THE JULIS-RABINOWITZ CENTER FOR PUBLIC POLICY AND FINANCE

WHAT IS THE POTENTIAL FOR MORE OPEN TRADE, AT THE REGIONAL OR CONTINENTAL LEVEL, TO HELP STRENGTHEN AND DIVERSIFY ECONOMIES?

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Outline of the Presentation

- Background and objectives;
- The structure of African economies: Intra-African trade as a driver of economic diversification;
- The catalytic power of the AfCFTA;
- Is the AfCFTA a panacea?
- Closing remarks;
I would like to thank the organizing committee of the 12th edition of the JRCPPF Conference for associating Afreximbank to this year’s event specially Professors E. Kapstein, A. Mian, L. Wantchekon, and P. Nuka;

We are very grateful Professor Wantchekon for what you have been doing over the years to promote the teaching of economics and more generally improve policymaking in support of growth and economic development across the region;

The objective of this session is to reflect on the interaction between intra-regional trade and economic diversification in Africa, specifically the role that intra-regional trade could play in the process of economic diversification;
The topic is timely because the increasing push for diversification of supply chains post-COVID-19—you have all heard “re-shoring” and “friend-shoring”—provides a huge opportunity for Africa to integrate GVCs through backward activities;

The topic is also very important because the diversification of sources of growth, which has provided the path for poverty reduction and effective integration into the global economy where trade has been dominated by manufacturing goods with increasing technological content has eluded Africa for decades, at huge costs;

As the manufacturing content of world output and trade expanded, the stickiness of the colonial development model of resource extraction led to a continued decline of Africa’s share of global trade, which has fallen below 3%;
Contribution of Africa to global trade

![Graph showing the contribution of Africa to global trade over time.](image_url)
The macroeconomic implications of that colonial development model have been significant as well and this is illustrated by:

1. The excessive exposure of the region to global volatility and recurrence of balance of payment crises;
2. The correlation between growth and commodity price cycles increases the risk of balance of payment crises and debt overhang;

That correlation is largely responsible for the perception Premium, which has led most countries across Africa to contend with large spread and default-driven borrowing rates which increase the fiscal incidence of sovereign debt and risk of debt distress;

Ghana which is the latest country to default across the region has a credit spread of 2598bps and is devoting over 50% of government revenues to external debt servicing;
Ghana vs. Italy Selected Bonds

ZQ018814 Corp (ITALY 2 % 10/17/29)
AS613887 Corp (GHANA 7 % 05/16/29)
ITALY 2 % 10/17/29 - GHANA 7 % 05/16/29
But the stickiness of the colonial development model of resources extraction also has significant welfare implications;

Africa which is home to 17% of the world’s population now accounts for over 60% of people living in extreme poverty in the world;

However, Africa’s economic prospects were expected to be brighter;

In his famous book titled “Asian Drama” Gunnar Myrdal, the 1974 Nobel Laureate in economics, predicted that Africa would enjoy better growth prospects than an overpopulated Asia;

But unlike Africa where natural resources remain the main driver of growth under the sticky colonial development model of resource extraction Asia went through a successful process of economic diversification to enjoy a brighter future;

Can intra-African trade put African economies on a similar path is the main question for us?
II. Structure of African economies: Intra-African trade as a driver of economic diversification
An overview of the structure of African economies and trade provides a good illustration of the stickiness of the colonial development model of resource extraction;

Despite attempts by various African governments to diversify their economies, commodities continue to dominate both growth and trade;

- In Nigeria, the largest African economy, oil exports account for over 90% of foreign exchange earnings and 60% of government revenues;
- Oil accounts for over 78% of GDP in Equatorial Guinea and only 4% of the labour force;

Natural resources which have been the major drivers of growth across Africa are not particularly labour-intensive and could explain the high incidence of poverty and informality;
Natural resources also dominate African trade; according to UNCTAD, only five African countries (Egypt, Eswatini, Mauritius, Morocco and Tunisia) moved out of commodity dependence between 1965 and 2019—further highlighting the stickiness of the colonial development model of resource extraction;

More than 80% of African countries are trapped in commodity dependence, deriving more than 60% of their foreign exchange earnings from commodity exports;

In addition to boom-bust cycles, the current structure of African economies and trade has exposed countries to long-term deterioration of terms of trade;

It is also responsible for the decreasing Africa’s share of global trade, now less than 3%, down from 5% in the 1960s;
Share of Global Merchandise Trade

Source: Author’s computation from DOTS; IMF, 2021
US top-25 trading partners (2010 and 2021)
But the structure of African economies also shapes the composition and direction of African trade; As part of the colonial legacy, African trade has remained highly extroverted, unlike other regions; Intra-African trade accounts for just about 15% of total African trade against, 72% in Europe and 67% in Asia; This highly extroverted direction of trade exposes countries to global volatility and adverse terms of trade shocks; Across the region economic policy has been reduced to balance of payment crisis management as a result; But another characteristic feature of intra-African trade is the dominance of manufactured goods;
Sectoral distribution of intra-African exports by country groupings (averages 2017-2019)

- **SIDS**
  - Agriculture & Food: 24.7%
  - Mining & Energy: 5.8%
  - Manufactured Goods: 69.5%

- **LLDCs**
  - Agriculture & Food: 36.2%
  - Mining & Energy: 28.7%
  - Manufactured Goods: 35.2%

- **LDCs**
  - Agriculture & Food: 31.5%
  - Mining & Energy: 38.8%
  - Manufactured Goods: 29.7%

- **Non-LDCs**
  - Agriculture & Food: 18.7%
  - Mining & Energy: 32.6%
  - Manufactured Goods: 48.7%

- **Africa total**
  - Agriculture & Food: 21.9%
  - Mining & Energy: 34.2%
  - Manufactured Goods: 44.0%
While primary commodities and natural resources dominate extra-African trade, manufactured goods dominate intra-African trade;

In other words, intra-African trade and industrialization are mutually reinforcing;

Under certain conditions intra-African trade could accelerate the process of industrialization and diversification of sources of growth and trade in Africa;

Can the AfCFTA which entered into force over two years ago be the reform that boosts the industrialization power of intra-African trade?
III. The catalytic power of the AfCFTA
Trade integration which allows countries to specialize in the production of goods and services for which they have a comparative advantage and to exploit economies of scale has delivered impressive results in other regions of the world, enhancing integration into GVCs and setting countries on an irreversible path of per capita income growth, welfare improvement and macroeconomic stability;

The defragmentation of Africa envisaged under the AfCFTA is expected to produce similar results;

It will accelerate the development of RVCs and the transformation of African economies to raise Africa’s share of global trade and strengthen its bargaining power in international trade negotiations;
By allowing corporations to spread the risk of investing in smaller markets, economies of scale associated with the AfCFTA will boost the productivity and competitiveness of African economies and accelerate the development of RVCs to gradually enable Africa to integrate the global network of frontier technology;

Preliminary estimates of trade and development impact associated with the AfCFTA are very encouraging:

- The AfCFTA will boost intra-African exports by over 81% and extra-African exports by 19% by 2035;

Manufactured goods are expected to make the most gains:

- A 110% increase for intra-African trade and 46% increase for extra-African trade;
The fact that empirical studies carried out by DFIs and international organizations (including UNCTAD, IMF, World Bank and Afreximbank) consistently show that manufacturing exports will receive the largest boost during the implementation of the AfCFTA is significant for several reasons;

- Over the years the correlation between manufacturing output growth and economic growth has been both positive and strong;
- But not only is the share of manufacturing in GDP positively related to economic growth, manufacturing output growth is poverty-reducing and its poverty-reducing effects are more pronounced in low-income countries;
At the same time, the importance of manufacturing for economic development has a strong theoretical foundation;

- Manufacturing offers special opportunities for capital accumulation—most recent estimates show that manufacturing drives over 20% of capital investment in the USA;
- The Manufacturing sector offers special opportunities for economies of scale and productivity growth—in the USA it accounts for over 35% of productivity growth;
- The manufacturing sector offers special opportunities for technology transfers and integration into global value chains;
- The manufacturing sector enhances the linkages and spillover effects—the direct backward and forward linkages between sectors and sub-sectors—to create positive externalities to investment in given sectors;

- Hence, the AfCFTA could reshape GVCs, end the marginalization of Africa for a more inclusive globalization process;
Where do the bicycles come from?

**Saddle exports**
- China: US$100 million
- Italy: US$85 million
- Spain: US$16 million

**Frame exports**
- China: US$977 million
- Vietnam: US$147 million
- Italy: US$66 million

**Brake exports**
- Japan: US$200 million
- Singapore: US$172 million
- Malaysia: US$152 million

**Wheel exports**
- China: US$170 million
- Italy: US$28 million
- France: US$26 million

**Pedal and crank exports**
- Japan: US$150 million
- China: US$137 million
- Singapore: US$117 million

Source: WDR 2020 team, using data from UN Comtrade database. See appendix A for a description of the databases used in this Report.
Boeing Global Supply Chain
The removal of tariff barriers and non-tariff barriers across AfCFTA member countries will facilitate the sourcing within Africa to form regional manufacturing clusters;

Significant progress have been made within the region, with improving business environment and investment climate likely to be further enhanced by the AfCFTA;

But in addition to benefits in terms of inherent economies of scale and productivity gains, a few provisions and protocols under the AfCFTA are likely to boost innovation to accelerate economic diversification across the region, including:
The Rules of Origin—the industrialization accelerator prioritizing local value addition will further catalyze technology transfer and the development of RVCs in Africa;

Intellectual Property Right (IPR) Protocol—has the potential to catalyze innovation and technological progress across the continent because more innovators will maintain rights to their inventions in the AfCFTA era;

Protocol on Investment and Competition policy—will further enhance spillover of technology transfer from FDI;

Empirical evidence shows that the intensities of FDI inflows to ASEAN nations were closely related to the level of technology transfer to the region;
IV. Is the AfCFTA a Panacea?
Although necessary it is important to stress that the AfCFTA is not a sufficient condition for economic diversification and global convergence;

As the example of Asian Emerging Economies shows no policy objective is as critical on the path of global convergence than closing Africa’s technology deficit if the AfCFTA is to meet the sufficiency test;

Investing in human capital and closing the technology deficit is key to lifting supply-side constraints and diversifying the sources of growth to boost African trade;

Closing that gap will also create the right conditions for commodity-based industrialization and enhance integration into GVCs through value-adding backward activities;
Investment in critical innovation systems, research and technological, as well as physical and digital infrastructure that can deliver new manufacturing technologies and processes is key in a region where huge infrastructure financing gaps have been a major constraint to growth;

The booming of start-ups across Africa suggests that the region is reaping the benefits of investment in IT infrastructure in terms of productivity, financial services and access to energy;

But closing the chronic deficit of infrastructure across the board, including energy in a continent where nearly half of the population do not have access to electricity is key for industrialization and economic diversification;
Strengthening the foundation of public-private partnership supported by academia will accelerate diversification to enhance the development impact of investment in scientific research and innovation;

Financing African trade to drive the process of economic diversification is key in a region where trade financing gaps have remained very high;

Application of the Rules of Origin to reduce the risk of entrepot trade and accelerate the development of RVCs to sustain technology transfer and diversify African exports;

Creating the right research and policy environment, especially industrial policy, to accelerate the diversification of sources of growth for global convergence;
Trade facilitation measures are also critical in a region where non-tariff barriers have been just as costly for trade and growth as market fragmentation;

Speaking with one voice in the AfCFTA era is perhaps the most important challenge, one that will strengthen Africa’s bargaining power in international trade negotiations and resist the rush to bilateral trade deals;

Over the years, these bilateral deals have kept Africa at the short end of international trade negotiations stick, leading to trade deflection and weakening Africa’s voice at the global level;
How to navigate the fraught geopolitical environment to sustain the rise of RVCs and effective integration into GVCs either through ‘near-shoring’ or ‘friend-shoring’?

How to manage the adjustment costs and unequal distribution of inherent benefits of integration that could undermine implementation of the AfCFTA?

Even though the benefits of speaking with one voice at the global level are significant both in terms of growth and effective integration into the global economy, how do we get 55 countries to do so, and consistently?

And in the new global race for natural resources, how do we change the mindset which has for centuries led the world to see Africa as the continent where to get natural resources and not manufactured goods?
VI. Closing Remarks
Can intra-African trade accelerate economic diversification?

The short answer is yes because intra-regional trade and industrialization are mutually reinforcing in Africa;

Manufactured goods dominate intra-African trade and the rules of origin underpinning the AfCFTA will accelerate the economic diversification power of intra-African trade, which remains very low and hence has a lot of room to grow;

How to mobilize patient capital to close infrastructure deficit in a region where financing gaps are exacerbated by perception premiums and high fiscal incidence of sovereign debt?

In the new global race for natural resources—green minerals, how do we change the mindset which has for centuries led the world to see Africa as the continent where to get natural resources and not manufactured goods?
“The difficulty lies not so much in developing new ideas as in escaping from the old ones.”

John Maynard Keynes.