Policy briefing

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

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Recommendations

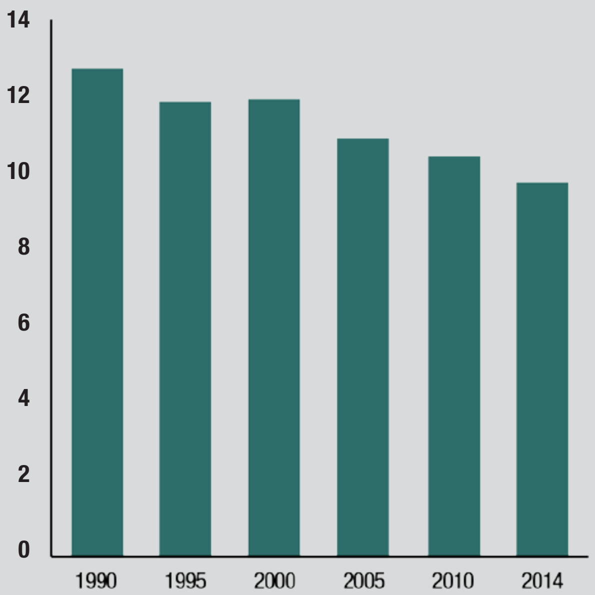
- Trade, including intra-African trade, and trade policy offer important and underutilised tools for African countries to achieve their industrialisation objectives.
- High tariffs on capital goods, inputs and intermediate products discourage domestic production and should be revised.
- African countries can accelerate their productivity gains by promoting participation in global value chains, for example by providing adequate infrastructure and a supportive policy environment.
- Complementary policies to improve skills, infrastructure, trade facilitation and access to affordable credit can boost industrialisation.
- Continental, regional and domestic policies should be aligned towards making industrialisation a top priority.

1. The importance of industrialisation

Africa's experience with industrialisation has been disappointing. Globally, the share of manufacturing in total output rises with per capita income until countries reach upper-middle-income status, then declines as services become more prevalent at higher incomes (Newman et al., 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%, 3 percentage points less than the 12.8% of 1990 (see Figure 1). The share of manufacturing exports in Africa's total exports similarly declined from 25.6% in 1995 to only 18.9% in 2014.

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

Figure 1: Manufacturing value added (% of GDP), Africa average



Notes: Averages calculated across African countries for which data are available.
Source: ECA calculations using World Bank WDI database.

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

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

Although the idea of actively using trade and trade policy to support industrialisation is not new, it has recently experienced a resurgence. Trade has greater prominence in the United Nations' Sustainable Development Goals than it did in the Millennium Development Goals, with trade-related targets included as means of implementation. The African Union's vision contained in Agenda 2063 calls for developing productive capacities, boosting intra-African trade, establishing a Continental Free Trade Area (CFTA) and improving regional infrastructure, among other trade-related priorities. African countries recognise the role the CFTA can play in achieving its industrialisation and have designated industrialisation as the central pillar of the CFTA project. The African Union's Regional Economic Communities (RECs) also recognise that industrialisation needs to take centre stage in regional integration and development agendas.

The remainder of this brief provides a set of policy suggestions on what needs to be done for African economies to industrialise smartly through trade, based on recent research by the United Nations Economic Commission for Africa (ECA) and ODI.

3. Priority policy recommendations on how to industrialise smartly

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 industrialisation. 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 resolve this issue by uncovering whether the requirements contained in trade agreements/arrangements are consistent with the productive capacities of African countries.

The imperative of advancing Africa's industrialisation should be central to the CFTA negotiations process. Modelling exercises conducted by the ECA indicate that establishing the CFTA would boost intra-African trade in goods by 52.3%, with estimated increases highest for industrial products (53.3%) (ECA, 2012). The final CFTA agreement should aim to commit member states to an ambitious liberalisation agenda for trade in goods and trade in services. This 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 CFTA industrial pillar. For example, flexible rules of origin with generous cumulation requirements would help encourage local and regional processing and the development of African industrial supply chains.

Africa should sequence its trade policy reforms appropriately. ECA modelling suggests implementation of new Economic Partnership Agreements in West Africa (WA) and Eastern and Southern Africa (ESA) would lead to a significant influx of EU exports to African countries, especially in industrial goods, and a reduction in intra-African trade. In absolute terms, EU exports to WA and ESA together would increase nearly twice as much as WA and ESA's exports to the EU under Economic Partnership Agreements and as compared to the baseline (Mevel et al., 2015). ECA modelling also indicates that, if implemented as planned, the three main mega-regional trade agreements (MRTAs) covering countries outside Africa – 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. Africa would see its total exports reduce by US$3 billion by 2022 compared to the baseline scenario without MRTAs (Mevel and Mathieu, 2016). Expeditious implementation of the CFTA is needed to avoid any trade losses from the changing trade landscape facing African countries. This will allow African countries to harness the economies of scale and learning by doing that is needed to develop competitive regional value chains and industries, which are well positioned to compete internationally and integrate into global value chains (GVCs). Reciprocal trade agreements should be well managed with phased tariff reductions on imports into Africa to enable African industries to adapt.

4. Using trade policy to promote industrialisation

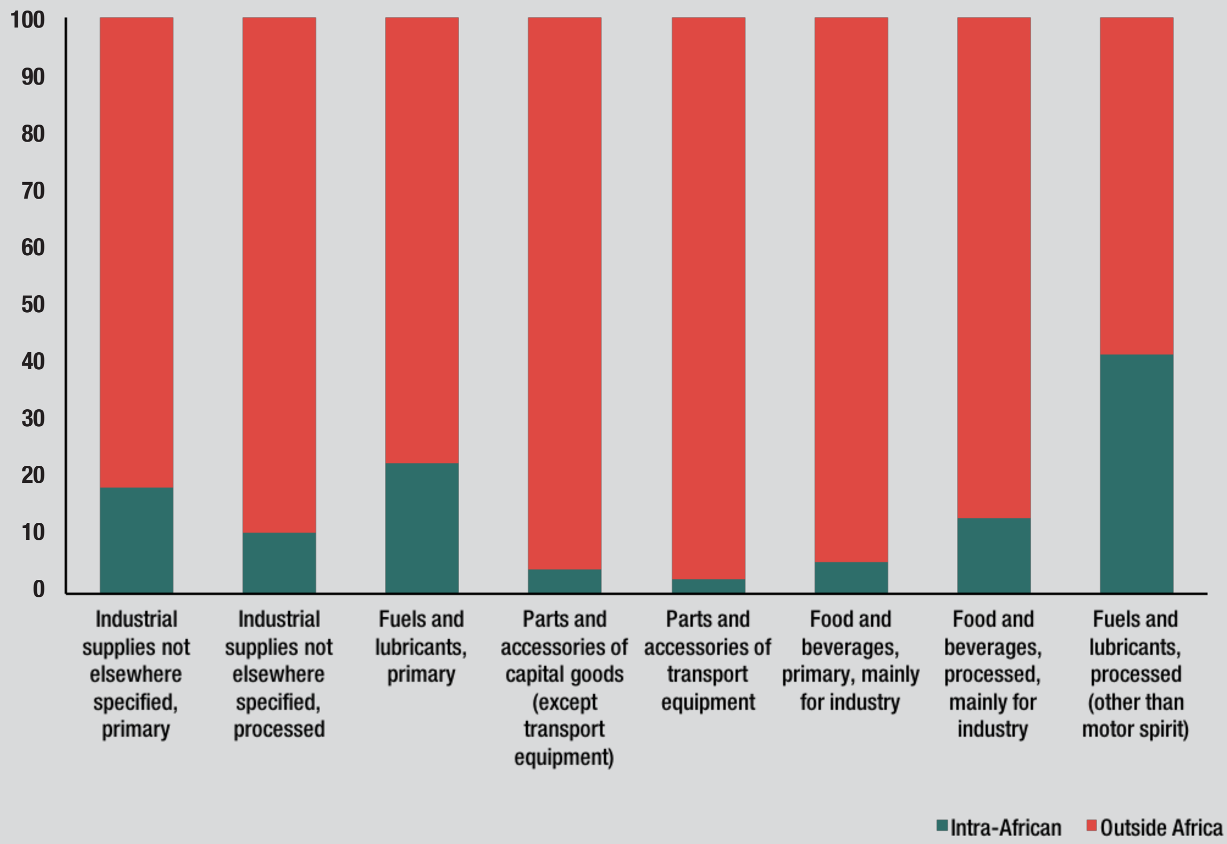
African countries should base their industrial development strategies on dynamic comparative advantages. There exists a weak relationship between effective rate of protection (ERP) and revealed comparative advantage. This indicates that sectors where countries have comparative advantage in production are not necessarily protected. However, higher rates of protection do not guarantee the sectors will grow. Tariff structures should instead aim to ensure sectors can achieve international competitiveness. Comparative advantage should, however, also be considered a dynamic concept – countries can also 'build' this 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 coupled with proactive export promotion policies. However, to be successful and achieve durable results, these tools need to be accompanied by relevant complementary policies.

Import and domestic tariffs should be structured in a way that supports industrialisation. In 2012, the mean ERP was greater than the mean most-favoured-nation tariff for 42 African countries for which data are available, with the exception of São Tomé and Príncipe. Tariff structures therefore tend to be defined in a way that provides additional protection on top of the nominal tariff. However, 21 cases out of the 500 analysed across all sectors and countries have negative ERP, and 65 cases have ERP lower than the nominal rate of protection. In general, all products that have ERP lower than the nominal rate of protection face a tariff structure that discourages domestic production, value addition and industrialisation. This could be due to high tariffs on the inputs certain industries and sectors utilise, but is also a result of low tariffs on final products. Increasing the tariffs on a sector's outputs may help promote domestic production in the short term, but it 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 of sectors that are often characterised by negative or low ERP, such as manufacture of food products, mining-related services and fishing and aquaculture.

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 (see Figure 2). In 2015, intermediate goods imported into Africa from outside faced a tariff rate of 7.5%, compared with 4.5% 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 industrialisation. Domestic intermediate import tariff structures should be reviewed to ensure consistency with industrial development needs and existing domestic and regional supply capacities. The CFTA should also aim to significantly reduce internal tariffs on industrial intermediates.

African firms should upgrade industrial production through participating in GVCs. This would allow them to quickly gain the ability to produce and export higher value added products. Enabling participation in GVCs requires

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



Source: ECA calculations using CEPII BACI database, HS12.

overcoming the constraints to industrialisation 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.

5. Complementary policies for industrialisation through trade

Interventions to reduce non-tariff trade costs are needed to address the binding supply side constraints to industrialisation. The continent's cost of trading with the world was 283% 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 impacting African countries. The 2012 Boosting Intra-African Trade (BIAT) Action Plan was designed by the African Union Commission, with support of the ECA, to address 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 BIAT initiative has been relatively disappointing, slow and uncoordinated so far. To reduce Africa's non-tariff trade costs, the BIAT clusters must be mainstreamed into development policy and programmes of African countries and RECs. A weak relationship between ERP and exports in African countries suggests high levels of ERP are not having the desired effect of supporting industrialisation, laying emphasis on the need for such complementary measures.

Africans must be equipped with the skills needed to engage productively 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 mentioned by global executives when considering manufacturing investments in Africa (ACET, 2014).

Regular training needs assessments and national manpower surveys are required to identify the skills gaps of African industries and to 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 mobilise the funds required for its implementation. New and innovative sources of financing will be needed to raise the $68 billion estimated costs of immediate investment in the African Union's Programme for Infrastructure in Development required through to 2020. Focus should be placed on connecting African countries at the continental level. This will be crucial for facilitating intra-African trade gains made possible by the CFTA. Other behind-the-border inefficiencies, such as in customs operations, should also be addressed. Electronic single windows (ESWs) should be rolled out across all African countries under a pan-African approach that ensures harmonised ESW practices and operations. The 2013 World Trade Organization Trade Facilitation Agreement provides an opportunity for improved targeting of Aid for Trade activities towards objectives on trade facilitation.

Enhancing access to affordable credit will be particularly important for laying the groundwork for rapid industrialisation 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 communication technology to increase financial access. This 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 necessary infrastructure to support services. More strategic thinking is required on how to deal with services within 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, particularly to developed countries. Mutual recognition agreements for services standards can help, as can improvements to domestic regulatory standards and institutions governing services sectors (including around competition policy). Domestic 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.

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

African counties must increase 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 industrialisation, industrial development must instead become the core objective of trade policy (ECA, 2015). This coherence is important since trade policy alone, without appropriate complementary policies, cannot deliver the levels of industrialisation needed for meaningful structural transformation in Africa. A positive example is Chad's Plan National de Développement, 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, because it has been directly supported by efforts to enhance productivity, and 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 GVCs (ECA, 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 agro-processing. 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 organised on a cross-border basis, and used to provide incentives for local and foreign industry-related investments to take full advantage of trade liberalisation under the CFTA.

Notes

This policy brief was prepared by the Overseas Development Institute (ODI), UK, and the African Trade Policy Centre (ATPC) in the United Nations Economic Commission for Africa (ECA).

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