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AfCFTA – Africa's Path to Economic Prosperity

Howard Nicholas



Transforming Africa's Trade

African Export-Import Bank
Banque Africaine d'Import-Export



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About Afreximbank's Distinguished Lecture Series

The African Export-Import Bank (Afreximbank) Distinguished Lecture Series (DLS) publishes important papers that address current issues on African economic development, finance and trade. The papers are normally commissioned by Afreximbank and are usually delivered at major learning events organized by the Bank, including the Afreximbank Trade and Development Seminar Series, the Afreximbank Structured Trade Finance Seminars and the Annual Meetings of the Bank's Advisory Group on Trade Finance and Export Development in Africa.¹

¹ This paper is an extension of the keynote address delivered by Dr. Howard Nicholas, professor of economics at Erasmus University, on the occasion of Afreximbank's Annual General Meetings held during June 15-18, 2022 at the St. Regis Almasa Hotel in Cairo, Egypt.



Introduction

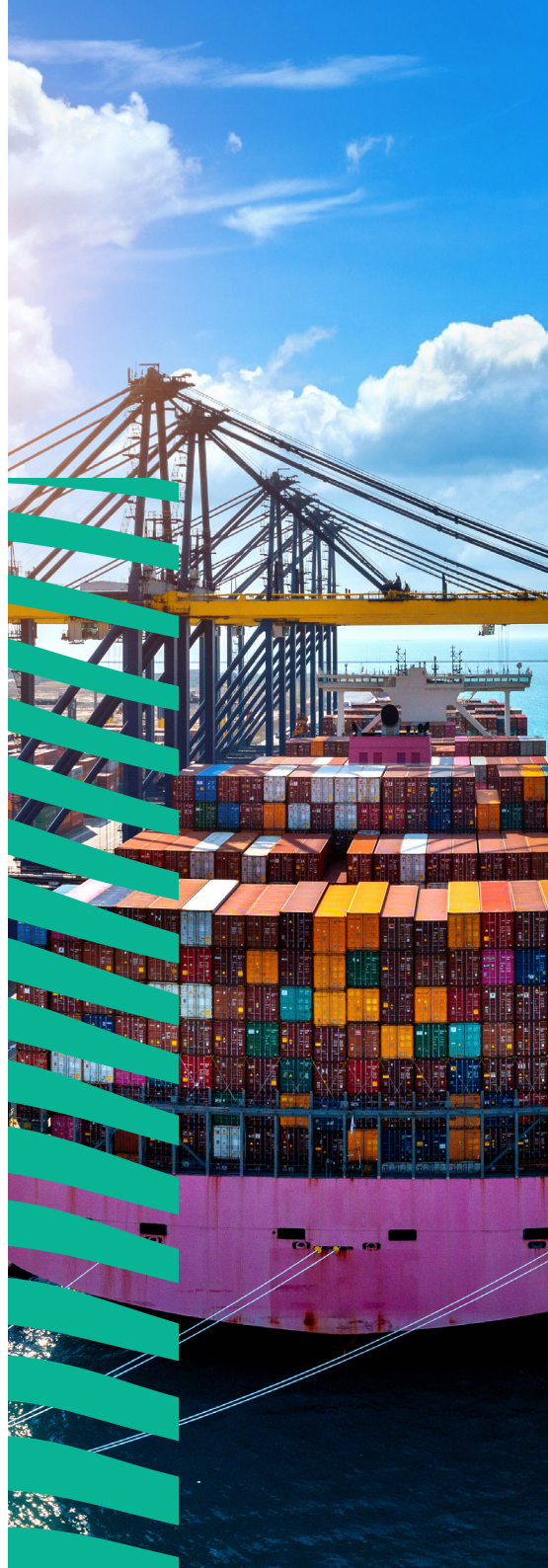
This lecture explores Africa's path to economic prosperity in the context of the implementation of the African Continental Free Trade Area (AfCFTA). Proponents of the AfCFTA have contended that among its most important purposes are to catapult Africa on a path to economic prosperity, increase its living standards, and improve livelihoods for the majority of its population.

The lecture argues strongly that this path requires a more economically integrated Africa and the adoption of an export-oriented industrialisation strategy. The role of the AfCFTA will be to promote the cohesion of the trade and regulatory landscape that encourages more intra-African trade, investment flows, and migration.

Background

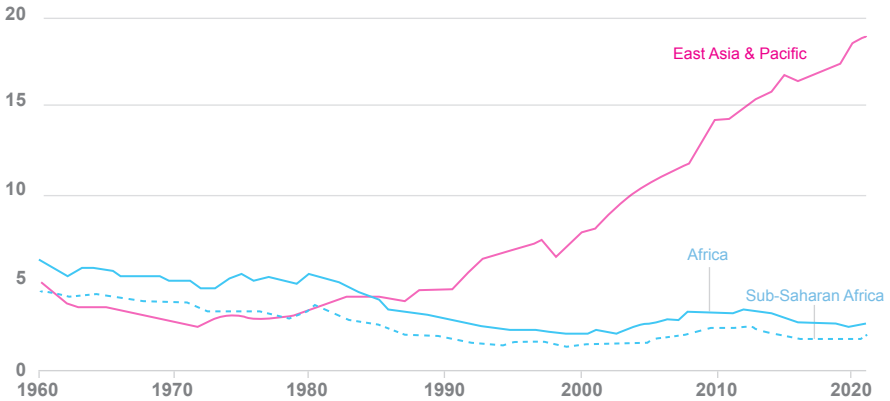
The African Union consists of 55 member countries with a total population of more than 1.4 billion people, a combined gross national income of US\$3 trillion, and an average per capita income of US\$1,958 per annum.

However, the economic performance of most countries on the continent stands in sharp contrast to the successful export-oriented industrializing developing countries. Figures 1 and 2 show that Africa's share of world trade and global gross domestic product (GDP) has grown much more slowly than the average of all developing countries, particularly those in the East Asian and Pacific region, over the period 1960-2020. Sub-Saharan Africa, in particular, has performed poorly, with its share of global trade decreasing by half over this period.



Figures 1:
Shares of global trade, 1960-2021

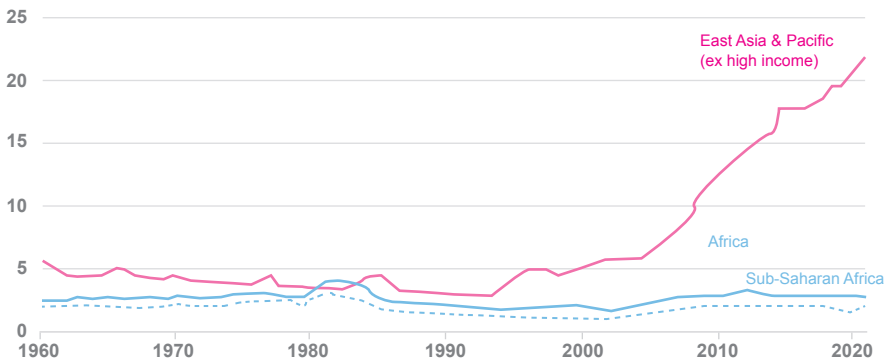
Shares of world merchandise trade by region, %



Source: World Bank

Figures 2:
Shares of global GDP, 1960-2021

Shares of World GDP trade by region, %



Source: World Bank

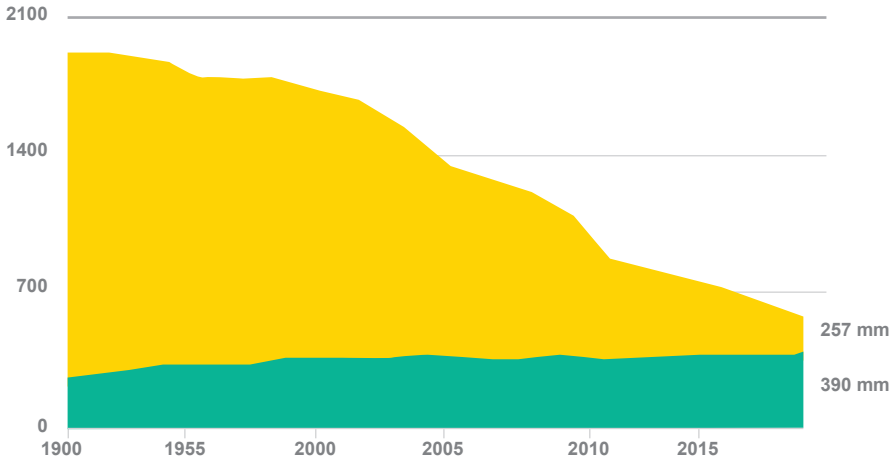
Africa’s relative growth stagnation has resulted in the highest number of individuals living below the international poverty line, making it the only region in the world where absolute poverty has been increasing. Figure 3 shows

that the number of people living below the poverty line (US\$2.15 per day) in Sub-Saharan Africa is significantly higher than the total number of people living below the poverty line in the rest of the world.

Figures 3:

Poverty count in Sub-Saharan Africa and the rest of the world, 1990-2019

Shares of world merchandise trade by region, %



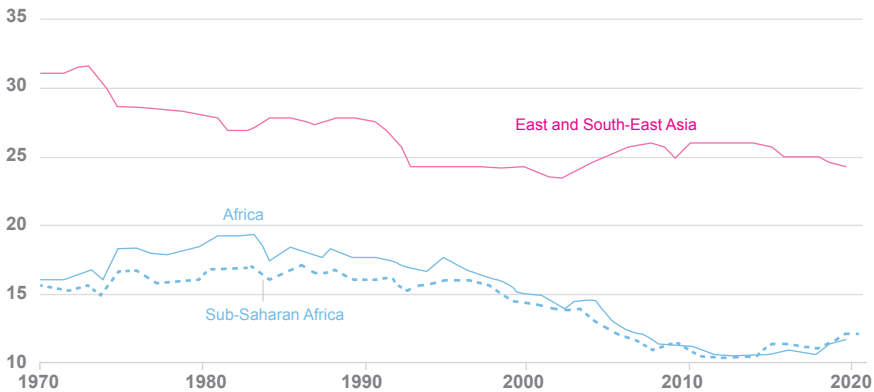
Source: World Bank

Figures 1 and 2 suggest that Africa's relatively weak economic performance is partly attributable to its subpar industrial and manufacturing performance. This is reinforced by figure 4, which shows a sustained decline in manufacturing as a proportion of GDP for both Africa as a whole and Sub-Saharan Africa in particular. These data also show that the decline in Africa's manufacturing production as a share of total GDP is in stark contrast to the trend of the share of manufacturing production in total GDP in the relatively successful East and Southeast Asian economies.

Figures 4:

Trends in manufacturing shares of DP in East Asia and Africa, 1970-2020

Manufacturing (value added) shares of GDP by region, %



Source: UNCTAD

The AfCFTA represents an historic opportunity for the continent to chart a new course for economic development and accelerate the structural transformation of its economies. For decades, Africa has been trapped in a colonial legacy of low-value raw material production associated with unfavorable terms of trade, where it exports raw materials and unprocessed commodities to the global market, and in return, imports finished products at a higher price. This model of development has kept the continent stuck in a perpetual cycle of poverty, with little to no value-added to its natural resources—limiting its competitiveness and integration into global value chains. However, in the context of the implementation of the AfCFTA, Africa can gradually shift toward a new paradigm—commodity-based industrialization through the production and export of value-added manufactured products—and contribute to accelerating the process of development

and structural transformation of the continent.

The African Continental Free Trade Area

After several years of discussions and negotiations between African countries, the African Union launched the AfCFTA in 2018. Its purpose is to integrate the continent's small markets and defragment the trade and regulatory landscape of the Africa—a landscape that has been engineered to a considerable extent by the European Union in the context of its imposition on African countries of the so-called Economic Partnership Agreements. Apart from the potential defragmentation of the regulatory landscape, other expected benefits from the AfCFTA include:

- a larger domestic market,
- improved competitiveness,
- lower input costs, and
- food self-sufficiency.

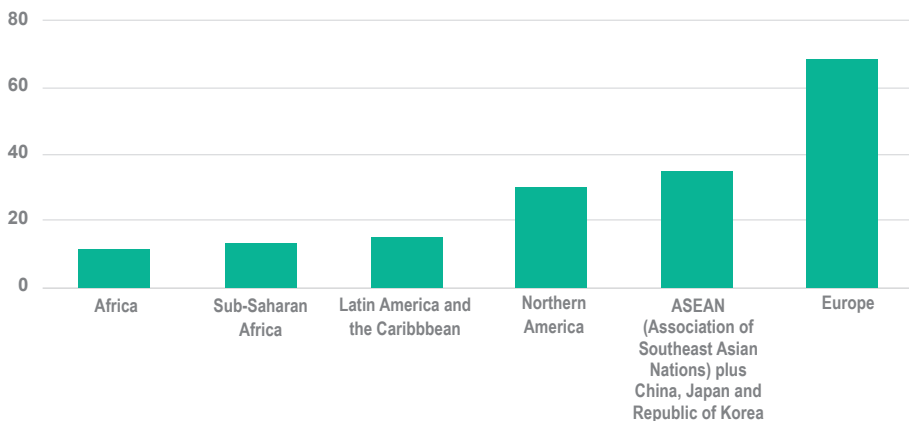
It has been repeatedly noted that intra-African trade is relatively small compared to trade within other regions of the world. Figure 5 shows that intra-African trade (at about 16 percent of total African trade) is the lowest among the major global trading blocs, amounting to about one-third of the intra-regional trade within the ASEAN region and about one-fifth of intra-regional trade within the European region.

The AfCFTA was designed to be implemented in three phases. Currently in Phase I, the focus is on establishing protocols for trade in goods and services, as well as dispute resolution mechanisms. However, progress toward completion of this phase has been slower than anticipated, largely due to protracted debate regarding rules of origin. Despite this challenge, stakeholders remain optimistic that these issues will be resolved in the near future. Phase II of the AfCFTA will build on the progress made in Phase I and will focus on the development of protocols for intellectual property, competition, and investment. This phase is crucial for ensuring that the benefits of the AfCFTA are fully realised and that the continent can optimize its economic potential. In Phase III, the focus is expected to shift toward the development of protocols for e-commerce. With the rapid growth of the digital economy in Africa, the inclusion of e-commerce in the AfCFTA is a critical step toward creating a more integrated and interconnected continent. This phase will involve the development of policies and regulations that promote the growth and development of the digital economy, while ensuring that all stakeholders are protected and empowered.

It is argued that the AfCFTA will promote the manufacture of automobiles, pharmaceuticals, leather products, garments, healthcare products, and beverages (Signé 2018). Concerns have been expressed regarding the potential for an increase in agricultural self-sufficiency given the need of the AfCFTA to abide by the limits imposed by the Agreement on Agriculture on state support for agriculture, the damage done to fledgling African manufacturing industries by foreign multinationals taking advantage of the enlarged domestic market, the social and economic damage that is likely to result from the privatisation of essential services such as transport and water, and the weakening of labour protection as companies adopt 'race-to-the-bottom' strategies. What has been largely ignored in the concerns expressed is that for the AfCFTA to have significant bearing on African living standards and poverty levels, its implementation needs to be accompanied by a comprehensive export-oriented industrialisation strategy, with export destinations being regions outside of the African continent and resulting in the accumulation of world money by a pan-African monetary authority.

Figures 5: Intra-regional trade as a share of total trade (2021)

Intra-regional trade in 2021, as a % of total trade



Source: UNCTAD

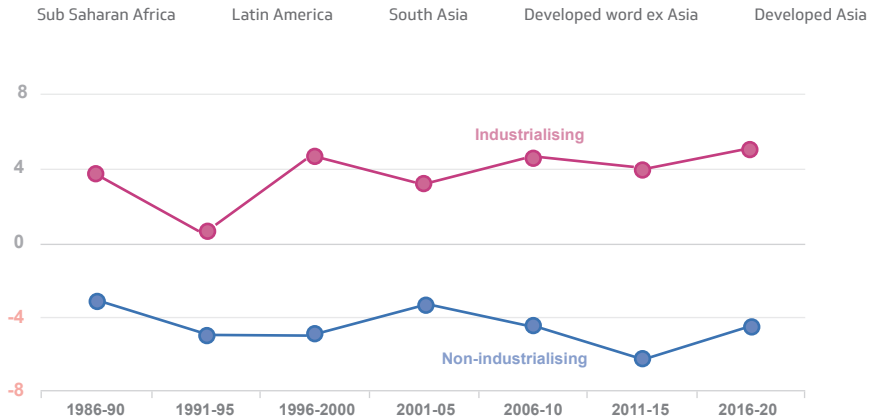
The Need for an Export-oriented Industrialisation Strategy

The adoption of an export-oriented industrialization strategy by Africa to complement the AfCFTA is motivated by the development impact produced by that strategy in other parts of the world and expected benefits for Africa. First, it would provide African firms with access to higher value-added inputs, which would help them upgrade their production capabilities. Second, it would allow for a greater expansion and diversification of products beyond the African market, which would enhance the continent's competitiveness in global markets. Third, this approach would help increase export receipts and improve the current account, providing a sustainable solution to persistent balance of payments problems that have afflicted many African countries.

As shown in figure 6, developing countries that have focused on

producing and exporting raw materials and low-value-added goods have been exposed to recurring adverse terms-of-trade shocks and associated current account deficits. In contrast, developing countries that have shifted toward higher value-added goods, that is, those that have adopted export-oriented industrialization strategies, have tended to experience more favourable current account positions. The issue with persistent current account deficits is that countries are forced to accumulate foreign debt to cover their foreign exchange shortfalls, making them vulnerable to debt and currency crises during global economic downturns. These crises, along with the contractionary "adjustment" policies that developing countries are often required to implement, have had a dampening effect on these countries' economic growth.

Figures 6: Per-capita income levels and export structures of selected countries, 2020



Source: IMF, Kapital Economics Notes:

1) Groups are unweighted averages based on a total selection of 122 developing countries.

2) Oil-producing countries were omitted from the study.

3) Industrialising countries are considered those countries who have more than 20% of their value added from manufacturing, more than 70% of their exports from manufacturing, and less than 30% of total exports accounted for by garments and textiles.

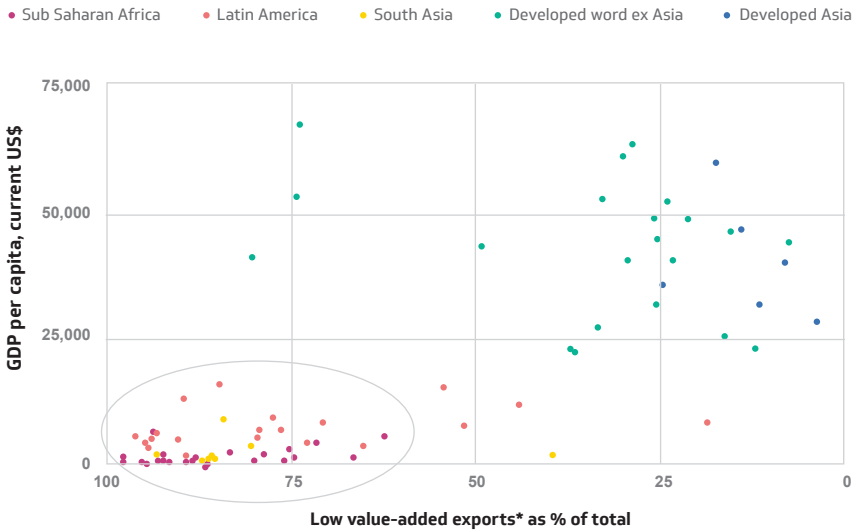
3) Non-industrialising countries are all other countries that do not meet the requirements of an industrialising country as specified in 3).

4) Group compositions change over time.

The argument for export-oriented industrialisation is not new, and several academics have made the case for developing countries to adopt such strategies. They often point to the successful East Asian economies that have followed this path and have witnessed sharp increases in manufactured export growth and increasing diversification of their exports. This diversification, coupled with increased production scale, has enabled these countries to penetrate global markets and rapidly increase their export earnings and per capita

income levels. In contrast, developing countries that have focused on raw material production or one or two low-value-added manufactured products have seen limited growth in export earnings and per capita income levels, as illustrated in figure 7. Figure 7 shows that countries with a higher production and export of lower-value-added products generally have lower per capita income, with the exception of certain oil-producing countries. This group of countries are mostly in the African, Latin American, and South Asian regions.

Figures 7: Per-capita income levels and export structures of selected countries, 2020



Source: World Bank, UNCOMTRADE *Primary commodities, textiles, garments and footwear

The AfCFTA can most certainly be used as an incubator of African export-oriented manufacturing companies. However, for this purpose, there needs to be a change in emphasis in certain aspects of it.

To begin with, instead of seeking to attract foreign investors per se, emphasis needs to be placed on attracting foreign companies with the necessary technology and market access that would aid attempts by African companies to produce increasingly higher value-added manufactures or components of high value-added manufactures. This would help African companies to be competitive and better integrated into the global value

chains of the large, advanced country manufacturing companies.

The services, investment, intellectual property rights, and government procurement protocols that are yet to be developed should pay heed to the promotion of export-oriented manufacturing. The design of the services protocol should allow for the provision of concessional financing by banks and trade-related insurance companies to support African companies seeking to export manufactured items outside of the African continent. The importance of these services in fostering export-oriented industrialisation is evident considering the experiences of the successful East Asian economies. The services protocols should also institute safeguards against the control by foreign and domestic monopolies of strategic services such as energy,

transportation, water, and others that have considerable bearing on the core costs of various manufacturing industries.

The design of the investment protocol should allow for the possibility of requiring foreign investors seeking to take advantage of the AfCFTA to direct a certain proportion of what is produced toward markets outside the AfCFTA, to require the use of inputs produced in the African region, and to encourage foreign investors to upgrade the skills of the indigenous labour force (Khor 2006). The proposed intellectual property protocols should seek to encourage the practice of technology transfer and not leave it up to the discretion of individual foreign companies making use of the AfCFTA, while at the same time instituting safeguards against the well-known predatory practices of foreign state and private research institutions (Tyfield 2008). Specifically, intellectual property protocols should pay heed to international codes on the protection of indigenous knowledge and genetic resources, especially the UN Convention on Biodiversity.

Protocols relating to government procurement should be limited to transparency in the bidding process, particularly in the early years of the AfCFTA, to allow for the promotion of African companies using this process. Further, competition policies should be formulated in the context of the current international setting and its increasing domination by foreign multinational corporations.

Lastly, in addition to the AfCFTA, there should be a concerted effort to facilitate greater economic integration within the continent. This should involve a shift toward adopting customs and monetary unions to prevent intra-African competition that could lead to a race to the bottom.

A monetary union, on the other hand, would expedite financial flows within Africa and support the emergence of a strong African currency. It may be worth considering bringing forward the proposed date of adoption by African Union countries for a single African currency to further promote economic integration. This would also increase Africa's bargaining power in bilateral and multilateral trade negotiations, to help strengthen the continent's demands for a renegotiation of the multilateral Agreement on Agriculture, which is a major impediment to African countries' attempts to achieve food self-sufficiency. Moreover, the issue of non-tariff barriers should be addressed, to aid the diversification of Africa's production base away from raw materials, basic agricultural products, and low-value-added manufactures.

Conclusion

The AfCFTA represents the largest free trade area in the world in terms of the number of participating countries. It is generally seen as having the potential to boost intra-African trade, foster regional integration, and promote economic development and structural transformation on the continent. However, the article argues that the AfCFTA alone is not sufficient to achieve these objectives. It needs to be complemented by a coherent and comprehensive export-oriented industrialisation strategy that would enable African countries to produce and export higher value-added manufactured goods to the global

market. Such a strategy would require a careful design and implementation of the AfCFTA protocols on trade in goods and services, investment, intellectual property, competition, e-commerce, and government procurement, as well as a coordinated effort to establish customs and monetary unions, address non-tariff barriers, and renegotiate the multilateral Agreement on Agriculture. It is only by pursuing this path that Africa can overcome its historical legacy of dependency on raw material production and low-value-added manufactures, and embark on a new trajectory of economic prosperity and social progress.



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Profile



Dr Howard Nicholas is an economist with extensive teaching experience in the area of business economics and financial markets, having taught these subjects for 40 years at the Institute of Social Studies (ISS) (part of Erasmus University of Rotterdam) where he was awarded best-teacher award every year (except one) since the award was first given in 2000 till his retirement in 2020.

In addition to teaching for the ISS, Dr Nicholas has taught at business schools in a number of countries including China, Vietnam, and Sri Lanka. He is regularly invited to give lectures on the global economy and is known by those who have attended his lectures for his early warnings on the Asian crisis in 1997, the global crises of 2001 and 2008, the little known crisis of the Chinese economy in 2015, and the global crisis of 2020.

At present Dr Nicholas continues to teach economics-related subjects in various countries, primarily in the capacity of senior trainer for a private company, the Economic Training and Information Studies (ETIS) company. Prior to setting up ETIS, Dr Nicholas helped establish the Institute of Policy Studies for the government of Sri Lanka in 1989, and an economic-advisory company, *Econsult*, in 1990.

Aside from his teaching experience and private endeavours, Dr Nicholas has published numerous articles in reputed international journals and two books on the theory of price (2011 and 2023) with Springer-Macmillan. He is currently working on two further books as sequels to his 2023 book on prices which are expected to appear in 2024 and 2025, respectively.

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