Algeria and Libya has averaged -82.3 per cent and -175 per cent since 2010. Mineral-rich and oil-importing countries have positive net foreign debt, and some extreme cases<sup>16</sup> have very high ratios, raising issues of debt sustainability.

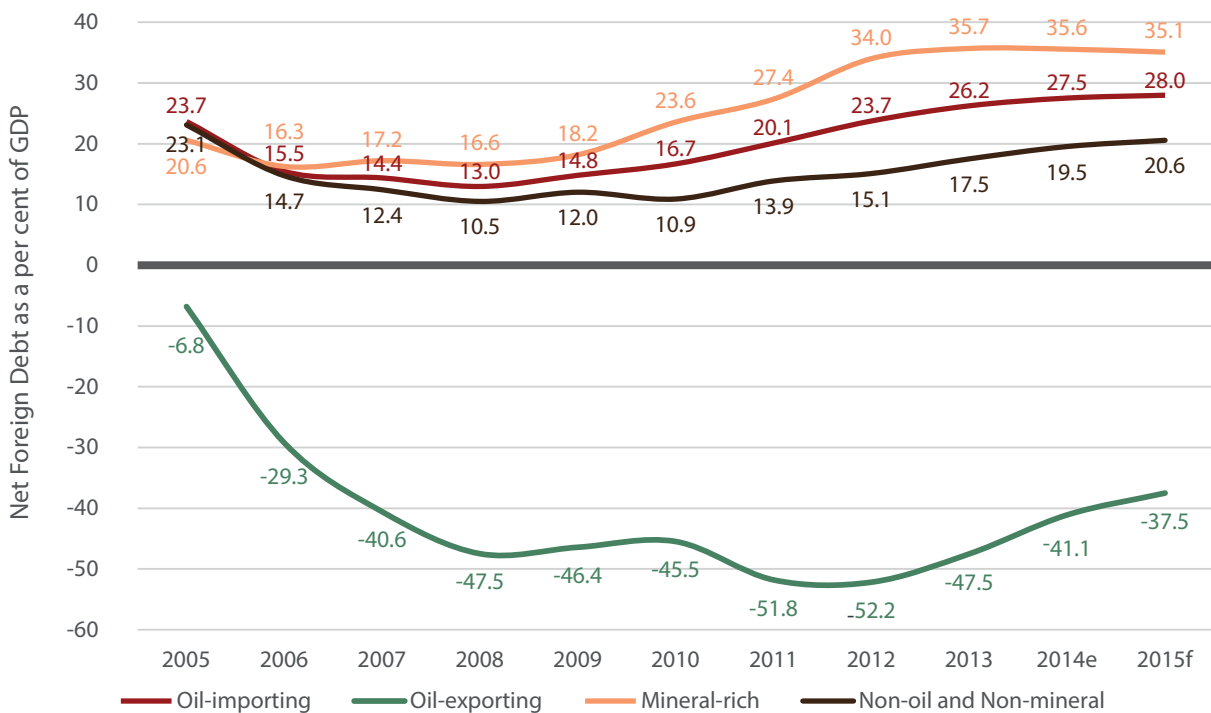
### Africa continues to attract private capital because of its improved business environment and increasing positive corporate sentiment ratings

### PRIVATE EQUITY IS AN OPPORTUNITY

Given precarious debt levels for many countries, slower economic growth, urbanization, population growth and rising demand for infrastructure, additional funds are needed. Private equity is one opportunity because countries that recorded more progress in terms of economic growth over the past decades are the ones that also attracted a greater share of private equity capital (ECA, 2014a). This source of funding is particularly promising for small and medium enterprises. Private equity could enhance domestic financing, given the high bank interest rates and weaknesses in financial intermediation in most of Africa.

Private equity investment has risen sharply in Africa over the past decade—albeit from a very low base—with average annual growth of 26 per cent, which reflects an improved business environment. During

**FIGURE 1.18: NET FOREIGN DEBT BY ECONOMIC GROUP, 2005–2015**



Source: Calculations based on EIU(2014).  
Note: e = estimate; f = forecast.

2006–2012, 28 per cent of private equity inflows into Africa were into consumer discretionary (an economic sector comprising businesses selling non-essential goods and services), 26 per cent industrials, 20 per cent materials, 12 per cent energy, 7 per cent financials, 3 per cent information technology, 3 per cent consumer staples, and 1 per cent healthcare (ECA, 2014a). However, the contribution of private equity inflows remains marginal in the cumulative global total (0.5 per cent over the period). Africa offers opportunities for private equity with its recent high growth, abundant natural resources, few private equity players, and growing market. African pension funds, currently estimated at \$1 billion in Africa, could become a viable source of capital for private equity through investment in profitable assets, hence raising enough finances to tackle Africa’s financing gap.

**Private equity investment has risen sharply in Africa over the past decade with average annual growth of 26 per cent, which reflects an improved business environment**

**African countries with higher savings have higher savings–investment ratios, indicating that big savers invest little at home**

**FIGURE 1.19: AFRICAN SAVERS AND INVESTORS, 2000–2010**



Source: Calculations based on World Development Indicators(World Bank (2014); database accessed December 2014).

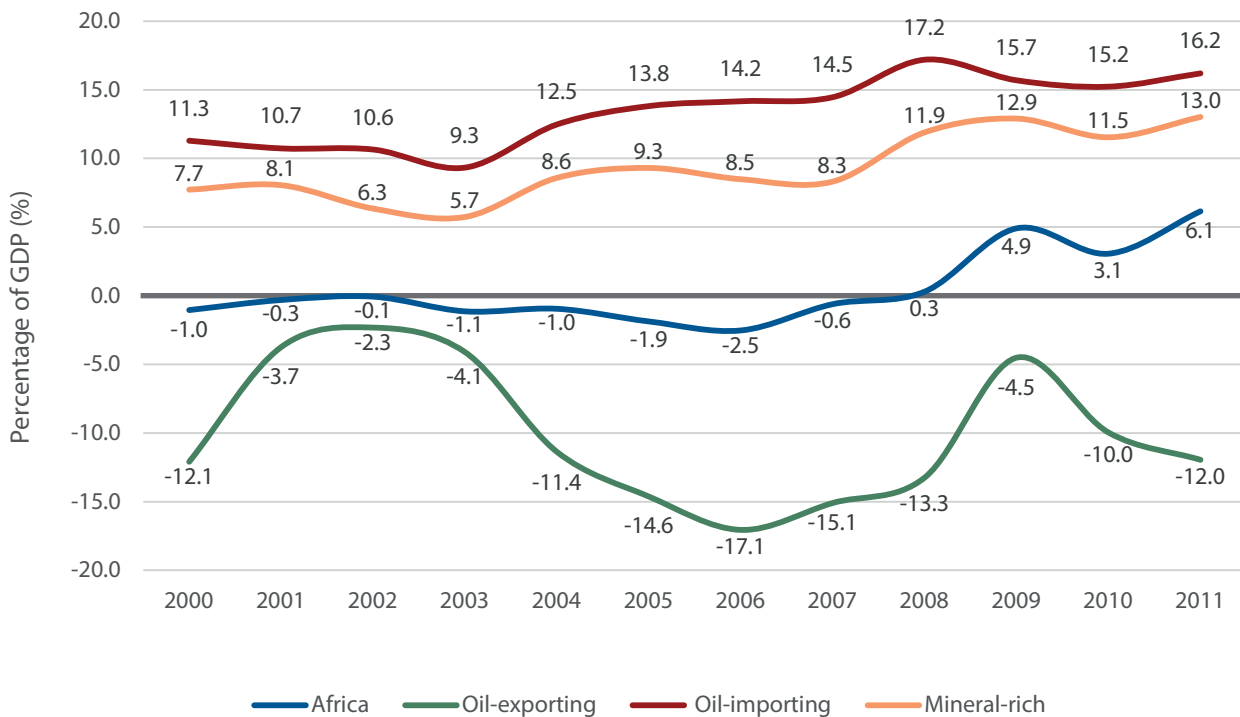
## AFRICAN COUNTRIES WITH HIGHER SAVINGS MAKE FEWER DOMESTIC INVESTMENTS

Relying on external sources only will not be enough for Africa to transform structurally. Evidence from East Asia shows that subregional economic growth was underpinned by high domestic savings and investment (NSI, 2010). In Africa during 2000–2010, at early stages of development, increases in savings led to a decline in investment until a level, after which savings enhanced investment as an economy grew (figure 1.19, left panel). However, African countries with higher savings tend to have higher savings–investment ratios, indicating that big savers invest little at home (figure 1.19, right panel). Those countries include Algeria, Angola, Republic of the Congo, Equatorial Guinea, Gabon and Côte

d'Ivoire—notably, Africa's main oil-exporters, suggesting that rather than investing, they are primarily building buffers against exogenous shocks (ECA and AUC, 2014).

Africa's recent growth has not generated enough savings for investment, partly because of high levels of (mainly private) consumption, which has widened the continent's financing gap, estimated at more than 5 per cent in 2011 and driven primarily by the resource gap in oil-importing and mineral-rich countries (figure 1.20). Indeed, during 2000–2011, the financing gap in oil-importing countries was higher than in mineral-rich countries and oil-exporting countries<sup>17</sup>—further proof that that despite having relatively high savings, oil-exporting countries invest less because they hedge against revenue volatility.

**FIGURE 1.20: AFRICA'S DOMESTIC FINANCING GAP, BY ECONOMIC GROUP, 2000–2011**



Source: Calculation based on World Development Indicators (World Bank, 2014).

## RISKS AND UNCERTAINTIES

A number of internal and external risks determine Africa's medium-term prospects. The continued decline in oil and commodity prices; slow recovery in the US, the euro zone and Japan; and the decline in demand for commodities in China will negatively weigh on Africa's medium-term trade performance. Tighter global financial conditions in developed economies might lead to a rise in interest rates, resulting in the outflow of private capital and an increase in the volatility of currencies. Those occurrences may affect frontier market economies, such as Ghana, Nigeria, South Africa, and Zambia. Although controls on capital flows offer a temporary solution, more robust strategies, such as adjusting funding strategies and plans and improving the business environment to retain capital, would provide a longer term solution.

Political instability, terrorism and violence in a number of African countries—such as the Central African Republic, the Democratic Republic of the Congo, Kenya, Lesotho, Libya, Mali, Nigeria, Somalia, and South Sudan—as well as civil and labour unrests in South Africa will remain a source of pessimism. However, the number of armed conflicts in Africa has decreased since 2000, and more initiatives are being undertaken at the continental level to address issues of peace and security (ECA, 2014c).

Finally, weather-related shocks will remain a source of downside risks, given that most African economies still depend on rain-fed agricultural practice. Global cooperation in addressing issues of climate change will go a long way to arrest some of those risks.

Medium-term capital inflows to Africa (and other developing and emerging regions) may moderate owing to fiscal consolidation in major donor countries (reduction in fiscal deficits) and tighter monetary conditions (to constrict spending) in developed economies.

The whole approach to forecasting is itself fraught with risk: differences in models and assumptions produce widely spread forecasts (box 1.7).

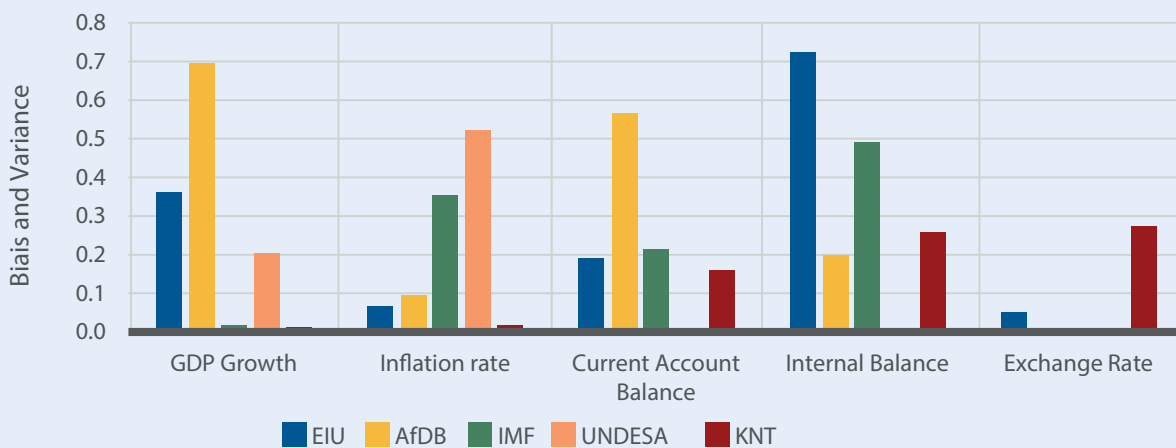
**BOX 1.7: HOME PLAYER ADVANTAGE?**

Some forecasters seem to be better at forecasting than others. For Kenya, for example, Kenya’s National Treasury (box figure 1) had the lowest forecast errors (based on Theil’s decomposition of the root mean square error) for GDP growth (0.01), inflation rate (0.02), and current account balance (0.16), while AfDB and EIU had the lowest errors for internal balance (0.20) and exchange rate (0.05), respectively, over 2009-2013. For the same period, the Morocco High Commission for Planning (HCP), for Morocco itself, also had the lowest forecast errors for three out of the five variables (box

figure 2) when set against four “non-national” bodies. HCP (0.22) gives the lowest forecast error for real GDP growth followed by AfDB (0.25), UN-DESA (0.27), IMF (0.33) and EIU (0.35), possibly because HCP is a “home” institution. It was also the best predictor for the fiscal balance, and, among two institutions only, the exchange rate.

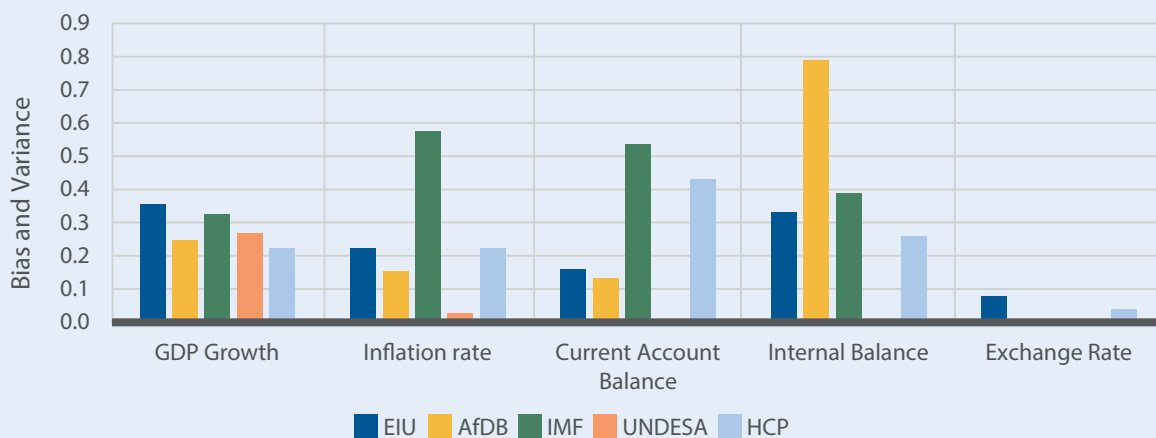
This suggests the need to support the statistical capacity and forecasting units of national institutions in Africa as sources of more accurate, timely and useful forecasts.

**BOX 1.7 FIGURE 1: ACCURACY OF AFRICA’S ECONOMIC FORECASTS-KENYA, 2009–2013**



Source: ECA and AUC calculation from IMF-WEO (2003-2013), EIU country reports, Kenya’s Budget Policy Statement (2011-2015), AfDB (African Economic Outlook, 2009-2014) and UNDESA (2009-2014)

**BOX 1.7 FIGURE 2: ACCURACY OF AFRICA’S ECONOMIC FORECASTS-MOROCCO, 2009–2013**



Note: Forecast values unavailable for IMF and AfDB on exchange rate, UN-DESA on current account balance, internal balance and exchange rate. Source: ECA and AUC calculation from IMF-WEO 2003–2013, EIU country reports, HCP, AfDB (African Economic Outlook 2009–2014) and UN-DESA.

# AFRICA'S TRADE PERFORMANCE

Trade is one of the measures of integration of economies with the rest of the world, and the structure of trade (imports and exports) is a summary of the production structure of the trading partners.

## THE MERCHANDISE TRADE BOOM IS TAPERING OFF

Africa's merchandise exports declined by 2.4 per cent in 2013 (the only regional contraction that year), after growth of 6.5 per cent in 2012 (the highest among world regions) (table 1.1).

Fuels and natural resource-based products—mainly in their raw form—accounted for close to two thirds of exports. Apart from South Africa, the top African exporters are its oil exporters. The

decline in merchandise exports is attributed to the upward trend in the prices of commodities<sup>18</sup> and the continued dominance of natural resource-based products. Such export swings underscore the need for Africa to diversify its production and export base by adding value to its commodity exports. (Imports continued growing, but more slowly—4.1 per cent in 2013, compared to 12.9 per cent in 2012.)

The share of Africa's exports in global merchandise exports is still low, declining marginally from 3.5 per cent in 2012 to 3.3 per cent in 2013 (table 1.2)—a contrast with 4.9 per cent in the 1970s. Some Asian economies that were at par with African economies in the 1970s—such as Indonesia, Malaysia and Republic of South Korea—increased their shares of the world trade hugely. Indeed Africa's share in global exports was higher than the East Asia region's

**TABLE 1.1: GROWTH IN WORLD MERCHANDISE TRADE, BY REGION, 2012 AND 2013 (%)**

	Exports		Imports	
	2012	2013	2012	2013
Africa	6.5	-2.4	12.9	4.1
Asia	2.8	4.7	3.7	4.5
Commonwealth of Independent States	0.9	0.8	6.8	-1.3
Europe	0.8	1.5	-1.8	-0.5
Middle East	5.2	1.9	10.5	6.2
North America	4.4	2.8	3.1	1.2
South and Central America	0.7	1.4	2.3	3.1
World	2.4	2.5	2.1	1.9

Source: WTO (2014).

**TABLE 1.2: WORLD TRADE AND AFRICA'S TRADE, BY REGION, 2013**

	World Trade, by Regions Value (\$ billion)		Africa's Exports, by Destination	
	Value (\$ billion)	%	Value (\$ billion)	%
Africa	602	3.3	97	16.2
Asia	5,773	31.5	188	26.6
Commonwealth of Independent States	779	4.3	2	0.3
Europe	6,646	36.3	216	35.8
Middle East	1,347	7.4	38	3.0
North America	2,418	13.2	54	8.9
South and Central America	736	4.0	30	4.9
World	18,301	100	602	3.4

Source: Based on table 1.4 of WTO 2014. International Trade Statistics.

Note: The difference between the total for Africa and its breakdown may result from rounding up of errors.

**TABLE 1.3: SHARE OF MANUFACTURES IN TOTAL MERCHANDISE TRADE BY REGION, 2013, PERCENTAGE**

	Exports	Imports
Africa	18.5	62.0
Asia	79.1	59.3
Commonwealth of Independent States	22.3	76.5
Europe	73.9	66.3
Middle East	20.5	69.7
North America	66.8	73.5
South and Central America	26.4	66.3
World	64.7	64.7

Source: WTO 2014.

share in 1970 and 1980. The dramatic change started around 1990 and has continued. In 1970 and 1980, Africa's share in global exports was 4.99 and 5.99 per cent, respectively. The corresponding figure for East Asia was 2.25 and 3.74 per cent, respectively. In 1990, 2000 and 2010, Africa's share of global exports was 3.02, 2.31 and 3.33 per cent, respectively, compared with East Asia's share of 8.06, 12.02 and 17.8 per cent<sup>19</sup>. About one-third<sup>20</sup> of the world trade in 2013 was by Asian countries.

Africa's traditional trading partners are being displaced by China and other Asian economies. Europe remains Africa's main trading partner, even with a decreasing share over the years: from 52 per cent in 2005 to 36 per cent in 2013. However, the Asian region (mainly China) is Africa's second largest trading partner. That region accounted for close to 27 per cent of total Africa's trade in 2013 (see table 1.2).

**TABLE 1.4: AFRICA'S TOP 20 MERCHANDISE EXPORTS TO THE WORLD, 2011–2013 (\$ BILLION)**

HS CODE	Product label	2011	2012	2013
	All products	607.4	653.3	581.8
27	Mineral fuels, oils, distillation products, etc.	346.8	392.6	340.9
71	Pearls, precious stones, metals, coins, etc.	44.8	46.4	32.4
26	Ores, slag and ash	23.3	20.1	24.2
85	Electrical, electronic equipment	11.7	10.6	11.5
87	Vehicles other than railway, tramway	9.1	9.8	11.4
74	Copper and articles thereof	11.8	11.8	11.2
84	Machinery, nuclear reactors, boilers, etc.	9.1	8.9	9.3
18	Cocoa and cocoa preparations	8.6	10.1	8.7
72	Iron and steel	10.8	8.9	8.6
89	Ships, boats and other floating structures	7.3	6.7	7.9
08	Edible fruit, nuts, peel of citrus fruit, melons	6.6	9.4	6.7
62	Articles of apparel, accessories, not knit or crochet	6.7	5.9	6.4
28	Inorganic chemicals, precious metal compound, isotopes	6.6	5.1	4.6
31	Fertilizers	5.0	5.1	4.5
76	Aluminium and articles thereof	5.3	4.2	4.4
39	Plastics and articles thereof	3.9	3.8	4.0
03	Fish, crustaceans, molluscs, aquatic invertebrates NES	3.9	4.2	4.0
25	Salt, sulphur, earth, stone, plaster, lime and cement	4.3	4.5	3.9
09	Coffee, tea, mate and spices	4.2	4.1	3.6
61	Articles of apparel, accessories, knit or crochet	3.7	3.3	3.5

Source: WTO 2014.

Note: NES = not elsewhere stated.



Africa exported the lowest share of manufactures in the total merchandise exports—18.5 per cent—in 2013 (table 1.3). Asia had the highest share, followed by Europe. On the import side, the share was far less variable. Trade in intermediates and participation in the high end of global value chains accounted for the simultaneous high share of manufactures in total merchandise exports and imports of North America, Europe and Asia. Africa's low export figure is a reflection of minimal participation in GVCs.

Africa's exports are of course highly skewed towards unprocessed, resource-based commodities (table 1.4)—as with the first three Harmonized Commodity Description and Coding Systems (HS) 2 products, which accounted for 68 per cent of Africa's total merchandise exports in 2013.

The structure of Africa's imports from the world is fairly diversified, as the first 15 HS 2 items accounted for 64 per cent of its imports (table 1.5).

**TABLE 1.5: AFRICA'S TOP 20 IMPORTS FROM THE WORLD, 2011–2013, \$ BILLION**

HS	Product label	2011	2012	2013
	All products	560.6	570.6	592.1
27	Mineral fuels, oils, distillation products, etc.	85.3	95.9	94.3
84	Machinery, nuclear reactors, boilers, etc.	65.2	64.9	69.3
87	Vehicles other than railway, tramway	44.8	52.1	48.8
85	Electrical, electronic equipment	42.3	40.3	43.7
10	Cereals	27.3	25.9	22.7
39	Plastics and articles thereof	17.7	18.0	19.8
72	Iron and steel	17.1	18.9	19.1
89	Ships, boats and other floating structures	24.5	16.5	18.5
73	Articles of iron or steel	16.4	16.1	16.9
30	Pharmaceutical products	12.0	13.2	15.4
99	Commodities not elsewhere specified	6.5	11.1	11.7
90	Optical, photo, technical, medical, etc. apparatus	7.9	8.0	9.7
15	Animal, vegetable fats and oils, cleavage products, etc.	10.4	9.1	8.5
40	Rubber and articles thereof	8.0	7.5	7.8
48	Paper and paperboard, articles of pulp, paper and board	7.5	7.4	7.6
38	Miscellaneous chemical products	6.7	6.8	7.1
17	Sugars and sugar confectionery	7.8	7.0	6.8
71	Pearls, precious stones, metals, coins, etc.	2.5	4.1	6.0
29	Organic chemicals	5.9	6.1	6.0
94	Furniture, lighting, signs, prefabricated buildings	4.6	5.4	5.9

Source: WTO 2014.

Petroleum products well illustrate the need to join and develop regional and global value chains: in 2013, the continent exported products (mainly crude) worth \$340.9 billion but imported (mainly refined) products worth \$94.3 billion.

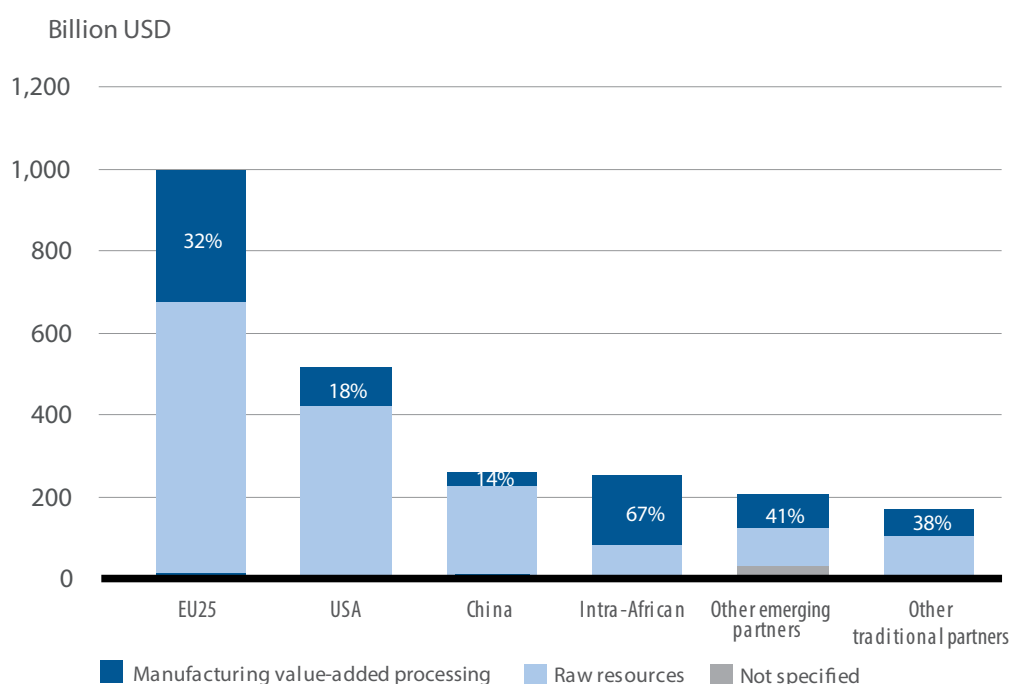
Intra-African trade, at 16.3 per cent of total trade in 2013, is still low when compared with other regions, so Africa’s policy response should be to consolidate that position and augment it via improved infrastructure, enhanced trade facilitation, reduced trade costs and greater efficiency generally (ECA and AUC, 2013). Its composition varies greatly from that for extra-African trade: about two-thirds of intra-African trade is manufactures (figure 1.21). Chapter 4 presents further analysis.

## SERVICES TRADE IS CHANGING ITS COMPOSITION

Services accounted for 13 per cent of Africa’s total exports in 2013, far smaller than exports of raw commodities and natural resources (which accounted for about 83 per cent). The share of services in Africa’s exports was smaller than that of most other regions except for the Middle East (figure 1.22). (The potential of services is discussed more fully in section 4.4.)

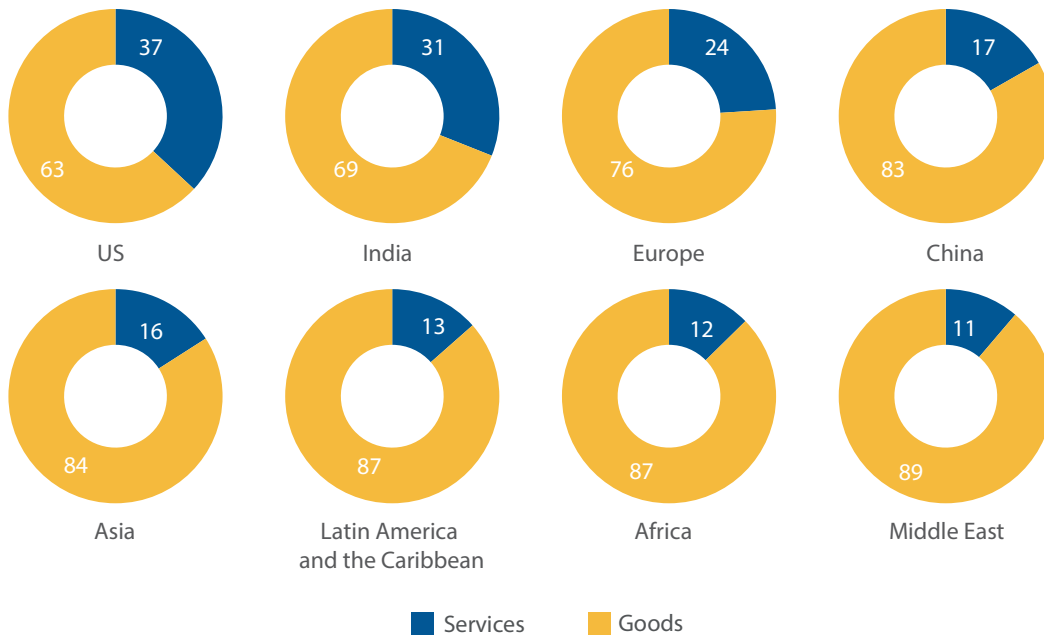
The composition of Africa’s services exports changed over the past three decades, and over 2002–2012 the shares of computer and information services, financial services, insurance, royalties and license fees, transport, construction, and travel all rose; those of other business services and of personal, cultural and recreational services went down (figure 1.23). Rates of change are in table 1.6.

**FIGURE 1.21: MANUFACTURING INTENSITY, BY MAIN DESTINATION OF AFRICA’S EXPORTS, 2005–2010 (%)**



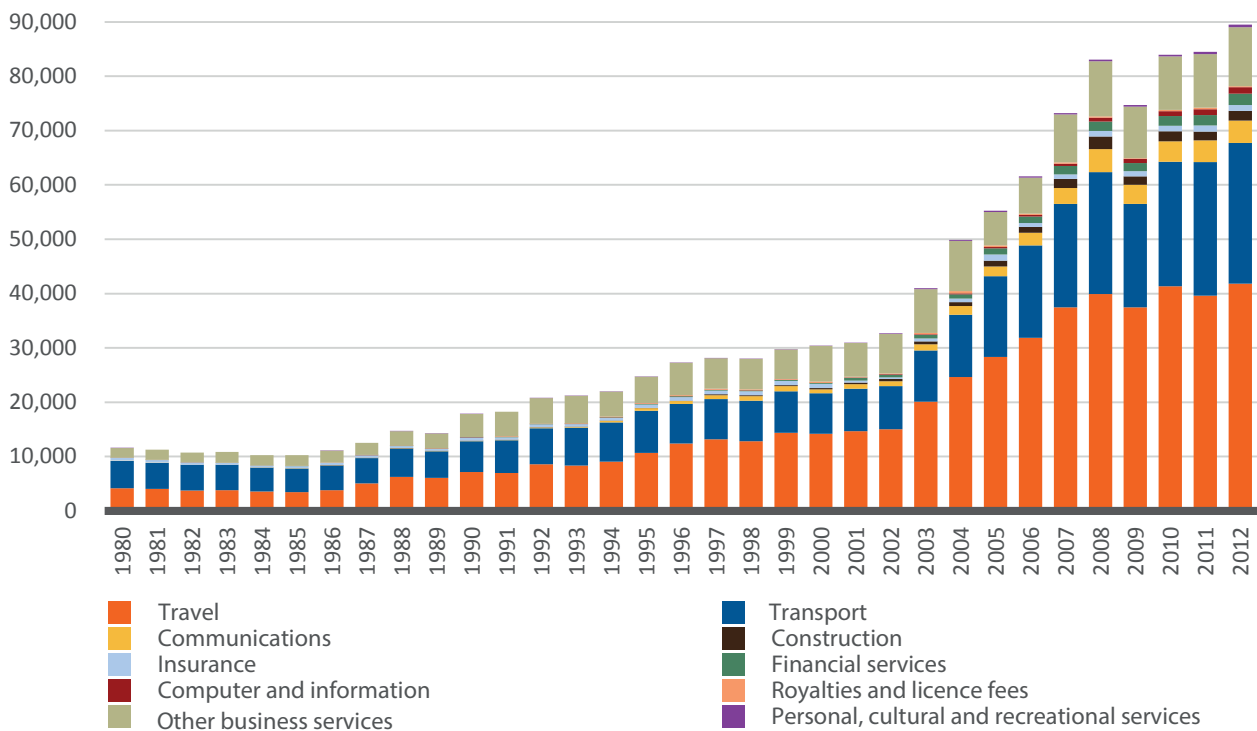
Source: AfDB et al. (2014).

**FIGURE 1.22: SHARES OF GOODS AND SERVICES IN EXPORTS, BY COUNTRY AND REGION, 2013 (%)**



Source: ECA calculations based on International Trade Centre, (2014). data.

**FIGURE 1.23: AFRICA'S EXPORTS OF COMMERCIAL SERVICES, BY CATEGORY, 1980–2012 (\$ MILLION)**



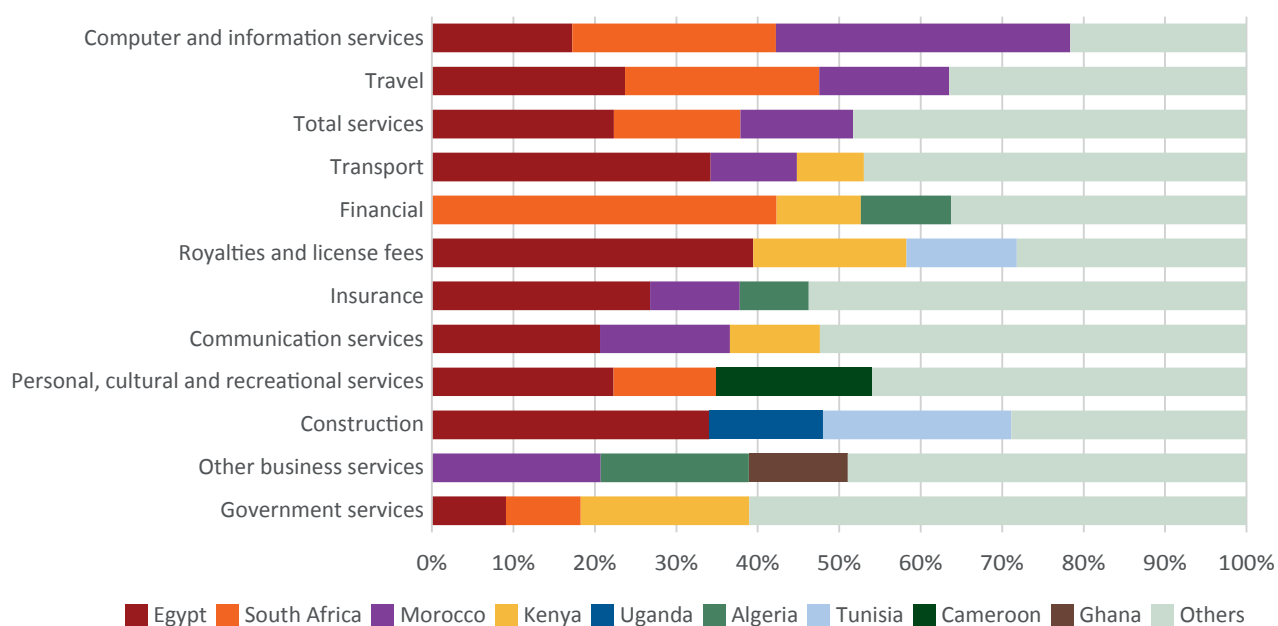
Source: ECA calculations based on International Trade Centre, (2014) data.

**TABLE 1.6: AVERAGE ANNUAL GROWTH OF AFRICA'S SERVICES EXPORTS, 2000–2013**

Category	Growth (%)
Computer and information services	20.0
Financial services	11.6
Insurance services	11.6
Royalties and licence fees	10.6
Transport	10.0
Construction	10.0
Communication services	9.8
Travel	8.2
Personal, cultural and recreational services	6.9
Other business services	0.2

Source: ECA calculations based on UNCTADstat 2014 data.

**FIGURE 1.24: SHARES OF AFRICA'S EXPORTS BY TOP THREE EXPORTING COUNTRIES IN 2012, BY CATEGORY**



Source: ECA analysis of International Trade Centre, (2014).

In 2012, Egypt, South Africa and Morocco accounted for 52 per cent of Africa’s exports of services (figure 1.24); Egypt alone accounted for 22 per cent. Financial services, of which South Africa accounted for 42 per cent of Africa’s exports, were the most concentrated sector. The top three exporters accounted for 78 per cent of exports of computer and information services.

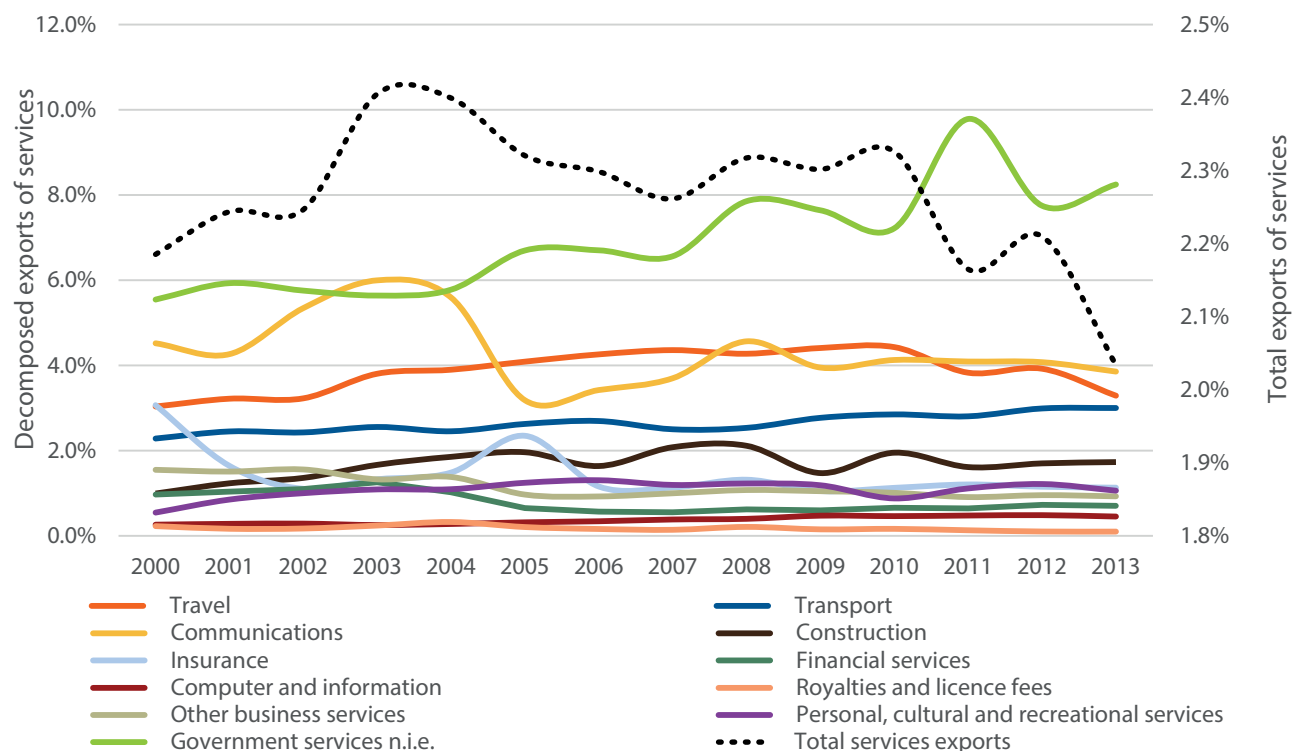
The services industry consists of large employers, employing 47 per cent of the population on average in the 12 African countries for which data are available over the period 2009–2013<sup>21</sup>.

Over 2000–2013, Africa’s share of global services exports decreased slightly from 2.2 per cent to 2.0 per cent. (Not all categories were affected, though, as over the period Africa’s share of global exports of personal, cultural and recreational services increased by 94 per cent, construction by 74 per cent, and computer and information services

by 72 per cent—see figure 1.25. Africa’s imports of services have jumped, from \$36.9 billion in 2002 to more than \$141 billion in 2013. Across the 48 African countries for which data were available, 37 had a services trade deficit in 2012: Morocco, Egypt, Tunisia and Kenya were notable exceptions.<sup>22</sup>

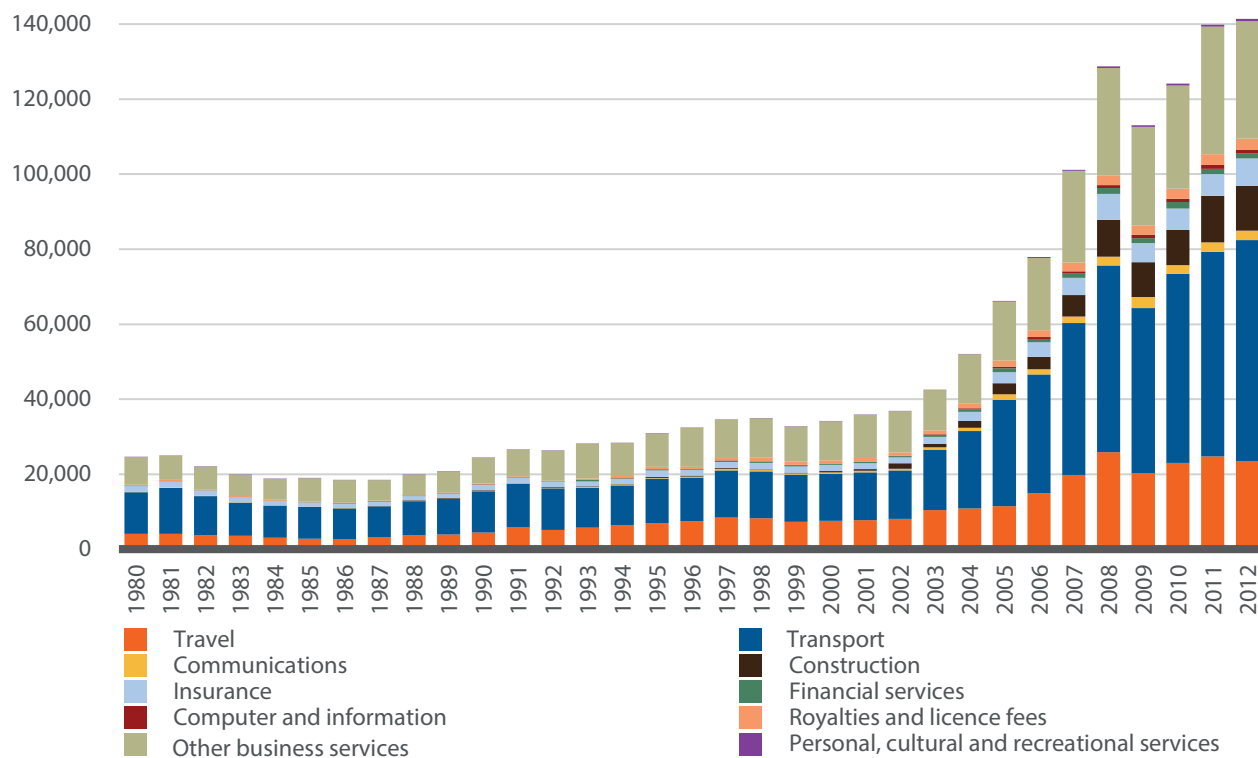
As with services exports, the composition of services imports has changed greatly over the period (figure 1.26).

**FIGURE 1.25: AFRICA’S SHARE OF WORLD’S SERVICES EXPORTS, BY CATEGORY, 2000–2013**



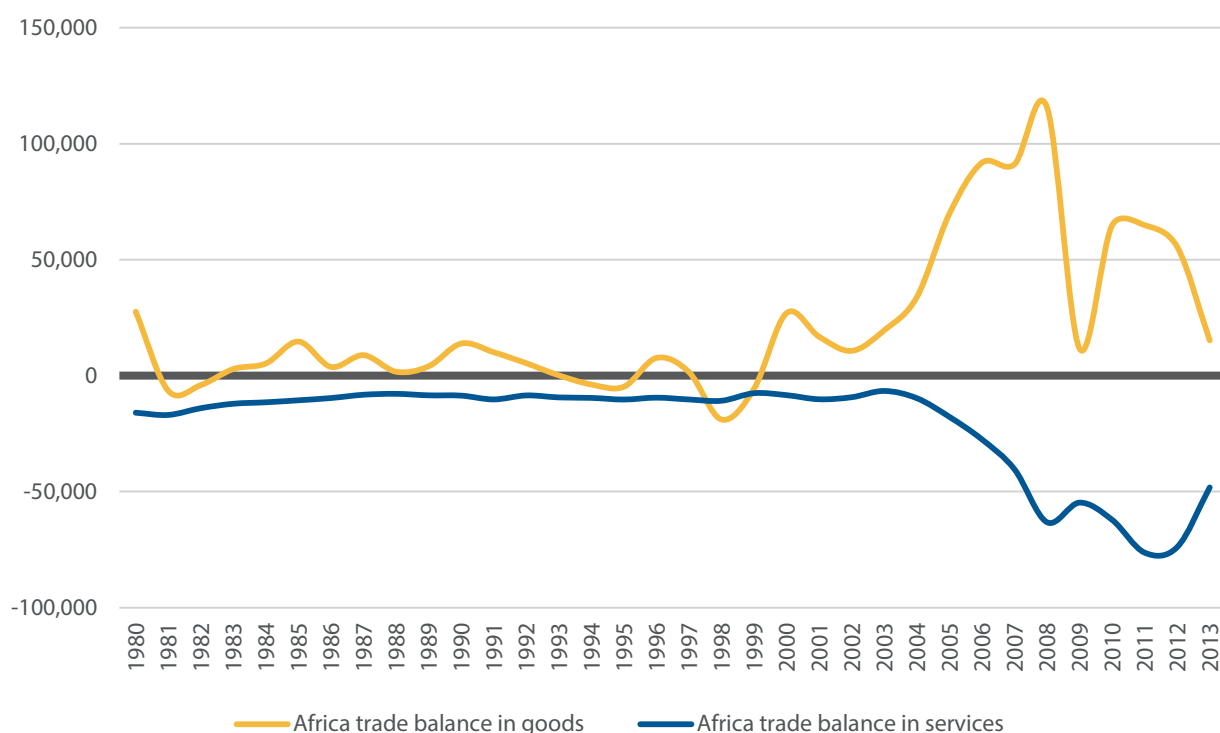
Source: ECA analysis based on UNCTADStat 2014.

**FIGURE 1.26: AFRICA'S IMPORTS OF SERVICES, BY CATEGORY, 1980–2012 (\$ MILLION)**



Source: ECA calculations based on International Trade Centre, (2014).

**FIGURE 1.27: AFRICA IMPORTS AND EXPORTS OF GOODS AND SERVICES, 1980–2013 (\$ MILLION)**



Source: ECA analysis based on UNCTAD Stat 2014.

## NET—AFRICA EXPORTS GOODS BUT INCREASINGLY IMPORTS SERVICES

To sum up both the goods and services sides, although Africa has been increasingly a net exporter of goods in recent years, it has become more and more a net importer of services (with a trade deficit of \$48.4 billion in 2013 for commercial services) (figure 1.27).<sup>23</sup>

The category of services imports that saw the fastest growth in Africa during 2000–2013 was transport (345 per cent),<sup>24</sup> although 35 of 39 African countries with available data had a trade deficit in transport services in 2012. Travel imports saw the smallest increase (39 countries), and only 11 had a trade deficit on that item in 2012, which may point to the need for further avenues to enhance the potential of African tourism.<sup>25</sup>

Table 1.7 shows Africa's trade balance across the various categories of services exports in 2012, in decreasing order.

**Africa has been increasingly a net exporter of goods in recent years, it has become more and more a net importer of services**

**TABLE 1.7: AFRICA'S TRADE BALANCE IN SERVICES, 2012**

Services category	Trade surplus/(deficit) (US\$), 2012
Travel	18,264
Communications	1,565
Financial services	735
Computer and information services	271
Personal, cultural and recreational services	(82)
Royalties and licence fees	(2,852)
Government services NES	(4,036)
Insurance	(6,151)
Construction	(10,175)
Other business services	(20,495)
Transport	(32,961)
Other services	(41,226)
Total services	(71,315)

Source: ECA calculations based on UNCTADstat 2014 data.

Note: NES = Not elsewhere stated

## CONCLUSIONS

African countries need to leverage the progress that has been made and continue building robust institutions that maintain and improve the business environment, economic governance and macroeconomic management. Strategies that (a) close the human capital gap, a move also vital for inclusive growth (chapter 2); (b) address the manufacturing deficit in Africa's growth by maximizing the benefits of trade, including via a selective trade policy framework (chapter 3); (c) reposition Africa in global value chains and facilitate trade in intermediates and services via export diversification (chapter 4); and (d) get trade agreements to advance its industrialization via trade and complementary policies (chapter 5) will make Africa more able to steer its own direction rather than be buffeted by the fickle winds of the global economy.

Winds are shifting as the global commodity supercycle comes to a close. Declining capital inflows resulting from tighter monetary policies in developed economies; declining growth in emerging economies, such as China; and the economic fragility in the euro zone—still by far Africa's largest trading partner—are having an impact on Africa. The continent must therefore keep improving its business environment, governance, and fiscal and monetary policies while safeguarding its economies from internal and external shocks.

Africa must of course overcome its physical infrastructure deficit. That effort calls for innovative financing, especially in today's environment—particularly on the domestic front—to direct savings to industry (particularly manufacturing) and to mechanized agriculture. Remittances, the largest and most stable source of external financing, must be leveraged. A first step would be to lower the cost of sending money to Africa, which averages 11.9 per cent for sending \$200.<sup>26</sup> Governments also should make better use of pension funds and

private equity, whereas those governments with large international reserves should not only save to build buffers against exogenous shocks but use them for development, especially in growth-enhancing sectors.

**African countries need to leverage the progress that has been made and continue improving its business environment, governance, and fiscal and monetary policies while safeguarding its economies from internal and external shocks**



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# ENDNOTES

- 1 Most data in this box are from UN-DESA 2014a and 2014b, unless otherwise stated.
- 2 See IMF, 20 January 2015. World Economic Outlook Update, IMF, Washington, DC.
- 3 Visit [http://www.bls.gov/news.release/archives/empsit\\_01092015.pdf](http://www.bls.gov/news.release/archives/empsit_01092015.pdf). Accessed 23 January 2015.
- 4 Go to [http://ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms\\_337069.pdf](http://ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_337069.pdf). Accessed 23 January 2015.
- 5 Africa's growth was previously estimated to grow at 4.0 per cent, 4.7 per cent, and 5.0 per cent in 2013, 2014 and 2015, respectively, but has been lowered because of instability in some oil-producing countries in Africa.
- 6 Assuming a low-case scenario that foresees continuing geopolitical tensions and declining business confidence in the euro area, Africa's growth is projected at 4.3 per cent in 2015 and 4.5 per cent in 2016. Another low-case scenario that projects declining economic activities in the BRICS (given their close trade and investment ties to Africa) forecasts Africa's growth at 4.2 per cent in 2015 and 4.3 per cent in 2016.
- 7 Most mineral-rich countries are oil-importers.
- 8 For details see The Economist, 11 January 2015. "Why Africa is becoming less dependent on commodities." <http://www.economist.com/node/21638205/print>. Accessed 20 January 2015.
- 9 Simulating the impact of oil prices on African economies,

$$g_{it}^G = \sum_{j=1}^p \delta_j g_{it-j} 1_{i \in G} + \sum_{j=0}^p \gamma_j \Delta \log(oil\_price)_{t-j} 1_{i \in G} + \underbrace{\beta_j \Delta \log(oil\_price)_t 1_{i \in G} 1_{\{July\_08 \leq t \leq dec\_08\}}}_{shock1} + \underbrace{\eta_j \Delta \log(oil\_price)_t 1_{i \in G} 1_{\{Jun\_14 \leq t \leq dec\_14\}}}_{shock2} +$$

where  $\varepsilon_t \approx ARMA(p, q)$  is the GDP growth rate. The superscript  $G$  refers to a specific group of countries, which could be all of Africa, oil-exporting, oil-importing or mineral-rich countries; while the subscripts  $i$  and  $t$  refer to country and time, respectively.  $1_{i \in G}$  is a dummy variable, which takes the value of 1 if country  $i$  belongs to group  $G$  and takes the value of 0 otherwise.  $\Delta \log(oil\_price)$  is the change in oil price.

$1_{\{July\_08 \leq t \leq dec\_08\}}$  and  $1_{\{Jun\_14 \leq t \leq dec\_14\}}$  are two dummy variables, which take the value of 1 if the time period is between July–December 2008 and June–December 2014, respectively, and 0 otherwise. Shock1 and shock2 capture the impact of oil shock—which happened in July–December 2008 and June–December 2014, respectively—on a specific group of countries.  $\varepsilon$  is the stochastic component, which is assumed to follow an Autoregressive Moving Average (ARMA) process of order  $p$  and  $q$ , where  $p$  and  $q$  are the optimal maximum lags of the ARMA process.  $\delta$ ,  $\lambda$ ,  $\beta$  and  $\eta$  are parameters estimated using the robust Ordinary Least Square (OLS) method. Data used for this simulation cover the period January 2000 to December 2014 for 53 African countries, corresponding to a total of 9,450 observations.

- 10 Lesotho and Equatorial Guinea removed.
- 11 The Economist, 11 January 2015. "Why Africa is becoming less dependent on commodities." <http://www.economist.com/blogs/economist-explains/2015/01/economist-explains-5>. Accessed 23 January 2015.
- 12 Frontier markets include Ghana, Kenya, Mauritius, Mozambique, Nigeria, Senegal, Tanzania, Uganda and Zambia (ECA, 2014c).
- 13 Dutch disease is the negative impact on an economy of anything that gives rise to a sharp inflow of foreign currency, such as the discovery of large oil reserves. The currency inflows lead to currency appreciation, making the country's other products less price competitive on the export market.
- 14 Sources: Banque de France 2012; Bhushan, Aniket. 2013; ECA 2014a; Ethiopian Diaspora Portal, <http://www.ethdiaspora.org.et/index.php/dea-dg/ittc/gerdbond/item/106-the-gerd-bond-guidelines>. Accessed November 2014; Gerrard, Chris. 2013; Kamau, Anne. W. and Mwangi S. Kimenyi. 2013; Newsday 2014; The New Zimbabwe.com 2014; Plaza, Sonia. 2011; The Economist. 2011.
- 15 Bank of Botswana Financial Statistics, September 2014
- 16 Such as Cabo Verde (59 per cent of GDP), Ghana (28 per cent of GDP), the Sudan (55 per cent of GDP), Mauritania (52 per cent of GDP), Mozambique (28 per cent of GDP), São Tomé and Príncipe (117 per cent of GDP), Senegal (25 per cent of GDP), Seychelles (90 per cent of GDP), Tunisia (50 per cent of GDP), and Zimbabwe (338 per cent of GDP).
- 17 Nigeria and Libya were not included owing to missing data.
- 18 The current decline in oil prices may lead to further fall in Africa exports in the coming years.
- 19 Figures based on ECA and AUC (2013).
- 20 Asia's total trade was \$5.64 billion in 2013, and the total world trade (according to WTO) was \$17.93 billion. Thus the share of the region was 31.46 per cent.
- 21 World Bank data. Note that data for the 12 countries is available for different years within 2009–2013.
- 22 ECA analysis based on WDI data.
- 23 ECA calculation based on UNCTAD statistics, including non-government services not categorized.
- 24 ECA analysis based on WDI data.
- 25 ECA analysis based on UNCTAD data.
- 26 World Bank (2013). Send Money Africa Report. [http://sendmoneyafrica.worldbank.org/sites/default/files/SendMoney\\_Africa\\_Remittances\\_Report\\_2013.pdf](http://sendmoneyafrica.worldbank.org/sites/default/files/SendMoney_Africa_Remittances_Report_2013.pdf). Accessed December 2014.

**Part 1: Economic Growth, Structural Change and Social Development**

CHAPTER

2

**STRUCTURAL CHANGE  
AND SOCIAL DEVELOPMENT**

To ensure that robust and resilient economic performance is commensurate with sustained and inclusive development, Africa must adopt social development strategies that are consistent with the expansion of industrial and modern sectors.

Industrialization is a key catalyst for diversifying the production structure of African economies and creating job opportunities for an ever-growing workforce.

Sustained economic growth and substantial poverty reduction in Africa require the development of productive capacities in such a way that the working-age population becomes more fully and productively employed. National productive capacities develop through the interrelated processes of capital accumulation and technological progress, which in turn lead to structural change.

Social development is both an output and input into a successful structural transformation agenda. A healthy and educated workforce equipped with high-quality and relevant skills requires an alignment of industrial and social policies that foster economic diversification, create employment opportunities and reduce poverty.

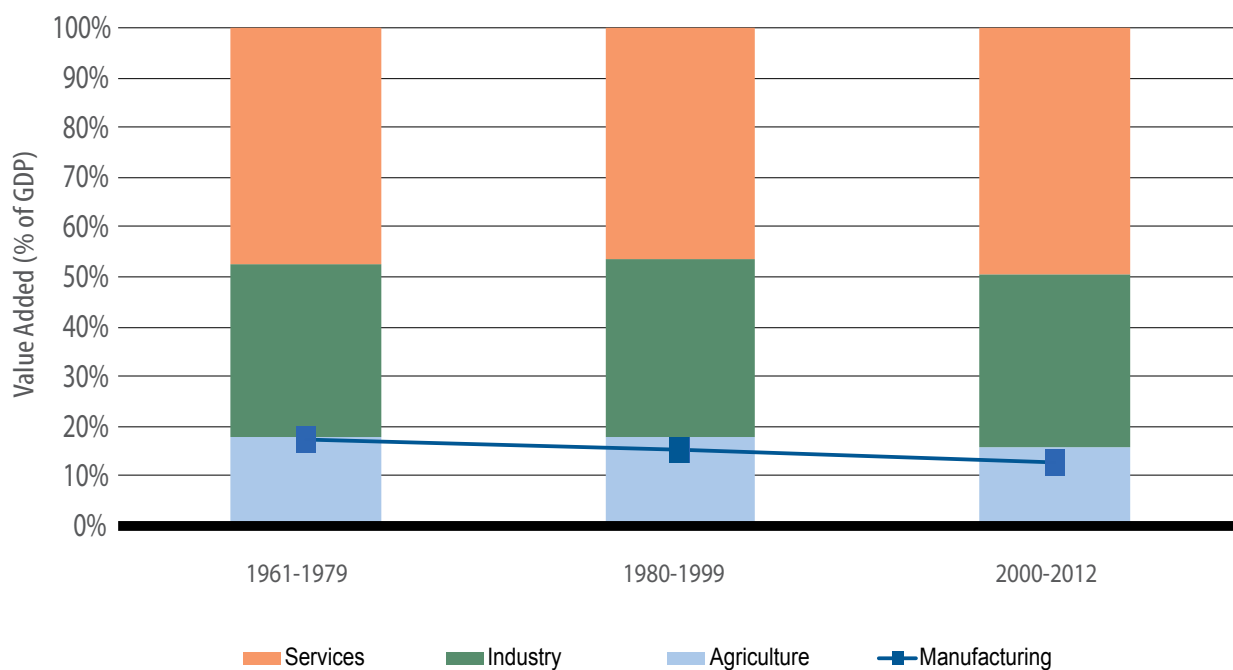
The demographic dynamics and urbanization processes currently in force in Africa present a mixed picture of challenges and opportunities, and the factoring of these social phenomena in a structural transformation agenda is important. The rapid urbanization in the continent should be driven by the development of industrialization and competent service sector delivery reversing past trends.

Employment to population and labour force participation are on the rise in Africa and expected to continue increasing given the demographic growth currently prevailing. Informal employment

continues to form the largest proportion of employment opportunities, despite inadequate working conditions and social protection regimes. Structural change has been minimal since independence. Continent-wide, the composition of GDP by sector has changed little (figure 2.1). For example, the share of industry has remained almost constant at about 35 per cent of value added since the 1960s, and the contribution of manufacturing has actually decreased, resulting in de-industrialization. This is particularly pronounced in natural resource-rich countries where industry is often focused on mining-related activities, with few jobs and few industrial linkages to other sectors.

After the fall in growth in all sectors except agriculture during 1980–1999, since 2000 there has been a recovery in average growth for industry, though not to the level of the early post-independence years, with manufacturing being the slowest sector and services the fastest (table 2.1).

**Industrialization is a key catalyst for diversifying the production structure of African economies and creating job opportunities for an ever-growing workforce**

**FIGURE 2.1: GDP COMPOSITION BY SECTOR, AFRICA, 1961–2012**

Source: Calculations based on World Development Indicators (database).

**TABLE 2.1: OVERALL AND SECTORAL GDP GROWTH (% PER YEAR)**

Growth	1961–1979	1980–1999	2000–2012
GDP	4.9	2.4	4.9
Agriculture	3.3	3.3	3.6
Industry	6.1	1.5	5.2
Manufacturing	4.4	1.7	3.1
Services	4.5	3.0	5.6

Source: Calculations based on World Development Indicators (database), accessed November 2014.

# GROWTH AND STRUCTURAL CHANGE UNDER SHIFTING POLICY PARADIGMS

African countries have followed a raft of economic policy paradigms since independence—reflecting the economic complexities and priorities of international financial institutions—often leading to policies loosely linked to African needs and unable to address their challenges. These strategies began with the initial phase of development planning (1960–1979), followed by structural adjustment programs (1980–1999) and the quasi-planning period (2000–present) (ECA, 2014).

Despite weaknesses, the post-independence years of development planning—planning which included import-substitution policies to support the development of local industries—helped African countries in their early stages. The sectoral share of agricultural value added in Africa decreased steadily, while the share of manufacturing and services followed an inverted U-shape, meaning an increase in value addition and employment at lower levels of growth with a decrease at higher levels (ECA, 2014)(figure 2.2). Africa did undergo structural change during the planning period of 1970–1979, but that change was limited by a lack of sound industrial foundation to meet growing internal demand, resulting in a limited contribution of manufacturing to transformation.

Structural adjustment programmes (SAPs) worsened the transformation process initiated during the planning period. Based on advice anchored in comparative advantage, SAPs led to a reallocation of employment from industry and services to agriculture and the informal sectors. Despite increases in GDP per capita associated with a decline in the value-added share in agriculture, the speed of this decline was less pronounced than in the earlier post-independence period. Similarly, manufacturing value added followed a skewed inverted U-shape, but the decline was less pronounced than during the planning period (ECA,

2014) (figure 2.3). Manufacturing's contribution to transformation was more limited than during the planning period.

Despite showing a decrease in the share of total employment, services saw their value-added share increase steadily, confirming that the layoffs due to privatization of state-owned enterprises increased the share of employment in agriculture and of value added in services (figure 2.4).

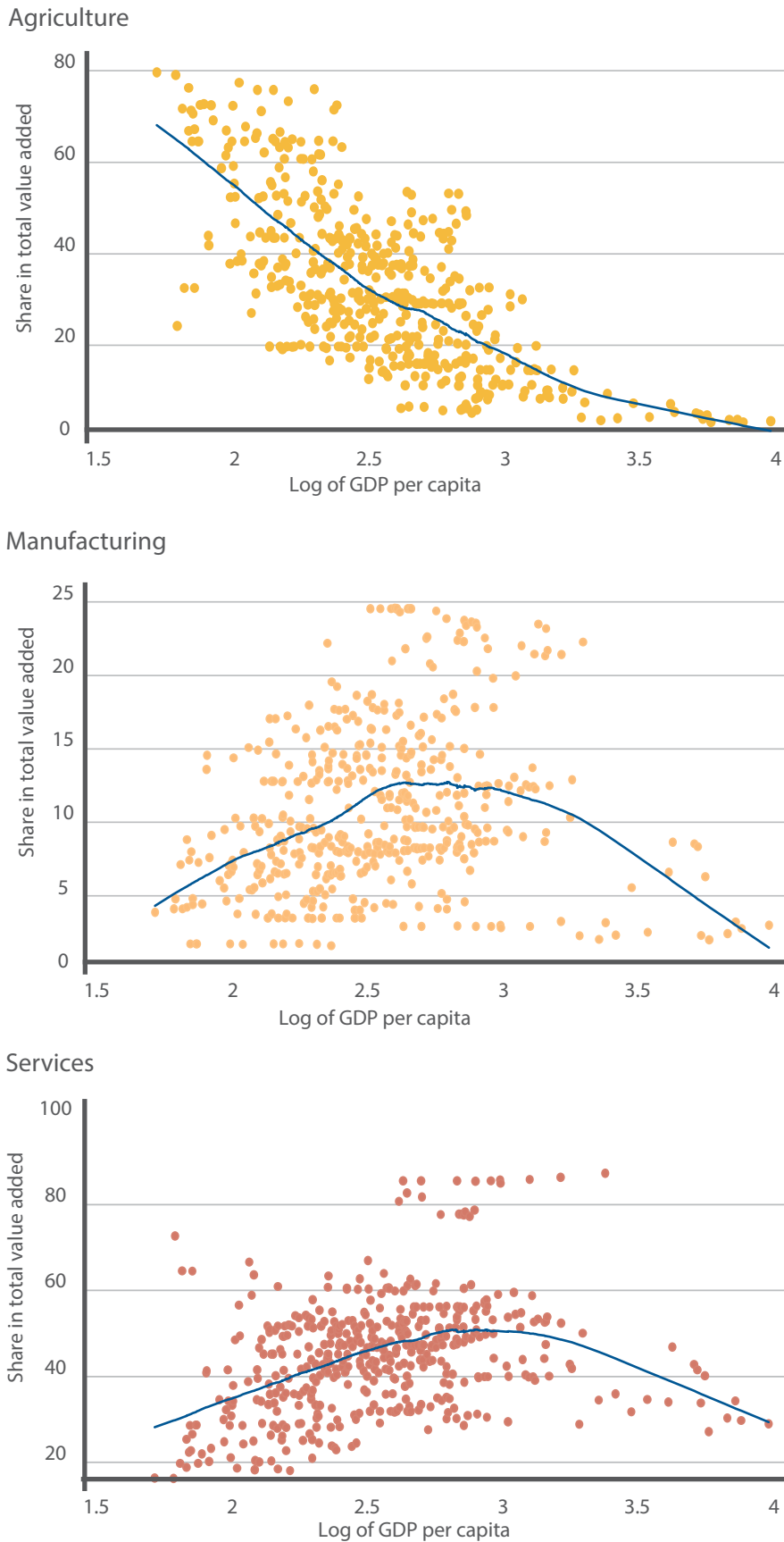
At the subregional level, the slowdown in industrial growth during the SAP period was particularly sharp in East and Southern Africa, while industrial growth in West Africa remained the most resilient.

Since 2000, the share of agricultural employment decreased with growth, while employment shares for industry and services picked up. The agricultural value-added share has continued falling while those of industry and services have continued to rise (figure 2.5). However, although employment opportunities in manufacturing rose steadily, their increase was slower than in the planning period (but faster than during the SAP period) (ECA 2014).

Subregionally, the recovery of overall growth after 2000 has been driven by accelerated industrial growth in East, North and West Africa, and by services in Central, East and West Africa (figures A2.1–A2.3 in Appendix 2). West Africa has contributed significantly to industrial growth on the continent in recent years, with annual growth of more than 8 per cent.

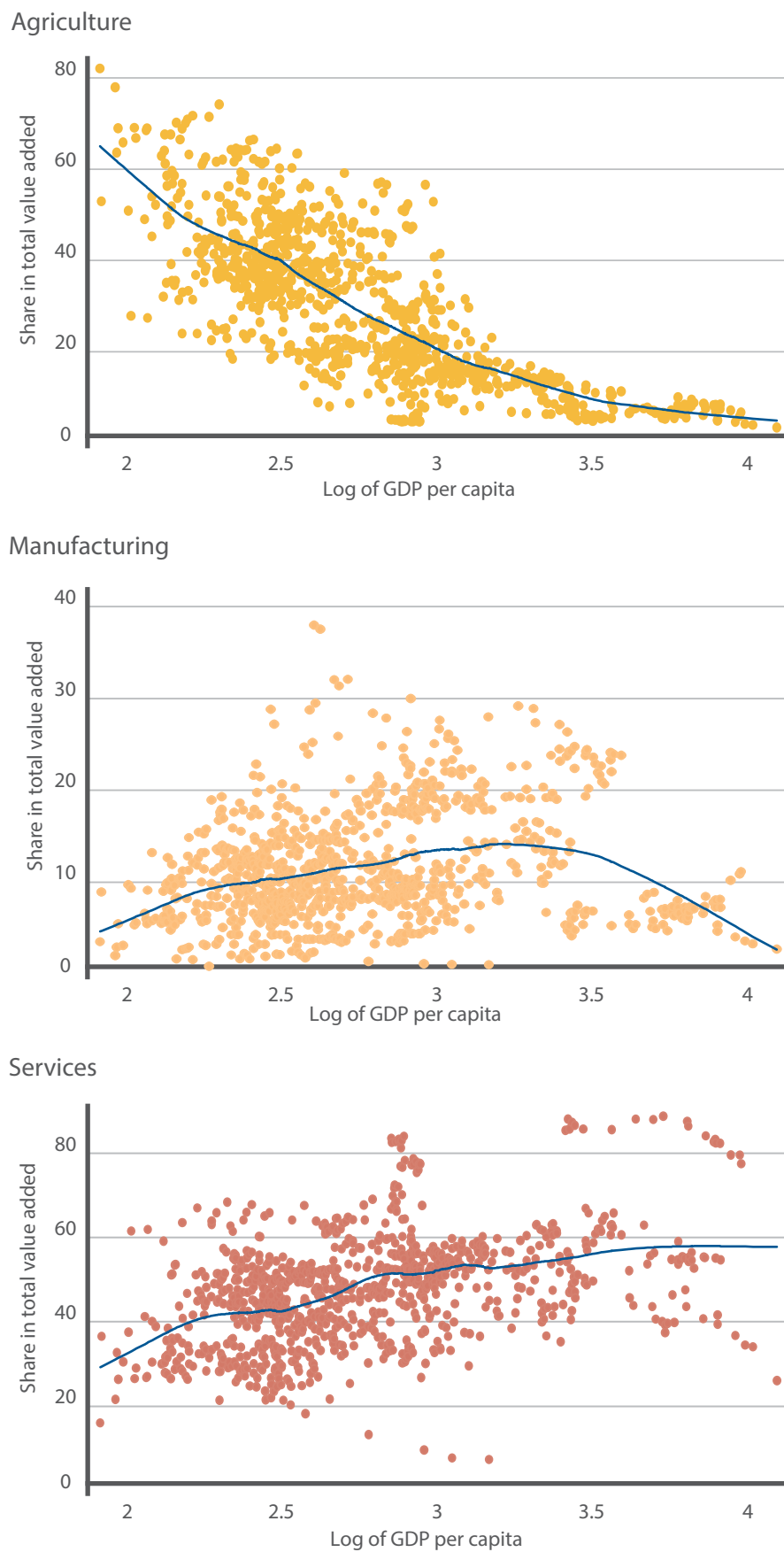
But industrial growth does not mean manufacturing growth: the wider category exceeded the narrower category regionally and subregionally (figure 2.6). This gap is particularly wide in Southern Africa, where average industrial growth over 2000–2012 was 3.6 times that of manufacturing, and 2.7 times in West Africa.

**FIGURE 2.2: SECTORAL SHARE OF VALUE ADDED IN AFRICA (1970–1979)**



Source: Calculations based on United Nations Statistics Division national account database and International Labour Organization (ILO) Key Indicators for the Labour Market (KILM), 8th edition.

**FIGURE 2.3: SECTORAL SHARE OF VALUE ADDED IN AFRICA (1980–1999)**



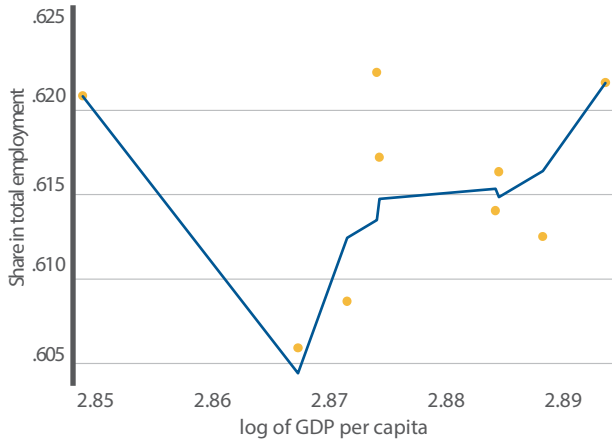
Source: Calculations based on United Nations Statistics Division national account database and ILO Key Indicators for the Labour Market (KILM), 8th edition.



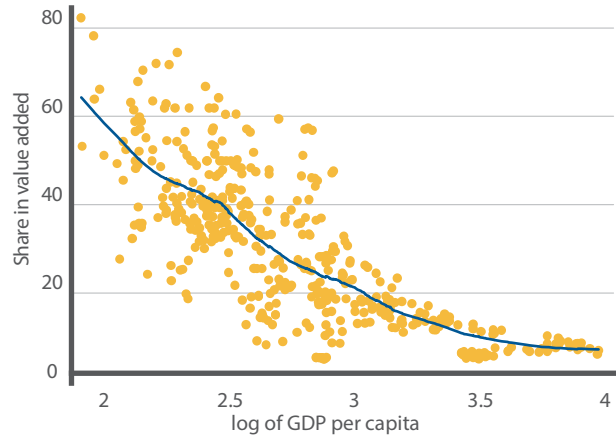
**FIGURE 2.4: SECTORAL SHARE OF EMPLOYMENT AND VALUE ADDED IN AFRICA (1991–1999)**

**Agriculture**

Employment (agriculture)

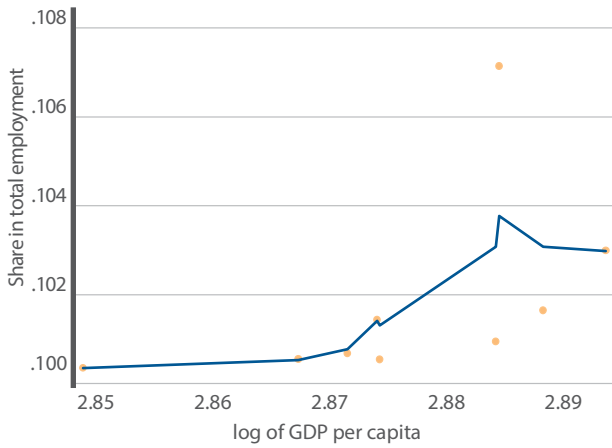


Value added (agriculture)

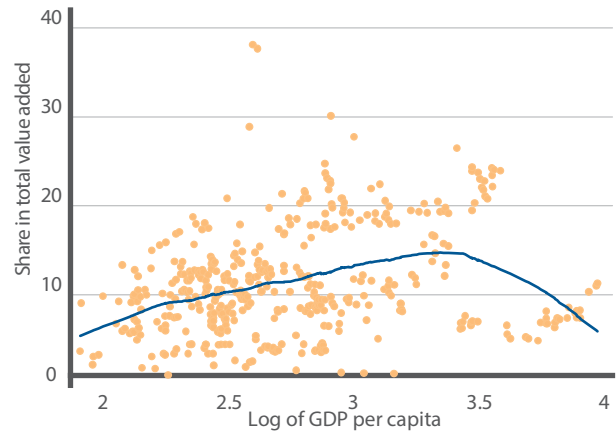


**Industry**

Employment (industry)

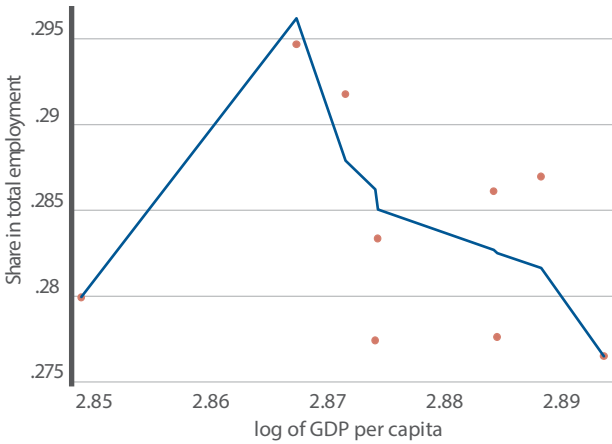


Value added (manufacturing)

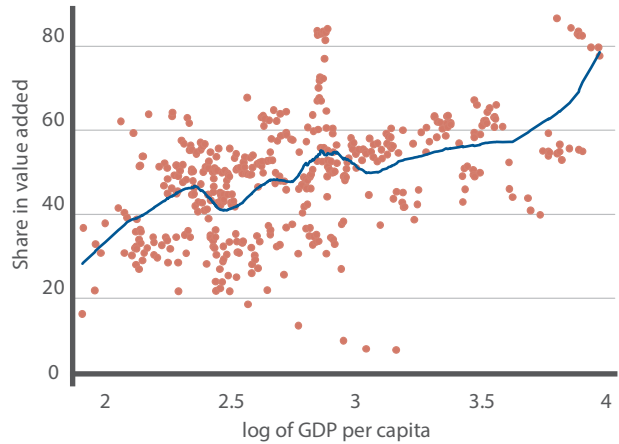


**Services**

Employment



Value added

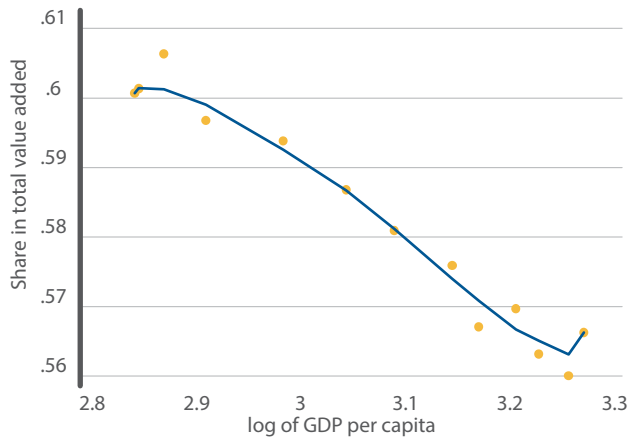


Source: Calculations based on United Nations Statistics Division national account database and ILO Key Indicators for the Labour Market (KILM), 8th edition.

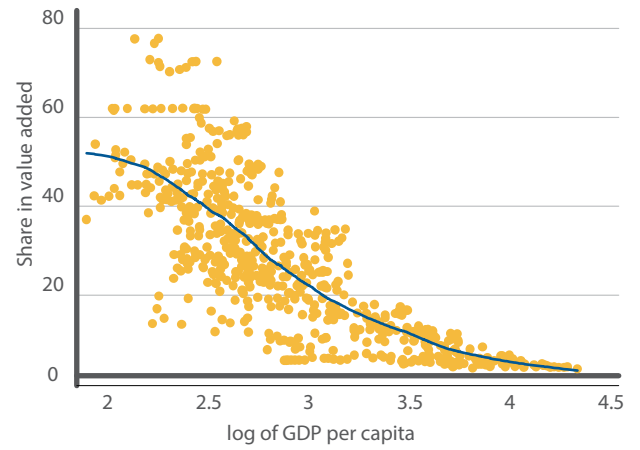
**FIGURE 2.5: SECTORAL SHARE OF EMPLOYMENT AND VALUE ADDED IN AFRICA, 2000–2012**

Agriculture

Employment (agriculture)

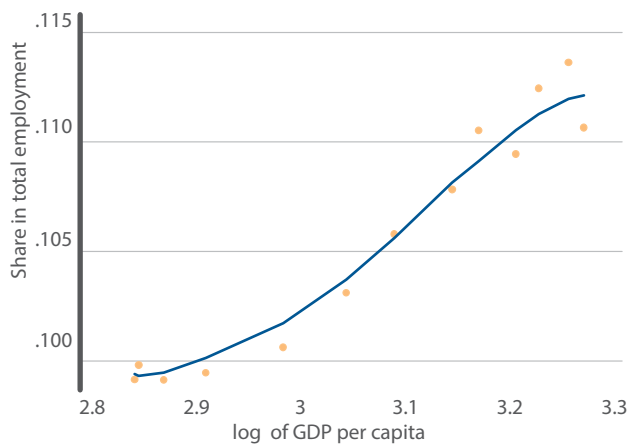


Value added (agriculture)

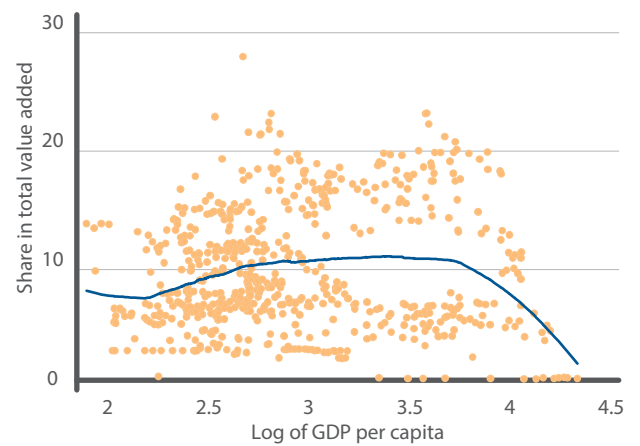


Industry

Employment (industry)

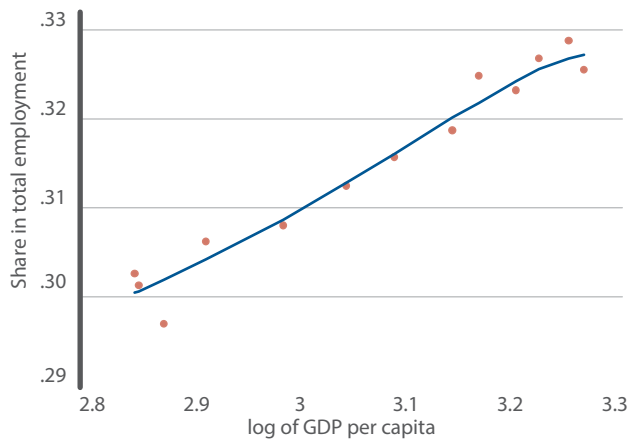


Value added (manufacturing)



Services

Employment



Value added



Source: Calculations based on United Nations Statistics Division national account database and ILO.

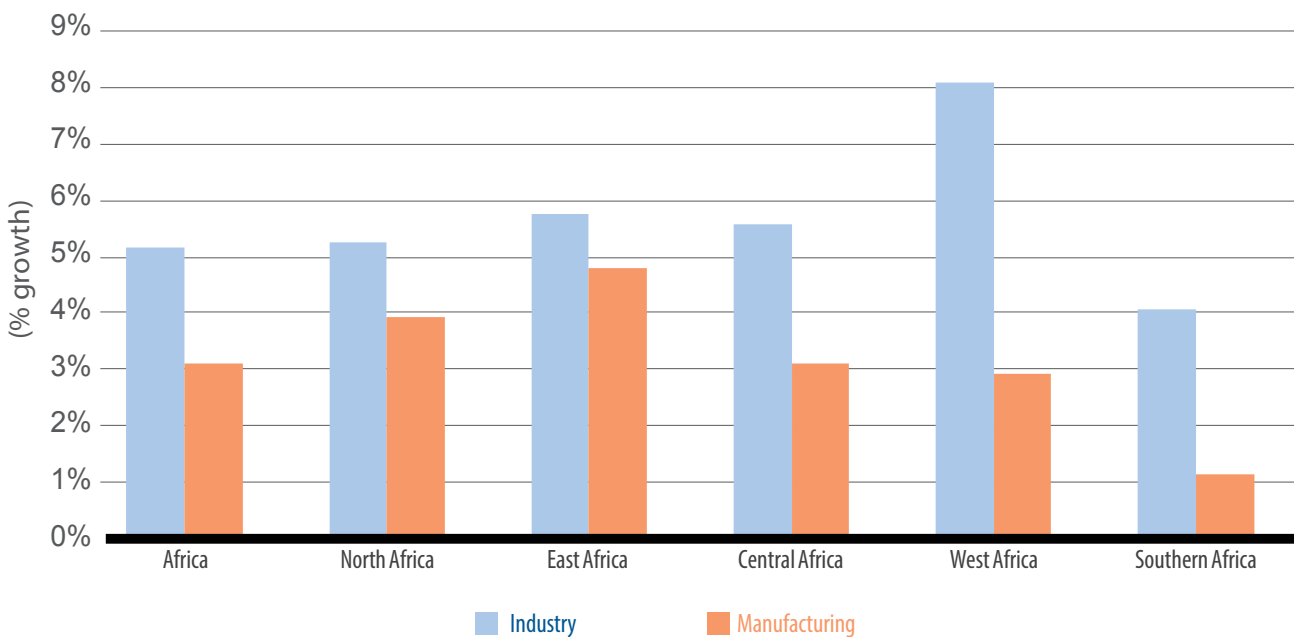
Differences in sectoral performances are also seen by economic group. For example, over the 2000–2012 period oil-exporting countries had higher average (and industrial) growth than oil-importers (for country groupings, see the Statistical note). The industry share of GDP in oil-exporting countries is also higher. Services remained the strongest driver in both groups, for oil exporters contributing 47 per cent and for oil importers 61 per cent.<sup>1</sup>

Like oil-exporting countries, mineral-rich African countries have benefited in the last decade from high commodity prices and strong demand from emerging markets such as China and India (see the Statistical note). But this is not shown in their average growth rate, which is lower than that of mineral-poor countries. Mineral-poor countries have also performed better than mineral-rich countries in all three sectors, with services growing

the fastest and agriculture the slowest. The higher share of services in the GDP of mineral-rich countries has seen that sector contributes the largest share to overall growth.<sup>2</sup>

Geographical features affect sectoral composition of GDP, with landlocked countries more dependent on agriculture than coastal countries (ECA and AUC, 2014). Landlocked countries may also face more challenges in developing industry, because of disproportionately high trade and transaction costs and poor access to ports, hindering opportunities to benefit from regional and global trade. Therefore structural transformation may remain slower in these countries. However, for 2000–2012 GDP growth (bolstered by agriculture) was stronger in landlocked countries than in coastal countries (see the Statistical note).

**FIGURE 2.6: INDUSTRIAL AND MANUFACTURING GROWTH RATE BY SUBREGION, 2000–2012**



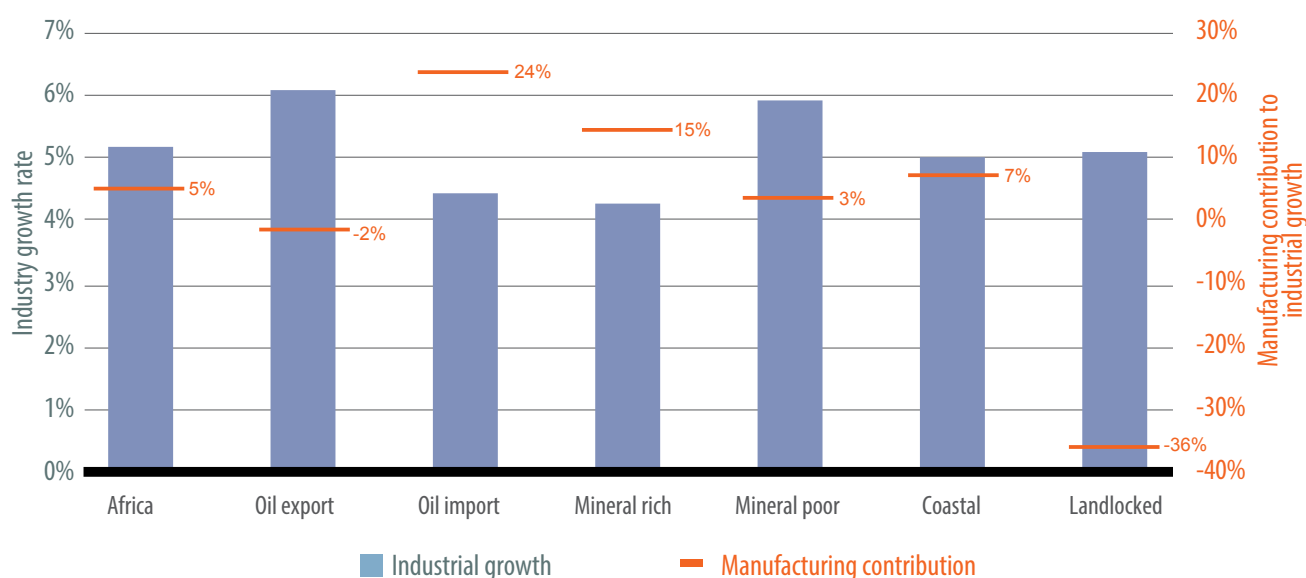
Source: Calculated based on World Development Indicators (database).

Manufacturing’s contribution is particularly low in oil-exporting, mineral-poor and landlocked countries (figure 2.7). In the first two groups, this low contribution comes from the low share of manufacturing in industrial output (16 and 11 per cent respectively). In landlocked countries, manufacturing growth is below that of industry.

At the regional level, manufacturing’s share in industrial output is 33 per cent, but its contribution to industrial growth remains slight overall at 5 per cent and rather bleak in oil exporting (-2 per cent), mineral-poor (3 per cent) and landlocked countries (-36 per cent), underlining the lack of structural change—services have been more important to economic growth—and the structural and policy challenges ahead for Africa’s long-term development (box 2.1).

**In Africa, manufacturing’s share in industrial output is 33 per cent, but its contribution to industrial growth remains slight overall at 5 per cent, underlining inadequate structural change**

**FIGURE 2.7: AVERAGE MANUFACTURING CONTRIBUTION TO INDUSTRIAL GROWTH, 2000–2012<sup>3</sup>**



Source: Calculation based on World Development Indicators (database).

## **BOX 2.1: IMPORTANCE OF GOOD MACROECONOMIC POLICIES FOR PRODUCTIVITY GROWTH**

Structural transformation—resource reallocation from low- to high-productive sectors—was behind China’s ability to sustain high productivity growth from 1978–1995 (see Fan et al., 2003). From 1950–1975 (“the golden age” of productivity), Latin America achieved more than 4 per cent productivity growth annually. Can Africa do the same?

ECA (2014) adopts the de Vries et al. (2013) approach to decompose aggregate labour productivity for 11 countries into two sources—productivity resulting from within-sector resource allocation and productivity resulting from cross-sectoral resource reallocation (structural change)—and examines the impact of policies on productivity, using the three policy periods above mentioned above.

During the SAP period, five of the eight countries that pursued SAPs saw labour productivity fall: Ethiopia, Kenya, Malawi, Nigeria and Tanzania. Botswana and Mauritius, which did not go this route, almost doubled productivity. All eight countries saw productivity bounce back in the quasi-planning period.

Half the countries that adopted SAPs experienced deterioration in the contribution of static structural transformation (labour did not sufficiently move towards sectors with higher productivity), while almost all the countries experienced a reduction in the contribution of dynamic structural change to aggregate productivity (productivity in expanding sectors did not grow faster than in shrinking sectors). But the decrease in industrial and manufacturing productivity

during the SAP period (for most countries that pursued SAPs) seems to coincide with improving agricultural productivity. After 2000, as productivity in industry and manufacturing started to pick up again, productivity growth in agriculture started slowing. The pickup in manufacturing productivity after 2000 was driven mainly by increased static rather than dynamic structural transformation.

Half the countries saw improved services productivity during the SAP period and most did after 2000. For most countries the contribution of static structural change to aggregate productivity in services has been positive during all three policy regimes.

Further analysis in ECA (2014) examining drivers of productivity-enhancing structural transformation underscores the positive and significant role of economic planning, institutional quality, political stability and human capital development. It also underlines the importance of good macroeconomic policy in structural change, vindicating the return to a measure of economic planning—policy that emphasizes the state’s role in development plans.

Policies fostering trade openness do not necessarily enhance productivity, as such openness undermined productivity over 1980–2010. This finding is supported by the negative impact of export diversification on productivity resulting from the continent’s reliance on raw commodity exports. Although Africa’s exports increased over the years, they remained concentrated in agricultural

commodities, unprocessed minerals and unrefined oil, raising economies’ vulnerability to global shocks. Value addition and export diversification are responses to this quandary.

Intra-African trade is more diversified and industrialized than exports to the rest of the world, although its share in Africa’s total trade is still less than 15 per cent.<sup>4</sup> That proportion needs to increase, as intra-African trade has a positive influence on structural change (ECA and AUC (2014). ECA and AUC (2012) have suggested trade policies (such as working with private entities) that foster regional integration, value addition and industrialization. (Chapters 3, 4 and 5 provide further analysis.)

Human capital is important for productivity. Life expectancy and public and private spending on health and higher education are factors having a significant positive effect—but Africa has not done so well in higher education. High-quality institutions ensuring low corruption and effective regulation, along with political stability and absence of conflict, have a positive influence—as do macroeconomic factors such as a competitive exchange rate and low inflation.

# SOCIAL DEVELOPMENT AND STRUCTURAL CHANGE: A BI-DIRECTIONAL LINK

Recent African economic performance has not followed an inclusive and sustainable path. Africa's low level of development stems from its slow move from commodity-based activities, contributing to trade-induced volatility in economic growth that hinders accumulation of physical and human capital. Life expectancy—a proxy for health—and post-primary education are significantly associated with productivity and structural change, which also require good human capital. The essential features that define economic change are tied to *social* transformation (ECA, 2014).<sup>5</sup>

Social policy has a vital role in strengthening these links. Malaysia, a successfully transformed economy, estimates future manufacturing-skill needs by identifying supply gaps in current arrangements. In Mauritius, technical and vocational educational training (TVET) accounts for about half of secondary school enrolment and provides skills to lower and middle-level technicians who boost industrial development. Mauritius also aligns social policies—including skills upgrading, employment and social protection policies—with its industrialization needs. Effective distributional policies and investment in research, innovation and technological upgrades are other important channels through which countries like Mauritius have achieved more equitable and inclusive social development (ACET, 2014).

Inclusive growth is fundamental for structural change to be truly transformative. Yet poverty is still rife in many parts of the continent, and the region is home to seven out of the world's 10 most unequal societies across many dimensions such as wealth, income and access to public services. To make inclusivity a reality, and in response to a call of ECA member states for an African development

framework, ECA has developed an index to measure social inclusion (box 2.2).

Country-based evidence from the ASDI can help inform policy makers on the drivers of exclusion in their respective countries and map policies that help reduce exclusion in that specific dimension of development. ASDI's computation can help countries improve data collection (particularly subnationally) and strengthen their capacity to monitor progress on poverty and exclusion.

ASDI can be a powerful tool in monitoring and guiding social investments and also indicating adequate fiscal transfers to subnational tiers of government to enhance equitable inclusiveness in socio-economic development.

## POVERTY AND INEQUALITY

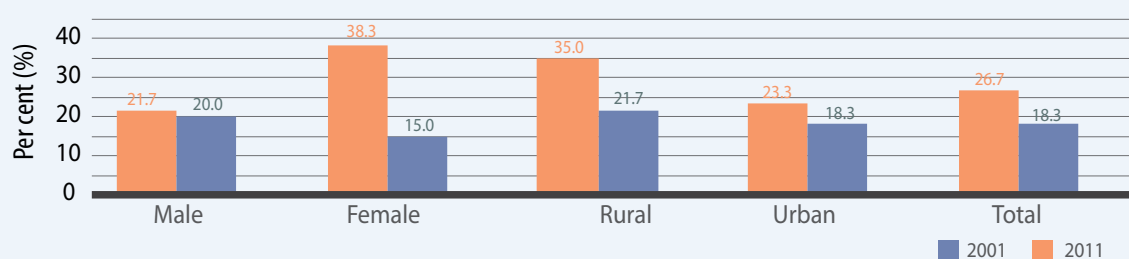
It is estimated that in 2015, 366 million people in Africa will still be living on less than \$1.25 a day (World Bank, 2014).

The growth elasticity of poverty (change in poverty with a 1 per cent growth rate) for resource-rich countries in Africa—defined as countries with an average resource rents-to-GDP ratio of more than 15 per cent—is  $-1.157$ .<sup>6</sup> This impact of growth on poverty is lower than any other regional average, highlighting the weak linkages between the commodity sector and the wider economy in these countries. For example, in East Asia the growth elasticity of poverty is twice as high—and three times larger in Latin America (Fosu, 2011). A low growth elasticity of poverty reiterates the structural imbalance between the capital-intensive growth sectors and the reduction of poverty through meaningful job creation.

**BOX 2.2: THE AFRICAN SOCIAL DEVELOPMENT INDEX (ASDI)**

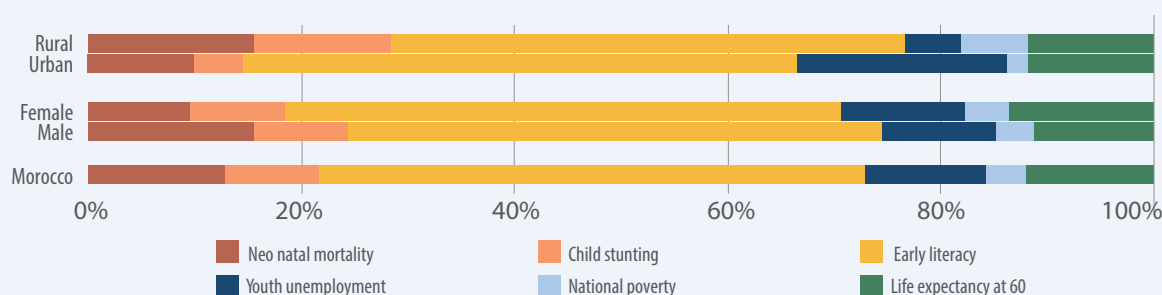
Following a life-cycle approach, ASDI aims to measure progress in reducing human exclusion in various dimensions of well-being, including health, education, employment and income. Its key feature is that it may be used at regional, national and sub national levels to assess the impacts of exclusion between different countries, locations and population groups, capturing inequalities within and between countries. ASDI can be used to identify the drivers of exclusion in each country or sub region and assess the impact of social policies on exclusion.

The tool is being piloted in five African countries. Preliminary findings from Morocco show that ASDI exclusion fell by a third over 2001–2011—particularly for women—whose rates dropped by nearly two thirds against under one tenth for men (Box figure 1).

**BOX 2.2 FIGURE 1: TRENDS IN EXCLUSION IN MOROCCO BY SOCIAL GROUP, 2001–2011**

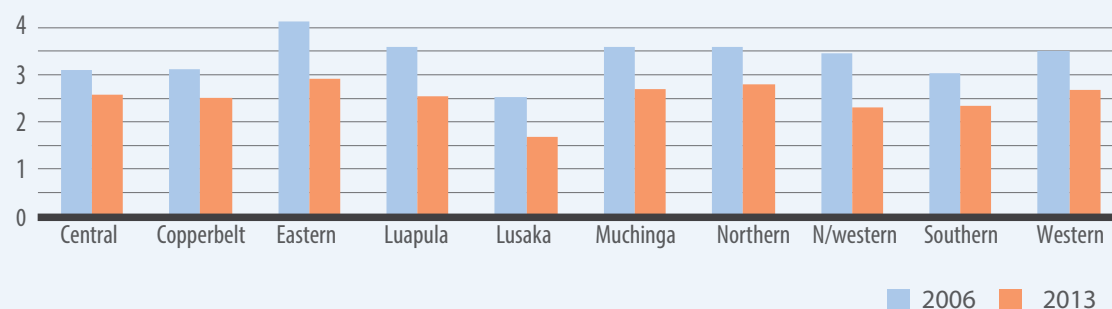
Source: ECA computation based on HCP data.

Further decomposition of the ASDI by subgroups shows the contribution of different dimensions to overall exclusion. Youth unemployment seems to be the main driver of exclusion in urban Morocco, while health in early stages of life seems to affect boys more than girls (Box figure 2).

**BOX 2.2 FIGURE 2: DECOMPOSITION OF THE ASDI IN MOROCCO BY DIMENSION AND SUBGROUP OF POPULATION, 2010-2012**

Source: ECA computation based on HCP data.

In Zambia, exclusion has fallen in all regions, but the historical and spatial decomposition highlights differences among subregions, demonstrating country specificity in mapping changes in exclusion (Box figure 3).

**BOX 2.2 FIGURE 3: THE ASDI IN ZAMBIA BY SUBREGION, 2006–2013**

Source: ECA's computation based on 2006 and 2010 Zambian Demographic and Health Survey and Living Conditions Monitoring Survey.

The responsiveness of poverty to economic growth is weakened by persistent socio-economic inequality in Africa. Widening inequalities in outcomes and opportunities significantly reduce the gains from growth accruing to the poor (Ravallion, 2001; Fosu, 2011). Inequality in the distribution of assets and in access to public services such as education and health care deepens the gap between the haves and the have-nots, creating a vicious circle of inequality, poverty and exclusion. There is evidence of higher inequality within countries and between population groups, providing fertile ground for socio-political instability.

## DEMOGRAPHY AND URBANIZATION

Africa is going through an unprecedented demographic and urbanization shift. Structural change there is far slower than it was in the transformed economies of East Asia. The East Asian countries' growth path has been associated with a positive demographic shift and seem to relate strongly to the region's fertility transitions. Due to fertility decline, their age structures evolved in a way highly favourable for economic growth,

giving these economies a potential to harness their demographic dividend.

A demographic transition entailing increased life expectancy and declining fertility has a direct and different impact throughout the lifecycle (box 2.3). The drop in Africa's total fertility rate—which still hovers at around five children per woman—is slow (Bongaarts, 2013). An increase in the share of the working-age population raises the labour supply and productive potential, contributing to a demographic dividend if the labour market absorbs this new tide of workers. Africa's population is expected to rise by 3.2 billion (of the projected 4 billion worldwide increase) by 2100. Its working-age population will increase by 2.1 billion over the same period, accounting for 41 per cent of global working-age population by 2100, a surge from 12.6 per cent in 2010 (Drummond et al, 2014).

Adequately harnessed, a rising share of the working-age population and resulting decline in the dependency ratio can lead to higher economic output, savings and investment (Lee, 2003; Galor, 2005). In Africa's least developed countries (LDCs),

### BOX 2.3: AFRICA'S DEMOGRAPHIC TRANSITION—A DIVIDEND THAT MUST BE ENCASHED

Africa's demographic transition is atypical among regions, particularly East Asia. Africa starts at a much lower base. In the 1950s the population share of those 15–64 was 0.55 per cent in Africa and 0.6 per cent in Asia. Africa's transition is longer, with Asia starting in the 1970s and Africa in the mid-1980s, and its peak, predicted at around 2090, is at a relatively lower level than other regions. Africa's transition is also far slower at about three generations as compared to one generation for other regions.

Nor is Africa's transition homogeneous. South Africa, Botswana, Cabo Verde,

Seychelles and Mauritius have nearly completed theirs, in a time frame similar to Asia and Latin America. Due to the fast decline in their mortality and fertility rates, the share of their working-age population increased by nearly 20 percentage points.

Economic impacts on the continent are notable. The changing age structure favours savings, higher female labour force participation and lower fertility (Bloom et al., 2009; Soares and Falcao, 2008). And with declines in child mortality, parents prefer fewer children, placing greater emphasis on the quality of education and

health, which (theoretically) increases productivity (Rosenzweig, 1990; Soares, 2005). The median African country with an initial per capita income level of around \$550 in 2010 can expect to benefit from a demographic dividend—beyond the growth that would occur with an unchanged demographic structure—of about \$1,350 by 2100. The resulting GDP per capita of \$3,865 is higher by about 56 per cent compared with a scenario of an unchanged share of working age population (Drummond et al., 2014).



demographic growth is the main driver of the labour force over the long run, and the age decomposition indicates that the youth bulge (15–29 years of age) is the main contributor of labour supply. Yet at the current pace of structural transformation—even in the optimistic scenario of all African LDCs meeting the Istanbul Programme of Action’s 7 per cent annual economic growth target by 2020—generating enough jobs to productively employ new entrants and reabsorb those in informal or vulnerable jobs is likely to prove extremely difficult (Valensisi and Gauci, 2013).

## **AFRICA’S RAPID URBANIZATION WITHOUT INDUSTRIALIZATION**

Urbanization in most developing countries is linked with industrialization, particularly the production of tradable, manufactured goods. In Africa this link seems to be missing, partly due to an income effect arising from natural resource endowments and resource rents disproportionately spent on urban goods and services. This gives rise to “consumption cities” that are populated primarily by workers in non-tradable services. The growth of “production cities”—what Africa needs—is underpinned by movement of labour from agriculture into industry (Gollin et al., 2014).

Despite rapid urbanization, Africa is still the least urbanized continent in the world, with only 38 per cent of its population in cities. In 1950–2005, its

urban population grew by an annual average of 4.3 per cent. Even though the annual growth rate declined to 3.4 per cent in 2005–2010, African urban areas grew 1.7 times faster than all other regions over the same period (UN-Habitat, 2010).

As the locus of economic activity shifted from the countryside, Africa gained 43 cities with more than 1 million people by 2005, up from just 28 cities a decade earlier, so that combined mega-cities and smaller urban areas accounted for 55 per cent of GDP (AfDB, 2011).

African cities exhibit the highest global income inequalities—with an average Gini coefficient of 0.529—while the world average is below 0.4.<sup>7</sup> Although urbanization has been associated with improved human development, rising incomes and better living standards, it is estimated that 40–85 per cent of Africa’s urban population lives in slums, and most cities are marked by sharp economic and social polarization (UN-Habitat, 2008). The urban poor live in life-threatening conditions with limited access to clean water, adequate drainage and sanitation. They are also affected by high levels of pollution due to toxic material, traffic

**Despite rapid urbanization, Africa is still the least urbanized continent in the world, with only 38 per cent of its population in cities**

### **BOX 2.4: DECONGESTING CITIES**

A few African governments have started to promote new urban development away from their major population concentrations. They are planning satellite cities to guide population pressure away from the capital and promoting urban corridors to disperse economic activity and populations.

For example, the Rwandan government has outlined an ambitious and innovative plan to develop mid-sized intermediary cities and boost economic opportunities there. It will also direct funds to vocational and technical training programs for youth, so that they will be able to help construct the necessary 35,000 urban housing units annually using cost-effective building materials and technology.

Similarly, Morocco has experienced huge success in stopping slum growth. Launched in 2004, its program focused on building affordable housing, developing infrastructure and creating better sanitation. As of 2011, 100,000 new housing units had been built and about 1.5 million people had been helped or moved out of slums. Residents now have sewage systems, clean water, electricity and access to schools and health clinics, some through public-private partnerships (Philips, 2014).

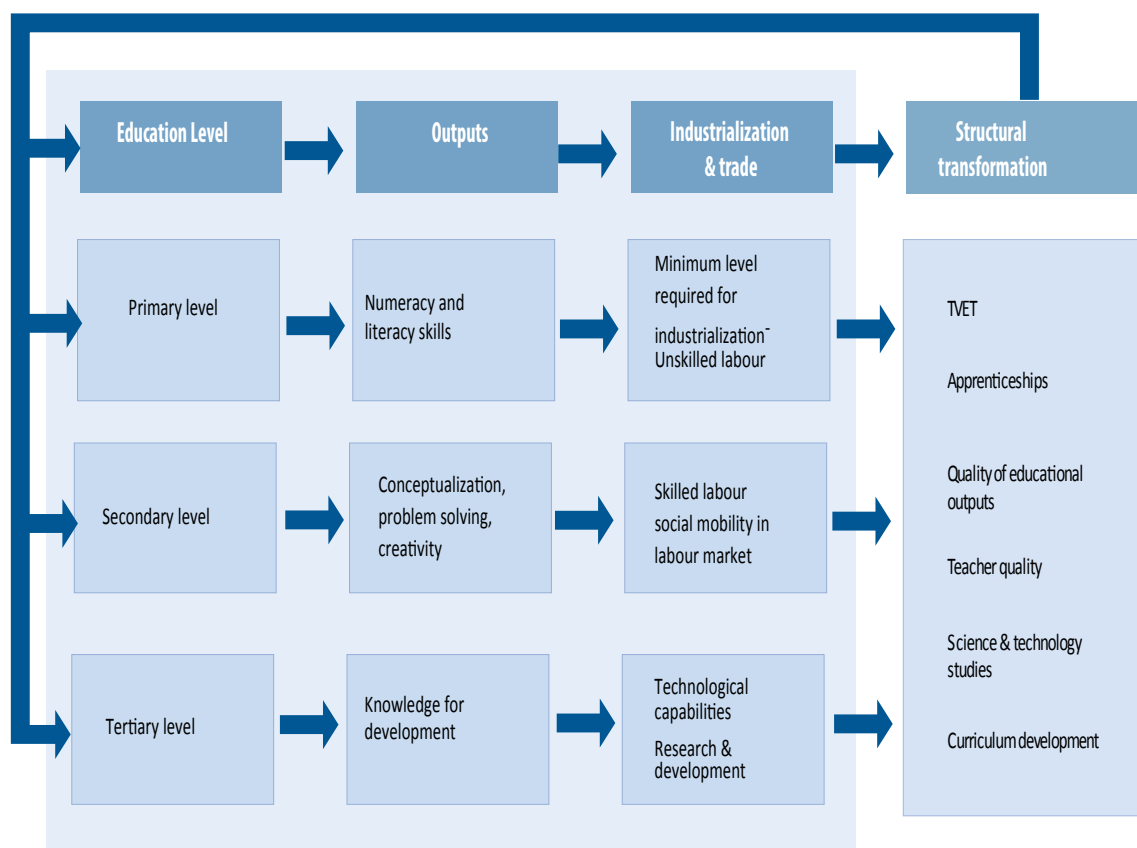
and industrial emissions, residential congestion and absence of green spaces. This situation affects labour productivity and capabilities, which some governments appreciate (box 2.4).

A slow demographic shift—a youthful population moving to urban areas that have a preponderance of consumption cities alongside an employment shortage in industrial and modern services—has exacerbated informal employment. Young people are particularly affected and experience high unemployment and underemployment rates. These trends have also increased the demand for public services, particularly education and health.

## BUILDING AN EDUCATED AND HEALTHY WORKFORCE

The skills required for transformation go beyond acquisition of formal schooling. National productive capacities develop through the interrelated processes of capital accumulation and technological progress. The assimilation rather than imposed adoption of technology through international trade was a key factor in East Asia’s change (Nelson and Pack, 1997), but this required policies that encourage entrepreneurship and innovation. Policies in which the educational system is combined with on-the-job training and apprenticeships among other informal training produce the skills required for transformation.

**FIGURE 2.8: EDUCATION AND STRUCTURAL TRANSFORMATION**



Source: ECA

Beyond hard technical competencies, soft skills are needed—such as cognitive, creative, problem-solving and managerial skills (figure 2.8)—which are difficult to develop in traditional school systems. Recent evidence shows that programmes combining in-class and on-the-job training provide soft (behavioural) skills and hard (technical) skills that can have a positive impact on employability and earnings. A poorly skilled and educated labour force is the top supply bottleneck underscored by global executives when considering manufacturing investment decisions in Africa (ACET, 2014).

### CONSTRAINTS OF PRIMARY EDUCATION

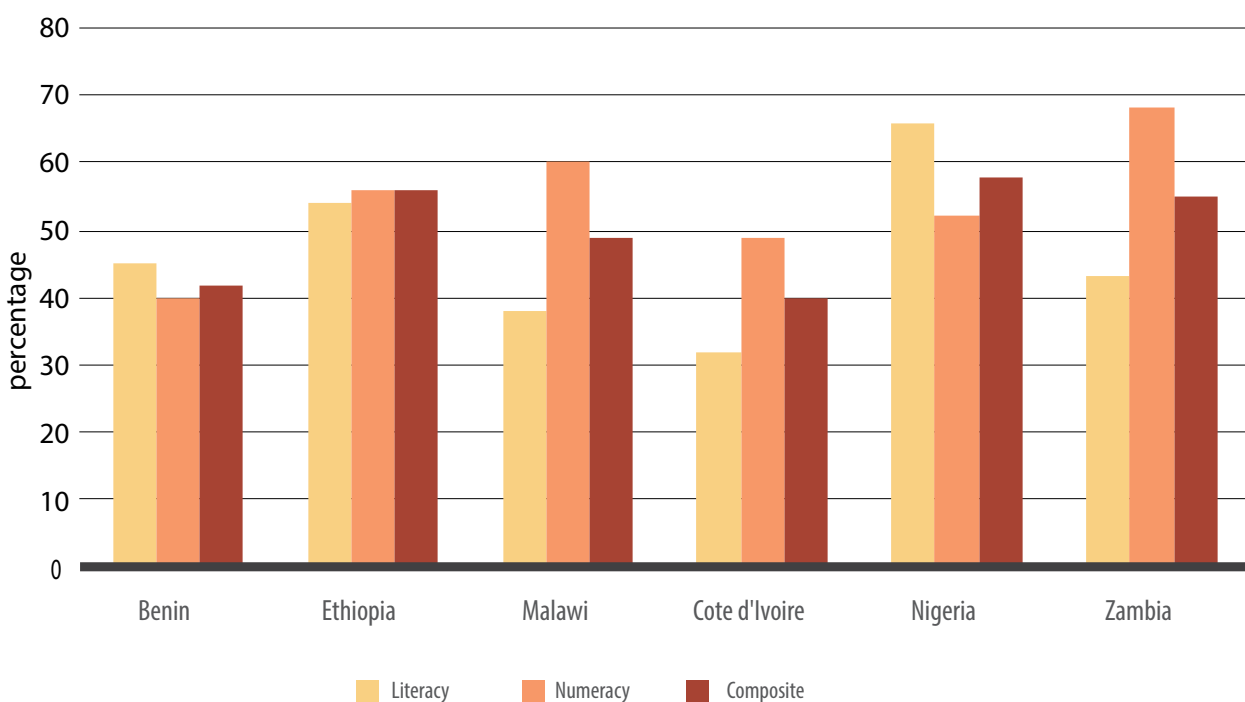
Africa’s progress in education has been aligned to attaining its stated goals (such as the Millennium Development Goals) and the need to provide universal primary education. Africa has improved primary school enrolment, which increased by 24 per cent in 1990–2012 (ECA, 2014), but failed to match

that improvement with progress in completion rates, which remain the lowest worldwide.

This progress is also permeated with inequities across income, gender and location. In Central, Eastern, Southern and West Africa only 23 per cent of poor, rural girls complete their primary education (UN, 2014). In some countries, children in the poorest 20 per cent of the population are three times less likely to be enrolled in primary school than children from the wealthiest 20 per cent. In 2007, African girls accounted for 54 per cent of the world’s out-of-school population (UN, 2014). Limited educational opportunities and rudimentary skills confine many workers to the informal economy because

**Africa’s progress in education has been aligned to attaining its stated goals (such as the Millennium Development Goals) and the need to provide universal primary education**

**FIGURE 2.9: LEARNING LEVELS IN SELECTED AFRICAN COUNTRIES (2013)**



Source: Calculations based on Watkins (2013).

of the vicious cycle of a workforce characterized by “low skill, low productivity, low wage and low investment” (Pina et al., 2012).

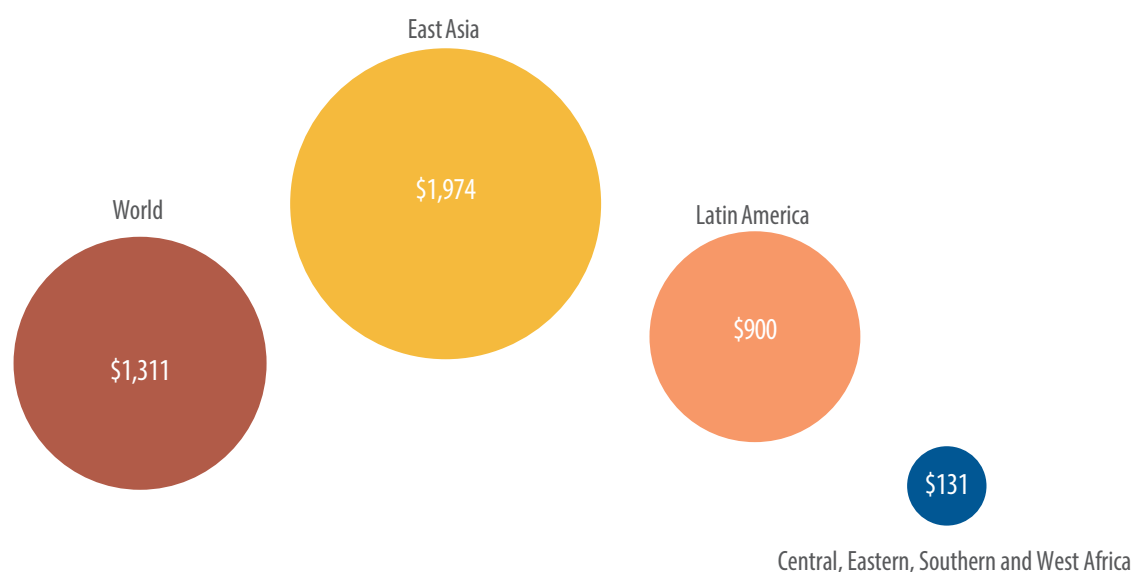
A 2013 survey shows that one out of three children in a selected group of African countries falls short of the minimum learning threshold on numeracy and literacy (figure 2.9), leading to skill gaps and increasing barriers to socio-economic opportunities (Watkins, 2013). But some African countries have linked improving the quality of primary school outputs to transforming their economies. Cabo Verde, the second African LDC to exit the LDC category after Botswana, has focused on its human capital development and educational systems. The strategic direction of its modern services was set by high enrolment and completion rates for primary school and high access to secondary education, alongside heavy investment in technical and vocational training (AfDB, 2011).

Overall educational quality, essential for an industrial workforce, is inadequate. The supply-side factor of large class size remains challenging. Of 162 countries with data, 26 had a pupil/teacher ratio above 40:1, 90 per cent of them in Africa. Africa has

a shortfall of about 1.7 million teachers, indicating the need for expanding training (UNESCO, 2014).

Unless governments move quickly, this shortfall will only worsen given population trends. In 2012, there were 35 per cent more children to accommodate than in 2000. The number of children enrolled increased from 62 million in 1990 to 149 million in 2012 but resources failed to keep up (UN, 2014). The fertility transition is roughly one-third slower in Africa than it was in East Asia, keeping primary school student inflows high (Bongaarts, 2013). If not matched by adequate funding and teaching standards, these trends will continue to undermine educational outcomes. The annual unit cost of public expenditure for primary schools in Africa per child is \$131, one tenth of the world average and almost invisible against the East Asian average of \$1,974 at purchasing power parity (PPP) (figure 2.10).

**FIGURE 2.10: UNIT COST OF PRIMARY SCHOOL IN 2010, AT CONSTANT PRICE PPP TERMS**



Source: Calculations based on UNESCO (2014)

## **IMPROVED SECONDARY EDUCATION, BUT NOT ENOUGH FOR THE LABOUR MARKET**

The low quality of primary education outputs is one of the drivers influencing a lower transition to secondary education. Secondary education enrolment and completion are important for young people to acquire the skills to access more specific technical and vocational training, which can encourage productivity gains (ACET, 2014).

Enrolment in lower secondary education increased from 29 to 49 per cent over 1999–2011 in Central, Eastern, Southern and West Africa. But completion rates remain low on average, at 37 per cent, and highly skewed towards higher-income urban populations. For example, in Rwanda and Malawi, both of which accelerated their lower secondary school enrolment in 2000–2010, completion rose from 9 per cent to only 15 per cent and from 16 per cent to only 25 per cent respectively (UNESCO, 2014). Thus at secondary level, increasing private school provision excludes a large share of the youth from quality education in many countries, partly because households bear up to 37 per cent of direct education costs in primary education on average, but 58 percent in secondary education.

However, the overall effect has been poverty reducing. In Tanzania, 82 per cent of workers with less than primary education were below the poverty line, but working adults with primary education were 20 per cent less likely to be poor, while secondary education reduced the chances of being poor by almost 60 per cent (UNESCO, 2014). Providing the education to transform knowledge into productivity is key for Africa's industrialization and includes wider access to secondary education. After 2000, manufacturing workers in Botswana, Cameroon, Ghana, Guinea and Kenya had six to nine years of schooling beyond primary school. In Namibia and Uganda, the largest proportion of the educated manufacturing labour force has 10–12 years of schooling (Fox, 2008).

## **TRANSITION FROM SCHOOL TO WORK**

Tertiary education enrolment in Africa is growing at 6 per cent a year, clearly insufficient to meet the need for highly skilled workers. Moreover, Africa's university enrolments are skewed towards humanities and liberal arts, with science and engineering only 25 per cent of enrolment. In the Republic of Korea, public universities provide 70 per cent of higher education, students pay lower fees for science, technology, engineering and mathematics (STEM) courses and the state gives subsidies for private university enrolment in similar courses (ACET, 2014). In Mauritius, the overall educational strategy links tertiary education to innovation and creativity (Government of Mauritius, 2009). In both countries this is aligned with a focus on TVET.

Traditional school systems are ill-equipped, but TVET centres are not given enough attention to meet the needs of industrial development. TVET in Africa accounts for less than 5 per cent of training among youth. Many courses are not formalized and have too few qualified staff, obsolete equipment, ill-adapted programmes and weak links to the job market. But in West Africa, governments that have put in place vocational training for workers in major urban cities have seen higher marginal returns from these programmes and improved individual income earnings than from general secondary education (Kuépié et al., 2009).

## **PROGRESS IN HEALTH IS ESSENTIAL FOR LABOUR PRODUCTIVITY AND INDUSTRIALIZATION**

Lewis (2014) noted that targeted programmes that alleviate poor health and malnutrition can help raise educational attainment and productivity, with multiplier effects on growth and development. Cole (2006) and Lu et al. (2009) found also that the impact of poor health (such as malnutrition, malaria and water-borne diseases) on total factor productivity and income losses is significant across a wide variety of specifications. Indeed, labour productivity forgone (measured by working hours

lost) due to undernutrition-related child mortality can affect the whole economy, reaching 11.9 per cent (of GDP) in Ethiopia, 1.4 per cent in Swaziland and 2.0 per cent in Uganda (AUC et al., 2014). Failure to prevent or respond to undernutrition in a child's early life often leads to incremental health costs and exclusion from full labour market participation in later life.

## POTENTIAL PRODUCTIVITY GAINS STYMIED BY WEAK EDUCATION AND HEALTH CARE

Progress in combating HIV, tuberculosis and malaria has been significant on the continent. Similarly, child and maternal mortality rates have decreased substantially. Medical advances have also contributed to reduced impact of communicable diseases on quality of life and income. For example, until recently HIV/AIDS was associated with a loss in worker productivity, income and welfare (ECA, 2004). But antiretroviral therapy coverage for 56 per cent of African patients gives important economic benefits through employment recovery. A recent study shows that many patients initiating treatment early avoided any loss of employment, and four years after initiating treatment patients had a 90 per cent chance of being employed. In contrast, HIV patients who lost their jobs before undergoing antiretroviral therapy faced long spells of joblessness (Barnighausen, 2012).

Potential productivity gains could be even greater if the issues of inequity of access and utilization of health services across income, gender and location are addressed. Health-related costs hit low-income groups disproportionately. In Ethiopia for instance, the cost of health care paid for by families is nearly 90 per cent of the total household health costs (AUC et al., 2014), putting a heavy burden on low-income families—and is one of the main causes of families falling into poverty.

This anxiety over health care costs will only become more prevalent as non-communicable diseases—such as cardiovascular diseases, cancers, diabetes,

hypertension and chronic lung diseases—demand increasing health spending.

## EMPLOYMENT IN MANUFACTURING AND SERVICES AS AN OUTCOME OF STRUCTURAL CHANGE

In South-east Asia—one of the fastest growing region—structural change brought large gains in labour productivity both in industry and service sectors (figure 2.11).

In countries such as Algeria, South Africa and Tunisia, decline in the contribution of low-productive agricultural employment supplemented by a rise in high-productivity industrial activities has opened avenues for economic diversification, increased competitiveness and integration of their transformed products in global value chains.

But jobs in Central, Eastern, Southern and West Africa are not moving out of agriculture as fast as theory predicts; and services are absorbing most of those jobs, leaving employment in industry stagnant at around 8.4 per cent during 2000–2013 (figure 2.12). This hampers economic and employment prospects as most services jobs are informal, having low productivity, low wages and poor working conditions. However, the job gain in high-end services reflects a successful shift (Chapter 4). For instance, Mauritius, expanded its tertiary sector through highly productive and labour-intensive activities (AfDB, 2011)

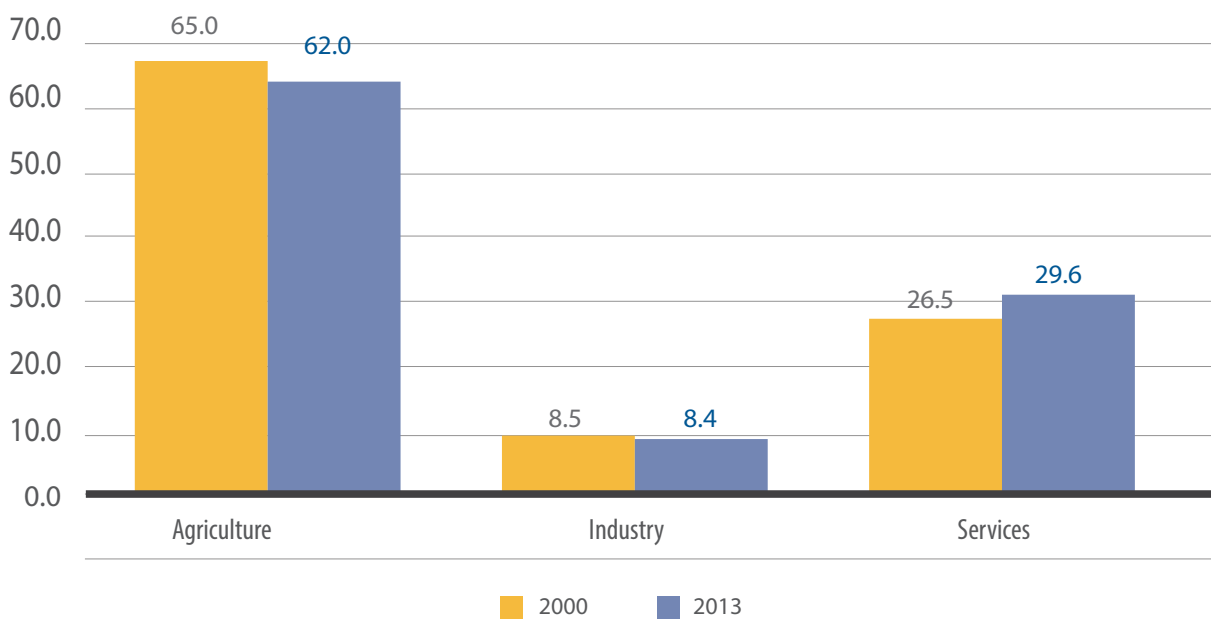
McMillan and Harttgen (2014) argue that a large share of Africa's recent economic growth can be attributed to a sharply declining share of employment in agriculture and a corresponding increase in labour moving from agriculture to more productive manufacturing and services. These declines have been more rapid in countries where the initial share of agricultural employment was highest, and where gains from commodity price increases have been spurred by improved governance and macroeconomic strategies.

**FIGURE 2.11: EMPLOYMENT BY SECTOR IN SELECTED REGIONS, 2000–2013 (% CHANGE)**



Source: Calculations based on Key Indicators of the Labour Market (KILM) (ILO 2014b).

**FIGURE 2.12: EMPLOYMENT BY SECTOR IN CENTRAL, EASTERN, SOUTHERN AND WEST AFRICA, 2000–2013**



Source: ECA calculations based on KILM (ILO 2014).

Finally, structural change and reallocation of jobs across sectors entail social adjustment costs. Layoffs, increased training needs for workers and reskilling requirements are only a few of the problems resulting from structural job shifts that also include greater demand for public services. The concentration of industries around big cities in Africa is also challenged by the lack of adequate infrastructure and provision of basic social services for workers who migrate to the cities in search of jobs—pushing them further into vulnerable low-quality employment.

## EMPLOYMENT-TO-POPULATION AND PARTICIPATION RATIOS INCREASE IN AFRICA

Africa's employment-to-population ratio is third highest among regions, behind East Asia, South-east Asia and the Pacific. In Algeria, for instance, this ratio is more than five times higher for men than women (66.1 per cent and 12.3 per cent), while in Botswana and Cameroon the gender gap is narrowing.

In 2012, female labour participation stood at 16 per cent, against 75.8 per cent for men (ILO, 2014). Similar figures are found in Mauritania, Morocco and Tunisia, at a ratio of 1:3. Over the last decade growth in labour-intensive sectors such as manufacturing and services has been inadequate to absorb labour supply, but institutional and cultural norms—including marriage and family planning—may have discouraged women from entering the market.

## WEAK LABOUR PRODUCTIVITY IS CURTAILING AFRICA'S EMPLOYMENT PROSPECTS...

One of the major challenges for meaningful job creation in Africa is low labour productivity. In 2012–2013, labour productivity grew at a mere 1.4 per cent in Africa, slower than in any other region.

Productivity gains are still held back by too little investment in factors of production, including

human resources. In four countries with data—Morocco, South Africa, Tanzania and Uganda, about one in 10 workers are underemployed.<sup>8</sup> The skills of the workforce are underused, with consequences for current and future productivity. Investment in education linked to technology and innovation and in skills development that boosts productivity and meets labour-market needs is rare. One example is the human resource strategy in Cabo Verde, which shows strong ties between universities and businesses. High-end productivity shifts to the services sector have been created through the production of knowledge-driven services driven by innovation and entrepreneurship, building on e-governance tools (AfDB, 2011).

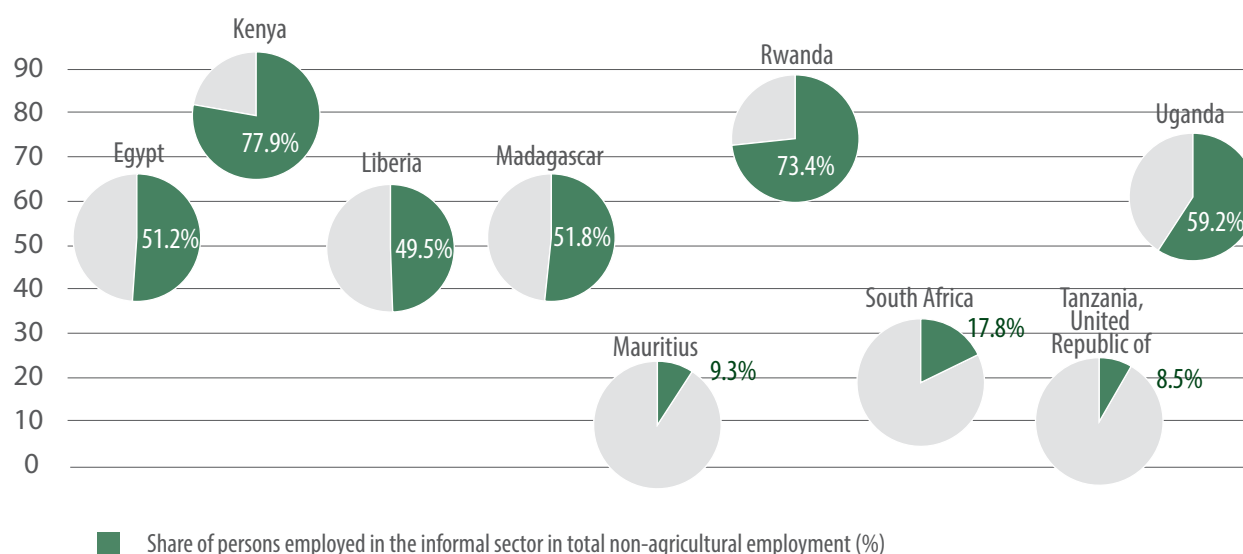
## ... WHICH CAN FUEL ECONOMIC AND SOCIAL INSTABILITY

With jobs often scarce, youth unemployment has reached worrying levels. In North Africa it reached 30.2 per cent in 2013, almost four times higher than adult unemployment (8.2 per cent). These gaps are even more pronounced for women—in Algeria in 2012, 36 per cent youth unemployment for women against 18 per cent for men, with 15.1 per cent of adult women unemployed and 5.7 per cent of adult men (ILO, 2014).

## INFORMALITY STILL DRIVES JOBS

As the formal sector—public and private—cannot absorb the increasing tide of job seekers, informal employment usually drives job creation in most countries. In 2012, 77.2 per cent of workers in Central, Eastern, Southern and West Africa were estimated either self-employed, own-account workers or contributing family workers (ILO, 2014). In Kenya and Rwanda, three out of four workers are employed in the informal sector, a proportion that increases to over 80 per cent among women. Informal employment data is scarce, but selected African figures show the high level of informality present (figure 2.13).<sup>9</sup>



**FIGURE 2.13: SIZE OF THE INFORMAL SECTOR, SELECTED COUNTRIES**

Source: Calculations based on KILM (ILO 2014).

Such high rates of informality are largely due to abundant labour supply compounded by an absence of social safety nets, making it hard for most low-skilled workers to quit the labour market. Most of these workers operate under a high degree of informality and vulnerability, resulting in small and unpredictable income, poor working conditions and low productivity. Such informality is likely to trap people into poverty.

Although informality is mainly used as a coping mechanism, there is large scope to harness the potential of the informal sector in Africa through targeted enabling policies that expanding social protection systems, tax incentives, skill development programmes, technology transfer and infrastructure investment. Some countries have already started such programmes. The coverage of social protection of informal workers in Africa today is estimated at around 10 per cent compared to over 50 per cent in Latin America and the Caribbean. Creating an enabling environment will help boost productivity and create spillover effects, expanding jobs overall. In Senegal for instance, the government has set up training and vocational programmes for informal-sector workers, 90 per

cent of whom have no schooling or just a primary school education, combining basic education and technical skills (Wather, 2011).

Informal trade is the most important source of employment among self-employed women in Central, Eastern, Southern and West Africa, at 60 per cent of non-agricultural employment. Informal cross-border trade in the Southern African Development Community (SADC) region is worth \$17.6 billion a year, accounting for 30–40 per cent of intra-SADC trade; 70 per cent of its traders are women. A decade ago female informal cross-border trade amounted to 64 per cent of national trade's value added in Benin, 46 per cent in Mali and 41 per cent in Chad and given the employment creation by the services sector, these figures are unlikely to have changed (ILO, 2004). In the Horn of Africa, unofficial exports of some agricultural commodities like livestock and grains to neighbouring countries may constitute over 95 per cent of total trade in these commodities (ILO, 2004). In Uganda informal exports of industrial goods to its neighbours came to an estimated \$118 million in 2006, or 96 per cent of official industrial exports.

Intra-African trade, a mere 14 per cent of total trade, has higher value added than Africa's trade with the rest of the world (ECA and AUC, 2012). A 1 per cent increase in official intra-African trade results in a 0.45 per cent drop in youth unemployment, with a positive female gender bias of 0.61 (Anyanwu, 2014). Given informal cross-border trade's contribution to

job creation, particularly for women, an enabling and regulatory environment for this sector is needed.

## TRADE AND EMPLOYMENT

Most of the voluminous theoretical and empirical literature on how trade affects job creation and wages considers the degree of trade openness, the role of labour market regulations and the adjustment costs associated with trade (Rodriguez and Rodrik, 2000; Baldwin, 2003; Lederman, 2011 among others)<sup>10</sup>. One study on the trade-growth linkage in Central, Eastern, Southern and West Africa found that a 1 per cent gain in the ratio of trade to GDP is associated with an increase of around 0.5 per cent of GDP growth in the short run and 0.8 per cent after 10 years (Brückner and

Lederman, 2012). Most conclude that trade can be a powerful driver of economic and employment growth, particularly in the long run, by boosting productivity and expanding opportunities for youth and women to participate in the labour market. But in the short run the effect is less clear, as some workers may experience job losses or wage decline, while the economy reallocates activities and resources towards trade and export-led sectors. Trade's effect on income distribution usually depends on redistributive policies.

## CONCLUSIONS

While the industrial sector has contributed to economic growth in recent years, the sector's growth has been driven not by growth in manufacturing but by services. Thus African countries need to put in place policies and strategies that can enhance structural change, especially in manufacturing and higher end services, alongside efforts to raise productivity in agriculture, as it is still the largest employer and the backbone of many African economies.

Africa's growth performance has been robust and resilient but has not been on the inclusive development trajectory necessary to translate growth into employment opportunities and reduce poverty and inequality. African countries need to embark on strategies that have at their core social development in all its guises, as human capital is central to innovation and industrialization and structural change.

Given the large informal sector involved in trade and its contribution to GDP, policies are required in several areas: labour market policies (that help develop human skills and adaptability and facilitate mobility across occupations, firms, industries and regions); an efficient regulatory framework (while keeping that burden to the minimum, fostering competition and helping ensure market openness); social protection mechanisms; fiscal and credit incentives for private sector development, mainly to small and medium-sized enterprises; and, for informal enterprises, better infrastructure and increased access to public goods, technology and formal financing.

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# APPENDIX 2.1

FIGURE A2.1: AGRICULTURAL GROWTH BY SUBREGION, 1961–2012

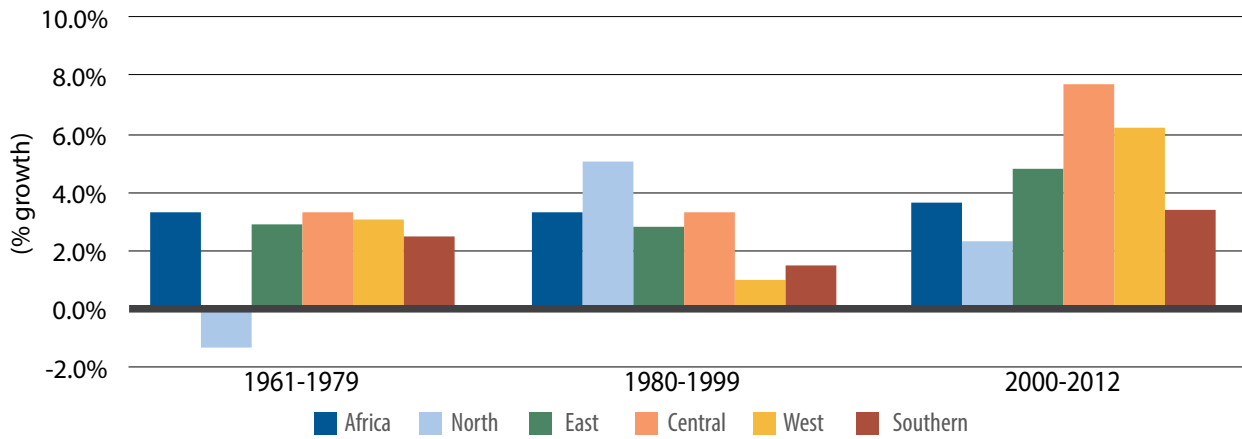


FIGURE A2.2: INDUSTRIAL GROWTH BY SUBREGION, 1961–2012

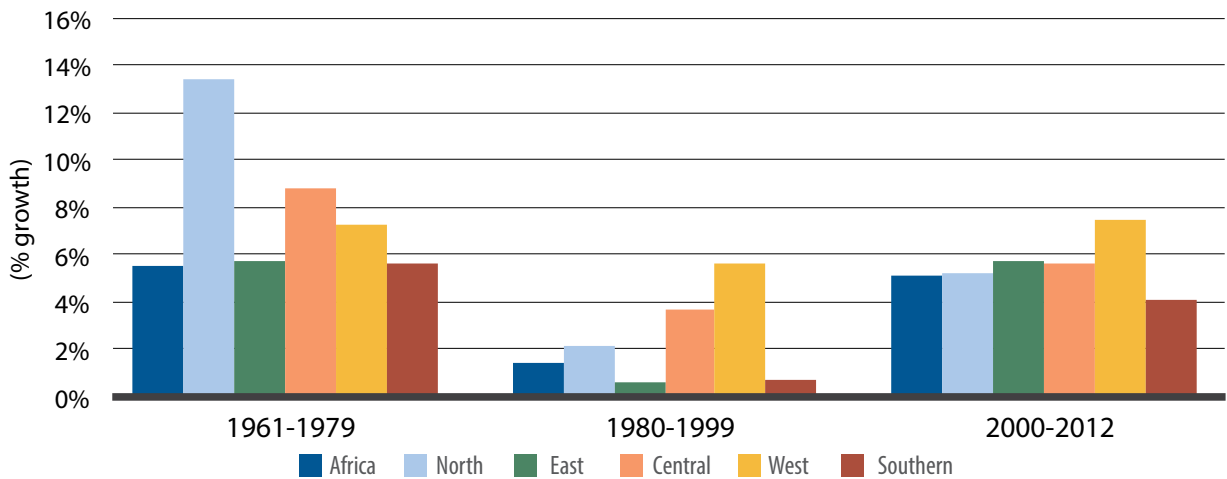
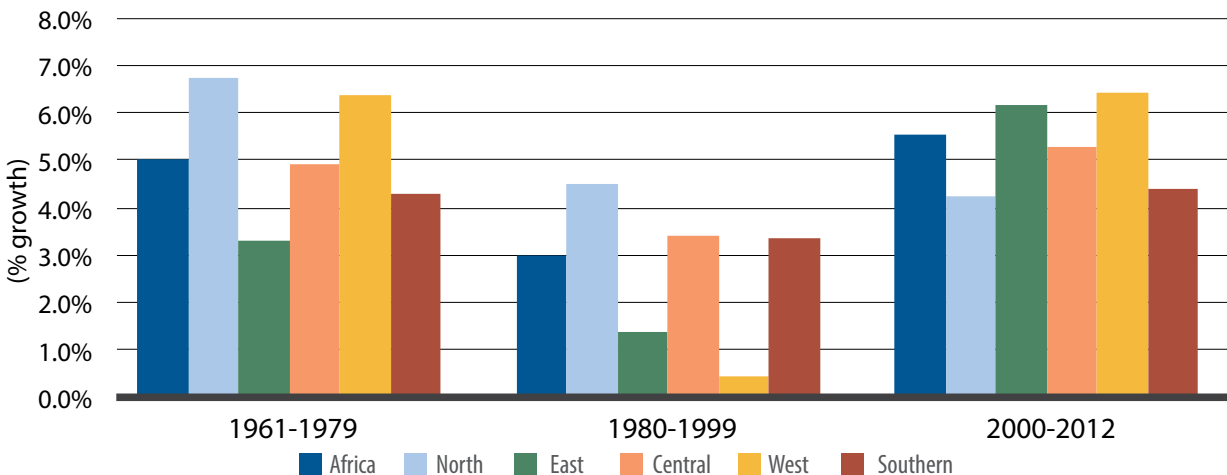


FIGURE A2.3: SERVICES GROWTH BY SUBREGION, 1961–2012



Source: Calculated based on World Development Indicators (database)

## ENDNOTES

- 1 ECA estimate based on World Development Indicators (database).
- 2 ECA estimate based on World Development Indicators (database).
- 3 For mineral-rich countries, 2001 and 2012 have been removed. In 2001, manufacturing output grew by an exceptional 19.1 per cent, while industrial production experienced growth of 1.3 per cent. Therefore the mechanical contribution of manufacturing rose to 603 per cent, relative to 11 per cent in the previous year. In 2012, industrial production grew at a rate of 0.1 per cent, while manufacturing production declined by -1.7 per cent, leading to a contribution of manufacturing of -399 per cent. For mineral poor countries, 2010 has been removed, as manufacturing contribution to industrial growth was 10694 per cent due to industrial growth of 0.04 per cent. For oil exporting countries, 2010 and 2012 have been removed. In 2010, as the contribution of manufacturing was 384 per cent, relative to -8 per cent in the previous year. In 2012, the contribution of manufacturing was -4438 per cent.
- 4 Data and discussion on trade openness, export diversification and the composition of intra- and extra-African trade are in Chapters 3 and 5.
- 5 A declining share of agriculture in GDP and employment, rural-to-urban migration underpinned by rural and urban development, the rise of a modern industrial and service economy, and a demographic transition from high to low rates of births and deaths (associated with better health standards in developed and urban areas).
- 6 Only six countries meet the criteria for which elasticity data are available: Burundi, Republic of Congo, Democratic Republic of Congo, Gabon, Liberia and Nigeria.
- 7 The world average is below 0.4 (UN-Habitat, 2010).
- 8 The indicator refers to underemployment as a percentage of the total labour force or of total employment.
- 9 The ILO-standardized definition of informal employment refers to the sum of informal jobs in formal enterprises, informal sector enterprises and households producing goods for own consumption or hiring paid domestic workers (ILO, 2014).
- 10 See also Cline (2004) for a comprehensive literature review.
- 11 2010 removed for West Africa in subregional figures due to the rebasing in Nigeria, leading to outlier growth values.

**Part 2: Industrialization–Trade Nexus**

CHAPTER

3

**THEORIES AND EXPERIENCE**

A properly designed and run trade policy—alongside complementary policies—can launch an economy into industrial take-off.

African countries need such policies to help them overcome their inability to industrialize. Rudimentary agricultural practices and largely informal services lead to missed growth opportunities. Thus Africa's key task is to promote robust and labour-intensive industries for employment generation and efficient use of the continent's diverse resources. Africa's industrialization should target markets in Africa (via

tighter regionalism) and beyond (via fairer trade agreements), and in both cases open markets will be critical.

This chapter presents some theory and a framework for a trade policy that potentially promotes industrialization, one that must ensure coherence with other national policies, be selective (primarily for reasons of cost) and operate in the shrinking policy space open to countries.

## THEORETICAL UNDERPINNINGS OF TRADE'S BENEFITS IN INDUSTRIALIZATION

Production is at the heart of trade. The application of trade theory therefore has an indirect impact on what trading countries should produce to maximize their welfare, and as trade theory has shifted, its assumptions for the global environment have altered.

Trade theories have evolved over the years from a macro-based to a micro-based perspective. Micro-based theories stem from the idea that trade is conducted by firms and not countries. Consequently, an understanding of firms' and industries' characteristics is important, and this is the basis of new trade theories. The issues addressed by these new theories and the experience of (especially newly) industrialized countries strongly suggests the need for Africa to rethink the design and implementation of its trade and complementary policies.

Modern industrial production is characterized by far fewer producers than in earlier years. For

instance, there are fewer than 20 major global car producers and even fewer global chocolate manufacturers. Entry by new firms into these and other industries is far from free because of the huge investment requirements. Additionally these few firms could collude to prevent entry by prospective firms. For trade-induced industrialization to be effective, African countries should have a deep understanding of the market structure and possible firms' interactions.

Economies of scale characterize modern production plants and technology. Modern machines and innovations have supported and maintained the hegemony of a few firms in a particular industry through embedding increasing returns to scale. Each vintage of technology improves the efficiency and capacity of earlier ones. Minimum plant sizes have been rising over the years, enabling firms to reduce unit costs.



Production structures with huge economies of scale create incentives to specialize and trade, even without differences in resource endowments or technology, in differentiated products that provide a similar level of utility. The scope and dimensions of economies of scale are extended by consumers' preference for variety and falling transaction costs. So although access to big markets is important in trade-induced industrialization, few African countries are in a good position to take advantage, putting the spotlight on regional integration as an alternative.

The corollary is producers' preference for input variety. An efficient production system sources inputs from different markets to minimize production costs. Trading in intermediate products and upgrading along a given value chain (or joining it) also require efficient trade facilitation.

Industrial production is characterized by externalities and spillovers. Negative externalities are detrimental to social, economic and environmental sustainability, and every effort should be instituted to curtail these undesirable side-effects of industrialization. Positive externalities and spillovers should be encouraged through deliberate government interventions. Different dimensions of externalities include research and development (R&D), learning-by-doing, learning to export, on-the-job training and

knowledge spillovers from foreign companies. Other types of externalities include product- and input-variety externalities, as well as information and coordination externalities—all need to be harnessed for structural change.

The need for government intervention may be clear, but it requires policymakers (or their advisers) to understand the World Trade Organization (WTO), its many complicated rules (box 3.1) and the economic channels through which trade and trade policy affect industrialization. Countries produce and export goods intensive in the factors with which they are abundantly endowed. Africa's natural resources are enormous—which explains its export pattern—but it needs to transform these resources into high-value products via industrialization. It needs to transform its cocoa beans into chocolate and process its crude oil into refined products. One thread among the many in the rich fabric of industrialization is trade policy.

**Getting trade policy right is a balancing act of providing incentives for firms to innovate, develop capacity, invest in R&D and upgrade technology**

### **BOX 3.1: MASTER IT—OR IT WILL MASTER YOU**

Established in 1995 as the successor to the General Agreement on Tariffs and Trade (GATT), WTO expanded the scope of trade and trade-related issues under its purview. However, it has made reaching a global agreement on trade issues vastly harder—unfinished negotiations after 15 years of the Doha Round and the proliferation of regional trading agreements bear witness to that.

Forty-two African countries are WTO members, but they have yet to develop their capacity to fully engage with WTO, especially to use the multilateral trading system to their advantage.

# A SELECTIVE TRADE POLICY FRAMEWORK

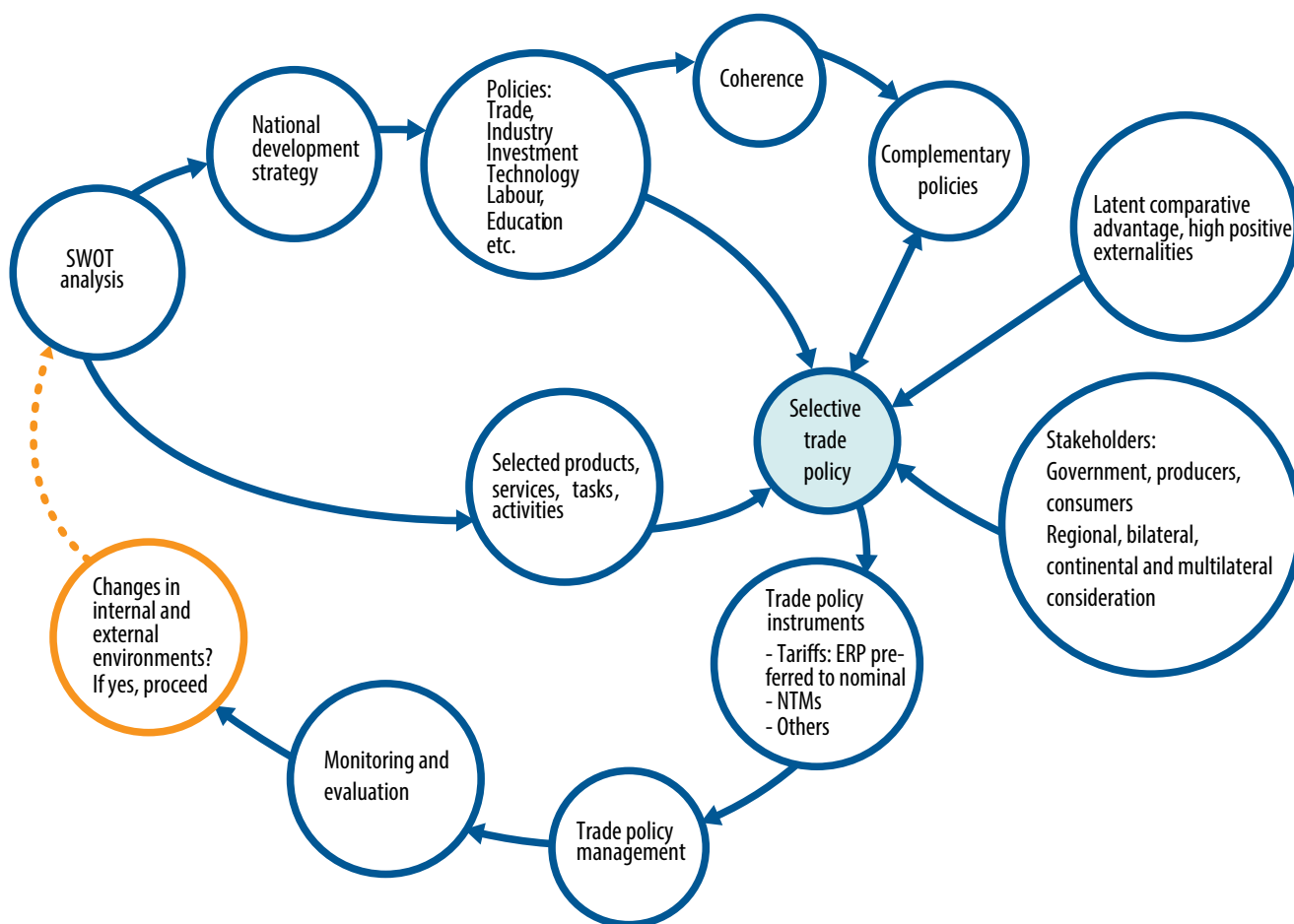
Getting trade policy right is a balancing act of providing incentives for firms to innovate, develop capacity, invest in R&D and upgrade technology. Yet it must not expose “infant industries” (see box 3.2 below) to international competition, because such exposure could de-industrialize the economy as these industries are submerged by the resources of far richer firms from abroad.

The starting point for a selective trade policy framework (figure 3.1) and for any national policy is the national development strategy.<sup>1,2</sup> The strategy should incorporate all the country’s attributes:

its opportunities and challenges as well as the linkages and synergies among economic sectors. A development strategy should also assign unique and non-conflicting yet complementary roles to different units and stakeholders. These roles are then translated into policy documents.

A strong relationship between the industrial policy and the national development strategy and between trade and industrial policies is required. These and other policy documents are expected to be highly coordinated. Indeed an ideal situation is an integrated trade and industrial policy. A similar

**FIGURE 3.1: A SELECTIVE TRADE POLICY FRAMEWORK**



Note: Arrows are required to indicate that at any stage in the process, a re-evaluation may be required. For instance, after monitoring and evaluation the process may be re-initialized at any stage.  
ERP = effective rate of protection.

strong relationship is expected between these two and other policies, including those for technology, labour, tax and the exchange rate. Coherence is important because trade policy alone, without appropriate complementary policies, cannot deliver on industrialization and structural change.

The next level concerns issues in developing the trade policy framework. A good trade policy must be interactive, iterative and evolving. A trade policy is interactive when all stakeholders are engaged or have equal opportunities to contribute to the process. Of course, trade has a very wide range of stakeholders ranging from ministries, departments and agencies of the government to producers and consumers. This approach allows the various groups to contribute to the process and the policymakers to achieve buy-in. More importantly, it also presents a platform for exchanging ideas and experiences, and in the process stakeholders tend to strategize on the best way to take advantage of the new trade policy (or its reforms).

The parameters informing the process include a country's endowments, technological capabilities of the manufacturing firms and other country's specific attributes. These parameters must be evaluated relative to other countries' attributes. The purpose is to provide information about a country's comparative advantages or disadvantages in different sectors (goods and services). It is desirable at this level—and more importantly, for a selective trade policy—that evidence-based studies should inform the determination of a country's comparative advantage. Hence, rigorous analytical studies are required (usually cast in SWOT analysis: Strength, Weakness, Opportunity and Threat analysis).

The expectation is that based on rigorous analysis, different countries (and even the same country at different periods) are well informed; and trade policy design responds to issues raised in the studies. Such an exercise may lead to different orientations to trade policy. Some countries may lean towards liberal trade policy; others may embrace restrictive

trade policy. The trade policy of a small, less-endowed country may not be necessarily close to that of a large and well-endowed country.

A selective trade policy entails two “big tasks”: selecting industries (or tasks) that will receive special treatment; and choosing trade policy instruments to influence not only the products but also the process. Some industries or tasks would be helped to compete globally; some (infant industries) protected from international competition for a while and developed to compete internationally later.

Selective trade policy has generated a wide debate on its various elements including the selection criteria, suitable policy instruments, and management of the process. These issues are yet to be fully resolved. However, the literature provides some parameters for selecting the winners and avoiding the losers.<sup>3</sup> The goal of selection should be paramount.

For selected industries, appropriate diagnostic checks are required to identify and analyse constraints to optimal performance and the possible policy tools (including trade policy). Other, complementary policies may be more potent in addressing some of the identified constraints (chapter 5). Or it may be that effectiveness of the appropriate trade policy instruments is constrained by these other factors. In any case, policymakers need to identify all possible policies required and—in the case of trade policy—all possible trade policy instruments.

Trade policy instruments for selective trade policy should be carefully selected and applied, with a good's value addition considered. Thus the focus should be on the effective rate of protection (ERP) rather than nominal tariffs. The possible effects of trade policy measures on global value chains (GVCs) (chapter 4) should be recognized and factored into trade policy design and implementation (table 3.1).

**TABLE 3.1: TRADE POLICY MEASURES AND POSSIBLE EFFECTS ON GVCs**

Trade policy measure	Potential investment-related effect (illustrative)
Import tariffs, tariff escalation. Non-tariff barriers: regulatory standards (e.g., technical barriers to trade and sanitary and phytosanitary measures).	Negative effect on export-oriented investment in operations that rely on imported content that is subject to the measure. Positive effect on market-seeking or import substitution investment (barrier-hopping).
Trade facilitation (applying to both imports and exports). Export promotion (e.g., export finance, credit guarantees and trade fairs).	Positive effect on export-oriented investment by reducing the cost of multiple border crossings on both the import and export sides and through expedited exports (of particular relevance in time-sensitive GVCs). Positive effect on market-seeking investment that benefits from facilitated (and cheaper) imports.
Preferential or free trade agreements (including rules of origin and sector-specific agreements).	Positive effect on investment that benefits from easier (and cheaper) trade between member countries, strengthening regional value chains. Positive effect on market-seeking investment through economies of scale from serving a bigger market. Consolidation effect on investment (primarily through mergers and acquisitions) as a result of reconfiguration of GVCs in member countries.
Market access development preferences (e.g., Generalised System of Preference, Everything-but-Arms, Africa Growth Opportunity Act).	Positive effect on foreign investment in preference-recipient countries targeting exports to preference-giving countries.
Trade remedies (e.g., anti-dumping, safeguards and countervailing duties).	Negative effect on export-oriented investment in the country affected by the measure (and on existing export-oriented investors who made investment decisions prior to the measure's enactment).

Source: UNCTAD (2013).

Other important considerations include the relative costs and benefits of the selected policy instruments, the relative effectiveness of the policy instruments, and the market structure of the selected industry. A selective trade policy is necessarily a dual-track approach—selected and unselected sectors. The selected sectors can constitute either a positive or negative list. The positive list contains industries empowered and supported to compete globally. The support accorded to them is mainly to address externalities and coordination failures. The negative list contains industries that are considered “infant” and thus shielded from international competition. Once a selective list is created, other sectors—whether positive or negative—are not in the list—and will be neither promoted nor protected.

When infant-industry protection is the basis of selection and tariffs are the dominant instrument, the relative costs and benefits of the three main possible policy instruments should be evaluated (box 3.2). These three instruments have different implications for raw materials, intermediates and final goods.

Most African countries rely on a narrow set of trade policy instruments, primarily tariffs, indicating lack of capacity to develop and institutionalize appropriate instruments. This is why, for example, many African countries bound their tariffs at ceiling level—contingent protection measures such as safeguard and anti-dumping measures require greater capacity—but the ceiling creates

### **BOX 3.2: PROTECTING INFANT INDUSTRIES: IMPORT TARIFFS, IMPORT QUOTAS AND PRODUCTION SUBSIDIES**

Essentially, three policy instruments may be used for protecting infant industries from import competition: import tariffs, import quotas and production subsidies.

In choosing an instrument from them, policymakers must, via analysis, select the one that will achieve two results: automatically decreasing the level of protection as learning progresses and productive efficiency rises; and immediately eliminating protection once learning has ceased.

Each of the three instruments has its disadvantages in terms of cost-of-protection implications. Generally, import tariffs and import quotas generate consumption and production distortion costs because they interfere with normal consumption and production decisions. But both yield tariff-revenue benefits to the government. A production subsidy generates only production distortion costs because it leaves the market price unchanged, though it places a cost burden on government rather than yielding revenue.

If policymakers want to minimize the cost of production (to consumers and the economy), they should use a production subsidy, which is also the most appropriate instrument for supporting domestic production of industrial raw materials and intermediate inputs. Thus products such as iron and steel; and cement—critical to and major inputs in other industries—should not be protected through import tariffs and import quotas. If they are, the result would be to raise their prices and hence the costs of the final products in which they are inputs. The appropriate instrument for this type of infant-industry protection is a production subsidy, whose effect is to reduce their costs rather than raise their prices.

It may be that production subsidies are infeasible owing to fiscal constraints. But even then, an intra-industry cross-subsidy could be considered. In particular, if the government wishes to support both the domestic production of the components and the assembly of motor vehicles, for example, part of the integrated policy package may offer tariff protection for the final product (the fully assembled vehicle) and production subsidy for the domestic manufacture of the most important components. In such a package, part of the tariff revenue derived by the government from the tariff-based policy part can be used to finance the production subsidy element.

In other cases an intra-industry cross-subsidy may not be viable—as two examples illustrate. The general concern over food security suggests that it may not be wise to use tariff policy instruments for encouraging the domestic production and processing of food products, such as rice and wheat, because tariff-based protection will raise food prices and thus penalize relatively poor consumers whose food security ought to be protected. More generally, a cheap food strategy is important in a labour-intensive industrialization and development strategy, which must rely on efficient, but low-wage, labour. Given the unique role of food as a wage-good, such a strategy is made feasible and may be sustained by an accompanying cheap-food policy.

The second example is the use of tariff policy instruments for promoting the domestic production of essential medicines and health products. As with food products, a tariff-based protection policy will raise prices of medicines and may place such products beyond the reach of those who need them most. In all such cases, the

more viable alternative policy instrument is a production subsidy, whose focus is to reduce the cost of domestic production, without interfering with import prices.

Finally, policymakers should be aware of the implications of applying the infant-industry protection argument without ensuring that the preconditions for success are met. Without a sufficiently large domestic market and a clear indication that the protected industries exhibit latent dynamic comparative advantage, enjoy significant economies of scale, and generate positive externalities and spillover effects, the protection policy is more likely to create a set of monopoly or near-monopoly producers whose efficiency will probably fall, rather than rise, due to lack of competition. As a result, such producers will keep demanding more and more protection, with the implied or expressed threat of mass unemployment if the government fails to meet this demand.

A government that does not wish to be coerced over a failed policy should, from the start, set clear preconditions and criteria for success when it adopts an industrial development strategy based on the infant-industry argument. It must also be prepared to rigorously apply the success test and not hesitate to “pull the plug” when this test is failed.

Source: Oyejide (2014).

uncertainties and sends the wrong signals to would-be investors as the country reserves the right to change tariffs at will.

Monitoring and evaluation, too, are often compromised or totally neglected, but can be supported by intermediate variables that can gauge progress or effectiveness of policy. Such variables may include changes in the component of trade being targeted (trade in intermediates), increases in foreign direct investment (FDI) to a particular sector of interest, and shorter clearance of goods from ports. Good trade policy is dynamic, is responsive to changes in the internal and external environment,

and is reviewed at intervals (long enough apart for firms to use it to ground their planning and investment).

## KEEPING UP WITH THE LEADERS

A possible dividend for latecomers into industrial development is that they can take advantage of the fact that capital usually moves from developed to less developed economies—the “flying geese” pattern. It begins with rapid expansion of labour-intensive manufacturing, the first stage of industrialization, which triggers changes in the economy. Of particular importance to capital are

### BOX 3.3: SUCCESSFUL NON-AFRICAN EXPERIENCES OF INDUSTRIALIZING THROUGH TRADE

The United Kingdom, the world’s first industrialized country, used government interventions to protect domestic industries in the early stages of industrialization, including selective industrial protection; gradual opening up, starting with tariff reduction, followed by free trade; and using the domestic market as a learning ground for international competition.

The list of protected industries started small and grew. Import protection was first applied to woollen products, cotton products and iron; then to other metals, wrought iron, leather, shipbuilding and fisheries; and then to flax and silk (Shafaeddin, 1998). “Only after the Industrial Revolution was well established and when Great Britain had consolidated its industrial base did it start to follow around 1850 a free trade policy after some gradual tariff reduction” (Shafaeddin, 1998).

Most other countries that industrialized followed this pattern, including Belgium, France, the Netherlands, Germany and

the US, but with gradually shortening periods of protection. And by the time the process reached Japan and East Asia’s newly industrialized economies—Hong Kong SAR, China; Singapore; Republic of Korea; and Taiwan, Chinese Taipei—they were even shorter.

A focus on East Asia is understandable given its spectacular growth and transformation—and subsequently on China, which has lifted more people out of poverty in 20 years than any other country, or even group of countries, has done in a comparable period.

#### Japan and the East Asian tigers

Japan began to liberalize its economy only after 1973, though after 1950 it had targeted for government interventions industries including motor vehicles, computers, electronics and electrical appliances, iron and steel, synthetic fibres, ship building, petroleum refining and petrochemicals. It used instruments such as loans, grants, tax incentives, and export promotion; domestic

market protection through prohibitive tariffs, import quotas, restrictions of foreign investment; and coordination of technology agreements and subsidies.

What dynamic African countries may learn from Japan is that the government regularly evaluated industrial performance and adjusted its interventions; it only gradually opened up the economy; it had a strong and interactive relationship with the private sector, in which firms usually respected non-binding “administrative guidance”: it focuses on technological development, industrial deepening and diversification now that it cannot use some of its traditional trade policy instruments; it thoroughly analysed its WTO agreements (e.g., aid for technological and regional development is still permitted, which it fully exploits); and it extensively uses trade associations (as WTO rules out some practices conducted by government but not by non-government actors). Needless to say, private standards are very high in GVCs, independent of WTO.

increases in wages and other factor prices. The effect of this expansion is the loss of comparative advantage by labour-intensive manufacturing, and thus it is the time for capital to fly to other countries or regions. Apart from seeking economies with low factor prices (including wages), investors consider macroeconomic stability, size of the domestic market and technological capabilities of the domestic firms.

In line with the flying geese structure, many analysts feel that movement of capital from China is imminent, although its next destination is unknown. While African countries are possible candidates for capital from China, other candidates are Vietnam, Cambodia and Bangladesh. African countries should position themselves to take

advantage of these opportunities. Japan is similarly positioning its companies for relocation to Africa by directing its spending on industrial training and education with a view to inculcate Japanese work ethics and methods in Africa. The British (and other westerners) brought their capital to Africa a long time ago (box 3.3).

## A possible dividend for latecomers into industrial development is that they can take advantage of the “flying geese” pattern.

The Japanese government still has a strong trade–industrial strategy with traditional instruments (protection of the domestic markets and promotion of exports) under new guise; moral suasion; policy instruments applied by category (“sunrise” or “sunset”); and a “moving band of openness.” This is not fundamentally dissimilar from other developed economies’ earlier opening up in a sector whose supply response had been fully developed.<sup>a</sup>

### China’s selective trade policy

The role of the state in China goes far beyond trade. As a developmental state, China has been able to develop coherent policy and implement it efficiently (Xiaoyun, 2014), integrating the selective trade policy closely with development plans.

Since the mid-1980s, the authorities have used different instruments to promote exports of selected products and sectors. Duty exemptions were granted, particularly to imported intermediates used in exports, on capital and technology through FDI, and on equipment imported by foreign firms in initial investment in affiliates in China. For

ease of administration, monitoring and evaluation of the various incentives, special economic zones were created.

Although China reduced its average customs tariff from 41 per cent in 1992 to 16.8 per cent over 1998–2001, the advantage derived from tariff exemptions has remained significant, and this selective trade policy has proved very successful in creating export-oriented industries based on imported inputs. The large gap between nominal and collected tariff rates reveals the extent of tariff exemptions (Lemoine and Únal-Kesenci, 2004). The gaps vary from one product to another. Some examples using 1997 tariff rates include processed food with nominal tariff rate of 23.2 per cent and collected rate of 3.7 per cent, a gap of 19.5 per cent; beverage with nominal rate of 60.2 per cent and collected rate 24.0 per cent, a gap of 36.2 per cent; apparel with a gap of 41.1 per cent (i.e., nominal rate of 41.8 per cent versus collected rate of 0.7 per cent) and leather with a gap of 35.2 per cent (nominal rate, 35.5 per cent; and collected rate, 0.3 per cent).

China’s selective trade liberalization expanded international processing, which was the engine of its rapid diversification of manufactured exports. The effective protection enjoyed by processing activities in the 1990s favoured strong productive links between China and its East Asian partners. Its integration with the production and trade networks of Asian firms was at the core of its foreign trade expansion. China’s selective trade policy thus strongly determined the commodity and geographical pattern of the country’s trade (Gaulier et al., 2004).

<sup>a</sup>“Restrictions on the ability of foreign firms to develop a permanent presence in the Japanese market have been removed only where Japanese firms have achieved a dominant position at home and a strong often dominant position abroad. In other words, restrictions have been removed where they don’t matter any more” (Singh, 2004: 10).

### **BOX 3.4: SOME REGIONAL INDUSTRIAL INITIATIVES IN AFRICA**

The East African Community (EAC) has two related documents on industrialization: the industrial strategy (2012–2032) and the industrialization policy (2012–2032). These documents promote “structural change of the manufacturing sector through value addition and product diversification based on comparative and competitive advantages of the region”.

The Southern Africa Development Community (SADC) Industrial Development Policy Framework (2013–2018) provides a blueprint for the industrial development of its 15 member states. The goal is to “promote development of an integrated industrial base within SADC through the exploitation of regional synergies in value-added production and enhancement of export competitiveness”, including via “collaboration in the development of regional value chains with targeted interventions”.

The Economic Community of West African States (ECOWAS) launched the West African Common Industrial Policy (WACIP) in 2010. Its vision is to “maintain a solid industrial structure which is globally competitive, environment-friendly and capable of significantly improving the living standard of the people by 2030”. The general objectives are to accelerate industrialization of the region through the transformation of local raw materials, develop and diversify industrial productive capacity, and strengthen regional integration and export of manufactured goods.

Sources: Based on EAC (2012), SADC (2013) and ECOWAS (2010).

## **REGIONAL INTEGRATION IS STILL A TRIUMPH OF HOPE OVER EXPERIENCE**

Africa’s regional approach to fostering trade-induced industrialization is so far a story of unfulfilled promise. In theory, such integration presents scope for policy to bolster the gradually rising but still small share of intra-African trade, especially in manufactures, and to promote regional value chains (RVCs) via larger markets as stepping stones to a continent-wide market. It can also serve as an agent of restraint (or discipline) and enhance the credibility of trade reform.

It is, however, labouring under heavy burdens: poor and inefficient regional infrastructure, both the “hard” and “soft” sides; and a failure by policymakers to fully appreciate the importance of trade in services, which has increased, abetted by a rise in FDI. (Chapter 4 presents an analysis of potential trade in regional and global value chains, as well as in intermediates and services.)

The efforts by Africa’s regional economic communities to promote industrialization appear largely ineffective. In 2004, an assessment of

industrial cooperation by these groupings found that they had done little to boost production, productivity or manufacturing value added (ECA and AUC, 2004)—a verdict that still holds a decade later. Once again, implementation is the stumbling block—not the underlying goals or documents (box 3.4).

The Action Plan for Accelerated Industrial Development of Africa (AIDA), for example, was adopted by the AU (Africa Union) Summit in 2008 and still has a guiding role for discussion of industrial development. The regional economic communities have indeed developed industrial frameworks, but have failed to tie them closely to their other activities and have not always garnered the full-throated support of member states. Perhaps more worrying is the virtual disconnection between their efforts and trade negotiations more generally, in particular North–South bilateral and regional trade agreements.

**Africa’s regional approach to fostering trade-induced industrialization is so far a story of unfulfilled promise**



## **TOWARDS A COORDINATED AND HARMONIZED TRADE FOR INDUSTRIAL DEVELOPMENT IN AFRICA: UNITED WE STAND, DIVIDED WE FALL**

The observed disconnection between continental initiatives and various regional and national activities especially in the area of trade calls for concern. Trade negotiations and related engagements at the national levels appear incoherent with various regional and continental initiatives. If the current trend is not checked, Balkanization of the continent is imminent, an antithesis of regional and continental integration agenda. African countries are consummating relationships with old and emerging development partners without due regards to both regional and continental integration agenda and their industrial development objectives. These relationships are from a very weak position based on so many factors, including (1) lack of sufficient capacity and technical know-how to effectively negotiate, and (2) asymmetries in the economic size of African countries and most of their partners. The European Union, the US and China for instance are each of them bigger economies than the entire economies of Africa.

Africa should consider, adopt and implement a continental negotiations template to guide countries in their engagements with the rest of the world. Such a template promotes coordination and harmonisation of engagements with these partners and Africa's regional and continental objectives. It also provides a platform for African countries' consultation with each other and prevents "incentive wars"<sup>4</sup>: a race to the bottom. Better coordination will ensure African countries have more bargaining power. The call for a negotiations template is not new: Mangeni and Karingi (2008) made a case for it in the negotiations of Economic Partnership Agreements (EPAs) in Africa. Similarly in the context of Africa and its emerging partners, AfDB et al. (2011) strongly recommended a continental framework. The recent efforts at fast-tracking the

African Continental Free Trade Area and the need to coordinate and harmonise different activities towards this goal, including harmonisation of common external tariffs at the continental level (see chapter 5), make a continental negotiations template imperative.

**African countries are consummating relationships with old and emerging development partners without regards to regional and continental integration agenda**

# TRADE POLICY COHERENCE AND SELECTIVITY IN A SHRINKING POLICY SPACE

**T**rade policy has many objectives, and promoting industrial development may just be one of them. And so its design, especially in ensuring coherence, as seen, is critical. The space in which to use such policies has, though, narrowed dramatically in recent years, largely because of the rules of WTO.

The analysis presented in this section derived mainly from findings from 10 country case studies and supplemented with extensive literature search. The country case studies were conducted with the aim of gauging the trade policy-making process especially in relation to industrialization. The fact is that countries have different objectives for their trade policies, and in some cases these objectives are not congruent. For instance, where maximization of revenue from trade taxes is the overriding objective, then tariff liberalization for promoting import of intermediate inputs and hence industrialization may be difficult to implement.

Two main instruments were designed for the purpose of the exercise. The first instrument was designed to obtain information from the private sector on their involvement and participation in the trade and industrial policy-making process. The second instrument was administered on the public sector: the Ministries, Agencies and Departments (MDAs) in the area of trade and industry. These instruments were supplemented with published sources including information from websites of various organizations at national, regional and international levels. The instruments were designed to seek understanding in the following areas: (1) the policy process at two levels namely: (a) coherence between trade policy and other policies especially industrial policy and the national development strategies; (b) the level of involvement of various

stakeholders; and (2) implementation issues on trade and industrial policies. Other issues relating to local processing, government policies especially in the areas of regional trade agreements, imports of raw materials and intermediate products and non-tariff measures were also covered.

Basic information with respect to the 10 countries is presented in Table 3.2. There are two countries per subregion. These countries also reflect the diversities of the African continent including landlocked versus coastal countries, net-oil exporting versus net-oil importing countries, islands and small countries. Based on the diversities of African countries as exemplified in the table, a one-cap-fits-all model is not expected and more so given that African countries are at different levels of development. However, the synergies created by the diversities of resources have not been effectively tapped into.

## COHERENCE NEEDS TO BE BEEFED UP

Most of 10 case-country countries have attempted to achieve some coherence between their trade policy and national development strategy. Long-, medium- and short-term planning is iterative, as most of the countries review their plans regularly (table 3.3). Trade policy coherence with industrial policy appears less strong.

Two prominent themes are to mainstream trade with the national development strategy;<sup>18</sup> and, for African least-developed countries (LDCs), to participate in the Enhanced Integrated Framework and its programme of Diagnostic Trade Integration Studies. (However, the goal of these efforts is to reduce poverty and not directly to promote

**TABLE 3.2: BASIC INFORMATION ON THE SELECTED AFRICAN COUNTRIES**

		Region	Location advantage	Resource endowment
1	Botswana	Southern Africa	Landlocked	Oil importing and mineral rich
2	Cabo Verde	West Africa	Island	Oil importing and mineral poor
3	Chad	Central Africa	Landlocked	Oil exporting
4	The Congo	Central Africa	Coastal	Oil exporting
5	Egypt	North Africa	Coastal	Oil importing and mineral poor
6	Morocco	North Africa	Coastal	Oil importing and mineral poor
7	Mozambique	Southern Africa	Coastal	Oil importing and mineral rich
8	Nigeria	West Africa	Coastal	Oil exporting
9	Tanzania	East Africa	Coastal	Oil importing and mineral rich
10	Uganda	East Africa	Landlocked	Oil importing and mineral poor

**TABLE 3.3: COHERENCE ISSUES IN TRADE POLICY DESIGN**

		Trade Policy	Industrial Policy	National Development Strategy
1	Botswana	2009 <sup>5</sup>	1998 <sup>6</sup>	Vision 2016, NDP10
2	Cabo Verde	No	No	Vision 2030 <sup>7</sup>
3	Chad	No	No	NDS <sup>8</sup> 2013-2015
4	The Congo	2014 <sup>9</sup>	2003 <sup>10</sup>	NDP 2012-2016
5	Egypt		2003	2014/15-2018/19 <sup>11</sup>
6	Morocco	1993 <sup>12</sup>	recently launched <sup>13</sup>	No
7	Mozambique		2007 <sup>14</sup>	2014
8	Nigeria	2002 <sup>15</sup>	2014 <sup>16</sup>	Vision 20:2020; Transformation Agenda
9	Tanzania	2009-2014	1996-2020 <sup>17</sup>	Vision 2025
10	Uganda	2008	2008	2000-2015

Source: ECA (2014) ERA 2015 Country case studies for ERA 2015. UNECA Addis Ababa

industrialization.) The framework is a multi-donor programme, designed to help LDCs become more active in global trading. It focuses on helping these countries tackle supply-side constraints to trade.

Five countries (Cabo Verde, Chad, Mozambique, Tanzania and Uganda) in the 10 case-study countries are in the framework, which has assisted them in capacity building; setting up structures to coordinate delivery of trade-related technical assistance; and building capacity to trade.

Appendix 3.1 outlines elements of trade and industrial policy in the 10 countries. Box 3.5 shows how Nigeria attempts to cohere its policy features.

## SELECTIVITY APPEARS FINE ON PAPER, BUT HAS TO BE ENFORCED

Most countries among the 10 recognize the need to be selective, add value, and develop or join regional and global value chains, as these ideas feature in most policy documents and in the various discussions held during the field trips. However, most countries are not fully adopting or effectively enforcing their selective trade policies.

For example, Nigeria has a huge number of fiscal (tariff and non-tariff) incentives to promote industrial development, but sectors are neither highly selective nor regularly monitored and evaluated. Although efforts to promote industrial development under the Nigeria Industrial Revolution Plan (NIRP) were recent, selecting the various sectors to be promoted appears to be based on rule of thumb and not on known rigorous studies. The number of subsectors (20) appears on the high side to qualify for a selective trade or industrial policy. Indeed, development of oil and gas-related industry alone along the value chains and possibly with a focus on the regional and continental markets would have been more transformative (box 3.6).

A major challenge for the NIRP is applying trade policy instruments given the country's commitments to the ECOWAS common external tariff (CET), which came into effect on 1 January 2015. For example, the change in tariffs for automobiles that was initially scheduled to begin on that date has been put on hold.

### BOX 3.5: FRAMEWORK FOR INDUSTRIAL DEVELOPMENT IN NIGERIA

The Nigeria Industrial Revolution Plan is rare in that it aims to ensure that industrial development integrates with other development plans, including the:

- National Development plans that have defined the vision and macroeconomic context (i.e., Vision 2020, the Transformation Agenda).
- National Development plans that will provide industry with raw materials (i.e., agriculture, solid minerals, gas master plan etc.).
- National Development plans that will provide the requisite assets and infrastructure for industry to thrive (i.e., power sector reform, transport, gas master plan etc.).
- National Trade Policy.
- National Micro, Small, and Medium Companies Policy.

Source: FMITI (2014).

**BOX 3.6: NIGERIA INDUSTRIAL REVOLUTION PLAN**

The plan focuses on four industry groups and 20 subsectors. The sectors have been selected because they are ready for accelerated ramp-up in capacity.

Sector	Subsectors
<b>Agribusiness &amp; agro-allied</b>	Food processing (specifically beverages, packaged food products)
	Sugar
	Palm oil processing
	Cocoa processing
	Leather and leather products
	Rubber products Textiles and garments
<b>Solid minerals &amp; metals</b>	Cement
	Basic Steel
	Aluminium
	Chemicals
	Auto assembly
<b>Oil and gas related industry</b>	Petrochemicals
	Fertilizers
	Methanol
	Plastics
	Refineries (with Oil & Gas Ministry)
<b>Construction, light manufacturing, and services</b>	Housing (i.e., supply side\construction)
	Light manufacturing (consumer and home goods)
	Services

**Agribusiness & agro allied:** Nigeria's rich agricultural ecosystem offers significant potential to increase production and growth. The NIRP's aim is to maximize the benefits from the country's agricultural resources, build an end-to-end integrated agro value chain, boost local production to meet local demand, and reduce the country's reliance on imports of processed food products. The NIRP is focused on mid- and downstream processing and market activities, and integrates with the Nigeria Agriculture Transformation Agenda (ATA), which increases agro-output to feed industry and the NIRP.

**Solid minerals & metals:** Massive unexploited raw reserves, notably iron ore, can enhance industrial output. The NIRP proposes to create a strong industry that can tap into the mining sector (initially focusing on the iron ore value chain) and build a competitive advantage around high-value high-volume products further down the value chain (e.g., automotive). The NIRP will create an enabling environment targeting large investors to institutionalize world-class production standards in the country.

**Oil- and gas-related industry:** Significant hydrocarbon reserves provide the foundation for Nigeria to build

competitive oil- and gas-driven industries (similar to Saudi Arabia). Nigeria could use its cheap and abundant gas to revitalize industry, encourage high value-adding downstream investments and build institutional industrial strengths.

**Construction, light manufacturing and services:** Multiple opportunities exist in the local market, driven by Nigeria's large consumer population, business demand and infrastructure needs.

Source: FMITI (2014).

## GETTING EVERYONE ON BOARD: THE POLITICAL ECONOMY OF TRADE POLICY REFORM

Trade policy making in most of the countries in the 10 appears to involve different internal stakeholder groups. Most of the producer associations consulted confirmed that they were involved in trade policy making but indicated that they were largely out of the loop when changes were made to policies. Consultations with producer groups varied by country. In some cases, they served as members of various committees and ministries, departments and agencies of government on trade and development issues. Traders are rarely consulted, and consumers appear completely neglected.

Trade reform in general, and trade policy reform for the purpose of promoting industrialization, is complex. It requires aggregation of various and diverse interest groups—national and international. Interest groups within the former include public, private and the non-governmental organizations (NGOs). Public stakeholders include ministries, departments and government agencies. There may be no consensus among these groups with regards to trade policy issues. For instance, the ministry of foreign affairs may approach the issue of trade policy reform from foreign relations perspective, the ministry of finance may place more emphasis on revenue from trade taxes while the ministry of trade and industry may be promoting industrialization through trade policy reform.

In a similar manner, the private sector group is as complex as its numbers of subgroups: producers versus consumers, and traders (importers versus exporters). The group of producers is not in any way homogeneous: producers that rely on imported inputs versus producers that are producing for export markets. NGOs, too, differ in their interests—the environment, child labour, animal rights, etc. The cooperation of these groups is important not only in policy design but also in its implementation. The interactions of international groups and the trade policy itself are usually outlined in agreements (bilateral, regional and multilateral), which may

extend to investment or the environment, further complicating cooperative efforts.

Multiple stakeholders have to be committed to trade policy reform, as the costs of reform (falling on the losers) usually precede its benefits (accruing to the winners), requiring solid management of the transition. If the transition is not properly sequenced (chapter 5), the whole reform may be derailed or truncated—even if the gains would, ultimately, have been more than enough to compensate the losers.

## POLICY SPACE IS NARROWING

African countries are being increasingly constrained in deploying trade policy. Instruments that were once legal and used by virtually all developed countries are being outlawed under WTO. The WTO discipline imposed on the use of tariffs and para-tariff measures has, for example, constrained their application for industrial development, although ceiling bound tariffs set by African countries and some flexibilities are still available, even if they signal uncertainties to investors (box 3.7). Indeed apart from agriculture where all tariff lines were “tariffed” and bound, most countries still have policy space in their tariff for manufactures, but this is unlikely to be for long—another reason for African countries to build the relevant institutions.<sup>19</sup>

Two approaches gauge the restrictiveness of policy space in the world trading system: dispute settlement indexation and historical benchmarking (what was available and what is now available). Using the first approach, Lee et al. (2014) catalogued activities at the WTO dispute settlement mechanism and revealed the virtual absence of African and other developing countries’ using a classification: developed countries, developing and least developed countries. Out of 86 dispute cases on subsidies and countervailing measures, half were between developed countries, and 43 per cent between developed and developing countries either as complainants or as respondents. Of the cases, 4.6 per cent were between developing

**BOX 3.7: SOME FLEXIBILITY STILL IN WTO AGREEMENTS**

WTO members retain some flexibility to support structural transformation, including tariff policy where some lines are still unbound, and where the difference between bound and applied tariffs provides room for modulating them in support of development goals. WTO members can also continue using certain kinds of subsidies and standards to promote research and development or innovation and can exploit flexibility in using export credits (UNCTAD 2014).

Under the Agreement on Trade-Related Investment Measures (TRIMs), countries may continue to impose sector-specific entry conditions on foreign investors, including industry-specific limitations. The agreement also allows some leeway through the mechanism of compulsory licensing (whereby authorities can allow companies other than the patent owner to use the rights to a patent) and “parallel” imports (i.e., imports of branded goods into a market that can be sold there without the consent of the owner of the trademark in that market) (UNCTAD 2014). Some scholars (e.g., Chang and Cheema, 2001, page 44) argue that there should be a way around it: “developing countries can maintain or even strengthen local content requirement, which is an important tool for technology upgrading”.

Developed, developing and least developed members of WTO have varying obligations. The least developed have the least stringent rate of commitments and time allowed to adopt them. African countries need to exploit this opportunity too.

On paper, infant-industry protection is still allowed under the GATT (Article XVIII: C),<sup>20</sup> but it is a Herculean task to invoke these provisions, especially for capacity-poor LDCs. Other “smart” policies can be used to develop industry, directly and indirectly, including balance-of-payments safeguards and contingent protection measures (Article XVIII: B).

Though greatly contained, support can still be offered to LDC firms, including export subsidies. Subsidies for regional development, research and development (R&D) and environment-related technology upgrading are still allowed. There are indications that the subsidy restrictions only cover “trade-related” policies, leaving room for “domestic” policies for learning and technology, including subsidies for equipment investment, start-up enterprises, and particular skills.

**TABLE 3.4: WTO DISPUTE SETTLEMENT CASES RELATING TO INDUSTRIALIZATION, 1995-2005**

Respondents	Local content requirements	Import controls	Non-agriculture export/production subsidies	Tax manipulation	Weak intellectual property right enforcement
Developing countries	11 Brazil, India, China	19 Argentina, Brazil, India, Rep. of Korea, Malaysia, Mexico, Philippines	3 Brazil, Rep. of Korea, Philippines	10 Chile, Dominican Rep., Rep. of Korea, Mexico, Peru	5 Argentina, India, Pakistan
Industrial countries	0	4 EC	18 Australia, Belgium, Canada, EC, France, Greece, Ireland, Japan, Netherlands, US	4 Japan, EC	10 Canada, Denmark, EC, Greece, Japan, Portugal, Sweden
<b>Total</b>	<b>11</b>	<b>23</b>	<b>21</b>	<b>14</b>	<b>15</b>

Source: DiCaprio and Gallagher (2006).

Note: Figures are number of cases. EC = European Commission.

countries, and 2.3 per cent were between developed and developing countries jointly against low income countries.

Yet African countries are conspicuous by their absence, either as complainants or respondents, despite the heavy presence of other developing countries. More than half the total cases related to import controls and subsidies (table 3.4).

Africa's absence is explainable by its lack of capacity to diagnose an issue and pursue a dispute in accord with WTO rules; and by inaction by developed-country members on the actions taken by developing countries because of their marginal impact on the developed countries' interests. In addition, the inactions by the developed countries may stem from the fact that they have alternative means of handling the issues through North-South agreements (chapter 5). However, as African countries are aspiring to structurally transform their economies either individually or in regional or continental blocs, their use of trade policy instruments that were once used by most developed countries may become inevitable. These may require seeking concessions or waivers. Even

where these instruments are not simply outlawed, the process of invoking them is more stringent, and therefore African countries should develop capacity to use such instruments.

Another perspective to the analysis of policy space at the multilateral level is the rule-based content analysis of the relevant trade agreements.<sup>21</sup> The use of subsidies to support industrialization and structural change particularly in the East Asian countries exemplifies this strand of analysis (UNCTAD, 2014). Other trade policy instruments that are now constrained include performance requirements on foreign investors with respect to exports, domestic content and technology transfers. Reverse engineering and imitations through access to technology are also constrained—again, approaches used earlier by developed economies (UNCTAD, 2014). Table 3.5 presents a summary of trade policy instruments that were GATT compliant and their status under WTO.

**TABLE 3.5: TRADE POLICY INSTRUMENTS, WTO**

Sector	Policy instrument	WTO compliant?
Goods	Tariff sequencing	No
	Import licenses	No
	Duty drawbacks	Yes
Subsidies	Export	No
	Production	No
	Research and Development (R&D)	Actionable
FDI	Local content	No
	Technological transfer	Yes
	Trade balancing	No
Intellectual property rights	Selective patent	No
	Compulsory licensing	Yes
Others	Skills building	Yes
	State-run firms	Yes

Source: DiCaprio and Gallagher (2006).  
 Note: All instruments are GATT compliant.



# CONCLUSIONS

In many African countries, trade policy design has not been effective, and its coherence with other policies has been limited—one reason why the majority of African nations have failed to diversify their exports from agricultural, mineral and crude oil products.

Another reason is asymmetric international trade agreements. Africa therefore needs to rethink its approach to trade and investment negotiations. Each bilateral, regional and multilateral trade deal has narrowed scope for traditional instruments once used by developed countries. African countries should halt this erosion by insisting on the right to promote industrialization, auditing agreements that they have signed to exploit any flexibilities, develop the capacity to do such auditing and, further, take full advantage of the agreements to which they are party.

A well-sequenced, gradual approach to upgrading and industrialization is more practical than short, sharp shocks. African economies should start from labour-intensive sectors and upgrade to medium- and high-technology sectors. Their trade policies must promote dynamic efficiency of mature firms and promote efficiency of “infant industries” through temporary shields from international competition. Trade policy design should be informed by factor endowments and comparative advantage, and should recognize that African industries are dependent on international markets for both inputs and outputs. Typically, good trade policies should strike a balance between promoting dynamic efficiency of mature industries and firms through exposing them to international competition, while shielding infant industries from fierce competition from established foreign industries until they

establish and develop some pockets of efficiency. But trade policy alone cannot deliver industrial development. African governments need to ensure that trade policy is coherent with other economic policies and is integrated into the overall national development strategy. Subsequently, coherence should be built at various regional economic communities (RECs) level, then continent-wide (chapters 4 and 5). In particular, Africa should adopt and implement a continental negotiations template that will help to promote coordination and harmonisation of policies and thus assist in fast-tracking the establishment of continental FTA and deepen continental integration.

**Trade policy design in many African countries has not been effective, and its coherence with other policies has been limited**

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## APPENDIX 3.1: KEY ELEMENTS OF TRADE AND INDUSTRIAL POLICY IN 10 COUNTRIES

### BOTSWANA

Botswana, a resource-rich landlocked country, has Vision 2016 as its main development strategy. Its economic principles are not very different from those in previous documents and include sustainable economic diversification, increased international competitiveness of the economy and export promotion.

The industrial policy interacts with a range of other policy documents such as the National Export Strategy for Botswana (2010), Economic Diversification Drive Strategy (2011), Investment Strategy (2010), Special Economic Zones Policy (2011), Competition Policy (2008) and Citizen Economic Empowerment Policy (2012).

Industrial policy falls within the Southern Africa Development Community (SADC) Industrial Development Policy Framework. The framework promotes cross-border value addition, particularly in pharmaceuticals, agro-processing and minerals.

### CABO VERDE

This small island country has no separate industrial or trade policy. Vision 2030 envisages that the competitive advantage of the country lies in services, especially tourism, supported by promotion of light industries and increasing agricultural productivity. Government efforts are, beyond maintaining a stable macroeconomic environment, incentives to attract investors, infrastructure investment and tourism promotion. Good governance and policy stability, which have become valued assets for the nation, need to be maintained.

### CHAD

Chad, a landlocked oil-dependent country, is yet to develop sectoral industrial and trade policies because of lack of capacity. The current national development strategy, the Plan National de Développement (PND 2013–15) was launched in April 2013 and provides major orientations on industrial and trade aspirations.

### REPUBLIC OF CONGO

Recognizing the role of trade to foster the development of the Republic of Congo as stated in its National Development Plan 2012–2016 (NDP), the country's Ministry of Trade drafted a

Trade National Development Plan (TNDP), which coherently fits into the country's NDP.

The vision of the country's TNDP is to develop an efficient trade system as a means to sustainable growth, improve national competitiveness, create jobs and reduce poverty. The objective is to improve the impact, efficiency and effectiveness of reforms and trade initiatives.

### EGYPT

Egypt's Medium-Term Macroeconomic Policy Framework for 2014/15–2018/19 appears to be the main compass for economic development. In it, the government expresses its intention to deliver on the following: sustainable real GDP growth of 6 per cent by the end of the forecast period, a faster pace of job creation in order to bring the unemployment rate below double digits, inflation within the Central Bank of Egypt's comfort zone, higher rates of domestic investment, improved export performance, greater efficiency in government spending through a planned reduction of the fiscal deficit to 8–9 per cent of GDP and government debt at 80–85 per cent of GDP, and the development and betterment of the country's human resources.

Egypt's Industrial Policy was launched in 2005. It took a substantial new direction for the industrial sector based on being more market- and demand-oriented and less interventionist. Up to 2011, this policy direction could be said to have been successful in promoting investment and exports, but failed to achieve structural change and industrialization. A new industrial policy document is being drafted.

### MOROCCO

Since the 1980s, there have been several attempts to harmonize trade and industrial policies to strengthen synergies, but they have failed to achieve coordination for several reasons. First, an overall national development strategy was lacking, and coordination and coherence between sectoral plans and policies were poor. The lack of a national planning institution in the current government adds to challenges.<sup>22</sup> Second is the tendency of industrial development policies to focus on attracting FDI rather than investing in local industries so as to boost technology transfer in the country. Third, the current National Pact for Industrial Emergence has focused on developing large industries rather than providing incentives to small and medium-

sized enterprises (SMEs). SMEs still face high set-up costs and operational constraints that hinder their competitiveness in global markets.

## MOZAMBIQUE

Mozambique produced a National Development Strategy in 2014. It stresses the importance of increasing coordination among government departments and institutions involved in economic development.

Mozambique is still implementing the 2007 Industrial Strategy, which was initially supposed to run until 2012. A new Industrial Strategy is currently being prepared and should be published by the end of 2014. Its trade policy has not been published since 1997. The International Trade Centre (ITC) has conducted a study on export competitiveness for Mozambique in 2012, but this still needs to receive government approval and to be turned into an implementation plan.

## NIGERIA

Two of the national development strategies clearly relate to trade and industrialization: the National Economic Empowerment and Development Strategy (NEEDS, 2004) and Nigeria Vision 2020 (2010). These documents emphasized the need to accelerate the pace of industrial development by increasing value added at every stage of the value chain, and to make the export of value-added goods the focal point of Nigeria's trade strategy.

The Federal Ministry of Industry, Trade and Investment (FMITI), with its various agencies, is responsible for the design, coordination and implementation of government policies in trade and industry. Although not yet approved, the country has almost completed the process of reviewing its 2002 Trade Policy, necessitated by the need to incorporate the ever-changing global, regional and bilateral trade environment. The primary goal of Nigeria's trade policy remains to enhance the positive impact of trade on economic growth and development, as well as the diversification and development of the economy through the efficient production and distribution of goods and services for the domestic and international markets.

The recent 2014 Nigeria Industrial Revolution Plan (NIRP) recognizes the problem of inadequate linkages among various stakeholders and sectors. The NIRP therefore proposes to link Nigeria's Industrial Policy with Nigeria's Trade Policy, and to integrate the Plan with all other ministerial plans of the Federal Government. This could increase coherence with other key initiatives such as the Gas Master Plan, the Infrastructure Master Plan, and the Science and Technology Plan. The NIRP is further highlighted in Box 3.6.

## TANZANIA

Tanzania's National Vision 2025, trade policy and industrial policy are closely linked, although there are some few gaps in implementation. Coherence stems from three sources: institutional, with both sets of the policies formulated under the supervision of the Ministry of Industry and Trade; a common grounding, in Tanzania's National Vision 2025; and private sector input, with representatives (particularly industrialists, farmers, traders, etc.) fully participating. And because these policies seek to address the needs of these private sector actors, the policies are inexorably complementary.

The policy documents are also similar in addressing promoting competitiveness; stressing value addition of exports; and integrating regionally.

## UGANDA

Uganda's National Development Plan, covering 2010–2015, stipulates the country's medium-term strategic direction, development priorities and implementation strategies.

The National Industrial Policy of 2008 lays out the goals for share of manufactured products in GDP, contribution of manufactured exports to total exports, and value added in industry. Its vision is to build a modern, competitive, integrated and dynamic industrial sector. It outlines four broad policy objectives to enhance the performance of manufacturing: promote development of value-added industries especially the agro-industries; increase competitiveness of local industries; enhance the development and productivity of the informal manufacturing subsector; and enhance applied research and technology development.

The current trade policy was also launched in February 2008 with the primary role of eliminating barriers to trade and providing an enabling environment where the private sector could operate competitively, reliably and sustainably. This was because trade in general (domestic trade in particular) was deemed to be constrained by issues of lack of information, poor marketing infrastructure, an inefficient transport system and lack of explicit support policies.

## ENDNOTES

- 1 Trade policy must be highly selective because of the high costs of negotiating and enforcing it. While recognizing the role and place of horizontal industrial policies, the vertical (i.e., selective) policies are important in developing dynamic comparative advantage.
- 2 A selective trade policy framework is used broadly to include any trade policy design that distinguishes among the various sectors, products, tasks and even processes. It is assumed that such a policy is cognizant of the linkages in a particular economy.
- 3 See Oyejide (2014) on selection for infant-industry argument, Spencer (1986) on criteria for selecting “strategic products” under strategic trade policy and Lin (2012) on how to select firms with latent comparative advantage.
- 4 This is defined as a situation where countries try to outbid each other for investment and aid.
- 5 This was the first integrated trade policy for the country. It is scheduled for review in 2015.
- 6 The 1998 industrial policy was the second. It is currently being reviewed. The revised document is to be sent to the Parliament soon.
- 7 Comparative advantage in tourism sector is to be combined with light manufacturing and increasing productivity in agriculture.
- 8 Trade and Industrial policies are embedded in the PND. Development of a sectoral industrial and trade policy is hindered by lack of capacity.
- 9 To be presented to the parliament before the end of 2014
- 10 La Charte Nationale des Investissements.
- 11 Medium Term Macroeconomic Policy Framework.
- 12 Now considered dated and plan is on the way to revise it.
- 13 A new Industrial Acceleration Plan (2014-2020) has just been launched. The National Pact for Industrial Emergence (NPIE) (2009-2015) was adopted in 2009.
- 14 A new industrial strategy is being prepared. It is due to be published in 2014.
- 15 The 2002 Trade Policy Review of Nigeria is under review.
- 16 The Nigeria Industrial Revolution Plan was launched in January 2014. The 2004 Industrial Policy is currently under Review.
- 17 Sustainable Industrial Development Plan. It was later reviewed and replaced with the Integrated Industrial Development Strategy 2025.
- 18 UNDP (2011) provides an indication of mainstreaming of trade into NDS by selected countries including the Central African Republic, Republic of Congo, Guinea Bissau, Lesotho, Mauritius, Nigeria, Rwanda, Sierra Leone, and Tanzania.
- 19 However, the gap between bound rate and applied rate signals uncertainty to would-be investors.
- 20 This article XVIII permits the use of quantitative restriction and non-tariff measures by developing countries for infant-industry purposes and other government assistance including for the balance of payments.
- 21 Commonly cited WTO agreements include the agreements on Subsidies and Countervailing Measures, on Trade-related Investment Measures (TRIMs), and on Trade-related Aspects of Intellectual Property Rights (TRIPs).
- 22 In 2003, the Ministry of Planning was replaced by the High Commissioner for Planning (HCP), who is under the high patronage of his Majesty the King. The main mandate of HCP is to produce statistics, forecasts, analysis and planning.

**Part 2: Industrialization–Trade Nexus**

CHAPTER

4

**REPOSITIONING AFRICA IN  
GLOBAL VALUE CHAINS AND  
FACILITATING TRADE IN  
INTERMEDIATES AND SERVICES**

Global value chains (GVCs) are an important feature in today's global economy. African countries show high participation in them, though at very low rungs of the ladder: that is, participation does not guarantee structural transformation. Africa needs to focus on improving its backward integration—the share of value added embedded in its country's exports—expanding GVC linkages to other areas of the economy. Trade-integrated regions are more attractive to lead firms in GVCs, and hence intra-regional trade in processed goods via regional value chains (RVCs) is the first opportunity for African firms to seize.

Although intermediate products account for the bulk of Africa's merchandise trade and represent its most dynamic component, Africa accounts for only 2–3 per cent of the global trade in intermediates, and its exports of intermediates remain dominated by mining products and resource-based manufactures. Despite its small size, intra-African trade in intermediates is far more diversified than the corresponding trade with the rest of the world.

Yet, the scope for incipient emergence of RVCs, particularly in manufacturing, is largely untapped due to an array of structural and policy constraints. That Africa sources 88 per cent of its imported inputs from outside the region bears witness to its RVCs' shallowness.

The service sector plays a key role in the competitiveness of manufacturing firms, represents a key source of value added that could help to diversify the economy, and affects the chances of countries adding value and climbing GVCs. Yet the strong growth of some service subsectors has not always translated into better services for local firms: for example, in many African countries, banks lend to large foreign mining projects but hold back credit from local SMEs. Services can also be an avenue for economic transformation, particularly for small countries and island states, as not all African countries can develop through manufacturing. Establishing services hubs and RVCs can help African countries exploit each other's capabilities and boost competitiveness.

## GVCS AND INDUSTRIALIZATION

Over the last few decades, transnational corporations have fragmented their production processes, allowing them to more efficiently exploit different countries' comparative advantages along (regional, subsequently global) value chains, forming a global division of labour. They have retained the most profitable links, while outsourcing or offshoring others through regional and international production networks.

Global chains have further spurred international trade, particularly trade in intermediate goods, which now accounts for about half of global trade (OECD and WTO, 2013). Their rising share has raised the sensitivity of international trade to changes in gross domestic product (GDP) over time (i.e., an increase of global trade elasticity to global real GDP) (Freund, 2009). The boom of global trade

in intermediates has also widened the spread between the pattern of international trade and the international process of value addition, because products assembled in a given country with intermediates imported from abroad embody only limited domestic value addition. The service sector now plays a fundamental role in adding value at each link along the supply chain, while foreign direct investment (FDI) helps drive international trade expansion.

Such an evolution in international trade brings about new opportunities, as well as challenges, to spur industrialization in Africa. On the positive side, the splintering of production processes allows firms to exploit more effectively various countries' comparative advantages, outsourcing and offshoring activities along the value chain,



without the need for each country to develop a whole vertically integrated sector. At a time when real wages have climbed steeply in several key manufacturing powerhouses (notably China), this could turn out to be a blessing for Africa, endowed as it is with abundant and relatively cheap labour. The average monthly wage of a low-skilled Ethiopian factory worker, for instance, is about 25 per cent that of a comparable Chinese worker. Similar cost wedges create an incentive for Chinese firms to relocate some manufacturing activities in Ethiopia, even with productivity differentials, as confirmed by the growing investments by Chinese manufacturing firms in the country (Wonacott, 2014).

Deeper integration into the global market could allow African producers to reach more efficient production scale and could translate into cheaper access to production inputs, with ensuing competitiveness gains for downstream activities. Participation in GVCs also increases firms' exposure to new technologies, tacit knowledge, and technical or managerial capabilities, fostering productivity gains, allowing firms to upgrade their activities and climb up the value chain. This process, however, is far from automatic.

On the negative side, there is a risk that the emerging global division of labour will lock in Africa's specialization in primary commodities, without its gaining much from the last decade's growth, which was characterized by a growing concentration of exports in primary products; that was spurred by FDI inflows predominantly directed towards extractive industries, which exported hard commodities but added little value (UNCTAD, 2013b). That is one of the most prevalent traits of Africa's forward integration into GVCs.

Similarly, while greater competition benefits consumers, it can hurt producers. One example is provided by the difficulties of Africa's textile and apparel industry, notably in countries such as Lesotho and Senegal, vis-à-vis its Asian competitors (Greenaway, 2009). (Here, the adverse effects on the industry-serving domestic markets was

compounded when the Multifibre Arrangement expired in 2005, increasing competition for developed country markets.) From a social-welfare perspective, greater competition can lead to more efficient allocation of resources worldwide, but in the short and medium terms, it imposes heavy adjustment costs on import-competing sectors, possibly derailing efforts to promote economic diversification.

A few successes apart, where rapid economic growth and booming trade have supported incipient industrialization, the continent has garnered few gains from a booming decade of economic growth and trade for its structural transformation. Although access to imported intermediate products, particularly for manufacturing, has grown, it has failed to reverse the continent's premature de-industrialization. Exports of resource-based intermediate goods have acquired over the last decade an even larger weight and remain the predominant form through which African countries enter global supply chains through forward linkages, as the region as a whole has moved towards an increasing concentration of its export bundle in a narrow range of mainly primary products (Ofa et al., 2012). In the last three years, for instance, African exports' concentration index has exceeded the value of 0.4, which is more than three times the corresponding index for Latin America and Asia. In the same vein, in 2010–2012, Africa's exports—mainly primary commodities—accounted for 82 per cent of Africa's total exports, up from an already high 76 per cent only 10 years before. Enhanced domestic value addition remains largely elusive, especially in value chains characterized by high standards and captive governance structures (box 4.1).

**Africa needs to focus on improving its backward integration, expanding GVC linkages to other areas of the economy.**

### **BOX 4.1: HOLDING THE CHAIN**

A crucial aspect in value chains is that developed country–led firms were outsourcing labour-intensive production stages to countries with low labour costs. These lead firms still play an important role by controlling and governing their value chains. The literature differentiates between “buyer-driven” and “producer-driven” value chains.

In industries whose production network is highly decentralized, as in labour-intensive consumer goods industries (agriculture, garments, footwear etc.), the value chain is buyer-driven. While barriers to entry are relatively low, producer’s opportunities to make profits are highly restricted through buyers in branded national markets. This means that these value chains are largely driven by the design, marketing and brand by the leading firms. Producer-driven chains are a common characteristic of capital- and technology-intensive industries such as automobiles and aircrafts, which have high barriers to entry.

Through further development of governance concepts to measure the complexity of the information between actors in the chain, Gereffi et al. (2005) identified five governance structures: markets, modular, relational, captive, and hierarchy. Most of the value chains in which African countries are participating in are characterized by a captive governance structure, where small suppliers depend on few large buyers, which allows the lead firm to control the value chain up to a high degree.

These asymmetries and the self-determination of product standards by the lead firm require closer cooperation of the government with the private sector to regulate the business behaviour in given chains. Gereffi et al. (2005) argued that improved standards, information technology and the capabilities of suppliers can shift the governance structure from captive and hierarchal towards relational, modular and market governance, which offers more opportunities for joining, and upgrading in, a value chain.

### **BOX 4.2: HOW TO MEASURE “PARTICIPATION” IN GVCs**

Participation in value chains is quantified by three major indicators: backward integration, forward integration and the total participation rate, which is the sum of the other two. Backward integration refers to the share of imported value added that is embedded in a country’s exports and entails the country’s position within the value chain. Forward integration describes the exported domestic value added that is further exported by third countries. In other words, a country that has a high forward integration rate exports a high amount of value added, which is often the case for exports of raw materials. This relationship indicates that a high share of forward integration in total exports is due to the inability to process goods within the country and therefore, often negatively associated with a country’s development.

Using the UNCTAD EORA Database, GVC participation rates are calculated from the Value Added in Exports Matrix, which is obtained by the product of the diagonal matrix of direct value added by sector and country, the Leontief inverse and the diagonal matrix of total exports by country and sector. The backward integration perspective refers to the share of foreign value added in a country’s exports. The rate is calculated from the non-diagonal column sum divided by total exports in value added. The forward integration perspective is the exported domestic value added that is further exported by third countries, and the rate is obtained by the non-diagonal row sum. The diagonal of this matrix is the domestic value added that is embedded in total value-added exports (UNCTAD, 2013c).

# STRENGTHENING PARTICIPATION IN VALUE CHAINS

Developing countries integrate into global trade mainly through GVCs, but joining them requires heavy human, financial and policy investments. And most developing countries with high participation (box 4.2) are at the lowest rung of GVCs, mainly due to technical constraints and control of the production chain by the lead firm.

## AFRICAN COUNTRIES SHOW HIGH PARTICIPATION IN GVCs, THOUGH AT LOW RUNGS

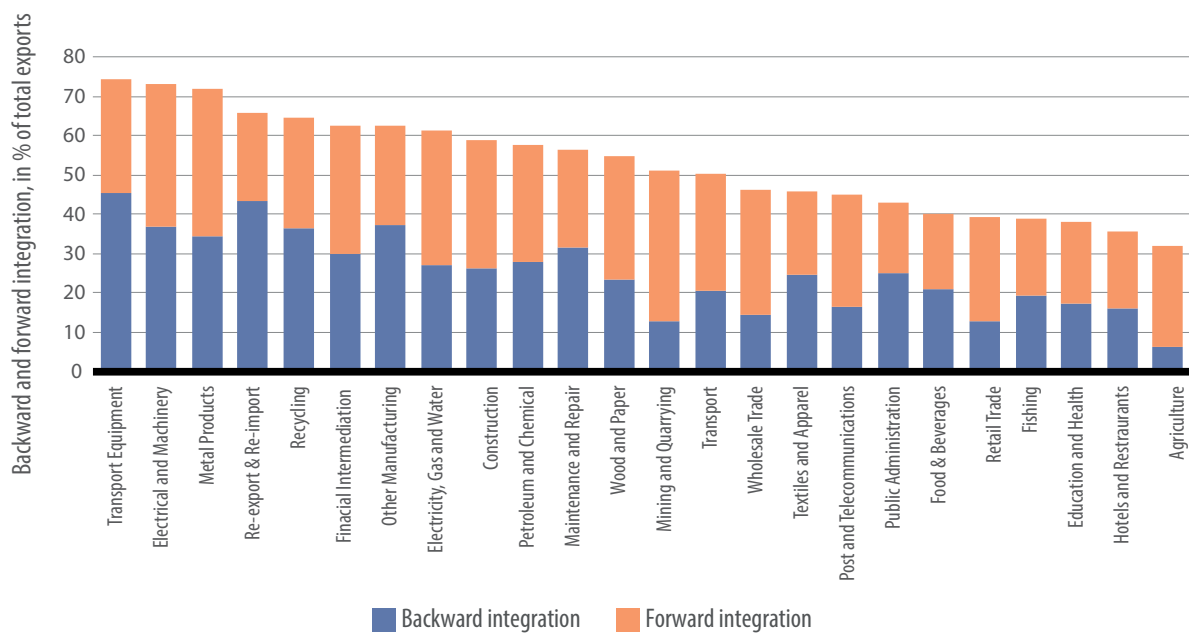
Africa is still an insignificant player in global trade in value added: in 2011, it was only 2.2 per cent, although this was up from 1.4 per cent in 1995.

Despite Europe's and North America's decreasing shares in total value added, these two regions and East Asia accounted for 79 per cent of global trade in value added.

Yet, Africa is a little more integrated than this number suggests, as it participates in GVCs mainly at their lower stages (and its share of services may be higher than current data suggest, too—box 4.7 below). The bulk of participation still comes from a high degree of forward integration driven by exports of raw materials.

On a sectoral level, the manufacturing of transport equipment shows the highest level of integration with GVCs (figure 4.1). This is driven by large

**FIGURE 4.1: GVC PARTICIPATION BY SECTOR, BACKWARD AND FORWARD INTEGRATION, 2011**



Source: Calculations based on UNCTAD EORA Database.

international car companies in Morocco and South Africa (AfDB, OECD and UNDP, 2014). Toyota is South Africa’s largest vehicle producer (UNCTAD, 2010).

Still, the Economic Report on Africa 2013 argued that the continent is not using its full potential for joining GVCs. For instance, Cameroon, Cote d’Ivoire, Ghana and Nigeria are leading exporters of cocoa beans but add very little value. Malaysia, Brazil and Mexico have achieved backward and forward integration in this sector, as a result of industrial policies and domestic capabilities. For instance, Brazil supported the soybeans as well as cocoa production by input subsidies, a generous credit policy and modernization of farming practices. In addition, it set export taxes and quotas to encourage exports in value added (ECA and AUC, 2013). An expansion in these labour-intensive industries also has generated new jobs that brought a social upgrade for poorer households rather than just an economic upgrade (Barrientos et al., 2011).

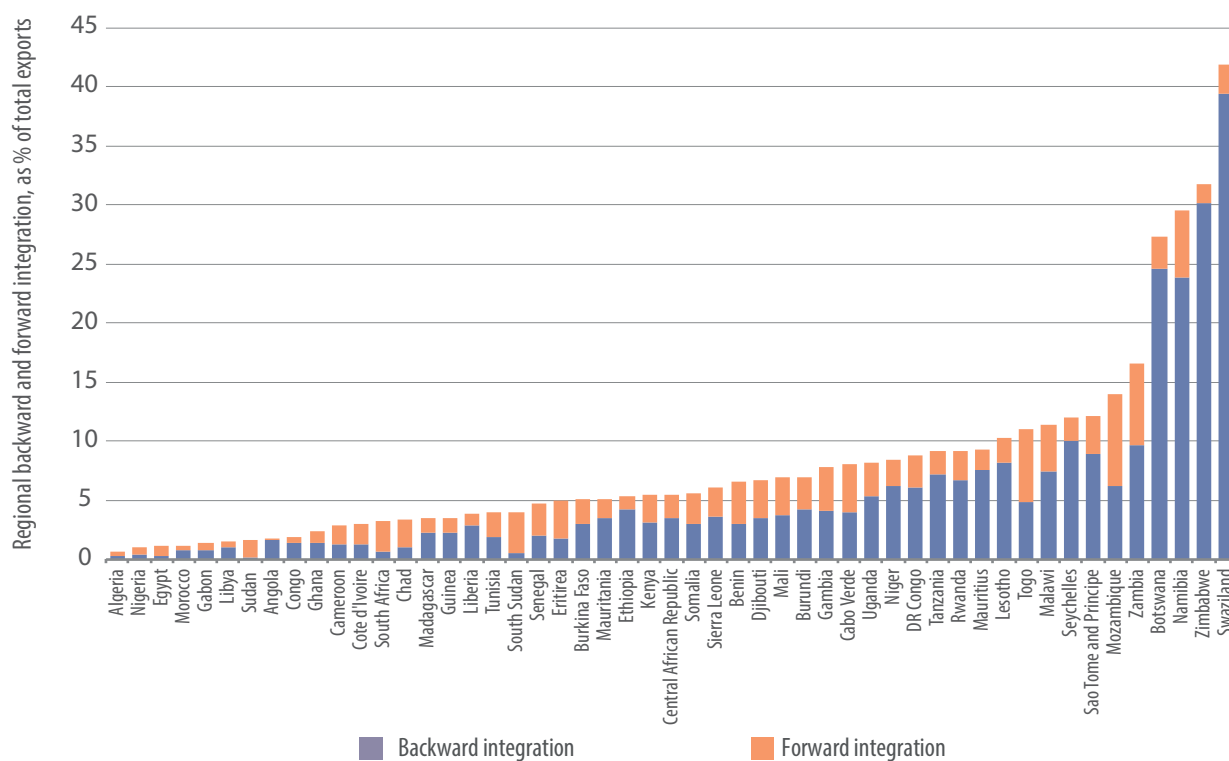
One way to move up from the bottom rungs is to become better embedded in RVCs, which offer a platform for learning and making economies of scale.

### REGIONAL CHAINS ARE A MUCH-NEEDED STEP TOWARDS GLOBAL CHAINS

Continent-wide RVCs are easier to organize and offer a better platform for economies of scale than global chains. Their administrative burden for rules of origin and traceability of products is also reduced, making them more attractive to the leading firms in value chains (Cattaneo, 2013).

In Africa, however, foreign value added that comes from within Africa as a share of total foreign value added is only 9.4 per cent, which is very low among other regions around the world. Intra-regional

**FIGURE 4.2: COUNTRY PARTICIPATION IN RVCS, BACKWARD AND FORWARD INTEGRATION, 2011**



Source: Calculations based on UNCTAD EORA Database.

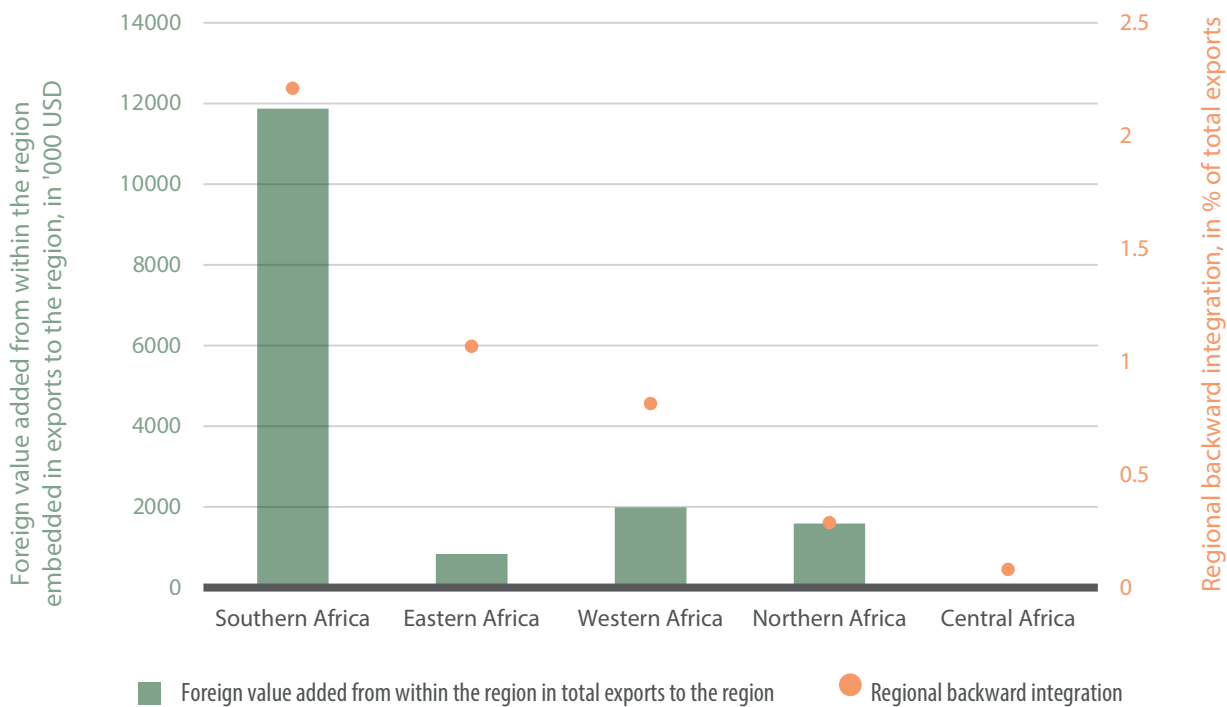
foreign value added in Asia, for example, is 39 per cent. Furthermore, the share of imported value added from Africa in exports to Africa (regional backward integration) is only 1.8 per cent, against 18 per cent in Europe and 7 per cent in Asia. Backward integration is generally higher than forward integration in Africa (figure 4.2); total participation in RVCs is low and highly variable.

While Algeria, Angola, Egypt, Nigeria, and South Africa are the drivers of regional trade in value added in absolute terms, these countries import, proportionally, very little value added from other African countries. In Egypt, for example, only 0.8 per cent of its value-added exports to Africa are imported from Africa, also shown in a low share of African total trade of intermediates sourced and sold within Africa compared with other African countries. Its forward integration is even lower at 0.3 per cent, which means that all the value added is

processed within Egypt and then exported as final goods to the region.

Conversely, Swaziland, Zimbabwe, Namibia, Botswana and Zambia contribute little trade in value added in absolute terms, but the share of backward integration in their total exports to the region is high (see figure 4.2). So while producers in, say, Botswana find it hard to compete with the more developed production base of SADC neighbours, their large markets provide export opportunities, which will only be grabbed when productive capacity, particularly human, is upgraded, taking the country further up the value chain. Relying on regional integration given its small domestic market, Botswana is a prime example of a country whose growth and industrialization need to be export driven via a regional strategy, letting it find its niche among regional producers.

**FIGURE 4.3: PARTICIPATION IN RVCs, BACKWARD INTEGRATION, 2011**

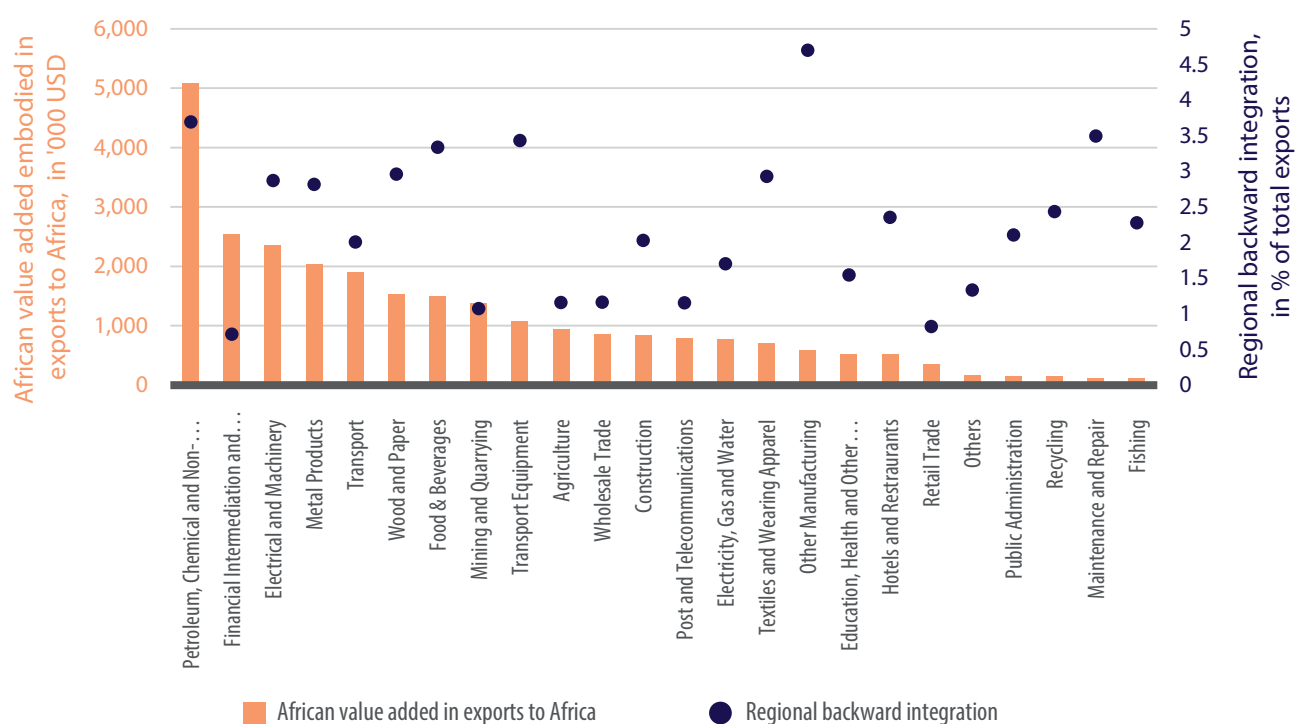


Within Africa, Southern Africa—followed by East Africa—is the most backward-integrated (figure 4.3), although their regional production networks are still poor, as indicated by their low shares of imported value added from the region in total exports to the region. Negotiations for the Tripartite Free Trade Area (Tripartite FTA) have to not only harmonize trade policies among member states but also establish industrial linkages.

In terms of sectors, manufacturing—especially that of transport equipment—is a key driver of intra-African backward integration (figure 4.4). Petroleum, chemical and non-metallic mineral products make up the bulk of regional trade in value added, with one of the highest shares of imported value added from African countries in total exports across sectors. This is a strong justification for developing a subregional petrochemical cluster, as in the Intergovernmental Authority on Development (IGAD) region.

Trade in value added in food and beverages and in textiles and wearing apparel also shows relatively high backward integration, although the absolute amounts are low. Agriculture is also untapped for value-added trade, but its RVC offers a much higher potential for inclusive growth than the countries' participation in GVCs. And, despite its large share of imported intermediates sourced from Africa, mining and quarrying's share of foreign value added from Africa is still very low; but regional mining has seen some movement in the Africa Mining Vision on harmonizing policies, laws and regulations nationally and in the regional economic communities (RECs) of SADC, ECOWAS, West African Economic and Monetary Union (Union Economique et Monétaire Ouest Africaine) (WAEMU/UEMOA) and EAC (Ramdoe, 2014), as has the leather sector in the Common Market for Eastern and Southern Africa (COMESA) (box 4.3).

**FIGURE 4.4: CONTINENTAL VALUE CHAINS BY SECTOR IN 2011**



Source: Calculations based on UNCTAD EORA Database.

**BOX 4.3: TAKING STOCK OF COMESA'S LEATHER VALUE CHAIN**

During the 17th Summit of the COMESA Council of Ministers in February 2014 in Kinshasa, the Democratic Republic of Congo, ministers underscored the importance of commodity-based industrialization and applauded the development of industrial clusters and value addition for products from the region. (COMESA has 19 African member countries with a population of about 450 million and a GDP of over \$500 billion). In partnership with the International Trade Centre, COMESA developed a leather strategy to increase value-added products rather than exporting raw materials.

Approved in June 2014 in Lilongwe, Malawi, the strategy fits within the COMESA Medium Term Strategic Plan and the Comprehensive African Agricultural Development Program (CAADP). It covers from pre- to post-slaughter production of high-quality hides and skins as well as finished products like foot wear, bags and leather garments, among others. The leather strategy serves to address key issues in quality of leather products such as streamlining marketing systems, access to affordable finance for all value chain actors, strengthening support institutions and creating a viable policy environment for the leather sector within the region.

The value chain runs from collection of hides and skins, to transformation into leather, to tanning and then to manufacture of leather products. The skins or hides and finished leather products are marketed and sold by either retailing SMEs or factories.

Bodies like the COMESA Leather and Leather Products Institute (LLPI) in Ethiopia, export promotion bureaus, and regulatory bodies such as national bureaus of standards and animal health services have offered capacity building, trade promotion and quality assurance in the leather sector. Customs authorities enforce trade policies to regulate cross-border trade of skins or hides and leather products. Banks (offering affordable credit to value chain actors) and transport companies (which manage logistics such as transport and storage) play their part too. The LLPI mobilizes stakeholders using the “triple helix” approach—the public and private sectors as well as academia and research bodies—for interventions along the links of the value chain.

COMESA's leather exports to the world increased by 50 per cent from \$282 million in 2008 to \$587 million in 2013, with the value-added leather rising from \$29.9 million in 2009 to \$49.7 million in 2013, pointing to COMESA's input.

Source: COMESA Secretariat: information provided by Rachael Nsubuga and Benedict Musengele (2014).

The chance to join a value chain and benefit from it depends heavily on the chain's structure, on a firm's access to imports and services, and on its production capabilities. Agricultural value chains put into sharp relief the fact that local and regional chains provide (some) economies of scale and are far less knowledge-intensive than global chains.

## **THE DEVELOPMENT AND PROMOTION OF LOCAL AND REGIONAL AGRO-FOOD CHAINS ARE VERY PROMISING AND LUCRATIVE AGRO-BUSINESS VENTURES**

The agro-food sector is highly concentrated worldwide and remotely controlled (Food and WaterWatch, 2010) through continued cross-consolidation by large foreign-owned global food

giants such as Nestle, Coca-Cola, Cargill, Unilever, Archer-Daniels Midland Company, Dole Food Company and Danone, to name a few (table 4.1). In this sector, the most profitable value chain segments are not open for penetration for every newcomer. The emerging African agro-food marketplace is no exception. As can be noted from Forbes' list of the world's biggest public companies (Forbes, 2014), global value chains are dominated by foreign-owned companies with unparalleled strength in terms of accumulated assets and value generation. A closer review of the wealthiest global companies reveals only one food company that globally ranks 11th, 45th, 63rd and 196th in terms of market value, profit, sales and assets: Nestle. A further look at the list of the top 100 food and beverage companies confirms the rise of several food companies, such as Nestle, Cargill, Cola and even cooperatives-based operators such as Fonterra in the world agro-food

processing industry. This underscores the strategic role of agriculture, value chains and agro-industrial development, out of which massive wealth and jobs can be created through specialization, diversification and smart investments in strategic commodity value chains and emerging markets. In African context, these large and diversified global companies have been very successful in taking advantage of lax domestic legislation to increase their grips over several identified lucrative regional value chains segments across Africa. Good cases

in point are the continued penetration through strategic alliance arrangements, increasing cross-control of shareholdings or agriculture-related operations of several once locally state-owned, Africa-based or -grown food companies such as SIFCA (<http://www.groupe-sifca.com>) and OLAM (<http://www.olamgroup.com>) by food giants such as CARGIL, Barry Callebaut, Wilmar International, Danone and Unilever, to name a few.

Despite progress made in recent years in trade

**TABLE 4.1: LIST OF THE TOP 20 GLOBAL FOOD AND BEVERAGE COMPANIES IN THE WORLD, VALUE IN BILLIONS (B)**

Rank food processing industries	Rank all industries	Company	Country	Sales	Profits	Assets	Market Value
1	36	Nestle	Switzerland	\$99.40	\$10.80	\$135.40	\$239.60
2	110	Unilever	Netherlands	\$66.10	\$6.40	\$62.70	\$124.50
3	148	Mondelēz International	United States	\$35.30	\$3.90	\$72.60	\$59.20
4	242	Danone	France	\$28.30	\$1.90	\$42.60	\$41.80
5	243	Archer Daniels Midland	United States	\$89.70	\$1.30	\$43.80	\$28.50
6	316	Wilmar International	Singapore	\$44.10	\$1.30	\$46.60	\$17.70
7	347	Kraft Foods Group	United States	\$18.30	\$2.70	\$23.10	\$33.50
8	379	General Mills	United States	\$18	\$1.80	\$22.90	\$31.80
9	465	Associated British Foods	United Kingdom	\$20.80	\$0.90	\$16.80	\$36.70
10	508	Kellogg	United States	\$14.80	\$1.80	\$15.50	\$22.50
11	593	ConAgraFoods	United States	\$17.90	\$0.80	\$20.40	\$13
12	611	TysonFoods	United States	\$34.80	\$0.90	\$11.80	\$14.80
13	637	JBS	Brazil	\$43	\$0.40	\$29.10	\$9.60
14	751	BRF-BrasilFoods	Brazil	\$14.10	\$0.50	\$13.70	\$17.50
15	759	Bunge	United States	\$61.40	\$0.20	\$26.80	\$11.70
16	902	Hershey	United States	\$7.10	\$0.80	\$5.40	\$23.30
17	956	Uni-President	Taiwan	\$14.50	\$0.50	\$12.40	\$8.80
18	1027	GrupoBimbo	Mexico	\$13.80	\$0.30	\$10.30	\$12.80
19	1039	Tingyi Holding	China	\$10.90	\$0.40	\$8.40	\$16.20
20	1054	Henan Shuanghui Investment	China	\$7.30	\$0.60	\$3.30	\$14

Source: Forbes, 2014; Rowan, 2013.



liberalization fronts including tariff levels in intra-African agricultural trade, high-entry barriers still impede small farmers from participating in regional food trade. This is due to observed trends in consolidation of most profitable agro-food segments or firms fuelled by rising agro-business growth opportunities, mostly captured, as can be seen, by transnational firms (table 4.1) operating in several lucrative regional food, fibre and beverage value chains within and outside Africa (AUC, 2014). Access to regional markets and most importantly access to critical agro-inputs and services such as technology, logistics and capital are lacking and unevenly skewed at the expense of small farmers, so as to suggest a need for an affirmative agenda to effectively level the African agro-business playing field. Beyond the companies controlling the products market as listed in table 4.1, it is worth mentioning that the key inputs markets (fertilizers, seeds, tractors etc.) are also controlled by global food companies such as John Deere and Monsanto, to mention a few, making it difficult for small holders to access agro-inputs at affordable prices. A case in point is Nigeria, where, despite the fact that agriculture accounts for about 23 per cent of GDP (now estimated at \$ 510 billion, 2013), only 1.4 per cent of loans from the banking sector is allocated to the sector. GDP growth has been in the order of 7 per cent each year in the past 10 years. But the largest economy of Africa has missed much of its potential to become a natural granary of Africa because of insufficient support provided to its small producers, whose productivity is among the lowest in the world due to lack of access to modern inputs and also the lucrative value chains segments captured across the country by several established global food giants.

Indeed, African governments have failed to successfully intervene in global and regional value chains, despite having on paper all it takes to transform African countries collectively into a net world exporter in food, fibre, beverages and critical agro-inputs in the context of an increasingly food-insecure world. A good case in point is the status of the maize value chains in Benin, where an ongoing ECA study on food value chains shows that

moving up the value chain is highly profitable for small family farms but missed due to insufficient transformative interventions, including branding and local content compliance in the sector to help small farmers move up (table 4.2).

The findings also suggest that maize processing in an improved maize pounder are highly financially profitable and that Benin has a comparative advantage in processing maize in this way. These prospects are hampered by several constraints that must be addressed in order to see efficiency improve in Benin maize value chains: poor access to inputs and labour, irregularity of supply, use of nonstandard weights and measures, lack of proper storage, limited availability of market information and insufficient access to finance according to the ECA study. In the meantime, the gains in most lucrative food value chains segments are captured and controlled by the established global food giants due to many of the bottlenecks that small producers faced, making it difficult for them to enter these chains without a clear affirmative transformative agenda for the poor.

A review of the evidence from the field also suggests that the profitability of maize production highly differs across regions and production systems. As in Benin, small scale producers across Africa should pay attention to industrial rural clustering and specialization as they consolidate their input and output operations across markets while moving up along food value chains segment in order to successfully penetrate and capture a fair share of the wealth created in local and regional value chains. To make this happen and to better assist small-scale value chains operators, African governments should scale up public spending on agriculture infrastructure and technologies and intensify efforts to encourage local and regional value chains' development and agro-industries' clustering. Finally, governments should intervene to encourage re-skilling and re-tooling of the most vulnerable value chains actors while strongly engaging the global as well as local private sector transformational agents. This will effectively contribute to the re-branding of products of African

**TABLE 4.2: PRODUCTION COST AND PROFITABILITY ALONG THE MAIZE VALUE CHAIN SEGMENTS IN BENIN IN 2013–2104**

Variables	Farm-Gate Product (\$/ha)	Collector/Assembler (\$/Kg)	Wholesaler (\$/Kg)	Retailer (\$/Kg)	Processed Raw Material (Gari) (\$/Kg)
Yield (tons/ha)	1350.18	—	—	—	—
Unit price (\$/Kg)	0.326	0.279	0.342	0.316	0.413
Gross Revenue	441.418	0.279	0.342	0.316	0.413
Production Cost					
Crop Purchase		0.249	0.275	0.278	0.27
Other Variable Costs	179.875	0.027	0.025	0.019	0.115
Investment Costs (equipment amortization)	48.636	0.002	0.003	0.003	0.008
Total Costs	228.512	0.279	0.303	0.301	0.394
Gross Margin	261.543	0.002	0.042	0.018	0.028
Net Profit	212.906	-0.0003	0.038	0.014	0.019
Rate of return					
Gross margin/Total Variable Costs	1.454	0.007	0.140	0.061	0.072
Net Profit/Total Costs	0.932	-0.001	0.128	0.047	0.049

Source: ECA's upcoming baseline studies on regional value chains integration 2013–2104.

Note: \$1 = 517.17 Fcfa.

Gari: is a granular flour made from fermented, gelatinized fresh cassava tubers.

origin in global food markets, to help Africa capture a greater share of the value generated out of its products and the hard toil of its small producers. With the rise of several locally home-grown African brands across Africa (Meyer, 2011), there is urgent need to see African governments intervene to prevent emerging success stories of the indigenous food sector be “financially cannibalized and owned” across Africa by the most financially endowed firms in the food and retail industry.

The most recent case in point is the world's biggest yoghurt business—Danone—which with 40 per cent stake of Brookside Dairy Limited, East Africa's largest milk company, is set to expand its reach in Africa. This acquisition gives Danone access to over 140,000 milk farms across the East African region, where it will collect and processes 750,000 litres of milk per day. It is perhaps worth mentioning

that Brookside enjoys the position as a market leader with an annual revenue of \$176 million in 2013. Beyond the acquisition of Kenya's Brookside Dairy, in early November 2014, Danone has also set plans to raise its stake in Moroccan dairy company Centrale Laitiere by 20 percentage points to more than 90 per cent at cost of 278 million euros (\$339 million). CentraleLaitiere holds a 60 per cent share of the Moroccan market, boasting a network of 38 distribution centres and some 75,000 sales locations, and around 500 million euros in annual sales. In 2013, Danone bought a 49 per cent interest in frozen dairy products company Fan Milk in West Africa. This company had a broad customer base in six West African countries, including Nigeria and Ghana, while Brookside is strong in such eastern nations as Kenya, Uganda and Tanzania. By enhancing efforts with three companies in the northern, western and eastern regions of Africa,

Danone—like many established value chains operators including traditional as well as newly arriving food giants operating across Africa—hopes to increase its presence and profit-making grip on the continent. With the ongoing observed growth strategies adopted by almost all the most admired and wealthiest firms in the food industry and beyond, transnational foreign-owned firms in the longer run are not far from taking full control of almost all profit-making opportunities at the expense of the dominant and weak African smallholder agriculture, totally crowding out along the way the emergence of indigenous-owned food giants or branded agro-businesses.

In sum, Africa's small-scale farmers are not yet well integrated horizontally and vertically along the global strategic commodities and food value chains, indicating the need for a clear regulatory policy framework that is conducive for the emergence of locally owned and branded food industries and products operating hand in hand in a mutually reinforcing manner with foreign-owned global food giants. For this to happen, African governments and agro-business captains must intervene now through public-private partnerships, investing together in a smart manner to establish rural industrial clusters under a sustained commodity-based industrialization strategy to bring about small farmers' shareholdings across Africa. The rural community and farmer-owned industrial cluster model is an imperative and a welcome move to make local and regional value chains development a mutually rewarding endeavour for all participants, including the weakest. There is still room for great optimism considering the success story of the young Senegal-based food company—Patisen (<http://www.patisen.com>)—which with its brand ADJA defeated the 150-year-old world food leader, Nestle, in the MAGGI Cube domestic market value chain segment (<http://www.jeuneafrique.com/Article/ARTJAJA2613p094.xml0/>) despite the limited resources it has at hand, compared to known muscles of the the global food industry leader.

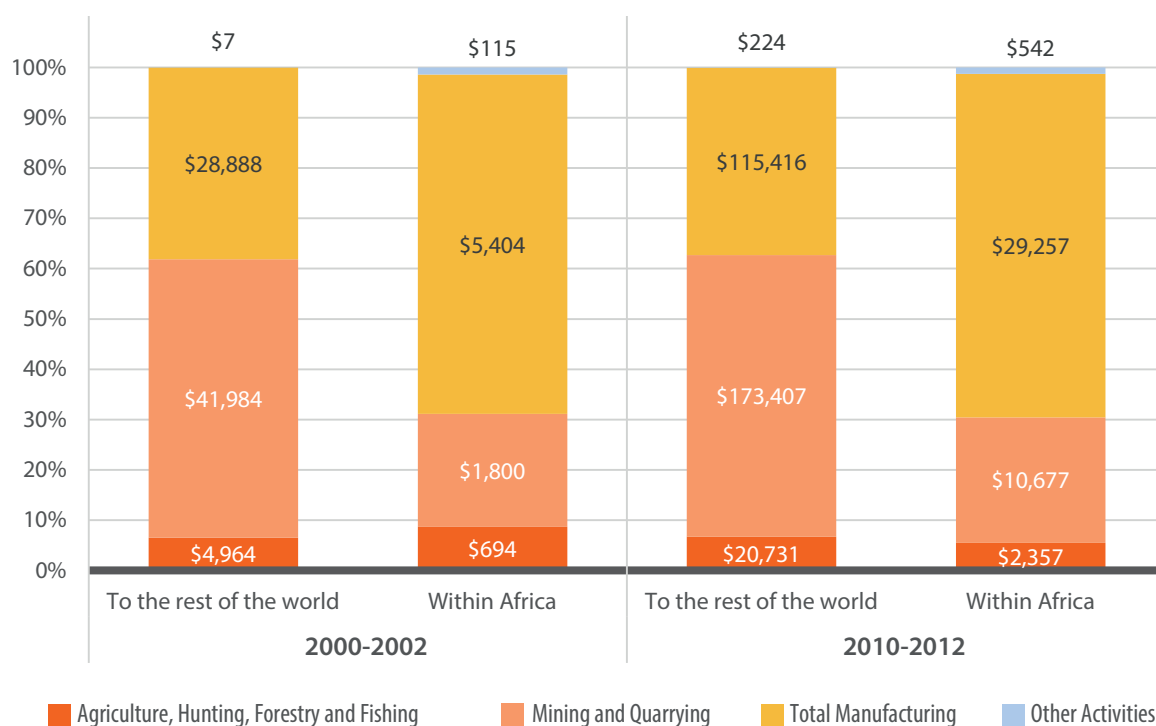
The cotton value chain is less dominated by a few leading firms. Therefore, the poor performance of African countries in exports in cotton fabrics is due to a low rate of technological innovation and poor access to inputs, including financial services, as well as a negative image of African cotton on the global market (ITC, 2013a). Successful upgrading had been realized in Zimbabwe by market liberalization in combination with a management system of quality improvements and control. In contrast, liberalization in Tanzania in the 1990s resulted in a large number of domestic market entrants, fostering price competition and downgrading processes due to lack of organization in the sector (Ponte, 2009).

Trade in value added in services is still largely untapped, and services are being incorporated into RECs' trade agreements (and see later this chapter). Low backward integration in financial intermediation, for example, is a major constraint, and linkages need to be tightened. The SADC—whose share of services in regional value-added trade within Southern and East Africa is around 8 per cent and 6 per cent, or much higher than in other African regions—is drafting a Protocol on Trade in Services, covering, among others, finance, tourism and construction. (Policy suggestions for RVCs in services are discussed below.)

### **INTRA-AFRICAN TRADE IN INTERMEDIATES OFFERS BROADER SCOPE FOR REGIONAL CHAINS TO EMERGE**

Poorly diversified and similar production structures across Africa constrain viable production networks. The limited size of the continental market—intra-African exports of intermediates averaged \$43 billion in 2010–2012, a small share of the \$313 billion to the rest of the world—represents additional constraints, especially in light of the fragmented nature of such a market.

However, over the last decade, intra-African intermediate exports have displayed a stronger dynamism than its intermediate exports to the rest

**FIGURE 4.5: AFRICA'S EXPORTS OF INTERMEDIATES BY MAIN SECTOR AND DESTINATION**


Source: Calculations based on OECD Bilateral Trade Database by Industry and End-Use Category (ISIC Rev. 3).

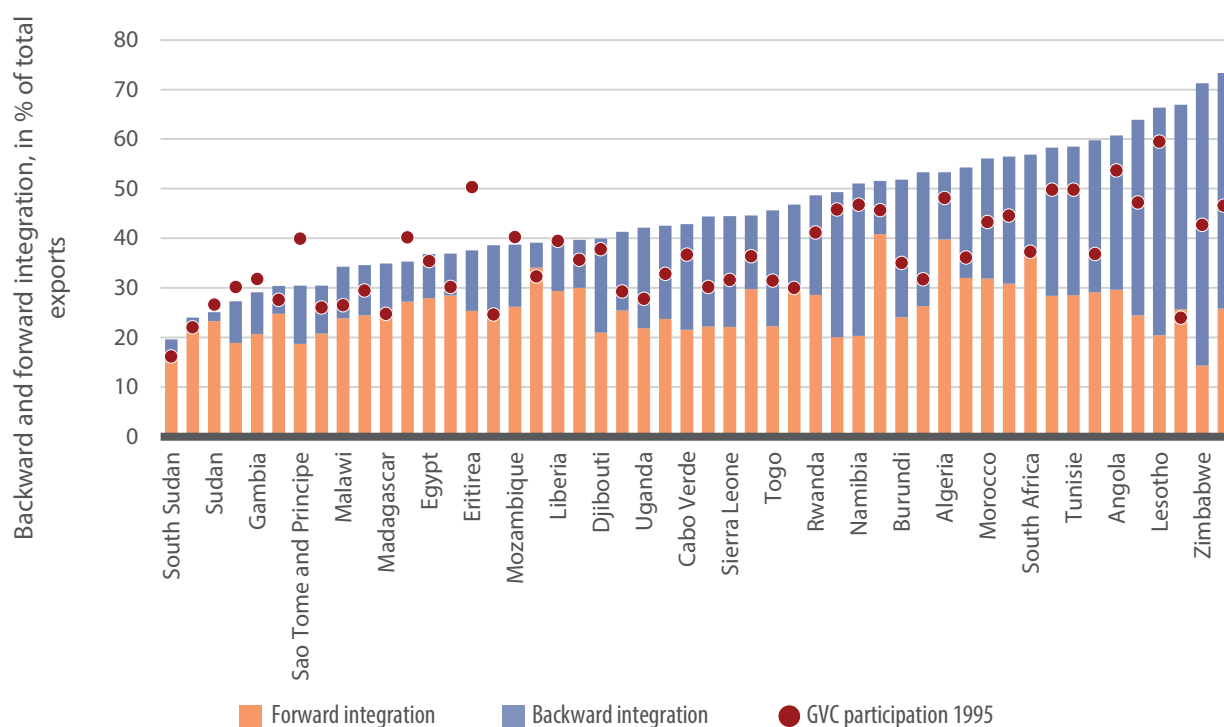
of the world, partly because intra-African trade—more diversified—offers broader scope for trading manufacturing intermediates: in 2010–2012, Africa absorbed 20 per cent of its intermediate exports in manufacturing, against 10 per cent in agriculture and only 6 per cent in mining and quarrying.

A complementary way to appreciate the radically different patterns of intermediates' ties to value chains at regional and global levels comes from figure 4.5, which juxtaposes the composition (and corresponding values) of intra-African exports of intermediates with those to the rest of the world. Half of Africa's intermediate exports to the rest of the world were accounted for by mining and quarrying, and manufacturing intermediates represented more than two thirds of intra-African exports, with a slight increase in the corresponding relative weight. Conversely, intra-African trade of agricultural intermediates has witnessed the slowest expansion across all the main sectors, with a sharp decline in its relative weight.

The intra-African market displays a few signs of dynamism and of incipient emergence of RVCs through trade in manufacturing intermediates. Countries such as Egypt, Ghana, Kenya, Nigeria, South Africa, Tanzania and Zambia have recorded gains in their exports of manufacturing inputs within Africa, building to some extent forward linkages with manufacturing firms within the continent. If regional integration records decisive progress, intra-African trade could be a springboard to wider economic diversification and industrialization.

### COUNTRIES HAVE SHOWN THEIR DETERMINATION TO JOIN VALUE CHAINS

The best performing countries in terms of GVCs' participation in 2011 and its growth rate since 1995 are Zimbabwe (71 per cent of total exports, 2011) and Tanzania (67 per cent) (figure 4.6). As seen, Zimbabwe is highly integrated into its RVCs

**FIGURE 4.6: GVC PARTICIPATION BY COUNTRY, BACKWARD AND FORWARD INTEGRATION, 1995 AND 2011**

Source: ECA's calculations based on UNCTAD EORA Database.

due to infant-industry protection from outside the region and regional integration efforts. Similar to Zimbabwe, Swaziland is highly integrated into GVCs. Especially for small landlocked countries, greater regional market access allows larger participation in value chains and offers opportunities to increase their production capacity. While most countries experienced a moderate, mostly positive change in GVCs' participation, Tanzania's integration has risen dramatically from 24 per cent of total exports in 1995, which was one of the lowest at this time. However, Tanzania managed to upgrade on a broad sectoral level and achieved the largest increase in backward integration.

While Tanzania experienced decreasing manufacturing value added during the SAP era, the Sustainable Industrial Development Policy, implemented in 1997, boosted growth in manufacturing value added. However, the share of trade in services has stayed quite low, with travel being the biggest service sub-sector. The

challenge for Tanzania is to develop key services for industrialization and structural transformation such as communication and financial services. In terms of trade policy, the country is a member of the well-integrated COMESA and EAC. Tanzania has made significant progress in improving its competitiveness and its business environment. Two major previous concerns, the inefficiency of the Dar es Salaam Port and excessive roadblocks, have been addressed (Tanzania country case study). Furthermore, the Department of Research and Development under the Ministry of Trade and Industry, through technical support and capacity building, helps industries to reduce production costs and meet international product standards. The emphasis on value addition of exports inevitably entails that Tanzania's trade policy advocates for promotion of industrial policies, with regional integration at the heart of both policies.

Although roughly 90 per cent of the African countries increased backward integration to GVCs between 1995 and 2011, there still remain many constraints in moving up the value chain. Take, for example, Mozambique, whose mining sector is highly integrated through the Mozal mega-project but poorly linked to other areas of the economy. Only 13 firms accounted for three quarters of the country's exports in 2013. In the four main exporting industries—aluminium, electricity, ores and gas—a single firm in each produced over half that sector's total exports (Sutton, 2014). Local SMEs often struggle to meet the quality standards to supply the mining sector with the required quality of inputs. Although the national quality control body (INOC) sets quality standards, these are not binding on most industries.

Manufacturing of transport equipment plays an important role in Morocco, whose government has recently been playing a more proactive role in accelerating growth in promising sectors. Among others, the “National Pact for Industrial Emergence” targeted the automotive and the aeronautic industry, aiming at creating a stable industrial base and moving up in the value chains. Morocco has attracted the Canadian aeronautics and train-building company Bombardier and the French car constructor Renault, increasing the country's participation in backward integration. However, the reliance on one key player in each sector is a concern. The network of SMEs is very poor, and this reduces the spillovers of increasing participation in GVCs to other areas of the economy and reduces opportunities for inclusive growth.

Southern Africa, as seen (figure 4.3), is the region most integrated into GVCs. North Africa and West Africa participate little in GVCs, and showed the lowest increase in backward integration between 1995 and 2011. This backs up the argument that trade-integrated regions are more attractive to leading firms, and that participation in RVCs should be a priority. Moreover, most African countries are in value chains controlled by their leading firms (see box 4.1).

Apart from this governance structure, structural factors such as the size of the market, as well as geographical location, impede GVC entry, though national policies removing barriers to trade can go a long way to improve the odds of joining (or upgrading in) a GVC.

**Roughly 90 per cent of the African countries increased backward integration to GVCs between 1995 and 2011, there still remain many constraints in moving up the value chain**

# THE PERSISTENCE OF BARRIERS TO TRADE

African economies' growing participation in regional and global supply chains has not jolted them into structural transformation, as most of them are stuck in the low end of the supply chain, with exports embodying little value addition.

As seen above, the terms of integration of African producers into the regional and global market are shaped by a wide array of elements, ranging from factor endowments to skill and technology acquisition, as well as trade and industrial policy frameworks. Their overlapping effects determine the ease with which certain activities can successfully be located in a given country, and producers can join and then ascend a GVC.

Splintering production processes have actually increased the relevance of establishing a conducive policy framework, in so far as countries compete more fiercely to attract the localization of shorter production phases. Thus harnessing trade for industrialization requires a careful assessment of impediments weighing on African producers' competitiveness, particularly for manufactured goods, which require longer value chains.

At a conceptual level, it is helpful to group barriers to trade into two broad categories: structural supply-side constraints, stemming from long-standing features of the economy, and trade policy constraints, which are more directly linked to the prevailing trade policy framework.<sup>1</sup>

## KEY SUPPLY-SIDE CONSTRAINTS

### SIMILAR STRUCTURES OF PRODUCTION ACROSS AFRICAN ECONOMIES

This fetters intra-regional trade, especially because low levels of industrialization typically constrain the scope for intra-industry trade. This is shown by the merchandise trade complementarity index (table 4.3) which assesses how the structure of a country's exports matches that of its imports from a potential partner.<sup>2</sup> After Oceania, Africa is one of the regions with the lowest index, reflecting a poor match between the relative composition of exports and imports at 3-digit SITC, Rev. 3 level (Annex 4.1).

**TABLE 4.3: MATRIX OF TRADE COMPLEMENTARITY INDICES BY REGION, 2012**

Importer-exporter	Developing Africa	Developing America	Developing Asia	Developing Oceania	Transition economies	Developed economies
Developing Africa	0.35	0.31	0.46	0.27	0.34	0.44
Developing America	0.58	0.58	0.63	0.47	0.59	0.67
Developing Asia	0.58	0.65	0.77	0.47	0.58	0.73
Developing Oceania	0.24	0.19	0.31	0.20	0.20	0.30
Transition economies	0.44	0.39	0.46	0.39	0.35	0.45
Developed economies	0.72	0.78	0.69	0.58	0.77	0.81

Source: UNCTADstat, accessed 20 December 2014.

Note: Because the index is calculated at regional level for all pairs of importer-exporter, the values in red on the diagonal should be interpreted as complementarities of intra-regional trade patterns.

Red tape and cumbersome regulatory frameworks stifle the emergence—and often the formalization—of firms, contributing to the so-called “missing middle”, or the few medium-sized enterprises in the typical African productive structure. Although countries like Burkina Faso, Mali and Rwanda have adopted reforms to improve the business environment and trim administrative requirements, more needs to be done.

### POOR INFRASTRUCTURE AND LOGISTICS

This deficiency weighs heavily on transport costs and therefore on a country’s competitiveness. Moreover, by affecting the pass-through of world market prices, it dampens the supply response, notably for rural small-holder farmers whose link to the market is often via intermediaries. The infrastructure deficit may be lowering the continent’s per capita economic growth by 2 percentage points a year, taking down firms’ productivity by as much as 40 per cent (Foster and Briceño-Garmendia, 2010; Ramachandran, Gelb and Shah, 2009).

The observation is that gains in this area can yield high returns (for example, Hoekman et al., 2011; Portugal-Peretz et al., 2012). Improving road quality in the ECOWAS region to the level of South Africa would boost intra-ECOWAS trade by more than 5 per cent (from 2012’s level) (Akpan, 2014).

Market failures in basic infrastructure, ranging from large fixed costs to spillover effects, are well known. Alongside the high potential returns from investments in these “social overheads”, they make a strong case for using public investment to crowd in private resources. While expansionary fiscal policies should not undermine macroeconomic management, they appear to be particularly promising for some development corridors, as in the Maputo development corridor and the Central Corridor (Bowland and Otto, 2012; Lisinge and Soteri, 2014).

### PAUCITY OF SKILLS AND HIGH-QUALITY INPUTS

Their presence is a key determinant of investment by transnational corporations (UNCTAD, 2013b). In a survey of 140 African firms, the lack of adequately skilled labour was cited as one of the most binding constraints to African producers joining GVCs (ECA, 2013).<sup>3</sup> These findings were corroborated by sectoral case studies on the cocoa value chain in West Africa (where local know-how was a barrier to moving up to processing and higher value-added activities), on the coffee value chain in Ethiopia and on the copper sector in Zambia (ECA and AUC, 2013). In a buyer-driven value chain such as textiles and apparel, where compliance with product specifications and lead times are critical, similar challenges are documented in Lesotho (Staritz and Morris, 2013).

The above examples point to the importance of not only strengthening the education system with particular attention to vocational training and high-level education (chapter 6), but also matching school curricula with the needs of the labour market and business community. This point is confirmed also by the success stories of the aluminium and diamond sectors in Mozambique (box 4.6) and Botswana, where skill upgrading plays a fundamental role in enabling local producers to link to global supply chains, and enhance local value addition. Connecting and climbing up GVCs also require producers, even in relatively less standard-intensive markets such as those in Africa, to pay greater attention to quality of inputs.

### RESTRICTED ACCESS TO FINANCE

To take 2013 as an example, domestic credit to the private sector by banks reached barely 29 per cent of GDP in Central, Eastern, Southern and West Africa, 35 per cent in Middle East and North Africa, but 45 per cent in Latin America and the Caribbean and 124 per cent in East Asia and the Pacific.<sup>4</sup> Such shallow financial intermediation is particularly binding on SMEs which, unlike multinationals, cannot easily tap international financial markets. Yet many banks



in the region hoard excess liquidity, as recognized at the 2013 International Finance Forum.

Given the region's low investment ratio (22 per cent of GDP), enhancing access to finance is crucial for mobilizing domestic resources and supporting productive capacities. Finance is an area in which Africa could leap-frog outdated technologies and exploit the potential of the fast-rising penetration of ICT as epitomized by the success of M-pesa in Kenya. That example also points to the fundamental importance of creating an adequate institutional and regulatory framework to attract private actors (M-pesa is commonly cited as having best practices), while also ensuring prudential supervision across the financial sector.

## TRADE POLICY CONSTRAINTS

### LITTLE EVIDENCE OF CONSISTENCY BETWEEN TRADE AND INDUSTRIAL POLICIES

High levels of protection, originally justified with the "infant industry" argument (chapter 3), have often become entrenched, offering few productivity gains but with rent seeking replacing the hunt for dynamic comparative advantage. Nigeria, for example, has adopted a swathe of incentives to industrialize, yet its system lacks focus and is poorly administered, ushering in opaque discretionary and arbitrary practices (Nigeria country case study). The success of industrial policies in East Asia has often been ascribed to the fact that protective industrial policies designed to kick start structural change were sooner or later followed by more subtle export-oriented policies aimed at sustaining productivity growth, competitiveness and innovation (chapter 3). African policy space, though not as broad, still offers flexibility, and African countries need to preserve and make full use of it through special and differential treatment provisions, including those on local content, export taxes, government procurement and intellectual property rights.

### HIGH LEVELS OF PROTECTION ON IMPORTED INPUTS

These often reflect successive rounds of reforms, stifling downstream activities and hampering domestic value addition. In LDCs, the trade-weighted applied tariff on industrial products was 18 per cent for intermediates and 12 per cent for finished products (Ofa et al., 2012). More broadly, tariff peaks and tariff escalation are present in North-South and South-South trade, hindering transformation and domestic value addition, especially in agricultural (ITC, 2010). The distortions from tariff peaks and tariff escalation appear a particular hindrance to the emergence of international supply chains. This burden calls for wide-ranging tariff reforms that ensure strategic consistency between the trade and industrial policy frameworks, pursuing trade liberalization not as an objective per se, but rather as a means to promote and strengthen a country's competitiveness, in light of its comparative advantages.

### HIGHER INTRA- THAN EXTRA-AFRICAN TARIFFS—ESPECIALLY TO COUNTRIES IN ANOTHER REC—THAN TO THE REST OF THE WORLD

While this skewed profile may be partly the result of preferential schemes for LDCs, such as AGOA and EBA (Ofa et al., 2012; ECA, 2013), it contributes to the shallowness of regional supply chains, particularly in manufactures where the continental market is particularly fragmented. This pattern questions the very sequencing of Africa's trade liberalization. Since the regional market tends to be more diversified and less standards intensive, it would be better to first facilitate intra-African trade to reach a more efficient scale of production, using the continental market as a springboard to compete globally. Yet progress of different RECs has been uneven in reducing tariffs among their members, and protection among the RECs remains heavy, as seen. This makes the case clearer for fast-tracking the Continental Free Trade Area (chapter 5).

## NON-TARIFF BARRIERS (NTBS)

These come in a wide array of regulatory measures other than duties (table 4.4), and may have a bigger trade-distorting effect than tariffs because of the generalized progress in tariff reduction at multi- and bilateral levels (Arvis et al., 2013). And as just seen with tariffs, even if RECs have eased (unevenly) their non-tariff trade frictions, these remain particularly high—bizarrely, often higher than for the rest of the world (Valensisi et al., 2014).

The impact of NTBs on aggregate is hard to overestimate, even though individual impacts are hard to match with specific NTBs. Data from the NTB observatory in the SADC suggest that the most frequent NTB complaints in the region relate to custom procedures followed by rules

of origin, transport, sanitary and phytosanitary issues (Chikura, 2013). To take an example, in 2009 a South African supermarket chain, Shoprite, paid ZAR 40 million to comply with SADC rules of origin, against tariff preferences worth little more than double that (ZAR 93 million). It spent ZAR 136,000 a week on import permits for Zambia, and different VAT and sales tax systems on intra-SACU trade cost it around 2 per cent of the sales (Charalambides, 2013).

Lack of harmonization of related provisions also cost: some RECs adopt a product-specific approach, while others apply value-added rules (ECA, AUC and AfDB, 2013). This increases the related administrative burden for all producers, especially SMEs (given their lower trade volumes)—

**TABLE 4.4: CLASSIFICATION OF NON-TARIFF BARRIERS**

<b>Technical measures</b>	A	Sanitary and Phytosanitary Measures
	B	Technical Barriers to Trade (TBT)
	C	Pre-Shipment Inspection and Other Formalities
	D	Contingent Trade-Protective Measures
	E	Non-Automatic Licensing, Quotas, Prohibitions and Quantity-Control Measures Other than for Sanitary and Phytosanitary or TBT Reasons
	F	Price-Control Measures, including Additional Taxes and Charges
<b>Non-technical measures</b>	G	Finance Measures
	H	Measures Affecting Competition
	I	Trade-Related Investment Measures
	J	Distribution Restrictions
	K	Restrictions on Post-Sales Services
	L	Subsidies (Excluding Export Subsidies Under P7)
<b>Exports</b>	M	Government Procurement Restrictions
	N	Intellectual Property
	O	Rules of Origin
	P	Export-Related Measures

Source: UNCTAD, 2013a.

another reason for fast-tracking the Continental (and Tripartite) Free Trade Area.

Beyond the regional arena, African countries would likely benefit from the adoption by their trade partners of less stringent preferential rules of origin, in line with the voluntary guidelines adopted at the Ninth WTO Ministerial Conference in Bali, Indonesia, in December 2013, as part of the LDC package.<sup>5</sup> During their bilateral negotiations, African countries should urge their trade partners to incorporate rules of origin arrangements in line with these guidelines.

Similarly, stringent standards and sanitary and phytosanitary measures, due to Africa's lack of quality-assurance and easily accessible standard-setting and -monitoring bodies, increase costs for African producers, particularly in developed-country markets. Given these bodies' large fixed setting-up costs, the case for a coordinated regional action—including strengthening the African Organization for Standardization—is self-evident.

Among NTBs, trade facilitation stands out. Disproportionately high trade-related costs in Africa are well documented.<sup>6</sup> For GVCs, the constraints of costly and time-consuming customs procedures assume even greater relevance, since goods are likely to be exported and imported several times along the value chain, often to exacting schedules. (Again, they hit SMEs disproportionately). Early evidence from corridor-management institutions, for example, suggests that the payoffs for cutting red tape may be quite high (Lisinge and Soteri, 2014).

All the above constraints pose a serious challenge to the emergence of regional supply chains in Africa, and more generally to the continent's favourable integration into the global market. Chapter 5 discusses in more detail how the trade policy constraints can be addressed.

## **Main barriers to Africa's trade are can be broadly categorised into structural supply-side constraints and trade policy constraints**

# AFRICA'S TRADE IN INTERMEDIATE PRODUCTS

Intermediate goods are non-finished goods, traded to be further processed before final use, and thus are production inputs for downstream activities.<sup>7</sup> In so far as intermediate goods embody value added imported into—or exported from—a given economy for further processing, imports of intermediate products can hence be taken as a proxy for backward linkages of the importing country to a value chain abroad, their exports as a proxy for forward linkage to the value chain.

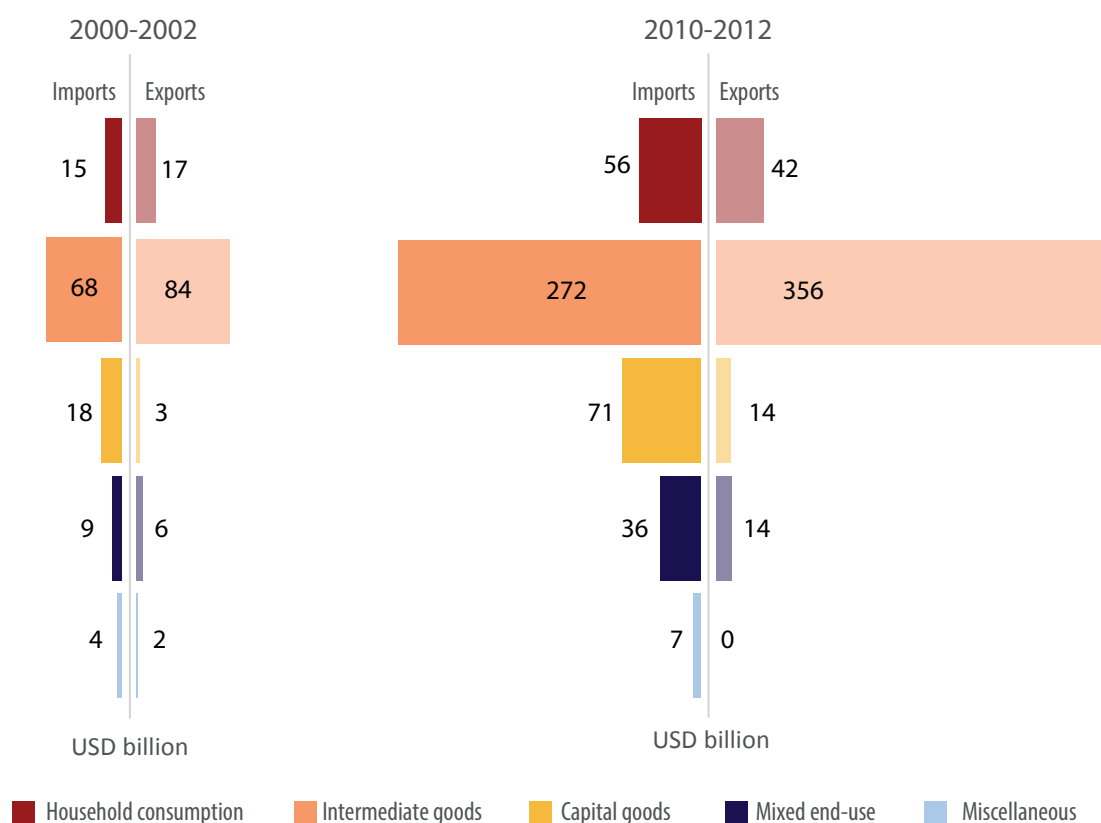
## IMPORTED INTERMEDIATES HAVE SURGED BUT WITHOUT BOOSTING AFRICA'S COMPETITIVENESS

In Africa, as in the world at large, intermediate products account for the bulk of international trade. Over the last decade, they accounted for a stable

share of 60 per cent of Africa's merchandise imports (capital goods roughly 15 per cent and consumption goods 14 per cent),<sup>8</sup> growing threefold to average \$272 billion over 2010–2012 (figure 4.7).<sup>9</sup> Its pace at country level appears strongly correlated with real GDP growth.

Intermediate imports were dominated by a handful of players—South Africa, Egypt, Morocco, Algeria, Nigeria and Tunisia—which account for nearly 75 per cent of the total and which source the lowest proportion of their intermediates imports from Africa (figure 4.8). The continent imports 88 per cent of its intermediates from the rest of the world, owing to manufacturing weakness and lack of linkages to the domestic or regional economy. These issues also emerge in smaller African countries. As Cruz et al. (2014:2) note for Mozambique, “Most

**FIGURE 4.7: AFRICA'S MERCHANDISE TRADE BY END-USE**



Source: Calculations based on OECD Bilateral Trade Database by Industry and End-Use Category (ISIC Rev. 3).

manufacturers source intermediates and raw materials from abroad, and the industrial sector generally has a relatively low degree of sectoral linkages. This comes in combination with the fact that very few manufacturing firms have entered foreign markets and only about 10 per cent of the manufacturing enterprises have foreign ownership’.

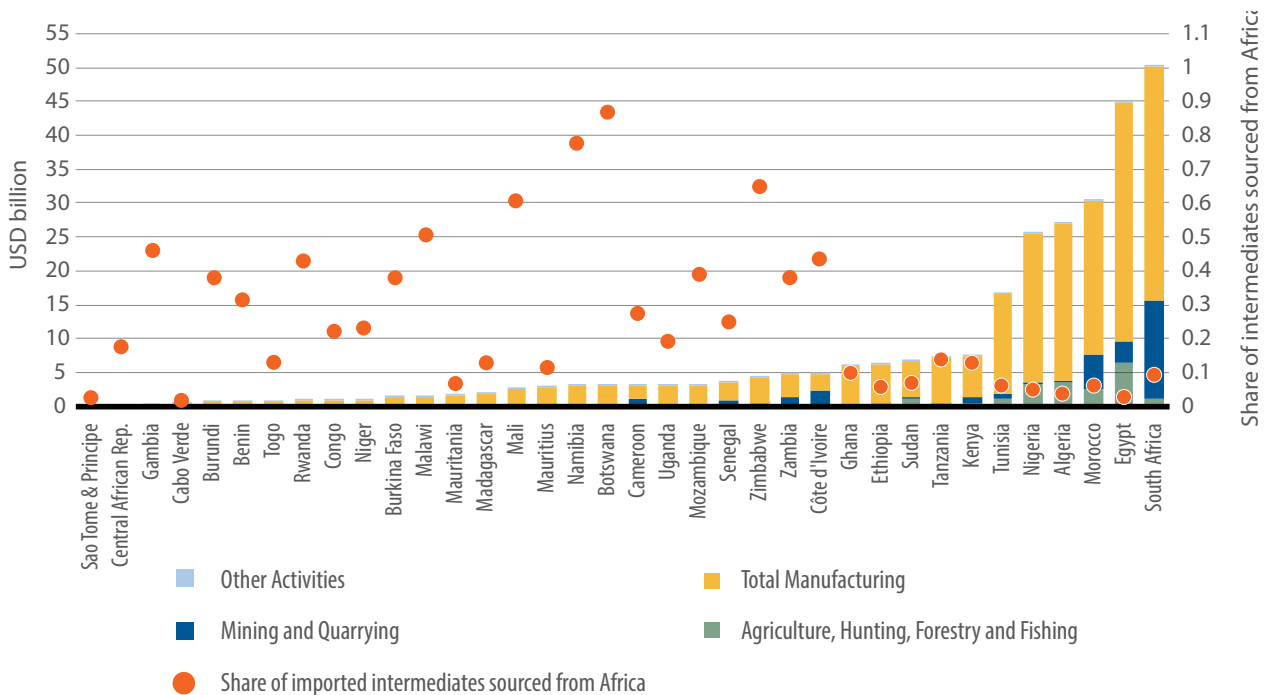
This points to a missed opportunity for the continent, whereby regional supply chains connecting neighbouring countries are very shallow, and leading countries fail to establish backward linkages with smaller and less industrialized neighbours. As analysed later, this situation can be traced to a wide array of constraints limiting intra-African trade, ranging from structural conditions such as infrastructure gaps, to trade policy-related issues such as inappropriate tariff structures and poor trade facilitation.

In terms of sectors, manufacturing is the main driver behind African countries’ growing demand for imported intermediates (see figure 4.8).

Chemical, rubber, plastic and fuel products, and to a lower extent metals, machinery and equipment, food beverages and tobacco, represent the bulk of manufacturing imported intermediates (figure 4.9). Growing imported manufacturing inputs have, however, brought only few gains for Africa’s manufacturing sector, often failing to offset its long-standing competitiveness gaps. For example, over 2000–2010, manufacturing value added more than doubled for the continent as a whole, with an increase of roughly 50 per cent in constant prices, but declined as a share of total value added.

Intermediate imports for mining and quarrying, as well as for agriculture, played a more limited role and were concentrated in a handful of large importers, notably Egypt, Morocco and Nigeria. The small size of Africa’s trade in agricultural intermediates and the geographical pattern of such trade reflects the persistent structural weaknesses of a crucial sector, which still contributes substantially to GDP and employs about 60 per cent of the labour force. With the exception of South Africa and the

**FIGURE 4.8: AFRICA’S IMPORTS OF INTERMEDIATE GOODS BY COUNTRY AND MAIN SECTOR, 2010–2012**



Source: Calculations based on OECD Bilateral Trade Database by Industry and End-Use Category (ISIC Rev. 3).

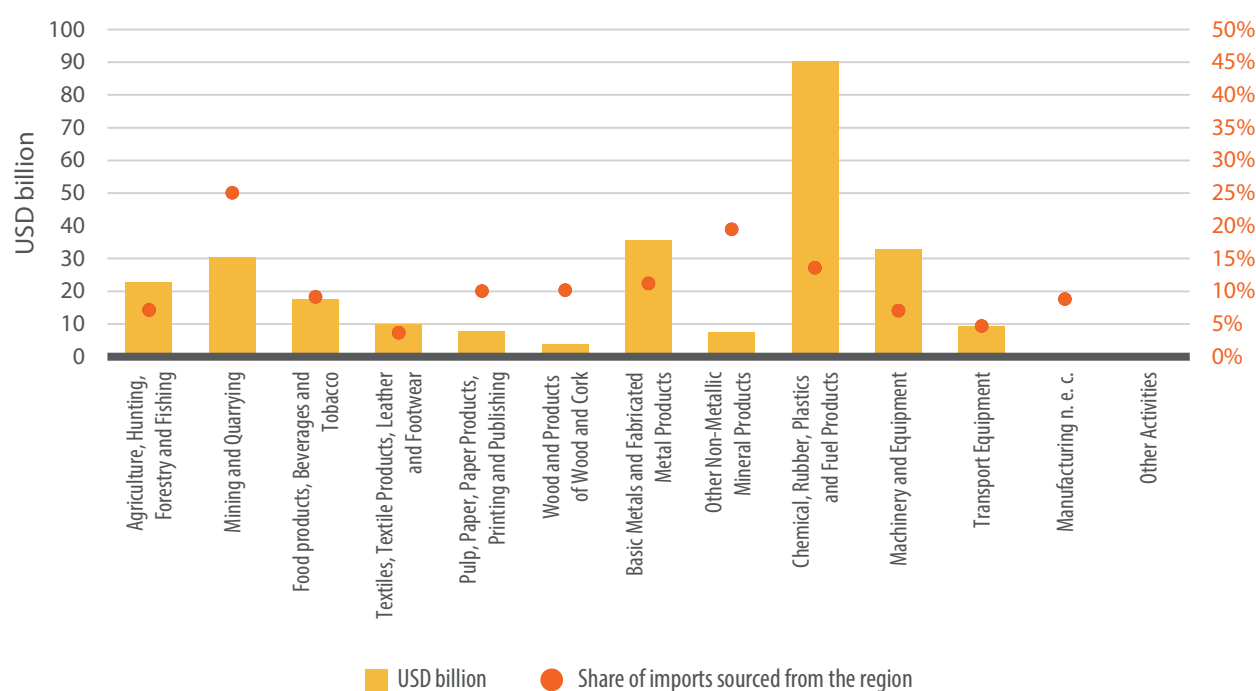
North African region, agriculture is characterized by severe under-capitalization and by the dualism between subsistence or quasi-subsistence farming (employing a limited range of inputs and serving almost exclusively the domestic market) and commercial cash-crop farming (mainly integrated in the global market through the supply of raw material).

For this reason, while the North African economies, which modernized agriculture to a degree, are the main African importers of agricultural intermediates, West African countries (notably cocoa and cotton producers), and to a lesser extent some East and Southern African economies (such as Ethiopia, Malawi and Uganda) export the bulk of agricultural intermediates, in most cases with little domestic processing and value addition: the Economic Report on Africa 2013 documented that more than 75 per cent of the cocoa exported from

Cameroon, Côte d'Ivoire, Ghana and Nigeria was exported in the form of cocoa beans, embodying far less value added than cocoa paste, cocoa butter or of course chocolate.

The extent to which the regional market supplies imported intermediates varies widely across economic sectors. If the evidence points, for instance, to some backward linkages in mining and quarrying—where 25 per cent of imported intermediates are sourced within Africa—in other sectors such as textiles or even agriculture the scope to establish regional supply chains is still largely untapped, with less than 10 per cent of intermediates imported from the region (see figure 4.9). Particularly striking, especially if compared to the East Asian experience, is the limited contribution of intra-African trade in supplying intermediate inputs for light manufacturing industries, which is the first rung of the product ladder.

**FIGURE 4.9: AFRICA'S IMPORTS OF INTERMEDIATE GOODS BY SECTOR, 2010–2012**



Source: Calculations based on OECD Bilateral Trade Database by Industry and End-Use Category (ISIC Rev. 3).

## INTERMEDIATE EXPORTS HAVE INCREASED VIGOROUSLY, BUT REMAIN DOMINATED BY MINING AND RESOURCE-BASED MANUFACTURES

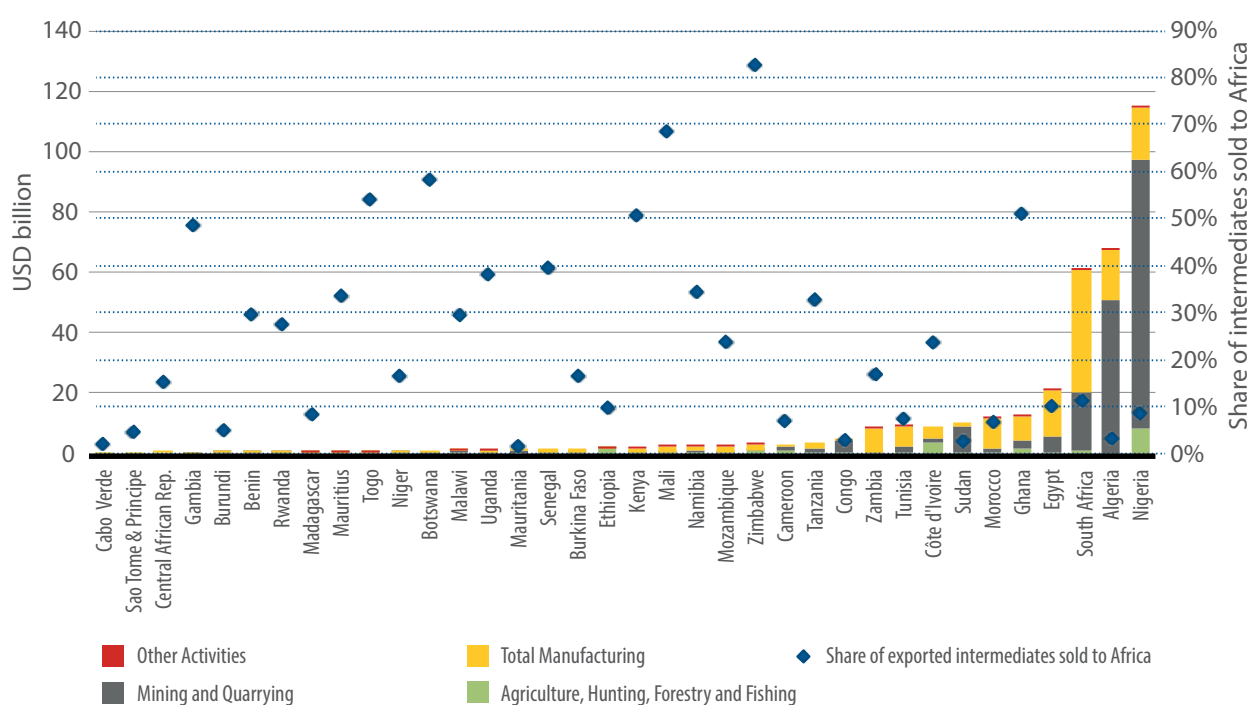
Intermediate goods account for the largest share of Africa's merchandise imports, but their weight in the export basket is even larger (see figure 4.7). Growing from an average of \$84 billion in 2000–2002 to \$356 billion 10 years later, intermediates have constituted the most dynamic component of Africa's exports in the last decade, expanding their share of total exports from 75 per cent to 83 per cent.<sup>10</sup> Regional figures are partly driven by fuel and mineral exporters such as Algeria, Nigeria, Sudan and Zambia, where over 95 per cent of exports, in the 2010–2012 period, was composed of intermediates (and even in the median African country intermediates accounted for around 75 per cent of merchandise exports).

Despite the sharp increase in the value of Africa's intermediate exports in the decade to 2011, the region still accounted for only 2 per cent of the

corresponding worldwide figure, versus 35 per cent for Asia and 4 per cent for Latin America (WTO and IDE-JETRO, 2011).

Whether by country of origin or sectoral composition, Africa's exports of intermediates tend to be even more concentrated than its imports, with resource-rich countries such as Algeria, Nigeria and South Africa playing key roles (figure 4.10). Africa's dependency on primary commodity exports is rising: the proportion of mining and quarrying in total intermediate exports has increased over the last decade (typically at the expense of agricultural intermediates) in about two-thirds of the 39 countries for which data are available. Therefore, half of the continent's exports of intermediates are mining and quarrying products. In other words, extractive industries remain the main channel through which African economies are connected to downstream GVCs, but they have weak linkages to the regional market, which accounts for only 6 per cent of mining intermediates exported (OECD, 2014a).

**FIGURE 4.10: EXPORTS OF INTERMEDIATE GOODS BY COUNTRY AND MAIN SECTOR, 2010–2012**

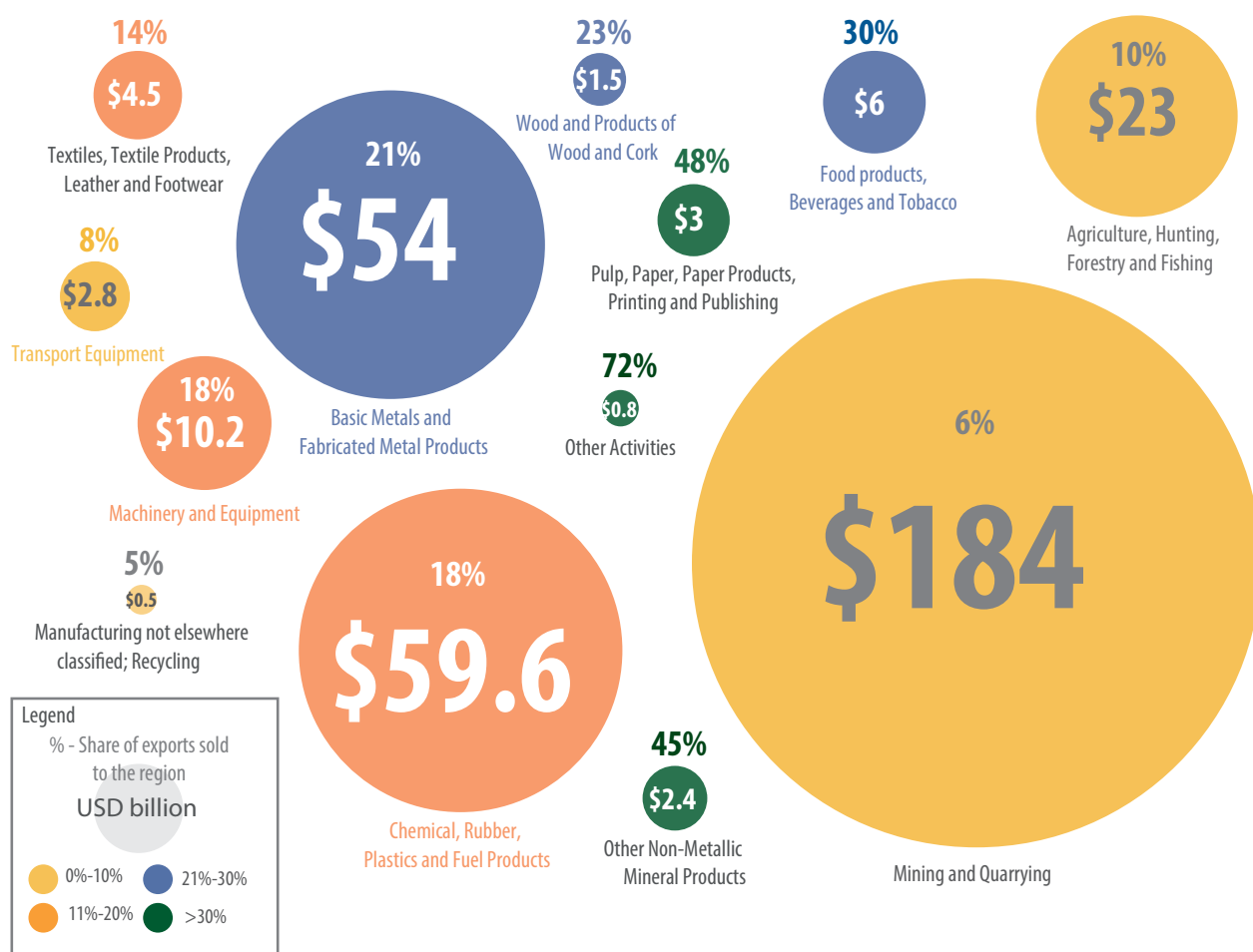


Source: Calculations based on OECD Bilateral Trade Database by Industry and End-Use Category (ISIC Rev. 3).

Moreover, even in extractive sectors where they have a clear comparative advantage, most African economies remain mired in the low end of value chains, supplying raw materials and other intermediates that embody very limited domestic value addition (ECA and AUC, 2013). In turn, failure to foster the establishment of forward linkages with the domestic economies reinforces the enclave nature of many extractive industries, leading to missed opportunities. The experience of Nigeria is emblematic: in 2012, it exported \$89 billion of crude oil but only \$5.6 billion of the refined sort, all the while importing \$5.5 billion in refined oil.

The experiences of other African countries suggest, however, that an appropriate policy framework could go a long way in fostering value addition in downstream activities, even in extractive industries. For instance, Botswana has managed to foster the emergence of a viable diamond-cutting and -polishing cluster employing several thousand workers by supporting the accumulation of sector-specific skills (ECA and AUC, 2013; Botswana case study). Similarly, Mozambican SMEs have entered the aluminium value chain centred on the Mozal smelter (box 4.4).

**FIGURE 4.11: AFRICA'S EXPORTS OF INTERMEDIATE GOODS BY SECTOR, 2010–2012**



Source: Calculations based on OECD Bilateral Trade Database by Industry and End-Use Category (ISIC Rev. 3).



#### **BOX 4.4: BUILDING LINKAGES IN EXTRACTIVE INDUSTRIES— MOZAMBIQUE AND NIGERIA**

Nigeria and Mozambique are Africa's leading oil exporter and its number two aluminium exporter. Their contrasting attempts in building backward and forward linkages with extractive industries show the complexity of any approach.

Aluminium production in Mozambique is dominated by the Mozal aluminium smelter, a joint venture of transnational corporations in which the Mozambican government has a 3.9 per cent stake. It employs 1,190 people directly and a further 1,500 indirectly, and has an annual turnover of about \$1.1 billion. The company uses mainly imported intermediates (alumina from Australia, coke from the US, and electricity from South Africa), but it has involved domestic SMEs in upstream activities, namely construction, maintenance, expansion and engineering services. Their engagement was boosted by SME empowerment initiatives supported by the International Finance Corporation. Until 2013, Mozal exported all its aluminium ingots, since it signed an agreement with Midalunder, which is setting up a factory to produce aluminium cables using 50,000 tonnes of Mozal's ingots (Sutton, 2014).

Nigeria's oil value chain accounts for 83 per cent of exports and two thirds of government revenues. Upstream (exploration and production) is dominated by multinationals, downstream (crude oil processing and marketing) has multiple local firms and refineries. Nigeria has a local content framework with an array of instruments, including priority for Nigerian operators in awarding oil field licenses, support for sector-specific skill upgrading and capacity development, establishing links between the fuel industry and academia, and ownership requirements in Nigerian subsidiaries.

It has secured mixed results. Local content has increased somewhat, mainly thanks to wide-ranging backward linkages with upstream activities, such as fabrication, construction, completion and control systems (Oyejide and Adewuyi, 2011). Forward linkages are far fewer: the Nigerian National Petroleum Corporation has a refining capacity of 445,000 barrels per day against a production capacity of 2.5 million. Moreover, local refineries operate well below their capacity, undermining profitability. Poor provision of infrastructure, corruption, security, and poor access to finance are the main constraints to this value chain's development.

Among manufacturing intermediates, even though their weight in overall exports is limited by international standards, Africa's exports have grown fourfold over the last 10–15 years, reaching an average value of \$145 billion in 2010–2012. It is sobering to note, however, that this value is mainly explained by resource-based products such as metals and chemicals, plastics and fuels (figure 4.11). Conversely, other manufacturing activities—whether light (textile, wood, food and beverages) or heavy (transport and machinery equipment)—play a minor role in the overall composition of Africa's intermediate exports.

This evidence, along with Africa's heightened reliance on imported inputs from the rest of the world, shows the patent long-standing weaknesses of the manufacturing sector (chapter 2). The paucity

of exports of manufacturing intermediates concurs with the evidence of persistently limited weight of intra-industry trade in the region, and points to the low level of integration into international production networks, regional and global. In a context where most African countries continue to have poorly diversified (and often similar) structures of production, premature de-industrialization exacerbates the situation by curtailing even further the scope for intra-industry trade. This is in striking contrast with the experience of East and South Asia, where the orderly sequence of industrial upgrading has given way to a dense regional network of production, characterized by a strong reliance on intra-regional trade in intermediates.<sup>11</sup>

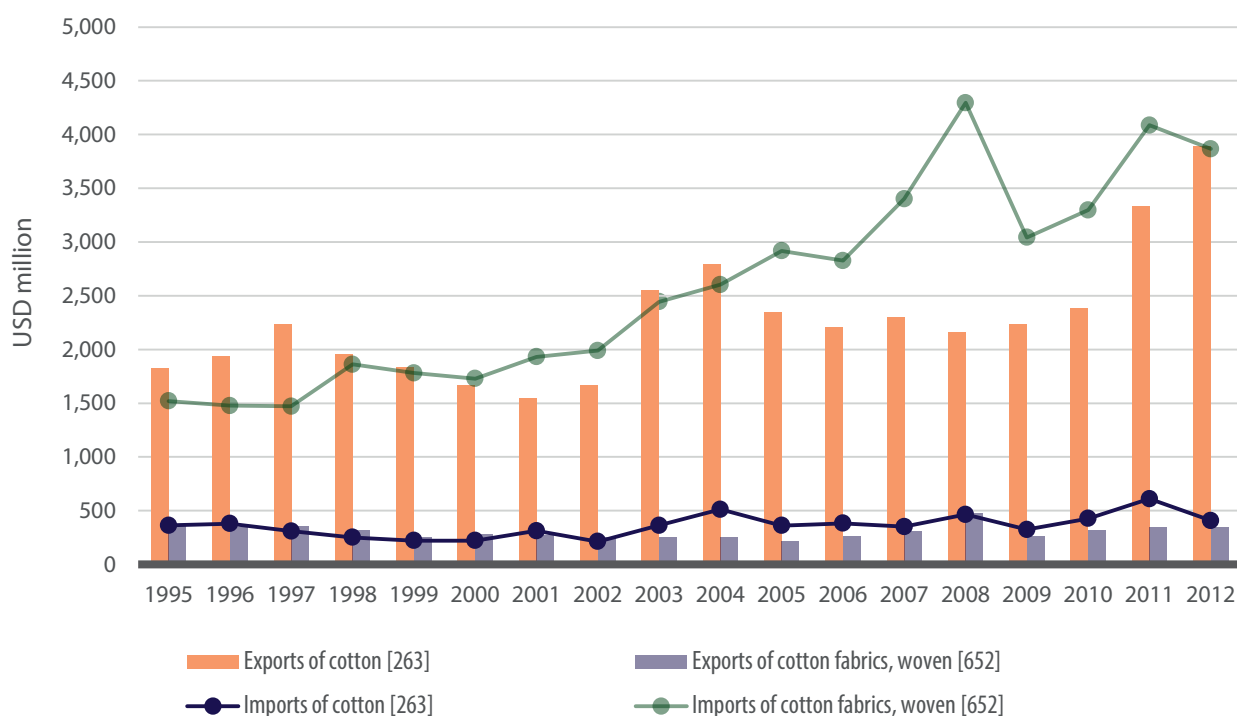
Four products in light manufacturing—food, textiles, paper and wood—play virtually no role

in overall intermediate exports. Typically the first rung on the manufacturing product ladder, they contributed only \$15 billion of the \$356 billion total intermediate exports (average 2010–2012). Over the last decade their imports grew far faster than their exports, especially food and wood products.

## In Africa, intermediate products account for the bulk of international trade

The lack of competitiveness of African manufacturing and the extent to which the scope for domestic value addition is left untapped are epitomized by the region’s trade in cotton, a key export product for countries such as Benin, Burkina Faso and Mali, among others. With \$3.9 billion of exports in 2012, Africa accounted for roughly 16 per cent of global cotton exports, but only about one tenth of this (\$0.4 billion) was cotton fabric (or around 1 per cent of worldwide exports). At the same time, the region was importing \$0.4 billion of cotton and \$4 billion of cotton fabrics. In other words, the region was trading raw cotton for cotton fabrics, missing a huge opportunity to add value domestically and industrialize (figure 4.12).

**FIGURE 4.12: AFRICA’S TRADE IN COTTON AND COTTON FABRICS**



Source: Calculations based on UNCTADstat, accessed on 10 November 2014 (SITC Rev. 3 codes in brackets).

# SERVICES IN AFRICA'S STRUCTURAL TRANSFORMATION

Services are an important component of any economy. They are key inputs to most other businesses, make a direct contribution to GDP and job creation, are a magnet for FDI, and are important for adding value along GVCs.

## SERVICES PROVIDE ESSENTIAL INPUTS TO MOST OTHER BUSINESSES

Infrastructure services such as energy, telecommunications and transport are essential for firms to be competitive; financial services are the oil of transactions and provide access to credit for investment; construction services are prerequisites for business development; and legal and accountancy services are vital in a thriving business environment. Some service sectors such as health care, education, water and sanitation are central to social development and a healthy, well-trained workforce.<sup>12</sup> Inexpensive and good-quality services can enhance competitiveness in agriculture, mining and manufacturing. According to the OECD (2013)<sup>13</sup>, as much as 30 per cent of value added of manufacturing's exports is from services inputs.

The boom in telecommunication services in Africa over the past decade is an example of how services development can spur growth in other sectors. The ICT boom in Africa, particularly mobile phones, has raised the continent's economic growth by, for example, promoting financial inclusion through mobile financial services and connecting farmers to markets (Andrianaivo et al., 2011)<sup>14</sup>. Kenya is ranked number one in the world for mobile money services and now boasts the highest share of population with access to financial services in Central, Eastern, Southern and West Africa, at more than 70 per cent (AfDB, OECD and UNDP, 2014). As SMEs in many African countries cite lack of access to finance as

a major obstacle to business development, the provision of financial services on the continent is particularly important for African business.

## THE SERVICES SECTOR CAN ATTRACT MUCH NEEDED FOREIGN INVESTMENTS AND PRIVATE EQUITY FINANCE INTO AFRICA

In 2012, 40 per cent of FDIs flowing to Africa went into services, up from 24 per cent in 2011 (UNCTAD, 2013b). Hotels and restaurants were one of the most promising sectors for attracting FDI in Africa over 2013–2015. Private equity in Africa is particularly attracted by the services sector. In 2012, the four most popular sectors for private equity in Africa were business services; information technology; industrial products; and telecoms, media and communications. Dominant activities attracting services FDI in Morocco, for example, were business services; finance; hotels and restaurants; and transport, storage and communications.<sup>15</sup> This shows how a well-designed tourism sector (like Morocco's) can be a magnet for investment. In 2012 tourism was Morocco's top foreign exchange earner, the second biggest contributor to GDP, and the second-biggest creator of jobs.

## SERVICES HAVE THE POTENTIAL TO BE AN ENGINE OF JOB CREATION

Given the weakness of the manufacturing base over the past decade, the movement of workers in Africa has been out of agriculture and into services (World Bank 2014). Services employed on average 47 per cent of the workforce in the 12 African countries with data over 2009–2013<sup>16</sup>, with peaks such as 65 per cent in Mauritius and 63 per cent in South Africa.<sup>17</sup> This shows that services are labour intensive and could play a significant role in Africa's

growth not only by supporting local industries but by creating a large number of jobs. However, despite the proven capacity of the services sector to create jobs for Africa’s youth, many of these jobs are in the informal sector. Also, data on the nature of these jobs are scarce and it is difficult to say whether they are concentrated around high- or low-productive services. It is possible that many of these jobs are of low quality in terms of security, wage and other conditions. African governments will need to use appropriate policies to ensure that the employment growth generated by services goes beyond the informal sector, for example by increasing incentives for business to enter the formal economy, and to prioritise the growth of high-productivity services such as ICT and business support.

### ACROSS AFRICA, GROWTH IN SERVICES IS STRONGLY CORRELATED WITH GROWTH IN GDP AND GROWTH IN MANUFACTURING VALUE ADDED

Evidence from economic development worldwide shows that the growth of the services sector tends to go hand in hand with GDP growth, with services accounting for higher shares of economic activities in richer economies. This is supported by data for African countries, which shows a strong correlation between growth in services value added and growth in GDP for African countries over 2000–2012. Only the correlation between growth in agricultural value added and GDP growth is stronger than the

one for services (table 4.5). Of course, correlation is not causation, and the relationship can run both ways: as GDP increases, the demand for services such as banking, insurance, business services, tourism etc. also rises. No matter the sense of the correlation, the fact that services value added and GDP growth tend to move together indicates a strong relationship between the two.

Across Africa, value added in services grew more than that in manufacturing, industry or agriculture over 2000–2012. The correlation between growth in value added in services and that in manufacturing is strong, at 0.85, pointing to the synergies between the two sectors. The fact that value added in services and that in manufacturing move quite closely together suggests that services are necessary to support the development of manufacturing.

### SERVICES ARE INCREASINGLY IMPORTANT IN AFRICAN ECONOMIES

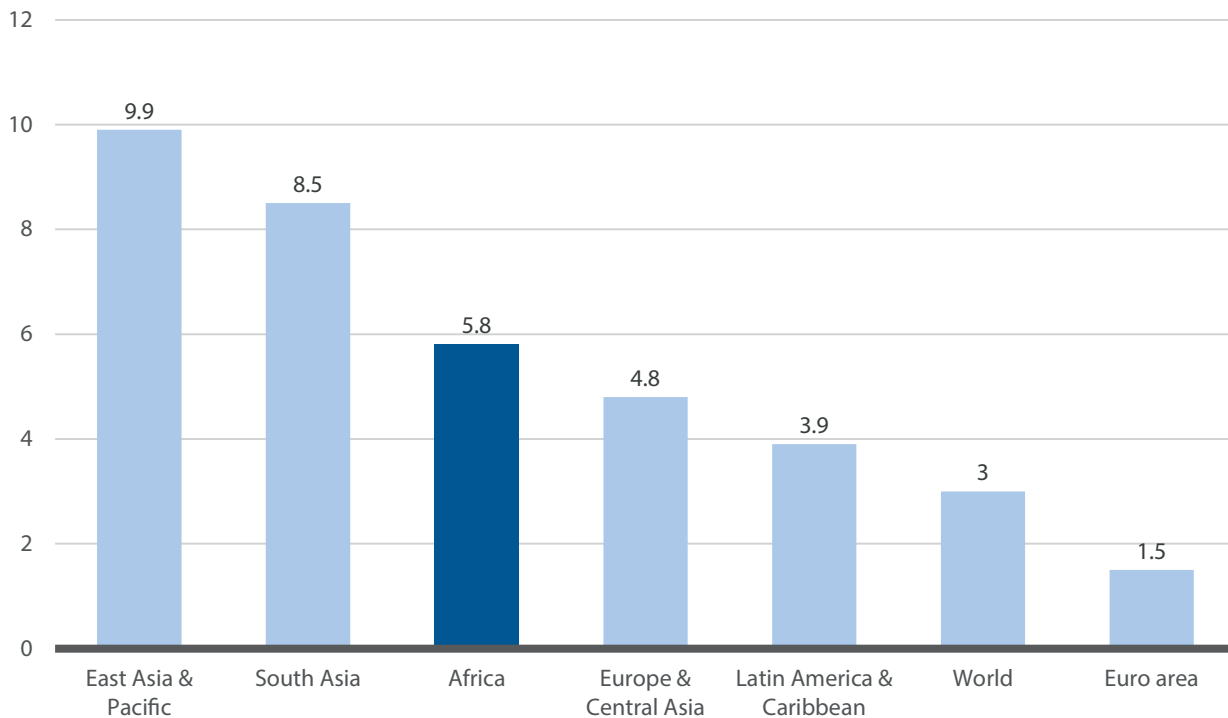
Structural transformation usually coincides with a growing role of industry and services in the economy (alongside a reduced role for agriculture). In 2013, the services sector was the main contributor to GDP in 35 out of 54 African countries.<sup>18</sup> Africa’s growth in services over 2000–2012 was higher than the world average and faster than that of several other regions (figure 4.13). Services may also be undercounted (box 4.5).

**TABLE 4.5: SELECTED GROWTH CORRELATIONS, 2000–2012**

Correlations	Growth in value added of:			
	Services	Industry	Manufacturing	Agriculture
GDP growth	0.86	0.70	0.81	0.90
Growth in GDP per capita	0.87	0.67	0.80	0.86
Growth in services value added	1	0.52	0.85	0.68

Source: Calculations based on World Development Indicators.

Note: Based on 53 African countries. Data on GDP growth for 2000–2012 for 49 African countries. Data on growth in agriculture, industry and services value added for 2000–2012 can be calculated for 34, 32 and 33 African countries.

**FIGURE 4.13: AVERAGE ANNUAL GROWTH IN SERVICES BY REGION, 2000–2012**

Source: Calculations based on World Development Indicators.

#### **BOX 4.5: SERVICES MAY BE UNDERCOUNTED**

Services make up roughly half of trade in value added for African countries. Among them, financial services are the largest contributor, followed by transport. Compared with the G7 countries (with 73 per cent of trade in value added), the share of services is still low and needs to be increased.

More and more evidence shows that the role of services in international trade is greatly underestimated in statistics. The trade in value-added data recently developed by the OECD suggests that the value of trade in services, when taken from a value-added perspective, may be approaching half of world trade exports (45 per cent). The important link between services and participation in value chains has been acknowledged by the term “servitization”, which means that the primary and secondary sector provide services such as marketing, warehousing and rental of equipment (OECD, WTO and World Bank, 2014). GVCs for services are still less important than for the manufacturing sectors, but they have been at an increasing scale. Hence they need to be emphasized by policy makers given their potential for moving into higher value chains.

The emergence of services and the increased fragmentation of GVCs (into “tasks”) have the potential to substantially rebalance the “old economy” distribution of comparative advantages based on natural endowments of developing countries. By creating a competitive advantage in a service task, countries can overcome traditional obstacles such as being a small market, being landlocked and being remote, thanks to ICT. Also, the fragmentation of production in GVCs and ICT development open up opportunities for SMEs to participate in the global economy by reducing the threshold and capital necessary to enter markets for intermediate goods and services (tasks). Kenya and Uganda are already well-known success stories in business and ICT service exports (OECD, 2014a).

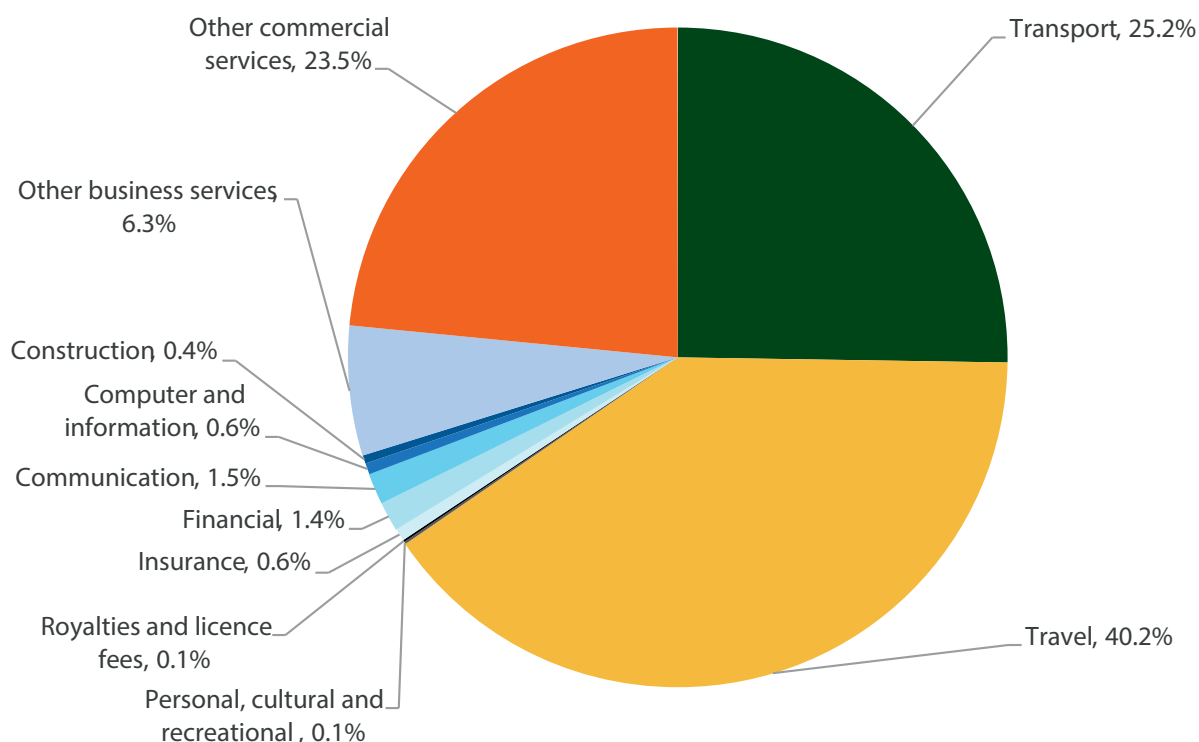
In 2012, all African countries for which data are available exported services. Africa’s exports of services increased from \$11.5 billion in 1980 to \$32.7 billion in 2002 and \$89.5 billion in 2012.<sup>19</sup>

In 2013 the biggest single item in Africa’s exports of services was travel<sup>20</sup> (40 per cent), followed by transport<sup>21</sup> (25 per cent) (figure 4.14). Other business services, one of the fastest growing sectors of world trade today—which includes for example professional, technical and IT-enabled business-to-business (B2B) outsourcing services—were also a relatively large share of Africa’s services exports in 2013 (6.3 per cent). This is an important category as it provides support to most other businesses.

The large sizes of travel and transport in African exports of services reflect the importance of tourism. Directly and indirectly, tourism accounts for 10 per cent of GDP in Central, Eastern, Southern and West Africa and employs millions. The industry turnover is worth about \$170 billion a year. In 2013 more than 36 million people visited Africa, a figure that had been growing by 6 per cent over the past year (The Economist, 2014).

Increases in tourism receipts over the continent were largely made possible by improved aviation services. Air passengers to Africa doubled over 2000–2010, reaching 62.6 million.<sup>22</sup> Algeria, Egypt, Ethiopia, Morocco, Nigeria and South Africa have particularly strong aviation sectors, with airlines from these countries having carried between 17 million (South Africa) and 4 million (Algeria) passengers in 2012.<sup>23</sup> Egypt, Ethiopia, Kenya and South Africa carried the largest amounts of freight in 2012. Despite these successes, African aviation could perform much better if constraints such as lack of liberalization, which is contributing to increasing prices (average air fares in Africa rose 24 per cent between 2012 and 2013) were removed (The Economist, 2013). Flying across Africa remains much more expensive than flying across other world regions. In many African countries, government’s participation in the aviation sector does not encourage private investments (The Economist, 2013). Regional actions to open up aviation, such as the Yamassoukro decision, that aims to gradually

**FIGURE 4.14: AFRICA’S EXPORTS OF SERVICES BY CATEGORY, 2013.**



Source: ECA calculations based on International Trade Centre data.

**BOX 4.6: EVEN THOUGH BOOMING, MOZAMBIQUE'S FINANCE SECTOR TARGETS MAINLY LARGE MINING PROJECTS, LEAVING LOCAL FIRMS CREDIT CONSTRAINED**

Mozambique's fastest growing sectors in 2013 were mining, propelled by a boost in coal exports, and finance, fuelled by credit expansion and increased income, mostly in urban areas. According to the Banco de Moçambique, that aggregate outstanding credit issued by Mozambican banks grew by 33 per cent year-on-year in the 12 months ending in October 2013, to reach \$4.8 billion or 31.6 per cent of GDP. Over the same period, deposits grew by 17.6 per cent to reach \$6 billion (39.4 per cent of GDP). The country's middle class is swelling, albeit from a low base, and so is demand for corporate, investment and retail banking.

However, growth over the past few years has not led to more or cheaper lending to local firms. Major banks are, rather, largely positioning themselves to service corporate and investment opportunities from the large resource projects and major firms. This is evident in the divergence between the prime lending rate—the rate at which banks lend to their most creditworthy customers (i.e., large corporates)—and the average two-year lending rate. The World Bank's 2013-14 Global Competitiveness Report, which ranked Mozambique 137 out of 148 countries, found access to finance to be the most significant constraint on businesses. Interest rates remain high, at around 8.25 per cent but reaching peaks of 20 per cent and over for small debtors. Restrictions on the use of land as collateral (land is owned by the state) further limit access to finance.

liberalize and regulate intra-African air transport services, can help to unleash the potential of aviation on the continent.

**SOME AFRICAN SERVICES SUBSECTORS HAVE SEEN A PARTICULARLY STRONG GROWTH, THOUGH NOT ALWAYS BEING TRANSLATED INTO BETTER SERVICES FOR LOCAL FIRMS**

Between 2000 and 2012, some categories of services exports saw strong growth in Africa. African exports of computer and information services grew at an average of 20 per cent year-on-year, followed by financial and insurance services (growing at an average of 12 per cent each). The strong growth of these subsectors, however, has not always benefited local SMEs. In many cases, categories such as banking, insurance and business services have overwhelmingly targeted large projects in the mining sector or large foreign investors (box 4.6).

**THE SERVICES SECTOR IS AN AVENUE FOR ECONOMIC TRANSFORMATION, AS NOT ALL COUNTRIES HAVE A COMPETITIVE EDGE IN MANUFACTURING**

In 2013, services provided the largest contribution to GDP in the majority of African countries. Seychelles, Djibouti and Mauritius topped the list of African countries with the highest share of services in GDP in 2013 (table 4.6).

Services offer an option for economic transformation for countries, such as small island states (e.g., Seychelles, Mauritius, Cabo Verde) or small landlocked states (e.g., Botswana or Lesotho, where services value added was respectively 62 per cent and 60 per cent of GDP),<sup>24</sup> for which manufacturing might not be the best development option. India's growth pattern suggests that a shift into high-productivity services, bypassing manufacturing, represents another path to sustainable growth (Ghani et al., 2011). Modern services, such as software development, call centres and outsourced business processes, represent high value-added activities that can be important drivers of growth for innovative and technology-savvy countries.

**TABLE 4.6: TOP TEN AFRICAN COUNTRIES BY SERVICES AS PERCENTAGE OF GDP, 2013**

Countries	Services as % of GDP in 2013
Seychelles	81.1
Djibouti	77.0
Mauritius	71.5
Cabo Verde	70.3
South Africa	69.1
Botswana	61.8
Senegal	60.1
Eritrea	60.0
Lesotho	60.0
Gambia	60.0

Source: ECA analysis based on ASYB database.

They use skilled workers, exploit economies of scale and can be exported. Cabo Verde, for example, aims to become an international platform for high value-added services such as banking, tourism, ICT and business processing and maritime services, exploiting its high literacy rate, social, political and macroeconomic stability and low corruption (Rocha, 2010).

African countries with a relatively high share of services in GDP tend to be resource poor: the correlation between the World Bank's natural resources rents index<sup>25</sup> and the share of services in GDP is strong and negative, at  $-0.73$ .<sup>26</sup> This suggests that resource-rich countries tend to expand their

industries (such as mining and oil) more than their services.

Some countries, such as Kenya and Rwanda, are already well positioned to become services hubs in their regions and have adopted modern competition laws. Kenya is capitalizing on its technological advancement, strong private sector, well-developed financial markets and ICT infrastructure to expand its services exports, which have already been a key driver for the economy over the past few years. In 2012, it had a large trade surplus in services of \$2.4 billion,<sup>27</sup> thanks to increased foreign exchange receipts from tourism, transport, communication and financial services.



**BOX 4.7: SERVICES AS AN ALTERNATIVE TO MANUFACTURING-LED DEVELOPMENT IN RWANDA**

Developing a manufacturing industry is particularly challenging for Rwanda, given the landlocked nature of the country, NTBs that impede trade among EAC partners, and weaknesses in transport infrastructure. The government is therefore targeting service subsectors, including ICT, tourism and finance. Many services are, by nature, unimpeded by high transport costs. The government is trying to catalyse the emergence of a service-based hub in Rwanda, to serve regional markets.

So far there have been some encouraging developments. Service exports in Rwanda have grown from \$59 million in 2000 to \$395 million in 2011.<sup>30</sup> Services accounted for more than 50 per cent of the growth of the economy between 2007 and 2013. In contrast, despite still being the largest sector, agriculture contributed barely more than one fifth to total growth. Under the government's Vision 2020, services are expected to take a lead in overall contribution to GDP, rising from the current 38 per cent to 42 per cent in 2020, overtaking agriculture as the leading

sector by 2015. Improved services can also increase productivity in agriculture, for example in tea, coffee and cocoa—large components of exports.

Wholesale and retail trade, education, finance and insurance, and transport, storage and communications have all been growing at more than 10 per cent per year since 2007. The ICT subsector too has been growing rapidly: over 2000–2011, it received \$552.7 million in investment, most of them after 2007. Tourism has been the main foreign exchange earner since 2007. Exports of travel and tourism were equivalent to 63 per cent of total services exports and 29 per cent of merchandise and services exports in 2011. By 2013, Rwanda received 1,137,000 visitors, generating \$294 million for the economy, up from \$62 million in 2000.<sup>31</sup> Tourism receipts are expected to grow at a compound annual rate of 25 per cent until 2017.<sup>32</sup> While “gorilla” tourism has been one of the main marketing points, the government is also diversifying tourism products. Moreover, thanks to modern

infrastructure and telecommunications, Rwanda is becoming increasingly attractive for conference tourism, hosting in 2014 the African Development Bank meetings in May and the World Export Development Forum in September (among other events).

In 2012, FDI stocks were estimated at \$329.1 million in ICT, \$124.1 million in finance and \$125.1 million in insurance, against just \$90.8 million in manufacturing.<sup>33</sup> The development of a competitive aviation sector is also part of the government's strategy to develop services. Rwanda had so far scarce air connectivity, and the air market in and out of the country was not a profitable option for private investors. The government is investing heavily in RwandAir, aiming to expand its annual turnover from \$46 million today to more than \$350 million by 2018, by increasing its destinations and fleet and improving its certifications and standards.

**The boom in telecommunication services in Africa over the past decade is an example of how services development can spur growth in other sectors**

Kenya has firms exporting high-value offshore services such as product development, research and development business ventures, insurance, accounting and business process outsourcing. Exports in ICT services already account for more than 10 per cent of total service exports and close to 20 per cent of FDI inflows (Rubadiri, 2012). Such growth benefits not only Kenya but also other countries in the region that can source high-quality services from Kenya.

Botswana is developing its financial sector, aiming to become a financial hub in the subregion. In 2003 Botswana created the International Financial Services Centre, where companies can be accredited to conduct cross-border business while enjoying tax exemptions. Currently around 50 companies—including big names such as ABN Amro, Banc ABC, African Alliance International and Vantage Mezzanine Fund<sup>28</sup>—are working within the Centre's framework. Thanks in part to the centre, Botswana attracted \$630.7 million of FDI in its finance sector in 2012 (88 per cent of total FDI in its services sector) (International Trade Forum, 2010). The volume of financial services exported from Botswana grew from \$417,000 in 2009 to \$5.1 million in 2012.<sup>29</sup>

Botswana was able to position itself as a services hub thanks to its advantageous geographic location (landlocked but at the centre of the 15-member SADC community), high regulatory standards, absence of foreign exchange controls and competitive business infrastructure. Such practices are particularly relevant for landlocked countries, which, through services, can turn geographical centrality into an advantage (box 4.7).

**Between 2000 and 2012, African exports of computer and information services grew at an average of 20 per cent year on year, followed by financial and insurance services (growing at an average of 12 per cent each), but this has not always benefited local SMEs.**

# CONCLUSIONS

African countries show high participation rates in GVCs, but at a low level, and the potential to tighten integration owing to the abundance of natural resources and low labour costs remains huge. The growing importance of ICT enables African countries to enter several value chains without developing the whole production process. Usually, services are poorly captured in traditional trade statistics, but they play a key role in increasing countries' participation in GVCs.

Successful policies need to include sectoral initiatives that develop product standards and good product quality, improve physical infrastructure (telecommunication, roads, ports etc.) to connect with global players, establish a national production networks, and reduce NTBs and increase tariff liberalization to reduce costs of trading.

Similarly, given the poor linkage between successful sectors and other areas, policies need to focus on establishing production networks within an economy.

The similarity in structures of production across African economies calls for renewed efforts to spur structural transformation and development of Africa's productive capacities, including dynamic industrial policies' broad array of measures that improve the business environment and enhance coordination among firms. Likewise, governments could endeavour to redress coordination failures and favour the emergence of viable clusters, especially in manufacturing, although an overarching approach is needed to ensure that fiscal incentives to attract local and foreign investment are justified by the scope for promoting backward and forward linkages.

On the financial front, African countries have increased their budget for infrastructure provision, including through regional frameworks such as the Programme for Infrastructure Development in

Africa (PIDA), so that Africa finances nearly half its infrastructure projects: \$42.2 billion out of a total of \$89.2 billion in 2012 (ECA, 2014a). Yet the financial needs remain daunting. An annual investment of \$7.5 billion is required over 2012–2020 to deliver projects in the PIDA Priority Action Plan, and \$360 billion for PIDA's long-term view over 2012–2040. Innovative financial mechanisms should therefore be considered (chapter 1).

A promising approach for African countries would be to start developing and strengthening RVCs by developing regional clusters. Intra-African trade, in view of its more diversified composition, represents a promising avenue to support industrialization and foster the emergence of interconnected regional supply chains, notably in manufacturing.

It is imperative for African countries to identify—working with the private sector and other stakeholders—their own strategic priorities, coordinate with regional partners the sequencing of trade facilitation measures, and assess related financial and technical assistance needs. In doing this, African countries should make full use of the flexibilities available under Section II of the Trade Facilitation Agreement, to sequence the different measures in such a way that the commitments undertaken at the multilateral level are fully supportive of regional integration (chapter 5).

Trade and industrial policies matter more than ever in shaping the outcome of the emerging global division of labour. In light of this, it is imperative for African countries to adopt a consistent trade and industrial policy framework, connecting RVCs and GVCs more closely. How these policies may be able to do this is the subject of the next chapter. For services in particular, a few suggestions may be highlighted.

African countries need to create services RVCs for business to benefit from expertise in the region. This requires trade in services to be opened up, particularly within the continent, and the various areas of the sector to be regulated to ensure fair competition. For example, Africa currently imports a large share of construction services from outside the continent, a rate that could be cut if it standardized regulations, streamlined border processes and removed duties on transit services.

Some policy actions Africa-wide would support such developments, including:

- Letting skilled workers move freely across the region through better immigration and employment laws. Services need people and ideas to move around quickly, so as to source the best talent.
- Ensuring that trade policies do not overprotect local services. Businesses in one country should be able to benefit from the availability of good support services in other countries in the region, without limiting their choices to what's available in their own countries. At the same time, services firms should have access to procurement opportunities at subregional or continental levels.
- Adopting continent-wide investment regimes, improving technical interoperability, and mutually recognizing qualifications. These influence countries' capacities to access outsourcing.
- Building hubs of excellence in services. Software and hightech parks, for example, can help service firms bypass their infrastructure and regulatory bottlenecks that the rest of the economy struggles with. Investors generally respond positively to the heightened transparency and predictability of the parks' regulatory environment (ITC, 2013b).
- Accelerating pro-competition regulation of telecoms, transport, banking and insurance.
- Including services in the Continental Free Trade Agreement planned for 2017.

## **A promising approach for African countries would be to start developing and strengthening RVCs by developing regional clusters**

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## APPENDIX 4.1 CORRESPONDENCE BETWEEN OECD AND BILATERAL TRADE DATABASE BY END-USE CATEGORY AND OTHER TRADE CLASSIFICATION

	UN Broad Economic Category (BEC)	Harmonized System 1998	Harmonized System 1996 and 2002	Harmonized System 2007	Harmonized System 2012
Intermediate goods	111, 121, 21, 22, 31, 32*, 42	(01–19, 21–45, 47–56, 58–60, 63, 65–76, 78–85, 87, 89–96)*			
Household consumption	112, 122, 32*, 522, 61*, 62*, 63*	(02–04, 06–11, 15–24, 30, 32–40, 42–44, 46, 48–52, 54–59, 61–74, 76, 82–85, 87–97)*			
Capital goods	41, 521	(01, 71, 73, 76, 82–91, 93–96)*			
Mixed use	Packed medicines	63*	3004xx		
	Personal computers	61*	8471xx		8471xx, 852841, 852851
	Passenger cars	51	87032x, 87033x, 87039x		
	Personal phones (fixed and mobile)	41*, 62*	852520	852520	851712
	Precious goods	21*, 22*, 61*, 7*	7101xx, 7102xx, 7103xx, 710820, 970400, 970500, 970600		
Miscellaneous	7*	Commodities not elsewhere specified			

\*Parts.

Source: Adapted from OECD, 2014b.

# ENDNOTES

- 1 A similar distinction is evident in the conceptualization of Aid for Trade, whose measurement includes four “proxies”, namely trade-related infrastructures, productive capacities, trade policy and regulations and adjustment costs.
- 2 The index of trade complementarity (TC) between countries  $k$  and  $j$  is defined as  $TC_{kj} = 1 - \frac{\sum_i (|M_{ik} - X_{ij}|)}{2}$ , where  $X_{ij}$  is the share of good  $i$  in the global exports of country  $j$  and  $M_{ik}$  is the share of good  $i$  in all imports of country  $k$ . The index ranges between 0 and 1, with zero indicating that there is no correspondence between country  $j$ 's export structure and country  $k$ 's import structure and one indicating a perfect match in the export–import pattern. As such, the index provides useful information on scope for intraregional trade, given that it shows how well the structures of a country's imports and exports match.
- 3 The corresponding global survey was conducted by OECD and WTO and covered firms in five economic sectors: agro-food, ICT, textiles and apparel, tourism and transport–logistics.
- 4 Data drawn from World Development Indicators database, accessed 25 November 2014.
- 5 The guidelines for preferential rules of origin for LDCs, adopted at the Ninth WTO Ministerial in Bali, are a set of voluntary measures aiming at relaxing some provisions on the use of foreign inputs and facilitating cumulation across LDCs.
- 6 One example should suffice: in 2012 the cost of exporting a standard container from Africa was \$1,875, significantly higher than the world average of \$1,470 (World Bank, Doing Business).
- 7 For a more precise correspondence between end-use categories and trade statistics classifications, see annex 4.1.
- 8 Mixed-end use products, whose share in total imports hovered around 9 per cent, refer to consumer-oriented final goods such as personal computers, phones, passenger cars, packed medicines and precious goods, which could be used by households and firms.
- 9 Unless otherwise stated, all data on trade by end use in this section are from the OECD Bilateral Trade Database by Industry and End-Use Category (ISIC Rev. 3), consulted 4 November 2014. This database combines trade data from OECD's International Trade by Commodities Statistics and UNSD's COMTRADE, with information from Input-Output tables to identify the correspondence of HS classifications to Broad End-use Categories. Two main caveats apply to its use: data are available only for 39 African countries, representing roughly 77 per cent of the continent's exports and 89 per cent of its imports; and, as with other bilateral trade data, mirror import and export flows may not often match, due to statistical errors, different criteria, varying evaluation methods for imports and exports, and re-exports (OECD, 2014b).
- 10 The share of capital and mixed-use products in Africa's export basket is negligible.
- 11 The “flying geese” paradigm is a model, originally proposed by Kaname Akamatsu in the 1930s, to describe the evolution of the international division of labour in East Asia. WTO and IDE-JETRO (2011) notes that in all major Asian economies except India, intra-regional trade accounts for over half of total trade in intermediate products.
- 12 We apply the definition of services adopted by the United Nations International Trade Centre (ITC), i.e., services comprise transport; travel; communication services; construction services; insurance services; financial services; computer and information services; royalties and license fees; other business services; personal, cultural and recreational services; government services and personal remittances.
- 13 OECD. (May 2013). Trade policy implications of Global Value Chains. Available from [http://www.oecd.org/sti/ind/Trade\\_Policy\\_Implications\\_May\\_2013.pdf](http://www.oecd.org/sti/ind/Trade_Policy_Implications_May_2013.pdf).
- 14 Adrianaivo, M., and K. Kpodar (2011).
- 15 ITC data.
- 16 Note that not all of the 12 countries have data available for the same year.
- 17 World Development Indicators.
- 18 ECA analysis of ASYB database.
- 19 ITC data.
- 20 WTO definition: Travel includes goods and services acquired by personal travellers, for health, education or other purposes, and by business travellers. Unlike other services, travel is not a specific type of service, but an assortment of goods and services consumed by travellers. The most common goods and services covered are lodging, food and beverages, entertainment and transport (in the economy visited) and gifts and souvenirs.
- 21 WTO definition: Transport services cover sea, air and other, including land, internal waterway, space and pipeline transport services that are performed by residents of one economy for those of another, and that involve the carriage of passengers, the movement of goods (freight), rentals (charters) of carriers with crew, and related supporting and auxiliary services.
- 22 ECA calculation based on African development indicators.
- 23 ECA calculation based on African development indicators.
- 24 Calculations based on World Development Indicators database (2014).
- 25 The World Bank's total natural resources rents indicator shows the sum of rents from all kinds of natural resources including oil, natural gas, coal, mineral and forest rents as a share of GDP. Rents are defined as the difference between the value of production at world prices and their total production costs.
- 26 ECA analysis of World Bank and ASYB data.
- 27 United Nations Comtrade data.



- 28 International Trade Forum Magazine. Trade in Finance Cross-border investments in Botswana. Issue 2010. Available from <http://www.tradeforum.org/Trade-in-Finance-Cross-Border-Investments-in-Botswana/>.
- 29 International Trade Forum Magazine. Trade in Finance Cross-border investments in Botswana. Issue 2010. Available from <http://www.tradeforum.org/Trade-in-Finance-Cross-Border-Investments-in-Botswana/>.
- 30 UNCTAD (2014). Services policy review: Rwanda. Available from [http://unctad.org/en/PublicationsLibrary/ditctnrd2013d6\\_en.pdf](http://unctad.org/en/PublicationsLibrary/ditctnrd2013d6_en.pdf).
- 31 Remarkable Rwanda. <http://www.rwandatourism.com/index.php/destinations-and-activities/nyungwe-national-park/96-media-centre/press-releases>.
- 32 Rwanda Economic Development and Poverty Reduction Strategy 2013 targets.
- 33 National Bank of Rwanda. Foreign private investment in Rwanda 2012. Available from [http://www.bnr.rw/uploads/media/Foreign\\_Private\\_Investments\\_in\\_Rwanda\\_2012.pdf](http://www.bnr.rw/uploads/media/Foreign_Private_Investments_in_Rwanda_2012.pdf).



**Part 2: Industrialization–Trade Nexus**

CHAPTER

5

**GETTING TRADE AGREEMENTS  
TO ADVANCE AFRICA'S  
INDUSTRIALIZATION**

Despite the huge gains in world trade growth brought about by the multilateral trading system embodied in the World Trade Organization (WTO), slow progress (box 5.1), repeated blockages, unequal negotiation powers and mitigated expected benefits have forced countries—particularly in Africa—to explore alternative routes to expand their trade.

Since the early 1990s, preferential trade agreements and regional trade agreements have proliferated.<sup>1</sup> These are against the principle of most-favoured nation (MFN) non-discriminatory treatment<sup>2</sup> but have been tolerated by the WTO either through waivers,<sup>3</sup> the enabling clause (preferential trade agreements between developing countries) or exceptions (free trade areas, customs unions and economic integration agreements). Africa is engaged—or is about to engage—in multiple regional agreements at all levels (unilateral and bilateral), but may well have to reconsider its negotiating approach, based on four main findings from recent analysis.

First, preferential schemes have been helpful in supporting Africa's trade with preference-giving countries, but they have failed to broadly enhance

Africa's industrialization. One of the key constraints limiting the use of preferences in manufacturing goods has been the imbalance between the productive capacity of African countries and stringent rules of origin. Although they remain important for Africa looking forward, unilateral trade preferences alone can hardly enable the conditions required for the development of regional value chains (RVCs).

Second, establishing the African Continental Free Trade Area (CFTA) could go a long way in supporting industrialization, a key for Africa's intra-regional integration. CFTA would help increase both intra-African trade and its industrial content, and the adoption of trade facilitation measures on top of CFTA reform would enhance positive outcomes. The level of ambition for Africa's regional integration should be elevated. Non-tariff barriers (NTBs) should be tackled along with tariffs on both goods and services. Greater attention should also be given to developing RVCs largely untapped within the continent.

Third, strategic Africa-wide trade policies are needed. Introducing reciprocity between Africa and traditional partners can provide significant trade

### **BOX 5.1: LATEST DEVELOPMENTS IN THE MULTILATERAL TRADING SYSTEM AND IMPLICATIONS FOR AFRICA**

After 12 years of unsuccessful talks in the Doha Round—also known as the Doha Development Agenda—it was only at the WTO Ministerial Conference held in Bali, Indonesia, in December 2013 that the agenda was revitalized with agreement on the “Bali package”. Trade facilitation, agricultural issues (especially those touching on cotton production), and developed and least-developed country issues are the agenda's three components.

The most important component for Africa was trade facilitation, but that raises some concerns. First, rapid gains for most African countries are unlikely. Having little export capacity, African countries may not benefit from these reforms as quickly as export-ready countries. Thus in the short run one can expect Africa's imports to increase more than its exports, deteriorating national trade balances. The difficulties for African countries in meeting sanitary and phytosanitary norms, standards and rules of origin could also undermine gains from trade facilitation reforms. But developing countries and LDCs are granted special and differential treatment with less pressing deadlines to adopt the agreement's provisions. Second, trade facilitation reforms are very costly, and although the Bali agreement offers financial and technical assistance to African nations, it is not subject to any binding commitment.

On 27 November 2014, the 160 WTO members reached an agreement that will formally incorporate the Bali agreement into the WTO's legal framework and will enter into force when at least two thirds of members have completed their national ratification process. This development offers some hope.

benefits for both parties. But initial asymmetric protection conditions lead to unbalanced gains, with Africa's benefits only expected for non-LDCs (least developed countries) in few agricultural sectors. Nonetheless, such reform should be used as an opportunity to strategically define external tariff structures (such as allowing cheaper imported intermediate inputs to be used in the production of industrial goods) to ensure that Africa's regional integration agenda and industrialization are not weakened. A brief review of policy space available in the different types of trade agreements suggests that South-South cooperation could be more promising than North-South engagements in supporting Africa's industrialization.

Fourth, the sequencing of trade policy reforms matters greatly. There is powerful evidence that CFTA should be put in place before other trade agreements are fully implemented by African countries or by the rest of the world (such as mega-regional trade agreements).<sup>4</sup> Doing so would not only preserve the anticipated benefits from these agreements but also offset most—if not all—their

costs to Africa and to its industrialization. And deeper, broader and bolder regional integration should be followed by the gradual opening-up of African economies to the rest of the world, as African countries would then be in better position to compete internationally. Conducive socio-economic conditions, peace and security, and political will are all important to ensure that Africa's structural transformation is effective.

The subsequent sections explore the expected impacts of the key trade agreements on Africa's industrialization, the interventions required to make them effective and the importance of sequencing trade reforms in a strategic manner.

**Africa is engaged (or is about to engage) in multiple regional agreements at all levels, but may well have to reconsider its negotiating approach**

## **FAILURE OF PREFERENTIAL SCHEMES TO BROADLY ENHANCE INDUSTRIALIZATION**

### **ECONOMIES OFFERING TRADE PREFERENCES HAVE ABSORBED A LARGE SHARE OF AFRICA'S EXPORTS, BUT SUCH SCHEMES HAVE DONE LITTLE TO HELP AFRICA INDUSTRIALIZE**

The preferential treatment of many developed and some developing economies seems to support African export growth. Over 2000–2012, the top five destinations of Africa's exports were all entities offering improved market access through preferential treatment (in decreasing order: the European Union (EU), the United States (US), China,

India, and Japan).<sup>5,6</sup> Not less than 72 per cent of cumulative total exports from strictly African LDCs were directed towards the top five partners outside the continent over 2000–2012.

The EU offers the most generous preferential scheme with nearly 100 per cent duty-free quota-free (DFQF) access granted to all LDCs since 2001, through the Everything But Arms (EBA) initiative.

China launched its preferential scheme in 2010, giving DFQF access for 60 per cent of tariff lines to 40 LDCs. In the programme's first year, 98.7 per cent of Chinese imports from LDCs were products

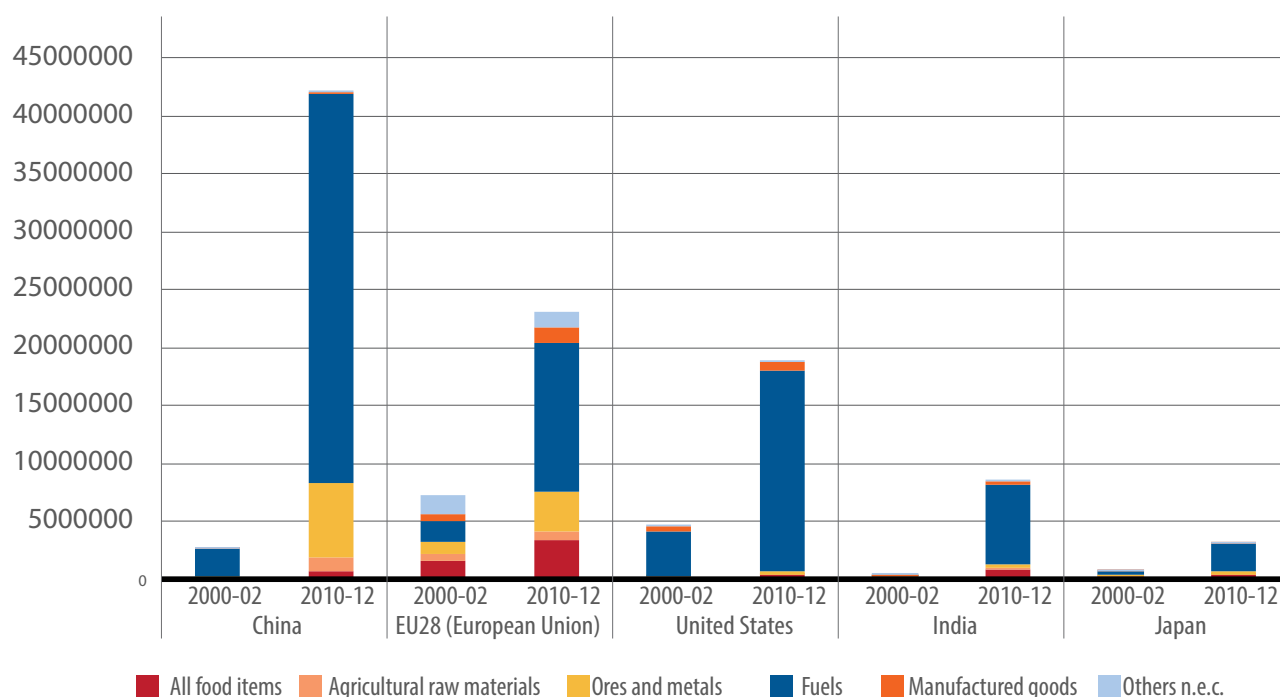
eligible for DFQF.<sup>7</sup> It is expected to expand to 97 per cent of tariff lines and is accessible to all LDCs with which China has diplomatic relations. China overtook the US and the EU for African LDCs as an export destination from 2006, and since 2010 African LDCs' export value to China has on average been greater than that to the EU and US combined (figure 5.1).

India's preferential scheme to LDCs started in 2008, progressively offering DFQF to 85 per cent of tariff lines by 2012. An additional 9 per cent of tariff lines are subject to preferential rates, leaving only 6 per cent of product lines on the exclusion list. Any LDC can benefit from the programme by simply sending the Indian government a letter of intent to use the preferences. African LDCs' exports to India increased greatly over 2000–2012, with the steepest growth in the second half of the period.

Japan provides generous trade preferences to all LDCs, with nearly 98 per cent of tariff lines eligible under DFQF. However, the US does not have a specific programme for LDCs but a range of initiatives that average about 83 per cent of tariff lines granting DFQF to an LDC (Odari, 2013).

The proportion of manufactured goods exported by African LDCs to their main partners is extremely marginal and did not improve over 2000–2012 (figure 5.1). Most exports from African LDCs to their top five foreign partners are still concentrated in fuels and to a lesser extent ores and metals, suggesting that trade preferences have failed to promote manufactured exports for LDCs, whether the destination is a traditional partner or an emerging market (although data from emerging economies must be interpreted cautiously as their schemes started recently).

**FIGURE 5.1: EVOLUTION OF LDCS' EXPORTS TO TOP FIVE DESTINATIONS OUTSIDE AFRICA, 2000–2002 VERSUS 2010–2012 AVERAGES (\$)**



Source: Authors' calculations based on UNCTADstat (accessed 5 January 2015).

All African countries (not just LDCs) are granted some degree of preferential market access through at least one of the Generalized System of Preferences (GSP) programmes offered mainly by developed economies. For example, Japan offers GSP to all African countries without exception.

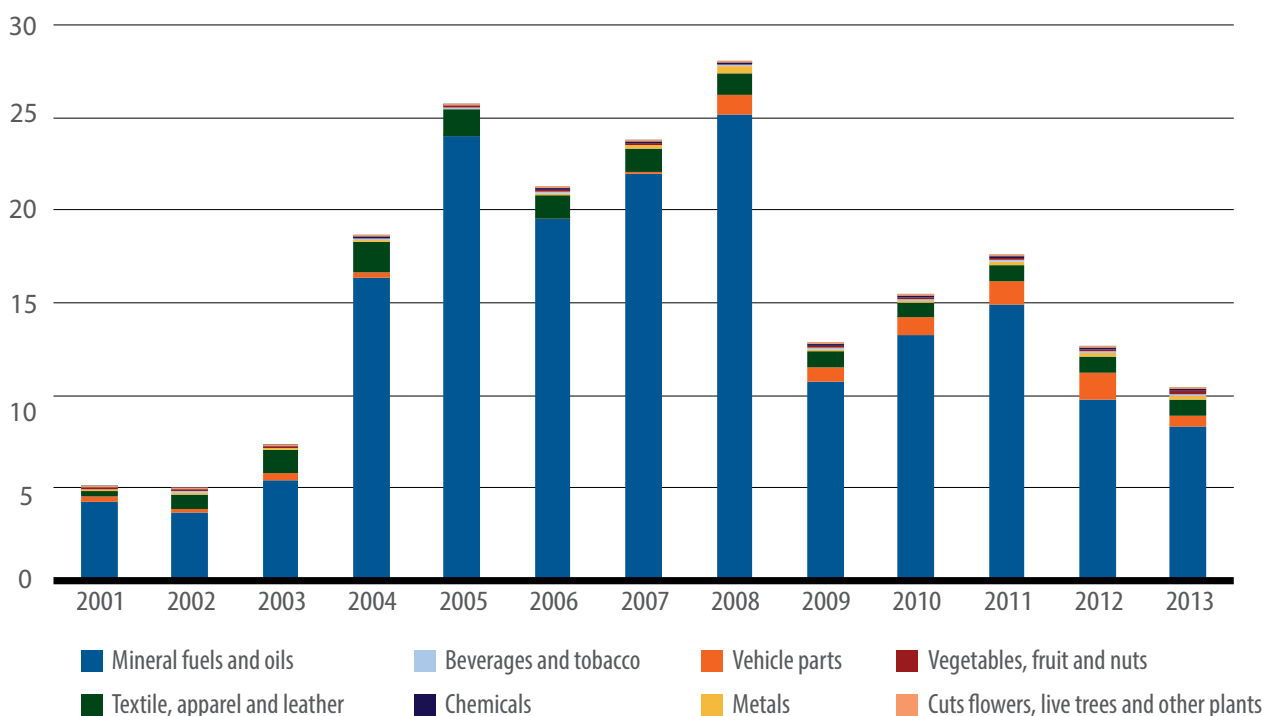
Rather than a preferential scheme for LDCs, the US has instituted the African Growth and Opportunity Act (AGOA) for most African countries.<sup>8</sup> It builds on the US-GSP by adding preferences for about 1,800 eligible tariff lines, bringing the total of African exports to the US to 6,400 lines exempt from tariff duties.<sup>9</sup>

AGOA also seems to have promoted US-Africa trade. Two-way trade between the US and AGOA-eligible countries increased nearly threefold over 2001–2013, reaching a peak of \$100 billion in 2008, with a growing share explained by AGOA-eligible products alone (excluding US-GSP product lines)

(ECA and AUC, 2014). Over 2001–2008, US imports of AGOA-eligible products rose sharply, from about \$5 billion in 2001 to \$28 billion in 2008 (figure 5.2). But after the global financial crisis, exports of AGOA-eligible products to the US slumped because of the combined effects of a drop in primary commodity prices in 2009 and lower US demand.

Thanks to AGOA, some African countries (including South Africa, Ethiopia, Ghana, Kenya, Lesotho (box 5.2), Madagascar, Mauritius and Swaziland) have grabbed export opportunities in a few industrial sectors—mainly textiles and apparel, but also vehicle parts in South Africa. But like other preferential schemes, AGOA has clearly not helped Africa to diversify its export products, with energy commodities still constituting the bulk of AGOA-eligible countries' exports to the US.

**FIGURE 5.2: EVOLUTION OF US IMPORTS OF AGOA-ELIGIBLE PRODUCTS FROM AGOA-ELIGIBLE COUNTRIES BY MAIN SECTOR, 2001–2013 (\$ BILLION)**



Source: Based on US International Trade Commission DataWeb, <http://dataweb.usitc.gov/> (accessed 21 November 2014).

### **BOX 5.2: LESOTHO'S APPAREL INDUSTRY DRIVEN BY AGOA AND ITS THIRD-COUNTRY FABRIC RULE OF ORIGIN PROVISION**

Lesotho gained AGOA-eligibility in 2001. Since then, its industrial base has gone from non-existent to thriving. Lesotho is now Africa's top garment exporter and a leading textiles exporter among AGOA beneficiaries, and private employment has surpassed that of government. Lesotho has eliminated barriers to US trade and investment and offers the protection of internationally recognized workers' rights.

In response to the AGOA apparel incentives, the apparel sector has become Lesotho's largest employer. Apparel is the country's largest export to the US, with twenty firms exporting there. In 2013, 45,401 jobs were created— 25,882 direct jobs and 19,519 indirect jobs split into 12,903 in textiles and clothing, and 6,616 in other sectors—for a 162 per cent increase since AGOA's inception in 2001. Lesotho's exports to the US grew 145 per cent from 2001 to 2013. In 2013 Lesotho's apparel exports to the US valued \$300

million and comprised 7,000 tons of fabric, 26 million pairs of jeans and 70 million knitted garments.

Lesotho is the only African country with a Better Work Programme (BWP). BWP Lesotho is a partnership programme between the International Labour Organization and the International Finance Corporation. The BWP's goal is to reduce poverty by creating decent work opportunities in Lesotho's garment industry.

The key to the success of the AGOA apparel program has been the third-country fabric provision (details are in the main text [see next sub-section]), which allows apparel manufacturers in least-developed AGOA beneficiaries to use yarns and fabrics from any qualifying country of origin. This provision accounts for more than 95 per cent of the apparel imports under AGOA, and virtually all of Lesotho's apparel exports are under this provision.

One challenge is the short duration of AGOA's provisions, making it hard for Africa to develop a vertically integrated textile–apparel value chain, especially as apparel orders are placed up to nine months in advance. Hundreds of thousands of jobs and hundreds of millions of dollars of orders could be jeopardized, and the longer the delay, the greater the losses. Until sufficient upstream textile production capacity has been developed, it is critical that AGOA continue to allow African apparel producers to use the yarns and fabrics required by their US buyers. US buyers have not accepted Lesotho's proposal to source material from Southern African countries (such as South Africa, Mauritius, Madagascar) owing to quality, standards and types of materials.

Source: Lerato Ntlopo, Trade Programme Director, Policy Analysis and Research Institute of Lesotho (PARIL). 1 December 2014.

### **REDUCING EXCLUSION LISTS AND FINDING A BALANCE BETWEEN PRODUCTIVE CAPACITY AND RULES OF ORIGIN**

The key for Africa's success is to use the preferences it has been granted rather than worry about the few products on exclusion lists that have a big impact (box 5.3). Lack of productive capacity, infrastructure challenges and difficulty in complying with export market requirements such as sanitary and phytosanitary norms, standards and rules of origin stand out as problems to be overcome in meeting this goal.

The critical issue for African countries lies in the imbalance between productive capacity and rules of origin. Many of the trade preference programmes

have rules of origin imposing minimum levels of local production that most African economies cannot achieve. For example, the EU-GSP requires a two-stage transformation process for textile and clothing products to qualify for preferential rates under the rules of origin for non-LDCs. First, woven yarn must be transformed into fabric and then fabric made into clothing (Kommerskollegium, 2012).

Thus it is impossible for non-LDCs to benefit from preferences under the EU-GSP when the clothing they are exporting to the EU is made of imported fabric. Cumbersome rules of origin can also vary greatly from one preferential scheme to another, rendering it even harder for countries to meet export requirements. Intended to limit trade deflection, rules of origin are increasingly used by preference-giving countries for other ends—such



as protecting import-competing industries in preference-giving countries or helping to establish industries in preference-receiving countries (Elliot, 2010). Such a situation can be perceived as “giving away with one hand (preferences) and taking away with another (restrictive rules of origin)” (Carrere and De Melo, 2011).

The solution to stringent rules of origin is not simply to upgrade the productive capacity of African economies, but to simplify the rules of origin imposed on them. AGOA’s third-country fabric provision illustrates how well exports respond to relaxed rules of origin.

US imports of AGOA-eligible textile, apparel and leather products from AGOA-eligible countries

more than tripled over 2001–2004, followed by a sharp decline until 2010 (figure 5.3). The decline occurred after the 2005 WTO Agreement on Textiles and Clothing (ATC) ended quotas for developing countries’ textile and apparel exports to developed countries. This agreement resulted in fierce competition for African countries on the US market from Asian economies such as China, Bangladesh, Cambodia and Vietnam.

Many argue that Africa’s exports of textile and apparel to the US did not disappear and even picked up again after 2011 because of AGOA’s third-country fabric provision. This provision allows 24 of the 38 AGOA-eligible countries<sup>10</sup> to source fabric from third countries for making clothing that can then be exported duty-free to the US market.

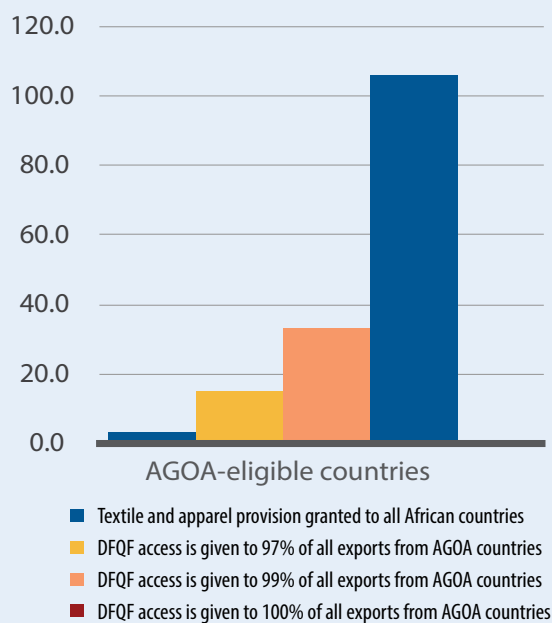
**BOX 5.3: LARGE IMPACTS FROM FEW PRODUCTS**

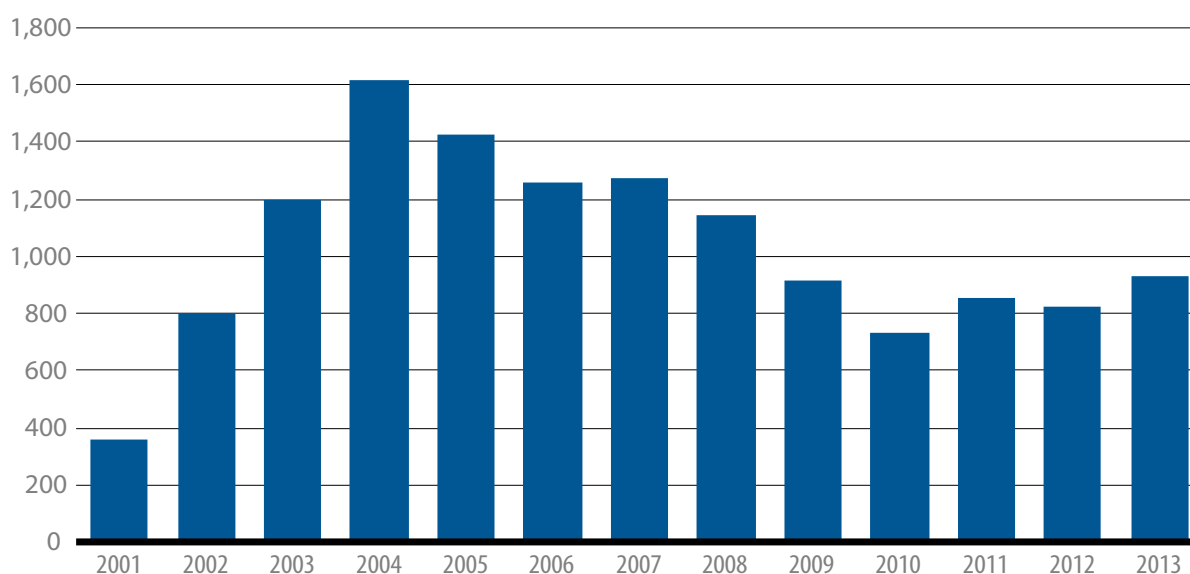
A few key items on exclusion lists—and therefore ineligible to DFQF—narrow the benefits for African countries. Assuming that AGOA legislation is extended after 2015 and that preferences would cover a wider range of products than those currently eligible for DFQF, African exports would be stimulated with benefits that are more evenly distributed across countries (ECA and Brookings, 2013). Such gains would be realized if the most sensitive US imports from AGOA-eligible countries (sugar, peanuts, leaf tobacco, cotton and diamonds) were also granted DFQF (box figure). And if the US does grant 100 per cent DFQF, American producers would not be negatively affected by the increase in Africa’s exports to their country.

Also, if WTO reforms for market access led to substantial trade and income gains for African middle-income countries, the expected outcomes would be much less for LDCs, with some potentially losing from multilateral trade reform (Bouët et al., 2006). Comparing trade and real income implications following the implementation of 97 per cent DFQF granted to LDCs (with full DFQF to LDCs on OECD markets), the authors show that DFQF granted to the 3 per cent most sensitive products could make a huge difference and reverse outcomes for all LDCs, leading to real income gains and trade expansion in agriculture and industry.

Source: ECA and Brookings (2013).

**BOX 5.3 FIGURE 1: AGOA-ELIGIBLE COUNTRIES’ EXPORTS TO THE US, FOLLOWING EXTENSION OF AGOA UNDER SEVERAL SCENARIOS OF POSSIBLE EXPANSION BY PRODUCT ELIGIBILITY, 2025 (\$ MILLION)**



**FIGURE 5.3: EVOLUTION OF US IMPORTS OF AGOA-ELIGIBLE TEXTILE, APPAREL AND LEATHER PRODUCTS FROM AGOA-ELIGIBLE COUNTRIES, 2001–2013 (\$ MILLION)**

Source: Based on US International Trade Commission DataWeb, <http://dataweb.usitc.gov/> (accessed 21 November 2014).

### TRADE PREFERENCES ALONE CANNOT BUILD RVCs, THOUGH THEY CAN SUPPORT A FAVOURABLE ENVIRONMENT

The link between increased trade and launch of value chains is not clear (chapter 4). AGOA, for example, has not yet led to the development of RVCs in Africa. One reason for this is AGOA's lack of predictability, which deters investment—as its preferences can be amended or withdrawn at any time. The third-country fabric provision is not an integral part of AGOA, and its renewal just before its slated expiration in 2012 created much uncertainty. The removal of preferences can have very negative effects and wash away entire industries. Madagascar was suspended from AGOA in 2009 but brought back in 2014, and its loss of preferences (owing to turmoil in the country) had a larger negative impact on the country's exports than the turmoil itself (Fukunishi, 2013). The country's suspension increased by 57.8 per cent the probability of closure for plants trading exclusively with the US. Prior to Madagascar's deferral from AGOA in 2009, as much as half of the textile industry's \$600 million annual income derived from its exports to the US.<sup>11</sup>

Another reason that trade preferences do not guarantee RVCs has to do with the trade preferences themselves. Edwards and Lawrence (2010) showed that AGOA-preferences in textile and apparel encourage production of low value-added products, promoting use of fabrics unlikely to be produced domestically. This production renders improbable the forging of backward linkages to local textile and apparel industries that are usually seen in the early stages of development.

This does not mean that preferences are unimportant and that they cannot provide a basis for RVCs and ultimately industrialization—but they do have to be backed up by national policies to increase worker productivity, upgrade labour skills and productive capacity (chapter 6), enhance competitiveness of African economies and attract investment.

To avoid disappointment, African countries engaging with emerging partners (especially China and India) must look carefully into the rules required to qualify for DFQF. As emerging countries give trade preferences to LDCs, it is critical that Africa be offered rules of origin allowing sufficient use of their

preferences in industrial sectors and having RVC potential. For example, the EU recently simplified the rules for LDCs to qualify for preferential rates under the EU-GSP and economic partnership agreements (EPAs), by requiring a one-stage rather than two-stage transformation process for textile and clothing products. Such efforts go in the right direction, but simplifying and harmonizing the rules of origin in all the preferential schemes would be ideal.

African countries cannot rely on preferences alone if they wish to sustainably industrialize through trade. They need to engage more deeply with partners from Africa itself and from outside the continent.

## REINFORCING TRADING RELATIONSHIPS WITHIN THE CONTINENT AS A STRONGER BASIS FOR INDUSTRIALIZING

In January 2012 African Heads of State and Government endorsed an African Union action plan, Boosting Intra-African Trade, and the establishment of a Continental Free Trade Area (CFTA),<sup>12</sup> entailing commitment to fast-track regional integration on the continent. If effective from its planned launch in 2015, a COMESA-EAC-SADC Tripartite Free Trade Area (TFTA)—encompassing nearly half of Africa—would give momentum to CFTA, tentatively scheduled for 2017.

### THE TFTA WOULD NOT EXCLUSIVELY STIMULATE INDUSTRIAL PRODUCTION OF BIG PLAYERS

Negotiations for a TFTA between three existing regional economic communities (RECs)—the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC), and the Southern African Development Community (SADC)—have been ongoing since the first TFTA

summit in Kampala in October 2008. On 25 October 2014 in Bujumbura, Burundi, the decision was made to launch the TFTA by ministers from its 26 member countries.<sup>13</sup> The draft agreement is to be signed by heads of state at a summit tentatively scheduled in May 2015, then ratified by the 26 member states and enter into force on a simple majority.

The TFTA will span the whole of East Africa from the Cape to the North African coast, creating Africa's largest free trade area.<sup>14</sup> With a combined population of 638 million people, and a total GDP of \$1.2 trillion, the economic implications of the TFTA are enormous. As with most regional integration schemes, the underlying economic rationale is to allow economies of scale and scope, greater competition, a more attractive internal market for investment (foreign and domestic) and more intra-regional trade. The agreement also has great symbolic importance, preparing the way for CFTA and ultimately a continent-wide African Economic Community.

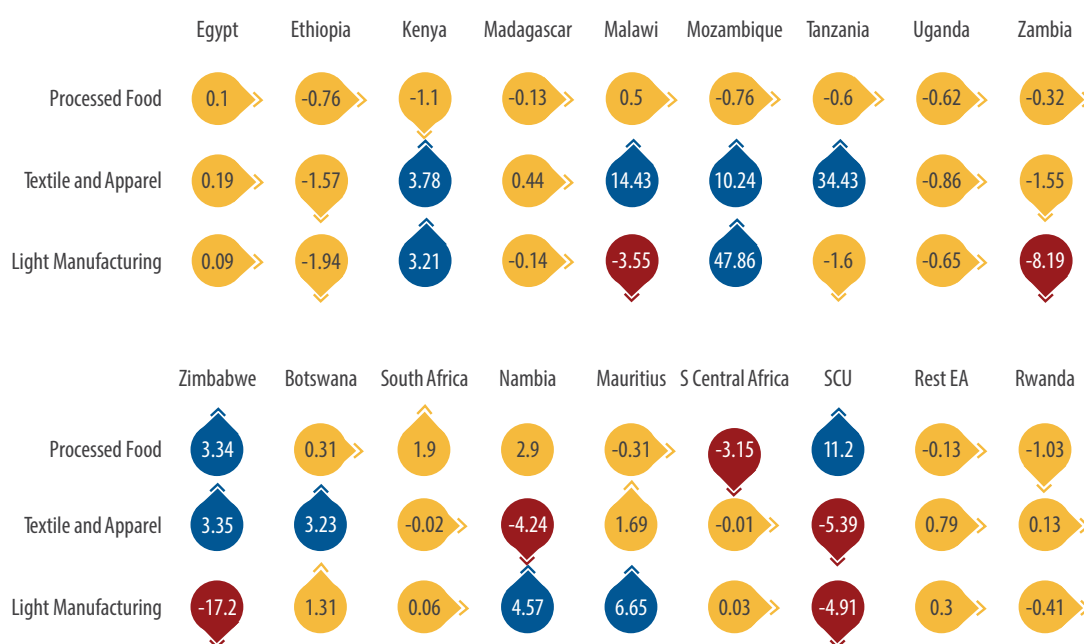
A key concern for smaller countries within TFTA is that their manufacturing would be overshadowed by Egypt and South Africa, the countries with the largest domestic markets and highest productivity,<sup>15</sup> which account for nearly two thirds of manufacturing value added in the TFTA. The top five countries in value-added terms produce more than 80 per cent of all manufacturing in the region. Would TFTA exaggerate this skewed pattern?

To answer this question, Mold and Mukwaya (2014) analyse the effects of the proposed TFTA, focusing specifically on the potential impacts on the industrial geography of the region. The authors concentrate essentially on intra-regional shifts in the textile industry, food-processing and light manufacturing, because these sectors are important in the early stages of industrialization and structural transformation. They find that eliminating the tariffs between TFTA members would result in only a 0.4 per cent increase in aggregate total volume of industrial output in the region.

The sectors could expect more pronounced changes, however. Processed foods show significant changes in production in two of 18 countries/regions in the analysis (Zimbabwe and the rest of the Southern African Customs Union, or SACU) (table 5.1). Textiles and apparel have substantial increases in production in six countries (Botswana, Kenya, Malawi, Mozambique, Tanzania and Zimbabwe), while only two experience notable falls (Namibia and the rest of SACU). Light manufacturing shows four countries with significant increases in output (Kenya, Mauritius, Mozambique and Namibia), while four countries/regions see declines (Malawi, Zambia, and Zimbabwe and the rest of SACU). In all other cases, the expected shifts in production are relatively small.

The results of the analysis seem to allay fears of industrial concentration. Neither South Africa nor Egypt appears to be the principal beneficiary in any of these sectors.

**TABLE 5.1: SHIFTS IN INDUSTRIAL PRODUCTION AFTER IMPLEMENTATION OF TFTA REFORM, PERCENT CHANGE COMPARED TO A SITUATION WITHOUT TFTA IN PLACE**



Source: Mold and Mukwaya (2014).

Note: "S Central Africa" stands for South Central Africa composite region made up of Angola and the Democratic Republic of the Congo; SCU stands for the rest of SACU, which includes Lesotho and Swaziland.

The analysis is likely to underestimate the net benefits, because the authors only eliminate tariffs for intra-regional trade for TFTA members and do not take into account any other impediments to regional trade, such as infrastructure deficits and NTBs. Nor were sector- or firm-level economies of scale considered.

## **BOOSTING INTRA-AFRICAN TRADE AND ITS INDUSTRIAL CONTENT THROUGH CFTA**

Building on the acquis of TFTA, Africa's CFTA is expected to bring considerable benefits to the continent. An enlarged integrated market—of 54 countries and about 1 billion people—free of tariffs and NTBs would allow for large economies of scale and stimulate intra-African trade. Moving towards integration beyond the RECs is essential—although tariff barriers to trade are currently being reduced within the RECs, significant tariffs still remain between them. As a result, global protection within Africa averages about 8.7 per cent but only 2.5 per cent to the rest of the world. For strictly industrial products the difference is even starker—9.0 per cent and 2.3 per cent (Mevel and Karingi, 2013).

In other words—thanks mainly to trade preferences—it is on average cheaper for African countries to export to a foreign market than to an African counterpart. So, CFTA could cause African economies to become more competitive internationally, since regional markets are easier to penetrate and have less restrictive standards than foreign markets.

The removal of tariff barriers within Africa on goods only could raise the share of intra-African formal trade from 10.2 per cent to 15.5 per cent in 10 years (Mevel and Karingi, 2012). The gain could be larger still if informal traders were better integrated into the formal system, as statistics on intra-African trade do not include informal cross-border trade (thought to be high).

Most of the increase from this removal would be felt in industry (figure 5.4), which is unsurprising as intra-African trade already tends to be more diversified

and has relatively higher industrial content than Africa's trade with the rest of the world. Africa's global exports are essentially composed of raw materials and primary commodities. Deepening regional integration could also make African nations less dependent on outside partners for their industrial needs, as most of Africa's imports from the rest of the world are manufactured goods.

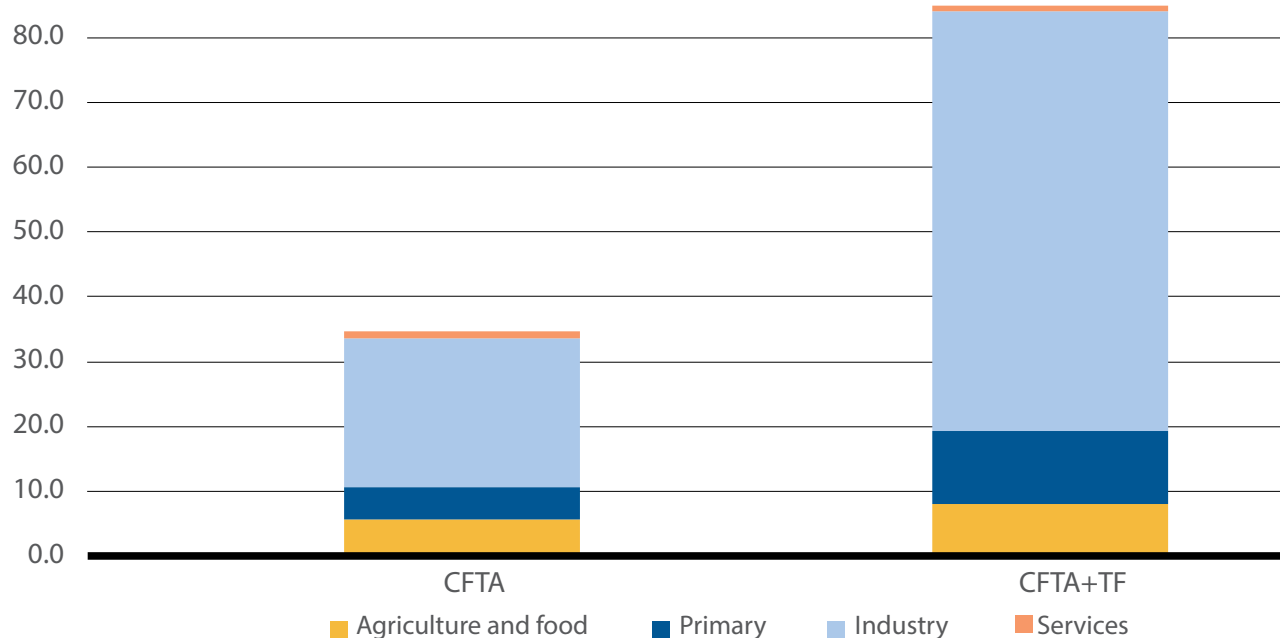
## **CFTA MUST BE ACCOMPANIED BY AMBITIOUS COMPLEMENTARY REFORMS, NOTABLY TRADE FACILITATION**

Regional integration reforms should be ambitious, not dealing with services at the margin (chapter 4). Although these reforms are likely to be tackled after goods, in a second phase of TFTA negotiations, it would be cost- and time-effective to address them only once in a continent-wide perspective (CFTA) rather than regionally (TFTA). Once negotiations on goods have progressed in TFTA, negotiations on services could be undertaken directly at the continental level on a parallel track to CFTA's negotiations on goods.

The success of the regional integration process in transforming African economies will also depend mainly on reducing NTBs in goods and services. Harmonizing rules of origin across the RECs is an imperative for a fully functioning CFTA.

Trade facilitation deserves particular attention for stimulating intra-African trade. If progress is made by reducing costs to trade across borders<sup>16</sup>—in parallel to eliminating tariff barriers on goods within Africa—the share of formal intra-African trade could more than double by 2022, (Mevel and Karingi, 2012), with a boost to the proportion of industrial products (see figure 5.4). And at country level, all African economies would see positive outcomes in both exports and real income. In other words, the trade opportunities brought by trade facilitation measures on top of CFTA would more than offset the few costs from declines in tariff revenues entailed by liberalization.<sup>17</sup>

**FIGURE 5.4: CHANGES IN INTRA-AFRICAN TRADE, FOLLOWING IMPLEMENTATION OF CFTA ALONE VERSUS CFTA ALONG TRADE FACILITATION MEASURES, BY MAIN SECTOR, 2022 (\$ BILLION)**



Source: Mevel and Karingi (2012).

Trade facilitation could even expand intra-African trade and Africa’s industrialization more than the above estimates, as it will lead to faster and more cost-effective sourcing of intermediate inputs, producing higher-value commodities (’Ofa and Karingi, 2013). This facilitation is vital to allow Africa to reduce the cost of its trade of intermediates with countries outside the continent, but also within the largely untapped regional market (chapter 4). Costs of trade across borders are often higher within Africa than between Africa and the rest of the world (ECA, 2013).

The financial costs of regional integration reforms should not be underestimated, which is one reason for African countries to consider greater domestic resource mobilization and curb illicit financial outflows (chapter 1 and Mevel et al., 2014).

### ENHANCING INTRA-INDUSTRY TRADE AND OPPORTUNITIES TO MOVE UP THE VALUE CHAIN THROUGH CFTA

African economies are often small and fragmented, sometimes leading to fears that regional integration may not benefit all countries—but this is not accurate, as shown earlier in the first sub-section of this chapter. CFTA can also create conditions for necessary productive capacity to enter new markets and take advantage of RVCs. And an integrated market could allow for complementarity in terms of countries’ involvement in the RVCs. Certain countries could focus on a specific stage of production for which they have the required productive capacity, while others could target different stages.

’Ofa et al. (2012) found a positive correlation between export diversification and intra-industry trade (exchanges of products within the same industry, those products being similar or

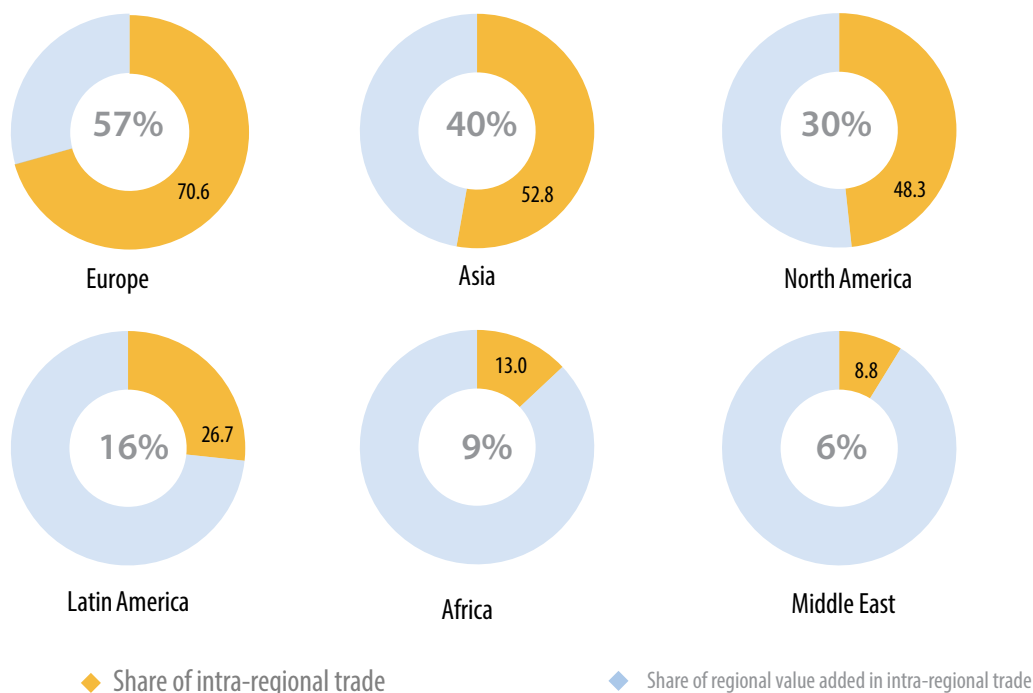
differentiated by quality/variety<sup>18</sup> or at various stages of production) for African countries. They also established a positive relationship between intra-industry trade and the share of manufacturing in GDP, suggesting that a move towards greater industrialization can favour intra-industry trade and vice versa. This finding is paramount, as it suggests that not only can trade support industrialization, but that industrialization can enhance trade. So, if the conditions for industrialization through trade are established, then a multiplication effect should be expected with trade and industrialization reinforcing each other.

Higher shares of intra-regional trade also are associated with higher shares of regional (as opposed to foreign or imported from outside the region) value added in intra-regional trade (figure 5.5). This finding is verified throughout all main regions, with Europe having the largest share of intra-regional trade and the biggest share of

regional value added in intra-regional trade, while Africa and the Middle East are lagging far behind. As already indicated (Chapter 4), in 2011 the share of intra-African trade was barely more than 10 per cent, while the local value added was only about 9.5 per cent of the total value added in intra-African trade. In other words, (see figure 4.3), the value-added in intra-African trade is mostly imported rather than local. But figure 5.5 suggests that a CFTA—expected to enhance intra-African trade and diversify Africa’s internal trade—would enhance output of value-added products issued from the regional market, supporting RVCs.

As pointed out earlier (in this sub-section), a country could integrate value chains at a specific stage of the production process and not necessarily at several stages, however. In the context of deepened regional integration this is even more relevant because within a larger market, countries’ production processes can complement each

**FIGURE 5.5: SHARE OF INTRA-AFRICAN TRADE VERSUS SHARE OF REGIONAL VALUE ADDED IN INTRA-REGIONAL TRADE, BY MAIN REGION, 2011 (%)**



Source: WTO, International Trade Statistics (2012) and ECA computations.

other and not necessarily be substitutes. Regional integration is not a zero-sum game. If one country gains at one stage of production, other countries' backward and forward linkages could still benefit. But just as trade preferences to African nations alone are unlikely to sustain Africa's industrialization, regional integration cannot be the Africa's sole trade strategy. It needs to engage with other partners outside the continent, because the African market is still relatively small. This strategy would mitigate potential shocks to the continent or to its largest trading partners. The current crisis in Europe, in light of the extremely high share of intra-Europe trade (70 per cent; see figure 5.7), illustrates that extreme integration can lead to serious challenges. Nonetheless, Africa's opening to the rest of the world needs to be smartly realized by an injection of strategic trade policies.

**Like trade preferences, regional integration efforts cannot be the Africa's sole trade strategy**



# NEED FOR AFRICA-WIDE STRATEGIC TRADE POLICIES WHEN OPENING TO THE REST OF THE WORLD

**A**frica is already in or negotiating bilateral and multilateral trade agreements that require reciprocity, but it has to preserve policy space (chapter 3 and the rest of this chapter). This space is crucial to guarantee that its priority industrialization efforts (such as regional integration) are not undermined. But this process requires strategic trade policies that do not discourage or limit North-South or South-South trade dynamics.

## INITIAL ASYMMETRIC PROTECTION STRUCTURES IN THE ECONOMIC PARTNERSHIP AGREEMENTS LEAD TO UNEVEN GAINS

The economic partnership agreements (EPAs)—reciprocal but asymmetrical trade agreements between the EU and 79 African, Caribbean and Pacific (ACP) countries<sup>19</sup>—have been justified by the need to comply with WTO rules of reciprocity and non-discrimination. Although the EU is expected to immediately grant 100 per cent DFQF market access to its ACP counterparts, ACP countries are to progressively open their markets duty-free for 75–80 per cent of their imports from the EU. Similar asymmetry is seen in the market access they grant each other. Although most African countries are already given large preferences on their exports to the EU market through the Everything But Arms Initiative for LDCs and Generalized System of Preferences for most middle-income countries (leaving just a few agricultural sectors still protected), the EU faces relatively high tariff barriers on nearly all its exports to Africa. Thus EPAs will not greatly improve Africa's access to the EU, while the EU will see its access to Africa's market significantly increased.

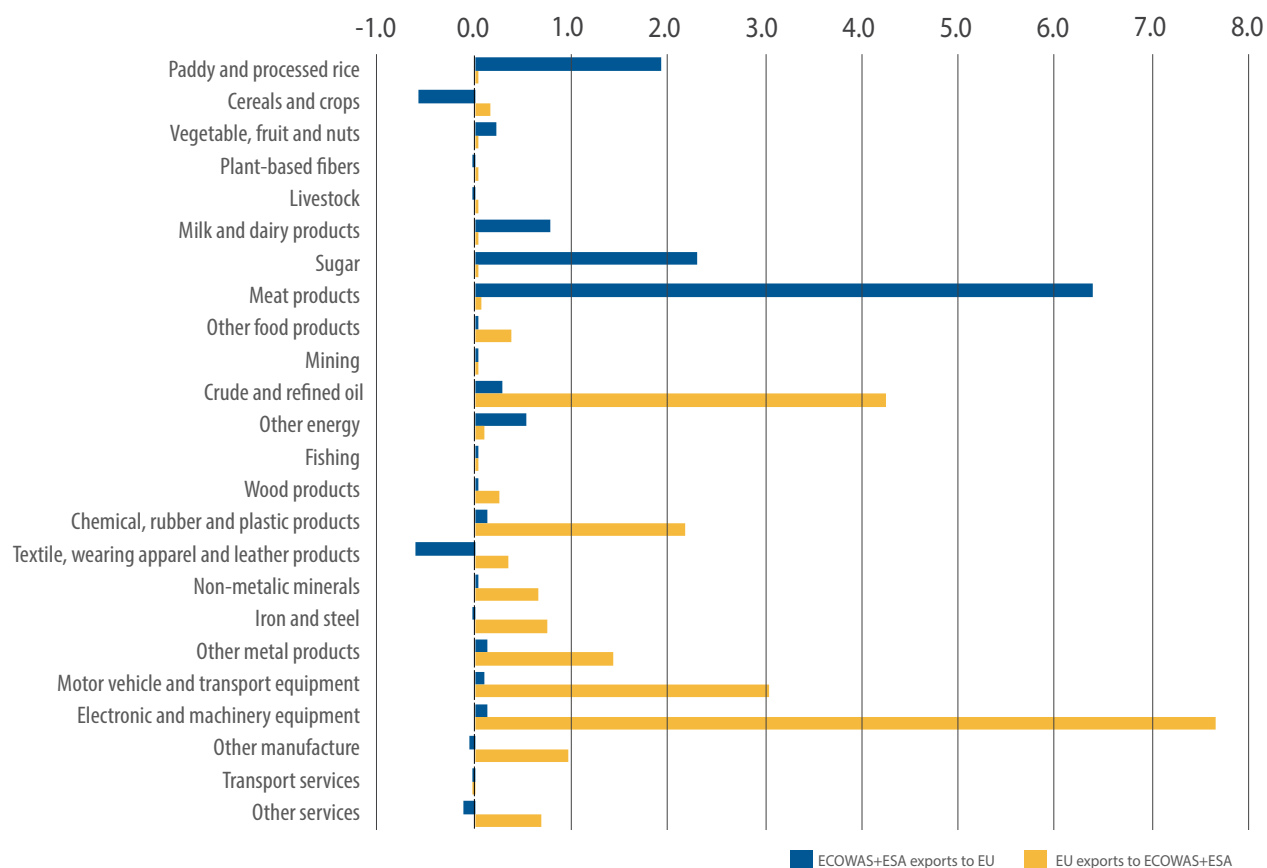
Although African countries have made great progress towards signing the agreements,<sup>20</sup> they still raise concerns. EPAs are expected to generate mixed outcomes for African economies with few benefits for Africa's industrialization, yet they are likely to reduce Africa's policy space.

A study by the Economic Commission for Africa (ECA) examined the implications of EPAs on Africa's structural transformation (Mevel et al., forthcoming). The exercise was undertaken for two of the five regional groupings in negotiation with the EU: the Economic Community of West African States (ECOWAS) and Eastern and Southern Africa (ESA).

Unsurprisingly, the ECA analysis points out that such initial asymmetric protection conditions will lead to uneven trade gains for Africa and the EU after EPAs are implemented. If EPAs generate exports for Africa, most will be in a few agricultural sectors (rice, sugar, milk, meat and vegetables, fruit and nuts), sectors for which gains could well be overestimated considering the difficulty for African nations in meeting the EU's sanitary and phytosanitary requirements. Also, EPAs would essentially benefit non-LDCs. Some LDCs (such as Ethiopia, Malawi and Zambia) will actually see their exports to the EU reduced after EPAs are implemented, because of eroding preferences following increased competition with African middle-income countries on the EU market. Such outcomes hardly support African industrialization. But the EPAs will bring larger and better distributed gains to the EU,<sup>21</sup> with exports increasing to Africa in nearly all sectors, especially industry (figure 5.6).

The increase in Africa's exports to the EU would also come at the expense of intra-African trade,

**FIGURE 5.6: CHANGES IN BILATERAL EU-AFRICA (ECOWAS+ESA) TRADE, POST EPAS, BY SECTOR, 2040 (\$ BILLION)**



Source: Mevel et al. (forthcoming).

which would fall by \$3 billion in 2040, following full implementation of ECOWAS-EU EPA and ESA-EU EPA. Also, tariff revenues for African governments would be significantly cut with the reform, limiting real income gains for African countries.

In March 2014 the EU Foreign Affairs Council, aware of some of the costs implied by EPAs (especially for LDCs), committed to provide financial compensation to African countries, to be disbursed between 2015 and 2020 under the Economic Partnership Agreement Development Programme. Nevertheless, this assistance will not be enough to compensate for the EPAs’ impacts on intra-African trade.

### AFRICA MUST BE STRATEGIC IN SETTING ITS COMMON EXTERNAL TARIFF (CET) STRUCTURES TO AVOID UNDERMINING ITS REGIONAL INTEGRATION PROCESS AND AFRICA’S INDUSTRIALIZATION

The Abuja treaty<sup>22</sup> of 1991 stipulates that African RECs must become customs unions, then consolidate into a pan-African customs union once CFTA is implemented. For this reason African countries should coordinate to ensure little variability from one CET structure to another (box 5.4), avoiding tariff distortions between regional groupings that will be hard to overcome as integration deepens.

To that end, the CFTA would harmonize protection within Africa and keep it lower than the protection that Africa will impose on the EU after EPA implementation. ECA (2012) shows that the adoption of a single CET structure for the whole continent could not only preserve intra-African trade gains from CFTA reforms but also expand Africa's global trade, especially if African tariffs on imported intermediates are reduced, thanks to cheaper imports of inputs for production. This would strengthen Africa's competitiveness, leading to export opportunities and gains outside the continent. In short, African trade blocks should align their CET structures with each other.

CET structures should also be constructed to favour imports of cheaper inputs critical in adding value in production and exports, with the ultimate objective of exploiting better trade opportunities and moving up the value chains. Protection of a few key industries from outside competitors (although these should only be temporary) could also help determine Africa's external trade policy (see box 3.2 and argument of the "infant" industry).

## TO WHAT EXTENT IS TRADE POLICY SPACE LIMITED BY TRADE AGREEMENTS?

The issue of narrowing policy space was discussed in chapter 3. The main concern for Africa relates to regional trade agreements, which may further limit policy options for industrialization, because under WTO rules the loss of policy space for African economies has so far been relatively insignificant given the more favourable treatment offered to LDCs—or nearly two thirds of African countries. It is evident that becoming a WTO member automatically restrains policy space to some extent, because it requires making commitments on maximum bound tariffs and future tariff cuts. However, the proposals on the table for agricultural as well as non-agricultural market access do not imply any tariff cuts to be made by LDCs in the near future.

If an agreement on agricultural and non-agricultural market access was to be reached middle-income countries would be required to reduce their tariffs, but in less than developed countries. Yet, policy

### BOX 5.4: CHALLENGES AHEAD FOR HARMONIZING CET STRUCTURES AT COUNTRY LEVEL (BOTSWANA) AND SUBREGIONAL LEVEL (ECOWAS)

As a member of the Southern African Customs Union (SACU), Botswana can trade nearly DFQF within the union, though it grants some flexibility to its members. For example, Botswana is allowed to protect its infant and key industries (flour, milk and seasonal vegetables), and temporary import restrictions can be used on agricultural products in situations of large surpluses. But the CET structure, imposed by all SACU members on their imports from partners outside of the Union, has been set mainly by South Africa and does not reflect well on Botswana's strategic export sectors such as beef or textiles.

Although it is difficult to come up with CET structures that fully satisfy all members, it is vital to set common rules beyond the RECs otherwise rules can become more complex as regional integration deepens. For example, the five SACU members along with Angola and Mozambique are negotiating an EPA with the EU under the "SADC" negotiating group, which does not match the Southern African Development Community (SADC) made up of 15 member states, themselves engaged in EPAs with the EU under four different negotiating groups—"SADC", Central Africa, ESA and even EAC. SADC is also part of the COMESA-EAC-SADC Tripartite with customs unions established or expected for each of the three RECs—a confused situation that must be stopped now.

As far as the West African region is concerned, ECOWAS has made substantial progress because its CET was launched in January 2015, consisting of five bands.<sup>23</sup> As a consequence, the ECOWAS CET structure is imposing an average of 9.0 per cent protection on imports from external partners (see Mevel et al., forthcoming).

space would tend to be more restricted for industrial goods than agricultural ones, since bound tariffs in industry tend to be lower (chapter 3).

Similarly, export subsidies and subsidies contingent on the *use of domestic over imported goods* are prohibited under WTO rules, yet are permitted to LDCs and low-income economies (below \$1,000 per capita). But the impacts on policy space and Africa's industrialization following the introduction of the trade-related investment measures and trade-related aspects of intellectual property rights in the WTO are more uncertain.

The potential loss of policy space with regards to the EPAs falls under two areas. First, although WTO does not expressly prohibit export taxes, they are to be restricted and monitored under EPAs. They cannot be increased and their use is subject to frequent reviews. But conditions vary because of bilateral negotiations between the EU and each of the five negotiating groups for Africa. Export taxes can be tolerated under specific circumstances (such as protecting infant industries, protecting the environment, maintaining currency stability) but only for a limited time and on a restricted number of products. Particular interests in export taxes for African countries include generating government revenues and reducing the price of intermediate goods for domestic manufacturing sectors (Bouët and Laborde, 2010).

Second, an MFN clause is included in the EPAs. This implies that any tariff concession granted by African countries to developed or major developing partners (a country's trade representing at least 1 per cent of the world trade in the year before an EPA is signed)<sup>24</sup> must be extended to the EU. African countries' freedom in trade policy is therefore reduced compared to what is imposed by the MFN clause contained in WTO law. For example, African countries offering preferential treatment to China or India would be feasible under WTO law, thanks to the enabling clause that allows for preferential trade agreements within developing countries. Yet the MFN clause in the EPA would force African countries to extend to the EU the preferential treatment

offered to China or India, potentially discouraging some developing partners from engaging with African countries.

But the MFN clause in EPAs is not automatic, and it has been agreed for countries that already signed or committed to signing an EPA that a joint EPA committee will assess the preferences in question before making any decision. Also, it appears very unlikely—although not impossible—that African countries would grant preferences to a third-party for a product on the EPA exclusion list.

Policy space in South-South cooperation and South-South triangulation (when a cooperation project between two or more developing countries is funded by a developed country) is often less restrictive than in North-South engagements. The United Nations Conference on Trade and Development pointed out that partnerships between developing economies are often based on the principle of "non-interference in the internal affairs of partner countries" (UNCTAD, 2010). In the case of aid, there is generally no conditionality attached to aid disbursement between two developing countries as opposed to aid provided by developed countries to developing ones.

China and India often provide aid to African countries in exchange for having access to natural resources, and the scope of African projects financed by Chinese investors is very different from those financed by traditional partners. China invests heavily on vast infrastructure projects and is willing to finance certain projects that do not appear economically viable and that traditional partners are not willing to invest in. An example is a pipeline project between Cameroon and Chad, planned for a small refinery and supported by the World Bank but never completed. Yet in 2009 China National Petroleum Corporation entered into a 60/40 joint venture with Chad's state-owned firm Société des Hydrocarbures du Tchad to finance what became Chad's first petroleum refinery (Poon, 2013). Such practices have increased considerably, and by the end of 2009 as much as 45.7 per cent of China's accumulated foreign aid went to Africa

alone. This practice is questionable to many, yet provides huge amounts of aid for financing projects critical to trade and industrialization, such as roads, railways, water supply, power generation, hospital and schools, while preserving Africa's policy space. The fact that less restricted policy options are available through South-South cooperation than under North-South engagements makes developing partners (especially China and India) very attractive to Africa. But Africa's benefits from opening its market with both Southern and Northern partners are expected to be still greater if trade reforms are well sequenced and gradual.

**China and India often provide aid to African countries in exchange for having access to natural resources**

## IMPORTANCE OF “SMART SEQUENCING” OF TRADE AGREEMENTS

### AFRICA IS LIKELY TO BE HURT BY MEGA-REGIONAL TRADE AGREEMENTS...

Regional trade agreements—tolerated by the WTO until now—are becoming more and more complex<sup>25</sup> and raise concerns over whether they secure aggregate global gains in market access.<sup>26</sup> The current negotiations of new mega-regional trade agreements (MRTAs) could help break the trend in the proliferation of regional trade agreements, but Africa cannot afford to be left out, and CFTA could be crucial for it here. A study from ECA (forthcoming) investigates the implications of key MRTAs for Africa, looking at the Trans-Atlantic Trade and Investment Partnership<sup>27</sup>, the Trans-Pacific Partnership<sup>28</sup>, and the Regional Comprehensive Economic Partnership<sup>29</sup> (RCEP). The analysis demonstrates the boost in trade for MRTA members following the quasi-elimination

of tariff duties on goods within these three agreements. Total exports of all countries signed up to them may increase by \$1 trillion by 2020, after implementation of the MRTA reforms.

Africa's exports, however, would fall by \$2.7 billion owing to fierce competition and some erosion of preferences on MRTA markets. Although the trade diversion effect seems very light, Africa's exports would fall in all main sectors, especially industry. By destination, the largest trade diversion effects for Africa would be with RCEP partners, notably China, as integration in that group would imply larger tariff cuts (given current high protection rates) and greater trade gains (figure 5.7). And as MRTAs are intended to go beyond goods trade and touch on services and investment, these expected negative impacts on Africa could be higher still.

### ... UNLESS IT GETS CFTA GOING

If Africa produces its own mega-regional trade agreement—CFTA—in parallel to the other MRTAs, outcomes for Africa would change drastically (figure 5.7). From a fall of \$2.7 billion without CFTA, CFTA could increase Africa’s exports by nearly \$40 billion (4.6 per cent), reflecting a boost in intra-African trade with more than two-thirds in industrial products.

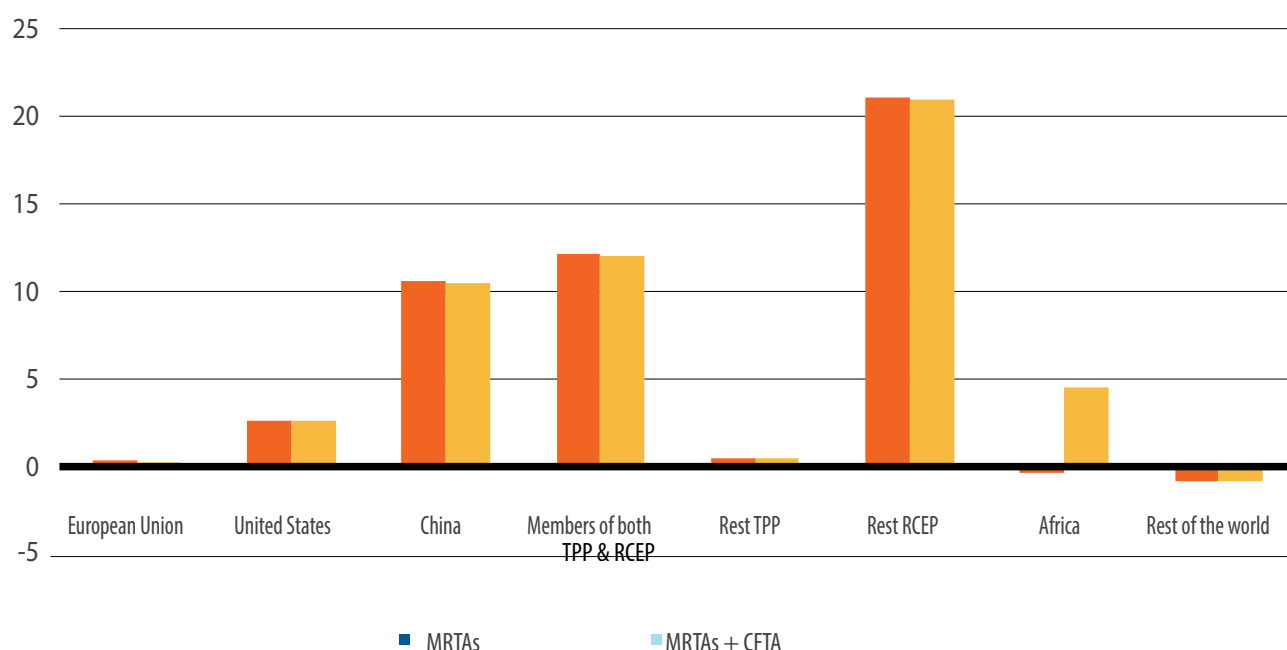
### CFTA MUST BE ACCOMPANIED BY BOLD REFORMS

If CFTA is launched before full implementation of the EPAs, the effects from EPAs on bilateral trade between Africa and the EU would not change much from those seen in section 5.3, and Africa-EU two-way trade would be boosted (Mevel et al., forthcoming). CFTA would also more than offset—and even greatly expand—EPAs’ likely negative

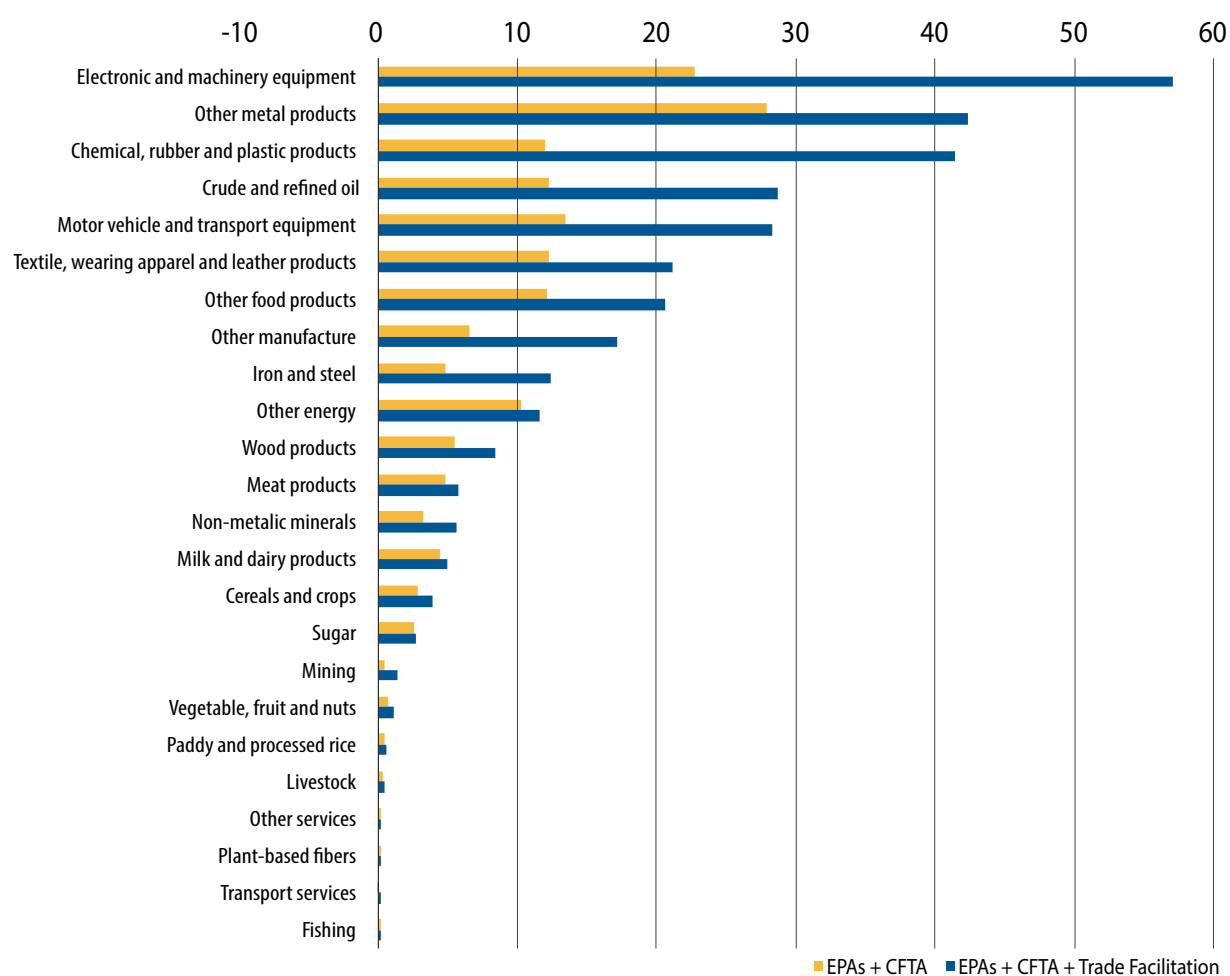
impacts on intra-African trade, and more so when trade facilitation reforms are adopted (figure 5.8).<sup>30</sup> The main gainers in intra-African trade would be electronic and machinery equipment, metals, chemicals, motor vehicle and transport equipment, textile, apparel and leather. A stronger case for trade facilitation—dramatically aiding as it does Africa’s industrialization—would be hard to make.

Thus, the central issue is to make regional integration with trade facilitation a top priority, using the transitional period provided under EPAs (box 5.5) to first deepen Africa’s integration. In that context, African member states and RECs should redouble their efforts in effectively implementing the action plan, Boosting Intra-African Trade (AUC and ECA, 2012). The action plan identified seven priority clusters to boost intra-African trade: trade policy, trade facilitation, productive capacity, trade-related infrastructure, trade finance, trade information and factor market integration.

**FIGURE 5.7: EXPORT CHANGES—MRTAS ALONE VERSUS MRTAS PLUS CFTA, BY MAIN REGION, 2020 (%)**



Source: ECA (forthcoming).

**FIGURE 5.8: GAIN IN INTRA-AFRICAN TRADE—EPAs WITH CFTA, WITH AND WITHOUT TRADE FACILITATION, BY SECTOR, 2040 (\$ BILLION)**

Source: Mevel et al. (forthcoming.).

As shown in section 5.3, trade facilitation clearly stimulates intra-African trade and supports the industrialization process. Building the necessary productive capacity, upgrading infrastructure to trade and mobilizing financial resources are equally critical steps before gradually opening-up the African market, and should be based on mutually beneficial international partnerships between Africa and the rest of the world. It will also be vital for Africa to create a social and political environment where peace and security triumph.

**If Africa produces its own mega-regional trade agreement in parallel to the other MRTAs, outcomes for Africa would change drastically**

### BOX 5.5: AFRICA MUST TAKE ADVANTAGE OF THE TRANSITIONAL PERIOD OFFERED UNDER EPAs TO HASTEN REGIONAL INTEGRATION

While the EU is expected to grant 100 per cent DFQF access to African countries in its market after signing the EPAs, African nations are required over a 15–20 year period to phase down to zero 75–80 per cent of the tariffs they impose on their EU imports.

Liberalization schedules and depth can differ from one African region to another depending on negotiations with the EU taking place at the regional level. For example, ECOWAS countries and the EU have agreed to the following tariff liberalization schedule to phase down to zero no less than 75 per cent of tariff lines imposed by ECOWAS on their EU imports:

**BOX 5.5 TABLE 1:**  
**ECOWAS TARIFF LIBERALIZATION SCHEDULE UNDER ITS EPA WITH THE EU**

Group	Product category	CET rate (%)	Applied rate (%) in			
			2015	2020	2025	2030
A	1	0	0	0	0	0
A	2	5	5	0	0	0
B	1	0	0	0	0	0
B	2	5	5	5	0	0
B	3	10	10	10	5	0
C	2	5	5	5	0	0
C	3	10	10	10	5	0
C	4	20	20	20	10	5
D	1	0	0	0	0	0
D	3	10	10	10	10	10
D	4	20	20	20	20	20
D	5	35	35	35	35	35

Source: Based on report from ECOWAS-EU-UEMOA Senior Officials' Meeting held in Dakar, Senegal, on 24 January 2014.

Note: Product categories are defined as follows. 1 is for "essential social goods, including essential medicines", 2 represents "goods of primary necessity, raw materials and specific inputs", 3 relates to "inputs and intermediate goods", 4 is for "final consumption goods" and 5 refers to "specific goods for economic development".

In that sense, tariff lines defined at the harmonized system 6-digit product classification have been placed under certain categories and groups that dictate the pace of the tariff liberalization to be undertaken by ECOWAS countries relative to the EU. Goods under category 5 ("specific goods for economic development") are given a 35 per cent protection level under the ECOWAS CET and will not be cut following ratification of EPAs as they can be considered extra-sensitive by the region. Similarly, goods classified under category 3 ("inputs and intermediate goods") that have been placed under group C (having a medium-high sensitivity) are given a 10 per cent tariff in ECOWAS CET. These will not be cut before 2025, when they will be reduced by half and then reduced to zero five years later.

Therefore, the full effect of the EPA reforms—as far as Africa's preferential access to the EU is concerned—will not be felt until at least 15 to 20 years after ratification of the agreements (by 2035 in the case of ECOWAS). Nonetheless, the EU will start gaining progressive preferential access to African markets soon after EPAs are ratified. So it would not be appropriate for African countries to wait until near the end of the transitional period to intensify their regional integration efforts. The sooner Africa's integration deepens and the faster CFTA is launched, the greater the benefits from integration reforms.



# CONCLUSIONS

Regional trade agreements “are important for the multilateral trading system but they cannot substitute it” as there are “global problems demanding global solutions”.<sup>31</sup> Issues surrounding trade facilitation, regulation of financial or telecom services and farming and fishery subsidies may be easier to address in a multilateral setting with a functioning dispute settlement mechanism (such as WTO’s). WTO is an invaluable framework for multilateral trade negotiations. Also, trade opportunities are greater outside of fragmented and relatively small regional markets.

However, the right sequencing of trade policy reform matters considerably, and regionalism can truly benefit African nations’ trade policy reforms. But not all forms of regionalism have the same impact.

Preferential schemes (such as AGOA) can surely support Africa’s trade, including in manufacturing sectors if stringent rules of origin are relaxed to fit the limited productive capacity of African economies. Yet given their unpredictability, trade preferences alone do not seem enough to develop the RVCs needed to sustain Africa’s industrialization.

Similarly, opening up Africa’s market through reciprocal agreements can deliver benefits to many African countries. But their impact on Africa’s industrialization depends highly on initial protection conditions. Trade agreements made with traditional partners entailing strong asymmetry in protection structures—largely owing to pre-existing trade preferences—can lead to very uneven gains. For example, the EPAs between most African countries and the EU could translate into significant benefits for a few African countries—especially those who initially received fewer preferences—but few non-industrial sectors, sectors usually facing strong sanitary and phytosanitary measures that limit their export potential. Thus, the EPAs should include

clearer explanations of sanitary and phytosanitary instruments so African countries are better assisted in meeting the EU requirements.

In such conditions, Africa should seize determining its external protection structures (such as facilitating imports of intermediates to be used in the production of industrial products) with both African and non-African partners. This step is critical in rendering more systematic industrialization benefits from bilateral agreements and guaranteeing that regional integration and industrialization efforts are not diluted.

Multilateral trade negotiations do not appear to pose a serious threat to the policy space of African economies. Nonetheless, the fact that more unrestricted policy options are available from South-South engagements than from North-South partnerships suggests that African countries would gain more by reinforcing trade ties with developing partners. However, Africa’s market should be opened progressively, and ideally intensified only when regional integration has deepened considerably across the continent.

Boosting intra-African trade and its industrial content can be achieved rapidly through CFTA, Africa’s own mega-regional trade agreement, by removing all tariff barriers on goods still remaining within Africa and tackling those related to services trade.

Yet, in order to amplify the benefits of trade and generate better distributed gains from trade across Africa, it is necessary to be bold and ambitious. For example, the reduction of NTBs—in particular the reduction of costs of trade across borders through aggressive trade facilitation reforms—are critical to ensure Africa’s industrialization. A more integrated African market can stimulate the productive capacity required to develop solid RVCs and can

assist diversification. The harmonization of rules of origin within the continent and possibly beyond will also be essential to reducing obstacles to trade and to those hindering movement up the value chains. So, African member states, individually and through the RECs, should make the necessary policy changes to realize the intra-African trade agenda and harness the domestic resources required.

CFTA should not be seen as an ultimate objective but rather a stepping stone to an African customs union aided by harmonized common external tariffs—a union which should open up trade with partners outside the continent. This demands that political commitments be made swiftly.

**Opening up Africa's market through reciprocal agreements can deliver benefits to African countries, but their impact on Africa's industrialization depends highly on initial protection conditions**

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## ENDNOTES

- 1 Before 1990 there had only been about 50 regional trade agreements notified to GATT/WTO, 24 years later as many as 604 (counting goods, services and accessions separately), 398 of which are in force. Information as of 8 January 2015. Retrieved from [http://www.wto.org/english/tratop\\_e/region\\_e/region\\_e.htm](http://www.wto.org/english/tratop_e/region_e/region_e.htm) (accessed 3 February 2015).
- 2 Under MFN treatment, when a country grants preferential treatment to one country, it must grant such treatment to all other WTO member countries. This is “non-discrimination”.
- 3 For instance, the US African Growth and Opportunity Act is a unilateral (non-reciprocal) agreement that is not strictly based on development criteria but rather geography (countries from Africa only are eligible), which needs a waiver from the WTO to operate.
- 4 Mega-regional trade agreements (MRTAs) are profound integration partnerships between countries often from different regions. Each MRTA usually accounts for a significant share of world trade and GDP.
- 5 Authors’ computations from UNCTADstat (accessed 5 January 2015).
- 6 It should be noted, however, that if we were to include African destinations of African exports then South Africa would be in fifth position just before Japan.
- 7 See WTO documentation referenced G/C/W/656/Rev.1, WT/COMTD/N/39/Add.1/Rev.1 from 1 December 2011
- 8 AGOA was enacted by the US president on 2 October 2000 but is set to expire on 30 September 2015. North African countries are excluded. As of 22 January 2014, 38 countries were eligible (retrieved from <http://agoa.info/about-agoa/country-eligibility.html>; accessed 15 January 2015). In 2014, Mali (on 1 January), Madagascar (on 27 June) and Guinea-Bissau (on 23 December) were reinstated in AGOA; but Gambia and South Sudan (on 23 December) lost eligibility as well as Swaziland (from 1 January 2015) because of missed deadlines in fulfilling human and worker rights’ requirements set by the Act.
- 9 Defined at the Harmonized Tariff Schedule 8-digit product classification code (HTS8).
- 10 See <http://agoa.info/about-agoa/country-eligibility.html> (accessed 22 January 2015).
- 11 See <http://www.brookings.edu/blogs/africa-in-focus/posts/2014/05/23-agoa-swaziland-madagascar-sy> (accessed 22 January 2015).
- 12 See AUC (2012).
- 13 According to the Bujumbura agreement, member states will join when they are ready, a principle known as variable geometry. At the time of writing (November 2014), 15 out of the 26 TFTA countries have submitted their tariff offers.
- 14 At market exchange rates of 2013.
- 15 For example, see C. Ligami, “EA Traders Fear Cheaper Goods from Egypt Will Swamp Regional Market”. *The East African*, 11 October 2014, p. 4, retrieved from <http://www.theeastafrican.co.ke/news/Cheap-Egyptian-goods-will-swamp-East-Africa-markets-/2558/2483156/-/yudp9jz/-/index.html> (accessed 3 February 2015).
- 16 Specifically assuming that customs procedures are made twice more efficient and the time goods are spending at African ports is halved.
- 17 If all African countries would see their trade stimulated following the CFTA reform, effects on real income would be more mitigated with nearly half of Africa negatively impacted—although only slightly—following large tariff revenue reductions implied by the liberalization reform (see Mevel and Karingi, 2012).
- 18 For example, sedans as compared to mini-vans.
- 19 North African countries (Algeria, Egypt, Libya, Morocco and Tunisia) are excluded from EPAs but have their own negotiations with the EU taking place under the Euro-Mediterranean (EuroMed) Partnership (but negotiations between the EU and Libya are currently suspended). An ECA study to assess the implications of EuroMed on industrialization of North African countries is ongoing and should be released later in 2015.
- 20 Negotiations between Africa and the EU are taking place under five regional groupings: East and Southern Africa (ESA), West Africa, Central Africa, the East African Community (EAC) and the South African Development Community (SADC). Although negotiations formally started in 2002 and were initially expected to be concluded in 2008, only four African countries from ESA (Madagascar, Mauritius, Seychelles and Zimbabwe) have EPAs in place. In July 2014, ECOWAS heads of state and Mauritania endorsed its EPA for signature. In Central Africa, only Cameroon ratified the interim EPA in July 2014 and on 4 August 2014 started provisionally applying the agreement. Burundi, Kenya, Rwanda, Tanzania and Uganda are negotiating a comprehensive regional EPA for EAC. In July 2014, EPA negotiations concluded in the SADC region with an agreement to replace the interim EPA signed—but never ratified—by Botswana, Lesotho, Mozambique and Swaziland.
- 21 While ECOWAS plus ESA exports to Africa would increase by \$12 billion, EU’s exports to ECOWAS plus ESA would increase by nearly \$18 billion in 2040, after ECOWAS-EU and ESA-EU EPAs are implemented.
- 22 See OAU (1991).
- 23 A tariff rate of 0 per cent is to be applied for ECOWAS imports from outside partners for “essential social goods, including medicaments”, 5 per cent for “goods of primary necessity, raw materials and specific inputs”, 10 per cent for “inputs and intermediate goods”, 20 per cent for “final consumption goods”, and 35 per cent for “specific goods for economic development”.
- 24 See <http://www.ictsd.org/bridges-news/trade-negotiations-insights/news/why-the-mfn-clause-should-not-be-included-in-epas-el> (accessed 9 January 2015).
- 25 Not just concluded between neighbour countries and based on rules that sometimes differ strongly from one agreement to another.
- 26 Because regional trade agreements often offer a greater level of market access achieved within each of them than what is expected through WTO, but with protection between them that usually remains very high—similar to Africa’s RECs.
- 27 Between the EU and the US.

- 28 12 nations are negotiating the TPP: Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the US and Vietnam.
- 29 16 countries are expected to establish the RCEP: Australia, Brunei, Cambodia, China, India, Indonesia, Japan, Lao People's Democratic Republic, Malaysia, Myanmar, New Zealand, Philippines, Singapore, the Republic of Korea, Thailand and Vietnam.
- 30 The effects obtained by ECA (forthcoming) are greater than those from Mevel and Karingi (2012) for at least three reasons: a more recent database was used for the simulations, the results are analysed over a longer horizon, and not only are cross-border trading costs for customs procedures and port handling used, but also information on inland transport (this information was unavailable for the 2012 study).
- 31 Speech made by WTO Director General, retrieved from [http://www.wto.org/english/news\\_e/spra\\_e/spra33\\_e.htm](http://www.wto.org/english/news_e/spra_e/spra33_e.htm) (accessed 6 November 2014).



**Part 2: Industrialization–Trade Nexus**

CHAPTER

6

**TOWARDS A SELECTIVE TRADE  
POLICY FRAMEWORK FOR  
INDUSTRIALIZING AFRICA**

## KEY THEMES

**A**frica's growth continued to increase in 2014, although at a lower rate than previously estimated, surpassed only by the East and South Asia regions. Private consumption and gross capital formation continued to underpin growth, supported by improved governance and macroeconomic management, rapid urbanization (and a rising middle class), diversified trade and investment ties with emerging economies, and improved regional integration and trade partnerships.

Africa's medium-term growth prospects remain strong, with some progress in enhancing productivity, associated with its recent high-growth performance. But enhanced intra-African trade and increased export diversification from agricultural commodities, minerals, and oil through value addition, and promotion of industrialization and structural transformation are required to stimulate Africa's growth further.

Medium-term prospects face several downside risks, including sharp slowdown in oil and other commodity prices, slow recovery in developed countries, slowing Chinese growth, and tighter global monetary policies.

### TRANSLATING THE GAINS FROM THE RECENT PAST INTO THE FOUNDATIONS FOR A SUSTAINABLE FUTURE

A leading challenge is to translate growth into sustainable and inclusive development. Social development strategies consistent with the needs of the industrial and modern sectors must be honed. The right socio-economic conditions—peace and security, as well as political will—are important.

Both theory and evidence suggest that trade can be a tool to promote industrial development in Africa.

Trade policy, through promotion of competition, innovation and efficient utilization of resources, can enhance the dynamic efficiency of mature firms and foster industrialization. But it must not expose infant industries to competition too early, as this can lead to de-industrialization. A critical factor for trade policy to promote industrialization is the appropriate balance between promotion of relatively mature sectors and simultaneous protection of fragile sectors. This is not easy, but it has been performed by most industrialized countries.

Trade-induced industrialization is not automatic, and it demands real effort. For trade policy to foster industrialization, coherent trade, industrial and other complementary policies are a prerequisite, and they must be tailored to the overall goals of a country's national development strategy while internalizing the external environment. Notably, trade policy must respond to developments in the global production architecture, especially production of intermediate goods rather than finished goods, and participation in one or two links along a value chain instead of all links. Thus a coherent trade policy that promotes trade in intermediates, in tasks and in services (services are key to international production processes) is an essential precondition of modern industrial development.

Structural transformation has been unconvincing in Africa as resources have kept moving from agriculture and industry to the services and informal sectors. Although industry has contributed to economic growth, its recent growth has not reached post-independence period levels, nor has it been driven by manufacturing. Low-return, low-productivity and the lack of structural change pose a great challenge for sustainable long-term growth in Africa.



The link between knowledge creation, technical and technological processes, entrepreneurship and innovation underpinned by a healthy and educated workforce is the strategic thrust for positive spillovers from and to successful structural transformation.

In itself, trade openness does not necessarily raise productivity, as it had a negative effect on productivity-enhancing structural transformation over 1980–2010. But it could when combined with policies for adding value to commodity exports and diversifying exports from agricultural commodities, unprocessed minerals and unrefined oil.

The experience of industrialized and emerging countries and of African countries in their previous attempt at industrialization suggests that a gradual approach to upgrading and industrialization is preferable. African economies should start from labour-intensive sectors and upgrade to medium- and high-technology sectors. As African countries are at different levels of industrial development, some will have to start with labour-intensive sectors, while others should be upgrading already.

## **GETTING TRADE AND OTHER POLICIES TO WORK TOGETHER**

Given that African countries depend on international markets for both inputs and outputs, trade policy instruments must be carefully selected to avoid negative policy externalities. They must promote dynamic efficiency of mature firms and at the same time promote efficiency of infant industries through a temporary shield from international competition. For the latter, tariff protection combined with activities to develop competitiveness of firms in the industry must be designed and implemented to address the source of externalities.

For most African countries, industrial development is just one of the objectives of trade policy. In order for trade policy to foster industrialization, industrial development must be its core objective. Thus coherence between trade and national development strategies needs to be ensured. Findings from 10 African country case studies on their trade and other policies, however, show little synergy, with few countries promoting industrialization, even though most of their policy documentation recognized the need to do so, via selectivity.

For trade policy to foster industrialization, it must be highly selective for two reasons: trade-induced industrialization involves huge resource costs and requires implementation, monitoring and evaluation. While recognizing the role and place of horizontal industrial policies, the vertical (i.e., selective) policies are important for developing dynamic comparative advantage. The need to add value and develop or join regional and global value chains also was featured in most documents.

African governments are, however, labouring in an ever-narrowing policy space. But they have yet to identify and deploy alternative instruments under global trading system rules. The point is that the world will not wait for African countries to catch up with industrialization: rather African countries need to be smart, analyse and exploit the system to their advantage, and deploy trade policy instruments, as the newly industrialized economies of East Asia did so well.

## **JOINING GLOBAL AND REGIONAL VALUE CHAINS**

Global value chains (GVCs) are an important feature in today's global economy. The growing importance of information and communications

technology (ICT) enables African countries to enter several value chains without having to develop the whole production process. Participation in GVCs and competitiveness are linked to having access to fairly priced and predictably delivered intermediate imports (a theme picked up below).

Regional and global trade and production networks open new potential opportunities for Africa's industrialization. Value chains offer the scope to engage in international trade at a specific stage of the production process, thereby harnessing comparative advantage. Services play a key role in adding value along the supply chain.

African countries show high participation rates in GVCs, though at a very low level. While backward integration has been increasing, Africa still needs to focus on improving it, as the larger share of Africa's GVCs participation is in forward integration, driven by exports of raw materials. Intra-regional trade in processed goods is the first opportunity for African firms to move up the chain. GVCs linkages need to be expanded to other firms and areas of the economy.

At the sectoral level, policy initiatives that improve infrastructure and linkages among firms in the value chain (e.g., the Mozal project in Mozambique) can increase Africa's backward participation, but they must overcome poor linkages between successful sectors and other areas of the economy. Hence, policies need to focus on establishing production networks within African economies: regional value chains (RVCs). Further, trade-integrated regions are more attractive to the leading firms in a value chain, as epitomized by Southern and East Africa, which are more integrated into Africa's RVCs, as they participate more in GVCs than other African subregions. Finally, as the leading firms control and set product standards in their value chains, making it almost impossible for local firms to move up GVCs, regional production networks should receive greater attention.

Participation in GVCs also requires investments in sector-specific skills and human capital, as well as infrastructure, financial services and conducive policy frameworks. Based on the level of development of these parameters in most African countries, intra-African trade and RVCs are a platform for learning and enabling economies of scale, facilitating Africa's industrialization and eventual entry into GVCs.

In intra-African trade, the weight of manufacturing intermediates is far greater than in the continent's exports to the rest of the world, suggesting considerable scope for regional supply chains to support Africa's industrialization. But as RVCs are poorly exploited (only 12 per cent of Africa's imported intermediates is sourced from the region), a strong production network at national and regional levels is needed to achieve economies of scale.

Large countries such as Algeria, Egypt, Nigeria and South Africa have, in relative terms, little participation in continental value chains (they account for the bulk of the continent's imports of intermediates, but source few of their imports from Africa). Conversely, small and landlocked countries such as Botswana, Swaziland and Zimbabwe are far more integrated, but trade the lowest absolute amount of value added. Southern and East Africa have the highest share of trade in value added within Africa and within their regions, and have been aided by their regional trade agreements. When well applied, sectoral policies may also be useful.

Moving up the value chain in agriculture is profitable and needs to be put on the national and regional development agenda. An expansion in these labour-intensive industries generates new jobs that bring a social upgrading. However, given the dominance of leading giant firms in the food value chains, policies need to invest massively in rural industrial clusters development under commodity-based industrialization.

## REVERSING THE WRONG-WAY TREND IN TRADE IN INTERMEDIATES

In the new global division of labour, transnational corporations retain the most profitable links of processing along their supply chains, while outsourcing or offshoring others through regional and international production networks. This has helped to spur international trade, particularly among intermediate goods, which account for about half of the world's trade.

Yet Africa is missing out: although intermediate products account for the bulk of Africa's merchandise trade (60 per cent of its imports and over 80 per cent of its exports), and although intermediates are the most dynamic component of Africa's merchandise trade (increasing fourfold over the last decade), Africa still only accounts for 2–3 per cent of the global figure. Imports of manufacturing intermediates have largely failed to reverse Africa's premature de-industrialization or to spawn the emergence of regional supply chains.

Worse, the continent's exports of intermediates are increasingly dominated by mining products and resource-based manufactures (basic metals and fuels), typically embodying limited domestic value addition. This trade pattern suggests that African producers are increasingly linked to GVCs, but mainly as suppliers of raw materials or other low-end products. The minor role played by exports of manufacturing intermediates—in particular light manufacturing inputs—concur with the evidence of persistently limited weight of intra-industry trade in the region, and points to the low level of integration into international production networks, whether regional or global.

## TRADE IN SERVICES: MORE IMPORTANT FOR SOME COUNTRIES THAN OTHERS

Services are becoming more important in international trade, contributing 50 per cent of Africa's total trade in value added. They have an essential role in Africa's economic transformation,

as key inputs to most other businesses, making a direct contribution to GDP and job creation, attracting investment into local businesses and pulling in foreign direct investment. Services can themselves be an avenue for economic transformation, particularly for small countries and island states, as not all countries can develop through manufacturing. Establishing services hubs and RVCs can help African countries exploit each other's capabilities and boost competitiveness.

## USING TRADE AGREEMENTS TO AFRICA'S ADVANTAGE

Preferential schemes have generally been helpful in supporting Africa's trade with preference-giving countries, but they have failed to broadly enhance Africa's industrialization. One of the key constraints limiting the use of preferences in manufacturing goods has been the inadequacy between productive capacity of African countries and stringent rules of origin under World Trade Organization (WTO) regulations. Although they remain useful for Africa, unilateral trade preferences alone will not help to develop RVCs.

Fast-tracking the implementation process of Africa's integration—specifically, setting up the African Continental Free Trade Area (CFTA)—seems vital for an industrializing Africa. It would help increase both intra-African trade and its industrial content. Adoption of trade facilitation measures on top of CFTA reform would vastly enhance the outcomes further.

Opening Africa's market to foreign partners requires strategic trade policies. Reciprocity between Africa and traditional partners can provide significant trade benefits for both sides, but initial asymmetric protection conditions are likely to lead to unbalanced gains, with benefits for non-LDC African countries only expected in a few agricultural subsectors. Still, such reforms should be used as an opportunity to strategically define external tariff structures (e.g., by allowing for cheaper imported intermediate inputs to be used in the production of industrial goods)

to make sure Africa's regional integration and industrialization agendas remain intact. Given the fairly tight policy space in different types of trade agreements, South–South cooperation could be more promising than North–South engagements.

Sequencing of trade policy reforms matters greatly for industrialization. There is powerful evidence that a CFTA should be put in place before other trade agreements are fully implemented by African countries or by the rest of the world (e.g., mega-regional trade agreements), which would not

only preserve the anticipated benefits from these agreements but also offset most—if not all—of these other agreements' costs to Africa.

## POLICY RECOMMENDATIONS

**African countries need to leverage the progress made and continue building robust institutions that improve the business environment, economic governance and macroeconomic management.** This will boost investors' and consumers' confidence and strengthen the continent's growth prospects. Growth must be sustainable and inclusive, with its sources diversified to reduce vulnerability of African economies to internal and external shocks. Policies should promote inclusive growth, productivity and structural transformation through industrialization, value addition, export diversification and regional integration.

**A social development strategy is necessary, as human capital is central.** The strategy must be anchored on long-term planning; anchored on strengthened productive capacities of the labour force through high-quality, equity-based education and health policies; and complemented by investments in research and development focused on driving industrialization and high-end services.

In many African countries, trade policy design has not been effective, and its coherence with other policies has been limited. The observed limited coherence is an important reason why the majority of African nations have failed to diversify their exports from agricultural, mineral and crude oil products. African countries need to mainstream trade policy into development strategies and ensure coherence among all national policies, but especially between trade and industrial strategies. Industrial policy should precede trade policy, and the latter should promote the goals of the former. Subsequently, coherence should be built at various regional economic communities (RECs) level, then continent-wide.

**Each country or region should first analyse its best route to structural transformation.** If industrialization is justified, the second level entails determining the role of trade and trade policy. This is largely because African countries differ by development and endowment: no single model will work for them all.

**A gradual approach to industrialization and upgrading along value chains is recommended.**

This comes from experience in the industrial development trajectories of East Asian economies and in Africa's own ambitious but failed attempts after independence. A well-sequenced, gradual approach to upgrading and industrialization is more practical than short, sharp shocks. African economies should start from labour-intensive sectors and upgrade to medium- and high-technology sectors. Their trade policies must promote dynamic efficiency of mature firms and promote efficiency of "infant industries" through temporary shields from international competition. Trade policy design should be informed by factor endowments and comparative advantage, and should recognize that African industries are dependent on international markets for both inputs and outputs.

Africa needs strategic continent-wide trade policies. Introducing reciprocity between Africa and traditional partners can provide significant trade benefits for both parties. But initial asymmetric protection conditions lead to unbalanced gains, with Africa's benefits only expected for non-LDCs (least developed countries) in few agricultural sectors. Nonetheless, such reform should be used as an opportunity to strategically define external tariff structures (such as allowing cheaper imported intermediate inputs to be used in the production of industrial goods) to ensure Africa's regional integration agenda and industrialization are not weakened.

A highly selective and carefully designed trade policy (to promote efficiency of mature firms and protect infant industries, avoid negative policy externalities, effectively engage all stakeholders in the process and put industrial development above other objectives) is important. Running and managing it are as important as designing it. It must be time-bound and must progress towards benchmarks that are regularly evaluated. And the process must be carefully managed to avoid political hijacking by well-connected insiders.

African countries need to rethink trade policy, taking deliberate steps resounding through all levels of trade and investment negotiations. Each bilateral, regional and multilateral trade deal has narrowed scope for traditional instruments once used by developed countries. African countries should halt this erosion by insisting on the right to promote industrialization, auditing agreements that they have signed to exploit any flexibilities, develop the capacity to do such auditing and, further, take full advantage of the agreements to which they are party.

**African countries should stop negotiating agreements as if industrialization does not matter.**

They should turn back the trend in policy-space erosion, especially when negotiating trade and investment agreements, by insisting on the need to use such policy instruments to promote industrialization. This is more relevant when negotiating bilateral and regional agreements with developed countries.

African countries would gain from developing capacity (to negotiate, implement, comply with obligations and defend rights) to take advantage of signed trade agreements. Tariffs are the easiest trade policy instrument to implement, and they also generate revenue for governments. However, other trade policy instruments, including para-tariff measures and contingent trade-protection measures, are valid. But using them is more demanding than enforcing tariff measures. Technical capacity and institutions need to be built, and regulations enacted. To promote industrialization, African countries need to move from tariff measures only and develop capacity to fully engage in modern trade policy.

Africa should adopt and implement a continental negotiations template that will help to promote coordination and harmonisation of policies and thus assist in fast-tracking the establishment of the CFTA and deepen continental integration. A promising approach for African countries would be to start developing and strengthening RVCs by developing regional clusters. Intra-African trade, in

view of its more diversified composition, represents a promising avenue to support industrialization and foster the emergence of interconnected regional supply chains, notably in manufacturing. Establishing the African Continental Free Trade Area (CFTA) could go a long way in supporting industrialization, a key for Africa's intra-regional integration. CFTA would help increase both intra-African trade and its industrial content. Boosting intra-African trade and its industrial content can be achieved rapidly through CFTA, Africa's own mega-regional trade agreement, by removing all tariff barriers on goods still remaining within Africa and tackling those related to services trade.

The sequencing of trade policy reforms matters greatly. There is powerful evidence that CFTA should be put in place before other trade agreements are fully implemented by African countries or by the rest of the world (such as mega-regional trade agreements).<sup>1</sup> Doing so would not only preserve the anticipated benefits from these agreements but also offset most—if not all—their costs to Africa and to its industrialization. African countries' ambitions for regional integration should be elevated with greater attention on deepening RVCs. And deeper, broader and bolder regional integration should be followed by the gradual opening-up of African economies to the rest of the world, as African countries would then be in better position to compete internationally.

Preferential schemes have been helpful in supporting Africa's trade with preference-giving countries, but they have failed to broadly enhance Africa's industrialization. African countries should be conscious of the need to use these schemes for promoting industrialization. One of the key constraints limiting the use of preferences in manufacturing goods has been the imbalance between the productive capacity of African countries and stringent rules of origin. Policies that

relate productive capacities of African countries with rules of origin are required for preferential schemes to promote industrialization. Yet, in order to amplify the benefits of trade and generate better distributed gains from trade across Africa, it is necessary to be bold and ambitious. For example, the reduction of NTBs—in particular the reduction of costs to trade across borders through aggressive trade facilitation reforms—are critical to ensure Africa's industrialization. A more integrated African market can stimulate the productive capacity required to develop solid RVCs and can assist diversification. The harmonization of rules of origin within the continent and possibly beyond will also be essential to reducing obstacles to trade and to those hindering movement up the value chains. So, African member states, individually and through the RECs, should make the necessary policy changes to realize the intra-African trade agenda and harness the domestic resources required.

African countries show high participation rates in GVCs, but at a low level, and the potential to tighten integration owing to the abundance of natural resources and low labour costs remains huge. African countries should design trade policy that promotes and reverses the current participation in GVCs at a low level.

CFTA should not be seen as an ultimate objective but rather a stepping stone to an African customs union aided by harmonized common external tariffs—a union which should open up trade with partners outside the continent. This demands that political commitments be made swiftly.

Trade policy alone cannot deliver industrial development, complementary policies and institutional structures are required. But trade policy alone cannot deliver industrial development.

The following specific policy instruments and institutional arrangements are required to enable trade to effectively promote industrialization:

- The growing importance of **information communication technology (ICT)** enables African countries to enter several value chains without developing the whole production process. Usually, services are poorly captured in traditional trade statistics, but they play a key role in increasing countries' participation in GVCs.
- Successful policies need to include sectoral initiatives that develop **product standards and good product quality, improving physical infrastructure** (telecommunication, roads, ports etc.) to connect with global players, establishing a national production network (business environment) to include more countries and reducing NTBs and/or increasing tariff liberalization to reduce costs of trading.
- Similarly, given the poor linkage between successful sectors and other areas, policies need to focus on **establishing production networks** within an economy.
- The similarity in structures of production across African economies calls for renewed efforts to spur structural transformation and development of Africa's productive capacities, including dynamic industrial policies' broad array of measures that improve the business environment and enhance coordination among firms. Likewise, governments could endeavour to **redress coordination failures and favour the emergence of viable clusters**, especially in manufacturing, although an overarching approach is needed to ensure that fiscal incentives to attract local and foreign investment are justified by the scope for promoting backward and forward linkages.
- On the financial front, African countries have increased their **budget for infrastructure provision**, including through regional frameworks such as the Programme for Infrastructure Development in Africa (PIDA), so that Africa finances nearly half its infrastructure projects. Yet the **financial needs remain daunting**. An annual investment of \$7.5 billion is required over 2012–2020 to deliver projects in the PIDA Priority Action Plan, and \$360 billion for PIDA's long-term view over 2012–2040. Innovative financial mechanisms should therefore be considered.
- It is imperative for African countries to identify—working with the private sector and other stakeholders—their own strategic priorities, **coordinate with regional partners the sequencing of trade facilitation measures, and assess related financial and technical assistance** needs. In doing this, African countries should make full use of the flexibilities available under Section II of the Trade Facilitation Agreement, to sequence the different measures in such a way that the commitments undertaken at the multilateral level are fully supportive of regional integration.
- The adoption of trade facilitation measures on top of CFTA reform would enhance positive outcomes. The level of ambition for Africa's regional integration should be elevated. Non-tariff barriers (NTBs) should be tackled along with tariffs on both goods and services. Greater attention should also be given to developing RVCs largely untapped within the continent.

## ENDNOTES

- 1 Mega-regional trade agreements (MRTAs) are profound integration partnerships between countries often from different regions. Each MRTA usually accounts for a significant share of world trade and GDP.



# **STATISTICAL NOTE**

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This year's Economic Report on Africa is based on the latest updated and harmonized data from various sources, including questionnaires developed by the authors. The main economic and social data variables are obtained from the United Nations Department of Economic and Social Affairs (UN-DESA) database and International Labour Organization (ILO). Data from the statistical databases of the International Monetary Fund (IMF), Economist Intelligence Unit (EIU), United Nations Conference on Trade and Development (UNCTAD), World Bank, the University of Groningen (Groningen Growth and Development Centre Africa Sector database) and some government departments in African countries are also used in connection with various economic indicators. Data published in the report may differ from those of previous editions due to recent revisions.

The UN-DESA Global Economic Outlook database provides comparable data on GDP growth for all African countries, except Seychelles and Swaziland for which data are obtained from the EIU database. Real GDP growth rates are generated using country data with 2005 as the base year. Sub-regional inflation rates for country groupings are weighted averages, where weights are based on GDP in 2005 prices. Baseline scenario forecasts are based partly on Project LINK and the UN-DESA World Economic Forecasting Model (WEFM). To estimate the impact of the recent oil price shock on Africa's GDP growth, the report uses the quadratic match-sum method to decompose low frequency data (annually) to higher frequency data (monthly). This method fits a local quadratic polynomial for each observation of the original series, using the fitted polynomial to fill in all observations of the higher frequency series associated with the period. The quadratic polynomial is formed by taking sets of three adjacent points from the original series and fitting a quadratic in order to make sure that the sum of

the interpolated monthly data points matches the actual annually data points.

Social data is based on the latest available data from the United Nations Educational, Scientific and Cultural Organization (UNESCO). Employment figures are from the ILO-Key Indicators of the Labour Market (KILM) database while data on trade (exports and imports) are from the UNCTAD and World Trade Organization (WTO).

Countries are classified into geographical regions and country groupings. Unless otherwise noted, the data covers 53 African countries (excluding South Sudan due to data unavailability). Geographical regions are: North, Southern, East, West and Central. Parts of the analysis are also based on country groupings of oil importers, oil exporters, mineral rich and mineral poor countries. Oil exporters are those with oil exports at least 20 per cent higher than their oil imports and include: Algeria, Angola, Cameroon, Chad, Congo Republic, Côte d'Ivoire, Congo DRC, Equatorial Guinea, Gabon, Ghana, Libya, Niger, Nigeria and Sudan. Oil importers include: Benin, Botswana, Burkina Faso, Burundi, Cabo Verde, Central African Republic, Comoros, Djibouti, Egypt, Eritrea, Ethiopia, The Gambia, Guinea, Guinea-Bissau, Kenya, Lesotho, Liberia, Madagascar, Malawi, Mali, Mauritania, Mauritius, Morocco, Mozambique, Namibia, Rwanda, Sao Tome and Principe, Senegal, Seychelles, Sierra Leone, Somalia, South Africa, Swaziland, Tanzania, Togo, Tunisia, Uganda, Zambia, and Zimbabwe. Mineral rich countries are those where mineral exports account for more than 20 per cent of total exports and include: Algeria, Benin, Botswana, Burkina Faso, Central African Republic, Congo DRC, Djibouti, Equatorial Guinea, Eritrea, Guinea, Lesotho, Liberia, Mali, Mauritania, Madagascar, Mozambique, Namibia, Niger, Rwanda, Sierra Leone, South Africa, Sudan, Tanzania, Togo, Zambia and Zimbabwe.

Mineral poor countries include: Angola, Burundi, Cameroon, Cabo Verde, Chad, Comoros, Congo, Côte d'Ivoire, Egypt, Ethiopia, Gabon, The Gambia, Ghana, Guinea-Bissau, Kenya, Libya, Malawi, Mauritius, Morocco, Nigeria, Sao Tome and Principe, Senegal, Seychelles, Somalia, Swaziland, Tunisia and Uganda. Groupings are based on UNCTAD trade data for 2012 and 2013 (SITC 33 for oil and SITC 27+28+32+34+35+68+667+971 for minerals).

The thematic part of the report employs primary data and information collected, harmonized and analysed by ECA's staff through questionnaires. Several interviews were conducted in 10 countries which included Botswana, Cabo Verde, Chad, Republic of Congo, Egypt, Morocco, Mozambique, Nigeria, Tanzania and Uganda. Additional information was also collected in some Regional Economic Communities (RECs). The interviews were divided into three groupings. The first set of questionnaires were administered to producers' organizations at the national level such as the local manufacturers associations and the Chambers of Commerce and Industry, and relevant organizations for the services subsector, in order to collect information on the structure of industrial sector, operational challenges encountered by African countries in the design, coordination and processes in the development and implementation of their trade and industrial policies. The second set of questionnaires was used for interviews with key officials in industrial and trade policies organizations (ITPOs) involved in the formulation, monitoring and implementation of industrial and trade policies in each country. Finally, a third set of questionnaire was developed to collect the views of RECs aimed at understanding, at the regional and sub-regional levels, measures and policies undertaken in order to foster industrialization through trade, the formation and challenges of industrial and trade policies from an historical perspective.





Despite slowdown, Africa's robust economic growth continued in 2014 and its medium-term outlook remains bright. This trend continued to benefit from improved business environment and macroeconomic management, increasing private consumption and public investment, and a buoyant services sector that outweighed the negative pressures emanating from weakening commodity prices. However, progress in social development remains slow with high poverty and unemployment rates. The structural transformation of African economies continued but at a very slow pace.

Trade-induced industrialization as a means to structural transformation requires conscious and concerted efforts of all stakeholders. Government interventions should include high level of coherence between trade and industrial policies and a carefully designed, effectively implemented, rigorously monitored and evaluated, and transparently managed selective trade policy. Government participation in the various trade negotiations at bilateral, regional and multilateral levels should ensure that its industrial aspirations are in no way compromised rather they should be enhanced.

This Report examines and provides analysis on the critical elements of effectively fostering industrialization and hence structural transformation based on an extensive review of experience with industrialised countries and Africa's post-independence attempt at industrialization. Ten country case studies were also conducted to shed light on industrializing through trade. The findings from this exercise informed the policy recommendations contained in this Report.

