# Africa from the Inside:

## Spotlight on Africa's trade

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## Will Africa's trade fortunes change?

Africa is often touted as the last continent still to industrialise. Overall, the continent has struggled to translate its natural resource wealth into greater prosperity and higher living standards for its people. With the United Nations expecting that there will be more Africans than Chinese by 2025, the need for economic transformation is clear.

But following a manufacturing-led growth path has been difficult. Manufacturing value added as a share of global manufacturing value added has been around 1% over the past three or so decades. The Sub-Saharan African (SSA) average for manufacturing value added as a share of GDP has declined over the past decades, and was only around 10% in 2017.

Economic diversification has been limited. This is particularly visible in the continent's export profile. Export baskets are over reliant on a single commodity, and lack value addition, adversely exposing countries to swings in commodity prices. In 2017, commodity exports accounted for more than 70% of merchandise exports in half of Africa's economies.

In fact, resource-driven business models remain the status quo in many parts of Africa and the region remains marginalised in global value chains. In value terms, mineral fuels made up 44% of Africa's export basket, followed by precious stones (9%) in 2001. This structure had not changed much by 2016, with mineral fuels at 35% and precious stones at 13%.

While the portfolio of exports did not expand, what has changed over time has been the destination of African exports. In 2001, the top four markets were the United States (16%), Italy (11%), France (10%) and the United Kingdom (7%). By 2016, China led the pack with 10%, followed by the United States (7%), France (6%) and India (6%).

It was in 2009 that China became Africa's single largest trading partner, surpassing the United States. Sino-Africa trade peaked five years later at US$221bn, and dropped thereafter largely on account of lower oil and other commodity prices to about US$170bn in 2017. It has recovered to US$204bn last year, and China has subsequently become one of Africa's most important commercial partners.

The challenge has been not only to diversify export baskets but also to reduce the trade imbalance that Africa runs with major trading partners like China, replacing the low-technology, labour intensive manufactured goods it imports from the world. The latter is the case, despite the existence of a large semi- or unskilled African labour force that could produce these imported goods locally.

There are a number of initiatives underway, by China but also by Africa itself, that could see a change in Africa's trade and economic diversification fortunes over the medium to long term.

For one, offshoring manufacturing investment from China, particularly in parts of eastern Africa, has increased the capacity of industrial activity in a number of economies. According to news reports by Xinhuanet, at the end of last year 3,700 Chinese companies had been established in the continent, and invested over US$46bn. In Ethiopia and Tanzania, for example, investment by Chinese firms has contributed to the development of value-added export-orientated industries in the footwear and glass production sectors respectively.

Chinese companies also have set up more than 50 economic cooperation zones in more than 20 countries, including Special Economic Zones in Ethiopia, Zambia and Nigeria. Although successes have varied, these have focused on boosting value-added exports from African countries, not only to China, but to the world – benefitting from Africa's preferential trade agreements with third markets. Also, China's currency swap deals with a number of African countries could further support commercial ties, including trade facilitation.

Moreover, China's global Belt and Road Initiative (BRI) has created new waves of infrastructure investments and activity also in Africa. This is making the continent more connected with itself, with China, and with the rest of the world. For example, according to Deloitte's [2018 Africa Construction Trends] report, one in three infrastructure and capital projects under construction in Africa (and valued at US$50m or more) are being constructed by China. One in five is being financed by China.

Estimates by the Heritage Foundation pin Chinese investment and construction activity across SSA at US$300bn (or 15% of China's outbound investment and construction activity) over the last 13 or so years. Similarly to what Deloitte's construction report finds, this activity has been concentrated in the Transport (33%) and Energy (32%) sectors – both crucial sectors for reducing production and transaction costs, and enabling value added activity in any economy.

China's investment in trade-enabling transport infrastructure, coupled with the African Union's *Agenda 2063* and the Programme for Infrastructure Development in Africa (PIDA), which pushes for greater regional integration, could see inland, hinterland and naval connections boost Africa's logistical and export capacity. This would improve shipping costs of African products, and possibly increase turnover. Regional cooperation on infrastructure improvement is important and could be especially significant for landlocked countries.

Additionally, with limited regional value chains, and a lack of integration into global value chains, improving connectivity and logistics could be integral for promoting African exports. Rail capacity and network improvements coupled with cross-border transport infrastructure could foster intra-African trade, as well as boost investment, the associated technology and skills transfers, and up growth in African economies. Indeed, a report published by the World Bank expects a boost to foreign direct investment (FDI) in Africa by 7.4% from the BRI transportation network investments alone.

Beyond greater physical connectivity through infrastructure builds, one of the most noteworthy recent developments is that African countries have prioritised to trade more with one another. The African Continental Free Trade Area (AfCFTA) agreement, which entered into force on 30th May 2019, will create a single market of 1.2 billion people, with a combined GDP of US$3.trn.

AfCFTA looks to up the current low intra-regional trade of the continent – Africa's exports to Africa itself stand at only 16-17% – largely by reducing key barriers to trade – both tariff and non-tariff barriers (NTBs). The framework agreement creates the largest single market since the establishment of the World Trade Organisation.

This could have multiple benefits for Africa's own value-added exports capacity. Estimates by the United Nations Economic Commission for Africa (UNECA) see intra-African trade increase by over 50% through the reduction of tariffs (import duties). Decreasing NTBs could see this increase in intra-African trade double. Simply put, a paper published in Foresight Africa 2019 by the Brookings Institute earlier this year showed that "when African countries trade with themselves they exchange more manufactured and processed goods, have more knowledge transfer, and create more value."

## Key takeaways

Arguably, a less fragmented and more coordinated Africa and resulting higher intra-African trade (especially by tackling NTBs and having greater access to more open markets), could have various positive spillovers. It could boost export sophistication of African economies, integrate them into regional and global value chains, build resilience to commodity price downswings, boost small and medium-sized enterprises, attract greater FDI, enhance productivity and foster innovation.

While this cannot happen in isolation and needs to be coupled with effective export strategies, industrialisation policies and so forth, Chinese investments in industrial activities in Africa, together with the focus of a more connected Africa – both in terms of physical infrastructure rollout and greater openness to trade – could not only help address Africa's trade imbalances but ultimately craft a more inclusive growth path for many African economies.

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