African (De)Industrialisation and the AfCFTA

By: Ioana Lungu

July, 2019

Discussion paper

german cooperation
DEUTSCHE ZUSAMMENARBEIT

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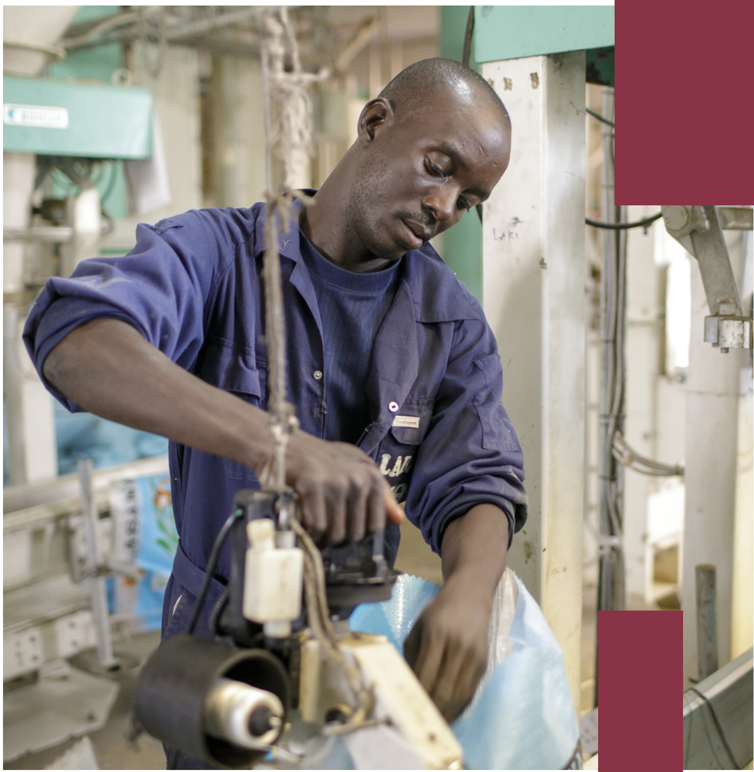


Industrialisation has long been on the policy agenda in Africa, although success has mostly failed to materialise. Studies find a historical tendency towards deindustrialisation in Sub-Saharan Africa (Jalilian & Weiss, 2000) and a constantly declining share of manufacturing and industry value added, a trend that has continued in recent years (Aryeetey & Moyo, 2011). This is all the more worrying, given that structural change (defined as shifting labour and capital from low productivity to high productivity sectors of the economy (Tregenna, 2015)) has been shown to be the key driver of economic development.

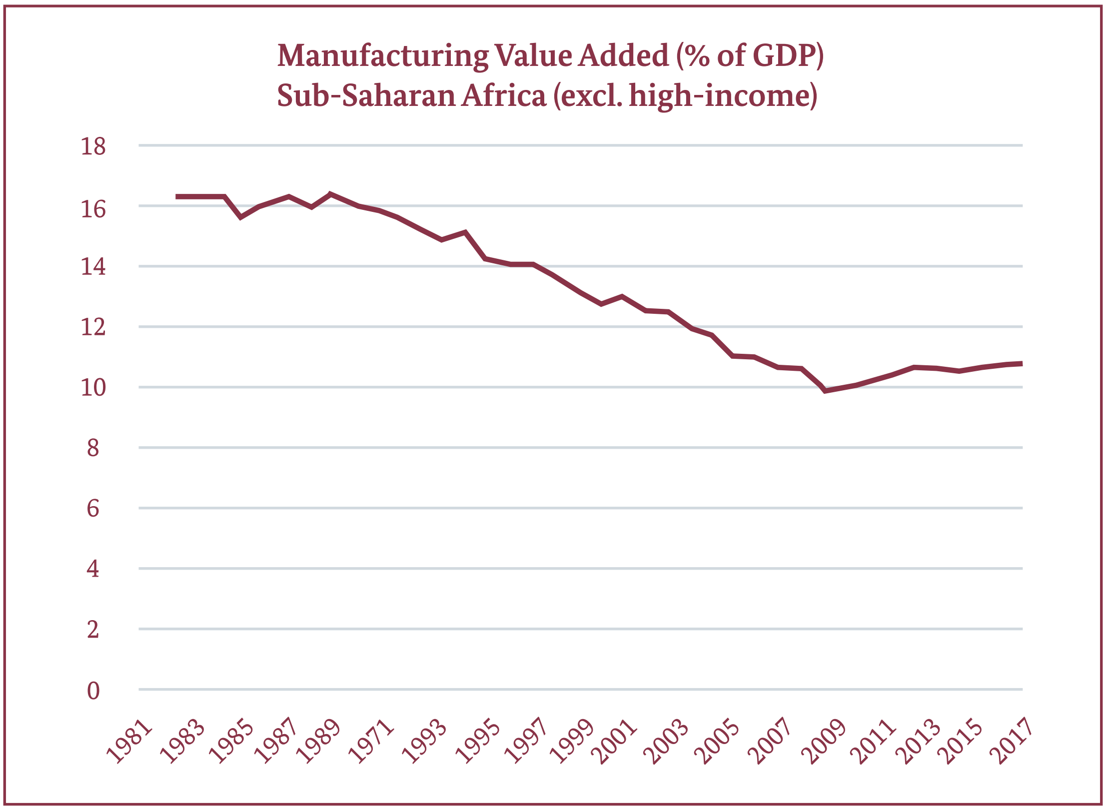


Figure 1: World Bank Data (2018)

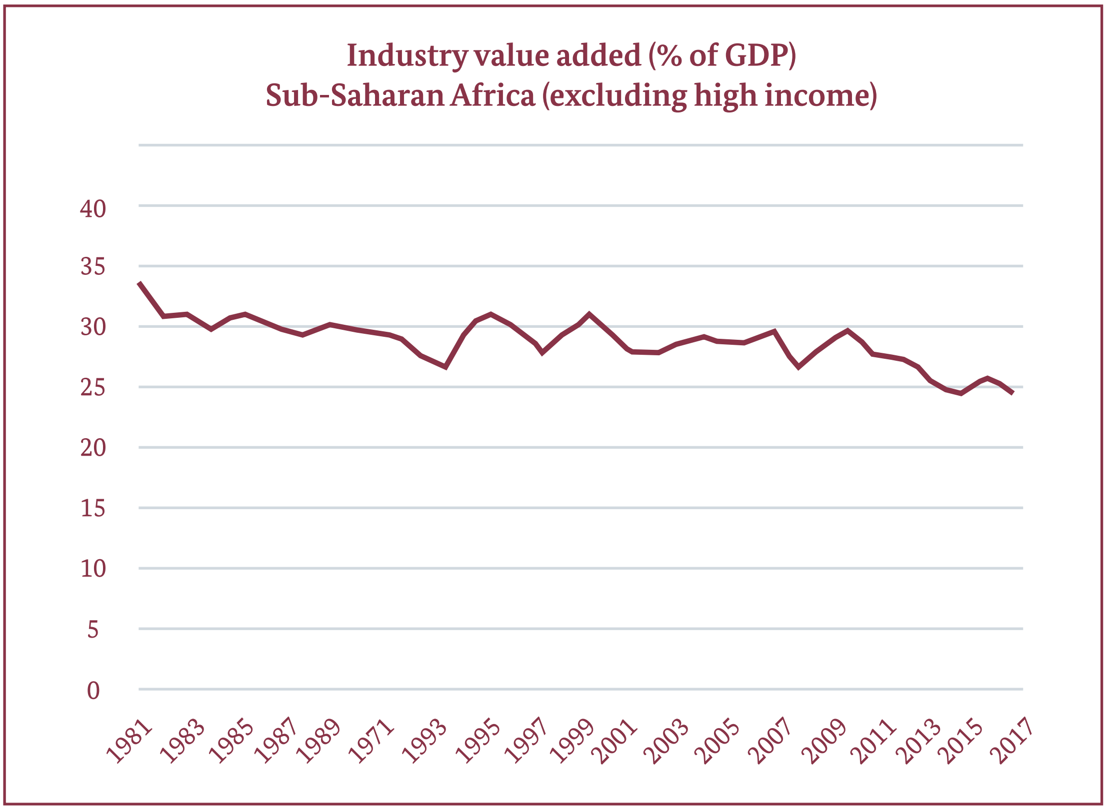


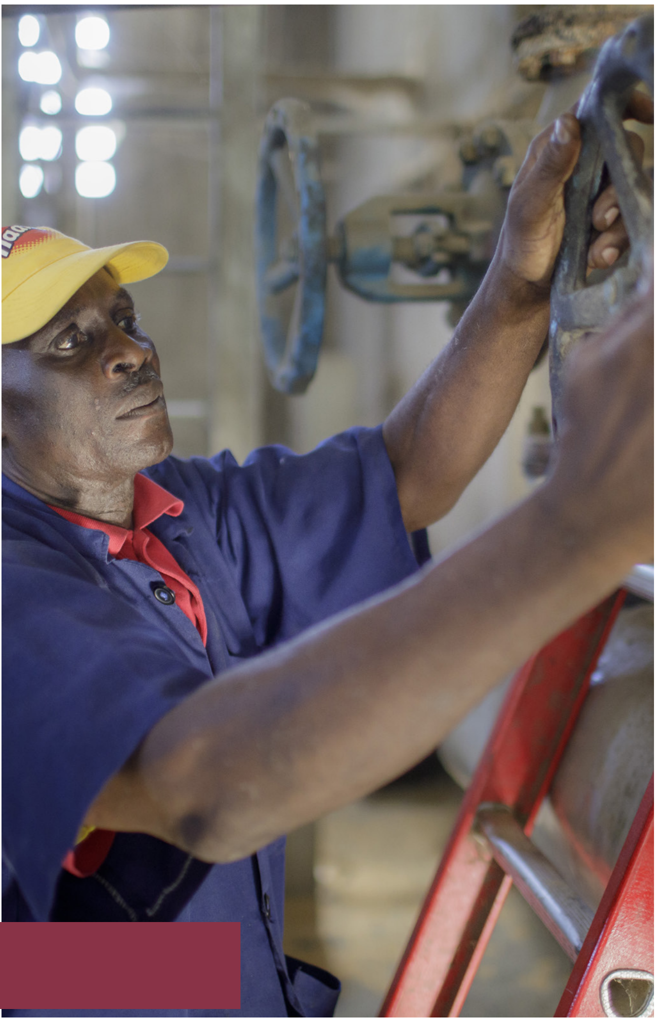
Figure 2: World Bank Data (2018)

Lin (2011) has observed ‘that dramatic acceleration in growth rates came about with the rapid technological innovation after the Industrial Revolution and the transformation of agrarian economies into modern industrialised societies. This intriguing trend has led us to recognize that continuous structural change prompted by industrialisation, technological innovation, and industrial upgrading and diversification are essential features of rapid, sustained growth’ (p. 3).

Although economies in Sub-Saharan Africa are some of the fastest-growing in the world, this growth has failed to materialise into economic diversification or an adequate expansion of the employment base. Indeed, the growth-poverty elasticity in Central and East Africa is the lowest in the world *(Fosu, 2017)*, with economic growth failing to translate into significant poverty reduction. Exports remain concentrated in the area of primary commodities, with very little diversification occurring over time *(Morris & Fessehaie, 2014)*. Even in areas where growth has occurred in high productivity sectors, such as resource extraction, these are often capital intensive and have little spillovers for human capital and employment creation.

Against this backdrop, the role of trade can be crucial. Historically, certain proponents of neoclassical schools of thought have pushed for trade liberalisation and non-state interventionism under the assumption that markets are inherently efficient and would lead to an optimal allocation of resources. Under this logic, economic development would follow naturally from a process of market opening and free trade. The role of the state should be limited to ensuring a good business environment and providing essential infrastructure.

Nevertheless, this model has come to be contested, due to its suboptimal results in recent decades and limited applicability to developing countries, whose markets are often non-existent or insufficiently developed and characterised by information asymmetries and negative externalities. Thus, free trade by itself is not enough to ensure industrialisation.



In the African context, the industrialisation challenge is twofold. First, trade liberalisation is far from achieved. African countries trade more with partners outside Africa than among themselves, which inherently leads to a fragmented continental market and the impossibility to make full use of regional value chains and economies of scale. Second, there is a lack of a coherent industrial strategy to be actively pursued and implemented by African Member States within a continental framework.

The African Continental Free Trade Area aims to address the first issue. By liberalising trade in goods and services, it aims to unlock the potential for enhanced regional and continental economic integration. Actors on the production side on the continent should thus be in a better position to access economies of scale, expand operations cross-border and develop regional value chains that increasingly embed African inputs. Furthermore, by accessing a unified continental market, different stages of industrial production along the value chain can be outsourced to various countries within the free trade area depending on their respective comparative advantages. The resulting intermediate products can then easily be reimported into the country of origin for further intermediate and final processing.

In terms of existing frameworks for industrial policy, the African Union's Agenda 2063 aims to generate a 10 per cent growth increase of the manufacturing sector by 2050. Similarly, the Action Plan for Accelerating Industrial Development in Africa (AIDA) has been designed to promote industrial development, including by facilitating the means for supporting Small and Medium-sized Enterprises (SMEs) to integrate in regional and global value chains. On the Member State level, countries such as Djibouti, Egypt, Eritrea, Ethiopia, Gabon, Kenya, Lesotho, Liberia, Mauritius, Nigeria, Rwanda, Tanzania, Uganda and Zimbabwe have adopted industrialisation strategies or policy frameworks (Asamenew, 2019).
The AfCFTA can be instrumental in achieving these goals. Research shows that successful industrialisation historically went hand in hand with trade related measures as part of the overall development strategy *(Aryeetey & Moyo, 2011)*. Eliminating tariffs for strategic sectors can facilitate the import of key inputs for the domestic industry and support value chain integration across the continent.

Furthermore, trade liberalisation within Africa would mitigate the issue of tariff escalation, in which tariff levels increase according to the level of processing of an imported product *(Morris & Fessehaie, 2014)*. This discourages resource-rich countries from moving up their value chain, a situation in which many resource-endowed African countries currently find themselves. If tariffs are liberalised within Africa, countries have an incentive to add more value to their intra-African exports without any repercussions.

Besides trade liberalisation, other flanking policies are crucial to ensure nascent industries get the support they need. Export subsidies for selected product categories, export insurance or ensuring a comprehensive export quality infrastructure in the form of government assistance and quality controls are all tools that can be employed to stimulate industrial production *(Aryeetey & Moyo, 2011)*. Sectoral incentives such as tax rewards or export rebates (in which the exporter can get a refund on the duties paid for importing raw materials, once these are processed into a more-value-added product and re-exported) can also be used.

Besides liberalising trade in goods, another area where the AfCFTA can play a role in supporting industrialisation is trade in services and movement of people, by facilitating a better allocation of human capital and supporting services for specific industrial sectors. Currently, negotiations for liberalising intra-African trade in services are under way. This has implications for sectors such as agro-industrial or textile value chains, that require a host of services such as quality control, transportation, financial and insurance or storage services *(Morris & Fessehaie, 2014)*.

The main ambition the AfCFTA is to significantly increase intra-African trade. Given the larger share of manufacturing value added for intra-African exports, there is abundant potential for increased industrial production on the continent. Nevertheless, in the absence of a sound industrial policy and AfCFTA flanking policies that would set the right incentives and provide adequate support for industrialisation, there is no guarantee that liberalised intra-African trade will by itself be enough to generate more value added production on the continent.

Contact Person:
Ioana Lungu
ioana.lungu@giz.de

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Published by

Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH
Registered offices Bonn and Eschborn, Germany
Support to the AfCFTA

GIZ AU Liaison Office
P.O- Box 100009
Addis Ababa, Ethiopia
T +251115157865
T +251 114 703355
F +251 114 703325
jasmin.gohl@giz.de
https://www.giz.de/en/worldwide/59611.html

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Text

Ioana Lungu

As of

July 2019

In cooperation with

African Union
African Continental Free Trade Area

On behalf of

German Federal Ministry for Economic Cooperation and Development (BMZ)

Addresses of the BMZ offices

BMZ Bonn
Dahlmannstraße 4
53113, Bonn
Germany
T +4922899535-0
F +49 228 99 535 -3500
poststelle@bmz.bund.de
www.bmz.de

BMZ Berlin
Stresemannstraße 94
10936, Berlin
Germany
T +49 3018535-0
F +49 30 18 535 -2501

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