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ECA POLICY BRIEF

Smart industrialization through trade in the context of Africa's transformation

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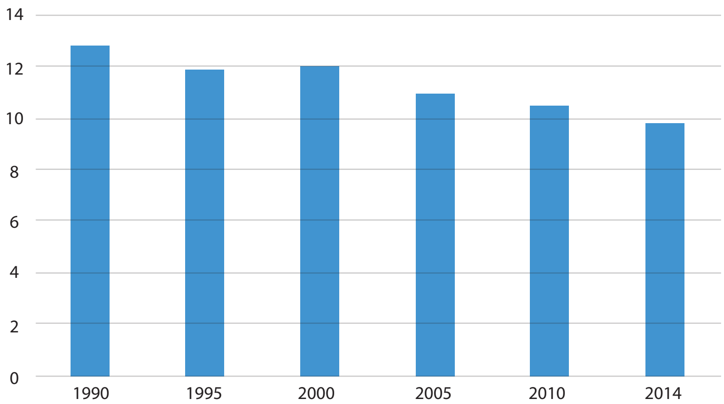
This policy brief highlights the importance of trade as a tool for achieving Africa's structural transformation agenda and provides focused policy recommendations on how African countries can more effectively use trade agreements, trade policy and trade-related complementary measures to industrialize..

1. Importance of industrialization

Africa's experience with industrialization has been disappointing. Globally, the share of manufacturing in total output rises with per capita income until countries reach upper-middle-income status and declines as services become more prevalent at higher incomes (Newman, and others, 2016). This has not been the case in Africa. In 2014, Africa's average share of manufacturing value added in gross domestic product (GDP) was 9.8 per cent, 3 percentage points less than the 12.8 per cent of 1990 (figure 1). The share of manufacturing exports in Africa's total exports similarly declined from 25.6 per cent in 1995 to only 18.9 per cent in 2014.

Figure 1:
Manufacturing value added (percentage of GDP), Africa average [a]



Source: Economic Commission for Africa.
a Figures computed using the world development indicators database of the World Bank. Averages are calculated for African countries for which data are available.

By moving labour and other resources from lower-productivity to higher-productivity activities and raising within-sector productivity growth, industrialization contributes to economic transformation (as defined by McMillan, and others, 2017). Moving forward, the transformation of African economies through industrialization will be key to achieving economy-wide productivity improvements, job creation and sustained progress in growth and poverty reduction.

2. Using trade as a tool to drive Africa's industrialization

Fresh thinking is needed on how to achieve Africa's industrialization objectives. Trade has a key role to play. Intraregional trade has the specific potential to facilitate increased economies of scale, diversification and value addition. In 2014, manufactured goods accounted for 41.9 per cent of intra-African exports compared with only 14.8 per cent of Africa's exports outside the continent. Intra-African trade is, however, underexploited owing to high trade costs in the region. Intra-African trade as a share of total African trade was 15.3 per cent in 2015. By comparison, trade among developing economies in East Asia as a share of total trade in the region was 32.1 per cent.

Although the idea of actively using trade and trade policy to support industrialization is not new, it has recently experienced a resurgence. Trade has greater prominence in the Sustainable Development Goals than in the Millennium Development Goals, with trade-related targets included as a means of implementation. In the African Union's vision contained in Agenda 2063, there are calls for developing productive capacities, boosting intra-African trade, the establishment of a Continental Free Trade Area and improved regional infrastructure, among other trade-related priorities. African countries recognize the role that such a free trade area can play in achieving its industrialization and have designated industrialization as the central pillar of the Continental Free Trade Area project. The continent's regional economic communities also recognize that industrialization needs to take centre stage in regional integration and development agendas.

The remainder of the policy brief provides a set of policy recommendations on what needs to be done for African economies to industrialize smartly through trade.

3. Priority policy recommendations on how to industrialize smartly

A. Articulating smart choices in trade agreements

African countries need to articulate smart choices within existing trade agreements and insist on using new trade agreements to promote industrialization. Ex ante and ex post-industrial impact assessments should be used as tools to support the mainstreaming of industrial priorities into Africa's trade agreements. For example, in many African countries, there exists an imbalance between productive capacity and stringent rules of origin and product standards. Industrial impact assessments could help to resolve this issue by assessing whether the requirements contained in trade agreements or arrangements are consistent with the productive capacities of African countries.

The imperative of advancing Africa's industrialization should be central to the Continental Free Trade Area negotiation process. Modelling exercises by the Economic Commission for Africa (ECA) indicate that establishing Continental Free Trade Area would boost intra-African trade in goods by 52.3 per cent, with estimated increases highest for industrial products, at 53.3 per cent (Economic Commission for Africa, 2012). The final agreement should be aimed at committing member States to an ambitious liberalization agenda for trade in goods and trade in services. Doing so will be crucial for boosting intra-African trade in intermediates, ensuring competitively priced service inputs and developing manufacturing regional value chains. The agreement should also include provisions that are consistent with the imperative of industrial development under the Continental Free Trade Area industrial pillar. For example, flexible rules of origin with generous cumulation requirements would help to encourage local and regional processing and the development of African industrial supply chains.

Africa should smartly sequence its trade policy reforms. ECA modelling suggests that implementation of new economic partnership agreements in West, East and Southern Africa would see a significant influx of European Union exports to African countries, especially in industrial goods, and a reduction in intra-African trade. It also indicates that, if implemented as planned, the three main megaregional trade agreements, namely, the Trans-Pacific Partnership, the Transatlantic Trade and Investment Partnership and the Regional Comprehensive Economic Partnership, will result in loss of market share by African countries, with reductions concentrated in industrial exports. Expeditious implementation of Continental Free Trade Area is needed to avoid any trade losses from the changing trade landscape faced by African countries. Doing so will allow African countries to harness the economies of scale and learn by doing what is needed to develop competitive regional value chains and industries, which are well positioned to compete internationally and integrate into global value chains. Reciprocal trade agreements should be well managed, with phased tariff reductions on imports into Africa to enable African industries to adapt.

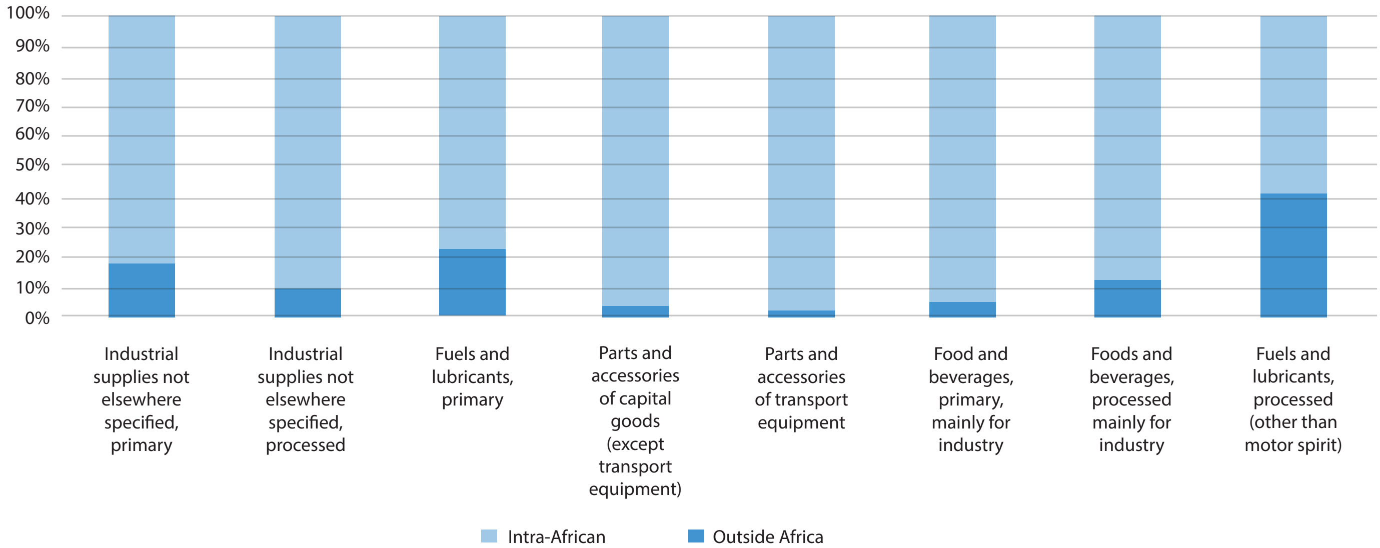
B. Using trade policy to promote industrialization

African countries should base their industrial development strategies on comparative advantages. There exists a weak relationship between effective rate of protection and revealed comparative advantage. This indicates that sectors in which countries have comparative advantage in production are not always protected. However, higher rates of protection do not guarantee that the sectors will grow. Tariff structures should instead be aimed at ensuring that sectors can attain international competitiveness. Comparative advantage should also be considered as a dynamic concept. In other words, countries can also “build” their comparative advantage in sectors that are deemed strategic for their growth. In such circumstances, trade policy tools, such as lower tariffs on key inputs, and time-bound and well-targeted export restrictions can be used. However, to be successful and attain durable results, these tools need to be accompanied by relevant complementary policies.

Import and domestic tariffs should be structured in a way that supports industrialization. In 2012, the mean effective rate of protection was greater than the mean most favoured nation tariff for 42 African countries for which data are available, with the exception of Sao Tome and Principe. Tariff structures therefore tend to be defined in a way that provides additional protections on top of the nominal tariff. Nevertheless, 21 cases of the 500 analysed across all sectors and countries have negative an effective rate of protection and 65 cases have an effective rate of protection lower than the nominal rate of protection. In general, all products that have an effective rate of protection that is lower than the nominal rate of protection face a tariff structure that discourages domestic production, value addition and industrialization. This could be due not only to high tariffs on the inputs utilized by certain industries and sectors but also to low tariffs on final products. Increasing tariffs on a sector’s outputs may help to promote domestic production in the short term but risks hampering improvements in real industrial competitiveness. A more suitable and sustainable solution would be to remove, or at least reduce, import tariffs on the inputs used by the sectors with a negative or low effective rate of protection.

Tariff rates should be reduced on important industrial intermediate inputs for which regional production capacity does not exist. Africa imports the large majority of its industrial intermediates from outside the continent at high tariff rates (figure 2). In 2015, intermediate goods imported into Africa faced a tariff rate of 7.5 per cent, compared with 4.5 per cent for intra-African imports of intermediates. Tariff rates are particularly high for industrial supplies and processed food and beverages. This significantly increases the costs of industrialization. Domestic intermediate import tariff structures should be reviewed to ensure consistency with industrial development needs and current domestic and regional supply capacities. The Continental Free Trade Area should also be aimed at significantly reducing internal tariffs on industrial intermediates.

Figure 2:
Shares of Africa's intermediate imports by separate intermediate, 2015 (Per cent)



Source: Economic Commission for Africa calculations using Centre for International Prospective Studies and Information and international trade analysis database, HS12.

African firms should industrially upgrade through participating in global value chains. Doing so would allow African firms to quickly gain the ability to produce and export higher value-added products. Enabling participation in global value chains requires overcoming the constraints to industrialization through trade, such as inadequate infrastructure and border-related and local distribution deficiencies (e.g., corruption, cumbersome customs requirements and inefficient services). Trade policy should also be used to create an attractive environment, for example, by reducing or eliminating tariffs on the imports to be used for processing. Several countries in Africa have established export processing zones, which use trade policy to promote the processing of goods. In order to develop these zones, trade policy tools need to be accompanied by complementary policies.

C. Complementary policies for industrialization through trade

Interventions to reduce non-tariff trade costs are needed to tackle the binding supply-side constraints to industrialization. The continent's cost of trading with the world was 283 per cent in ad valorem tariff equivalent in 2013, higher than that of all other regions except Central Asia, which has a higher share of landlocked countries. The reason for this is the prevalence of non-tariff measures and physical market access barriers that have an impact on African countries. The Action Plan for Boosting Intra-African Trade of 2012 was designed by the African Union Commission, with the support of ECA, to deal with the constraints to intra-African trade through identifying a number of key programmes and activities under seven clusters: trade policy, trade facilitation, productive capacity, trade-related infrastructure, trade finance, trade information and factor market integration. Implementation of the Action Plan has been relatively disappointing, slow and uncoordinated to date. To reduce Africa's non-tariff trade costs, the Action Plan clusters must be mainstreamed into the development policy and programmes of African countries and regional economic communities. A weak relationship between the effective rate of protection and exports in African countries suggests that high levels of effective rate of protection are not having the desired effect of supporting industrialization, laying emphasis on the need for such complementary measures.

Africans must be equipped with the skills needed to productively engage in skills-intensive manufacturing industries (e.g., the manufacture of apparel, machinery and equipment). A shortage of relevant skills is constraining the growth of Africa's industrial firms. A poorly skilled and educated labour force is the top supply bottleneck faced by global executives when considering manufacturing investments in Africa (African Center for Economic Transformation, 2014). Regular training needs assessments and national manpower surveys are required to identify the skill gaps of African industries and guide skills development.

Efforts to ensure an efficient and competitive trade facilitation framework should continue to receive attention. African leaders should take full ownership of the infrastructure agenda and mobilize the funds required for its implementation. New and innovative sources of financing will be needed to meet the $68 billion estimated cost of immediate investment in the African Union's Programme for Infrastructure in Development in Africa required through 2020. Focus should be attached to connecting African countries at the continental level. This will be crucial for facilitating intra-African trade gains made possible by Continental Free Trade Area. Other behind-the-border inefficiencies, such as customs operations, should also be addressed. Electronic single windows should be rolled out in all African countries under a pan-African approach that ensures harmonized electronic single windows practices and operations. The 2013 World Trade Organization Agreement on Trade Facilitation provides an opportunity for improved targeting of Aid for Trade activities towards objectives on trade facilitation.

Enhancing access to affordable credit will be especially important for laying the groundwork for rapid industrialization and supporting the integration of export-oriented firms into time-sensitive regional and global value chains. The continent should exploit the potential of the rapidly increasing penetration of information and communications technology to increase financial access. Doing so will require the establishment of adequate institutional and regulatory frameworks to attract private actors and guarantee prudential supervision.

African countries should invest in developing the infrastructure necessary to support services. More strategic thinking is required on how to deal with services under the framework of trade agreements involving African countries. Many African services firms need technical support to comply with quality and other standards requirements for market access for services exports, in particular in developed countries. Mutual recognition agreements for services standards can help, as can improvements to national regulatory standards and institutions governing services sectors, including with regard to competition policy. National regulatory frameworks for services in African countries should be non-trade-distorting. The continent should adopt an open trade policy towards services, including services imports.

D. Strengthening links among national development strategies, industrial policy and trade policy

African counties must increase the coherence between trade policy and industrial and national development policies. For most African countries, industrial development remains just one of many objectives of trade policies. In order for trade policy to effectively foster industrialization, industrial development must instead become the core objective of trade policy (Economic Commission for Africa, 2015). Such coherence is important, given that trade policy alone, without appropriate complementary policies, cannot deliver on the levels of industrialization needed for meaningful structural transformation in Africa. A positive example is the national development plan of Chad, which was launched in April 2013 and provides major orientations on industrial and trade aspirations.

Regional integration and trade policies should be aligned with development and industrial policies that incorporate key country attributes (opportunities, challenges, resources, linkages and synergies among sectors, etc.). Asia's regional integration has been particularly successful, given that it has been supported directly by efforts to enhance productivity, diversify and structurally transform the region's economies. Investments in productive capacities and technology transmission and adoption have been key to driving innovation and competitiveness and the integration into global value chains (Economic Commission for Africa, 2016).

Industrial parks and special economic zones can be used to exploit linkages between trade and industry. For example, Ethiopia has actively and effectively aligned its trade and industrial policies through developing a number of industrial parks that target investments and production in manufacturing export sectors, such as textiles and apparel, leather products, pharmaceuticals and agroprocessing. These parks are located along key economic corridors and connected to ports, airports, railways and universities. They also provide incentives to both manufacturers and developers to encourage expansion and production for export. Such an approach should be adopted in other African countries, but also regionally. Special economic zones and industrial parks could be organized on a cross-border basis and used to provide incentives for local and foreign industry-related investments to take full advantage of trade liberalization under Continental Free Trade Area.

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