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ECA POLICY BRIEF

Industrializing through trade

Trade as a catalyst for Africa's structural transformation

Inclusive and transformative development strategies are essential for translating Africa's recent growth momentum into meaningful creation of decent jobs and poverty reduction. Industrialization, the theme of several recent editions of the Economic Report on Africa, is the sure way of breaking the commodity boom and bust cycle, and also from Africa's dependence on primary commodity exports. The Economic Report on Africa 2015 builds on previous editions of the report that emphasized the need for developmental States and development plans to foster Africa's structural transformation, benefiting from the continent's resource endowments to promote commodity-based industrialization, and embracing dynamic industrial policy frameworks underpinned by innovative institutions, effective processes and flexible mechanisms.

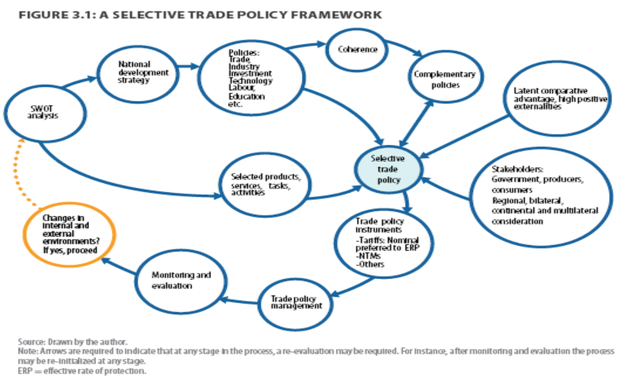
According to the Economic Report on Africa 2015, a properly designed and implemented trade policy – alongside complementary policies – is essential to promoting investment in high productivity activities and launching an economy into industrial take-off. Accelerating structural transformation requires coherence between national development strategy and trade policy on the one hand, and between trade policy and industrial policy on the other hand. This requires a deep understanding of the market structure and the possible interactions of firms on the continent. Production structures with large economies of scale create incentives to specialize and trade in differentiated products, even without differences in resource endowments or technology. Industrial production is characterized by externalities and spillovers, and negative externalities are detrimental to social, economic and environmental sustainability, hence the need to be curtailed. Positive externalities and spillovers should therefore be encouraged through deliberate government interventions in this regard. The State must play a catalytic role, informed by a good understanding of the global trade context (e.g. the World Trade Organization and its complicated rules) and the economic channels through which trade and trade policy affect industrialization.

Getting trade policy right is a balancing act of providing incentives for firms to innovate, develop capacity, invest in research and development and upgrade technology, without exposing "infant industries" to international competition, as this could de-industrialize the economy. This calls for a selective trade policy framework for industrialization.

Need for a selective trade policy framework

The starting point for a selective trade policy framework, as for any national development policy, is a country's national development strategy (figure 1). There must be a strong relationship between industrial policy and the country's national development strategy, with an integrated trade and industrial policy. A good trade policy must be interactive (in terms of coordination), iterative and evolving, in the sense that all stakeholders should be engaged and have equal opportunities to contribute to the process. It should present a platform for the exchange of ideas and experiences, and allow stakeholders in the process to strategize in order to benefit from the new policy, and be able to evaluate the parameters informing the process relative to other countries' attributes (e.g. country endowments, and technological capabilities of firms). In this regard, a selective trade policy entails two "big tasks": selecting industries (or tasks) that will receive special treatment; and choosing trade policy instruments to influence the products and processes, with products' value-addition at the core of it. Also, trade policy should be dynamic, responsive to changes in the internal and external environment, and should be reviewed at intervals long enough for firms to use it for their planning and investment purposes.

Figure 1: Selective trade policy framework for industrialization



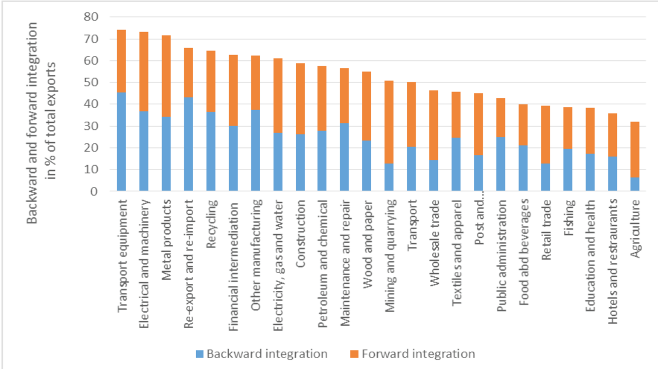
Source: Economic Commission for Africa, 2015.
Abbreviation: ERP, effective rate of protection.

Using qualitative data from country interviews with relevant government agencies, private sector organizations and research institutions, and quantitative data from national statistical organizations and international sources, several African case studies in the 2015 Report have shed light on the limitations of trade policy coherence and untapped potential for the continent. The findings revealed that most of the countries have attempted to achieve coherence between trade policy and national development strategies. Yet, trade policy coherence with industrial policy appears to be weak among most African countries. Most of the countries recognize the need to be selective when it comes to trade policies, add value, and develop or join regional value chains or global value chains (as most of these ideas feature in most of their policy documents), but they are not being fully adopted or effectively enforced. In terms of coordination, the results revealed that most of the stakeholders are involved in trade policymaking, but they are left out when policies are being reviewed or changed. Even with the shrinking of the policy space – as a result of the World Trade Organization rules and economic partnership agreements, there is ample room for smart industrial policies in African countries.

Global value chains are an important feature of today's global economy

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 one's comparative advantage more efficiently. Global value chains are an important feature in today's global trade, and African countries seeking to develop exports and grow their economies need to take them into account. African countries show high participation rates in global value chains, though at low rungs of the ladder, through forward integration driven by exports of raw materials (figure 2). This is not conducive for enhancing structural transformation, hence the potential of participating in global value chains to support structural transformation is largely untapped. Intraregional trade in processed goods seems to offer the best opportunity for African firms to move up the value chain by improving its backward integration. According to the report (ECA, 2015), African regions that are most integrated in global value chains also show highest regional value chains integration.

Figure 2 : Global value chains participation by sector, backward and forward integration, 2011



Source: Calculations based on the United Nations Conference on Trade and Development–Eora GVC Database.

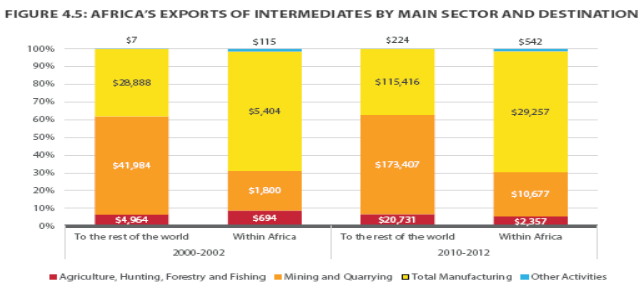
Imported intermediates have surged without boosting Africa's competitiveness

Intermediate products accounted for 60 per cent of Africa's merchandise imports, growing three-fold over 2010–2012, while Africa's exports have grown four-fold over the past 10–15 years, but mainly dominated by mining and resource-based products such as metals, chemicals, plastics and fuels. Together with increased reliance on imported inputs from the rest of the world, which are mainly composed of capital goods, intermediate exports show long-standing weaknesses of the manufacturing sector in Africa. Domestic value addition is left untapped because of the structural and trade policy constraints being faced by African economies.

The lack of competitiveness of African manufacturing globally, and the extent to which the scope for domestic value addition is left untapped, limit Africa's participation in the global arena. For example, 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 was cotton fabric, while at the same time importing $0.4 billion of cotton and $4 billion of cotton fabrics. The region was actually trading raw cotton for cotton fabrics. The same applies to oil trade in Nigeria. In 2012, the country exported $89 billion of crude oil and imported $5.5 billion of refined oil. Africa imports 88 per cent of its intermediates from the rest of the world (dominated by a handful of players, including Algeria, Egypt, Morocco, Nigeria, Tunisia and South Africa, which account for nearly 75 per cent of the total), and only 12 per cent from Africa (ECA, 2015).

In the meantime, data show that intra-African trade in intermediates offers a broader scope for regional value chains to emerge, as the intra-African market shows signs of stronger dynamism than Africa's exports to the rest of the world, and emergence of regional value chains through trade in manufacturing intermediates. More than 60 per cent of intra-African exports are in manufactured intermediates and Africa absorbed 20 per cent of its total intermediate exports in manufacturing, against 10 per cent in agriculture and 10 per cent in mining and quarrying (figure 3).

Figure 3: Africa's exports of intermediates by main sector and destination



Source: Calculations based on Organization for Economic Cooperation and Development Bilateral Trade Database.

Services are an important component of any economy and can increasingly play a key role in Africa's transformation, particularly in the context of global value chains. They are key inputs to most other businesses, they make a direct contribution to gross domestic product and job creation, attract foreign direct investment, and are important in adding value along global value chains. Literature shows that structural transformation usually coincides with a growing role of industry and services in the economy (alongside a reduced role in the agriculture sector). In 2013, the services sector was the main contributor to gross domestic product in 35 out of 54 African countries, and Africa's growth in services (at 5.8 per cent) over the period 2000–2012 was higher than the world's average (of 3 per cent), and faster than that of several other regions (ECA, 2015). Services are also critical in facilitating manufacturing activities through their impact on the financial, logistics and design services, among others.

Preferential schemes have failed to broadly enhance industrialization in Africa

The report observes that preferential schemes have strongly supported Africa's trade, but have done little for Africa's industrialization. During the period 2000–2012, not less than 72 per cent of total exports from African least developed countries were absorbed by just five countries, all offering improved market access through preferential treatment. But whether the destination is a traditional partner or an emerging market, these countries' exports were concentrated in fuels, and to a lesser extent, ores and metals. The benefits from preferential trade schemes are constrained by imbalances between the productive capacity of African nations and stringent rules of origin. But the third country fabric provision (e.g. relaxed rule of origin for textile and apparel) under the African Growth and Opportunity Act (AGOA), has helped in generating some degree of industrialization for countries such as Ethiopia, Ghana, Kenya, Lesotho, Madagascar, Mauritius, South Africa and Swaziland. However, AGOA has not helped Africa to diversify its export products, with energy commodities still constituting the bulk of AGOA-eligible countries' exports to the United States of America (ECA, 2015). It should be stressed that by their unpredictable nature, trade preferences cannot build the regional value chains required to sustain industrialization.

Accelerated regional integration and trade policy sequencing are essential

Enhance regional integration reforms in Africa and policy reforms will provide a stronger basis for industrialization. Reforms should be bold. The Continental Free Trade Area, along with reduction of trade costs through trade facilitation measures, has the potential to more than double the share of formal intra-African trade over the next 10 years. A boost in the proportion of industrial products would offer a bright perspective for Africa's industrialization. Moreover, the Continental Free Trade Area has the potential to enhance intra-industry trade (e.g. exchange of products within the same industry, those being similar or differentiated by quality and variety or at various stages of production), thanks to the positive correlation between intra-African trade and intra-industry trade. It could also provide opportunities to move up the value chain, as the report finds that increased shares of intraregional trade are associated with higher shares of regional value-added in intraregional trade. The Continental Free Trade Area is therefore expected to stimulate and diversify intra-

African trade and increase value-added output from the regional market, thereby supporting regional value chains. However, as is the case with trade preferences to Africa, regional integration alone cannot be Africa's sole trade strategy for industrialization.

Accordingly, there is need for the development and implementation of Africa-wide strategic trade policies when opening up with the rest of the world. Opening up Africa's market through reciprocal agreements can deliver benefits to African countries, but their impact on Africa's industrialization depends on the countries' initial conditions. Africa should determine its external protection structures – such as those that do not undermine its regional integration and industrialization efforts. Africa should stand firm to preserve its policy space when negotiating trade agreements with outside partners. It has been observed that South-South engagements tend to offer greater policy space than the North-South partnerships, suggesting that African countries would gain by reinforcing ties with their developing partners.

In the same vain, the report emphasizes that trade reforms need to be well sequenced and gradual if Africa is to benefit from its trade-induced industrialization process. African countries cannot afford to be left out of the new trend towards mega-regional trade agreements, and the Continental Free Trade Area offers a decisive response. Africa's market should be opened progressively, and ideally intensified only when regional integration has deepened considerably across the continent. Trade-induced industrialization benefits would be strongly enhanced if the Continental Free Trade Area is established before, for example, the economic partnership agreements with the European Union are fully implemented (ECA, 2015). African member States and regional economic communities should redouble their efforts in implementing the African Union Action Plan for Boosting Intra-African Trade.

In short, the Economic Report on Africa 2015 calls on African countries to leverage the progress made on the improved business environment, economic governance and macroeconomic management; and mainstream trade policy into their development strategies and ensure coherence among all national policies, with more emphasis on the linkages between trade and industrial strategies. Countries should first analyse their best route to structural transformation (since not all countries can develop through manufacturing, for example), with a gradual approach to industrialization and upgrading along value chains, combined with a highly selective and carefully designed trade policy.

African countries should insist on the need to use negotiating agreements to promote industrialization and use the present trade policy space effectively, since 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 design trade policies that promote and reverse their current participation in global value chains, as they show high participation rates in global value chains, but at a low level. They should start developing and strengthening regional value chains to support industrialization and foster the emergence of interconnected regional supply chains. Implementing the Continental Free Trade Area can boost intra-African trade and its industrial content if accompanied by bold reforms, such as those emphasizing the removal of all tariff barriers on goods and tackling those related to trade in services. These reforms demand that political commitments be made swiftly, with smart sequencing of trade agreements; and the Continental Free Trade Area should be put in place before other trade agreements are fully implemented by African countries or by the rest of the world.

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