

IMPROVING PARTICIPATION OF LLDCS IN RVCS AND GVCS BY REDUCING TRADE COSTS

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It is well recognized that the relatively strong growth experience of Africa of the last decade of so has not been inclusive. We have seen progress on economic and social indicators in terms of poverty, education and health, but the progress has been much slower than expected given the GDP growth rates and much slower than what is required to fulfill the developmental needs of the continent. It has been particularly disappointing that we have seen very limited structural transformation and diversification of trade and production, and productivity growth and improvement of competitiveness has been lacking.

The need for structural transformation has been identified as a priority in the continental developmental frameworks. At the regional level, it is at the centre of African Union's Agenda 2063, and it is also been a prominent feature in the national development strategies across the continent. Industrialization, and trade as a channel for industrialization, is a continental priority.

It is in this context that we should look at value chains in Africa. The move towards value chains that we have see globally can be seen as an opportunity. For African countries at lower levels of industrialization the possibility to join global value chain can mean technology transfer, learning from lead firms and having the option to develop industry around a specialist task or process, with lower requirements in terms of industrial capacity. We have seen countries like Mauritius developing exactly in this way, by joining value chains in textiles and moving up the chain as their capacity allowed.

However the relationship between value chains and structural transformation is not automatic. In fact African countries are already very connected to value chains, but at very low levels and mainly through primary commodities. In terms of value added, Africa is only a bit over 2% of the global total. Increasing specialization may further lock African countries into this position. The quality standards and other requirements by lead firms, mainly based in developed countries, make it difficult for African companies to join value chains at higher levels. Sub-optimal

investment in human capital, among other things, limits the competitiveness of African countries. This is the case even when the cost of labour is much lower than in Asia. For example, the cost of a low skilled Ethiopian worker is about 25% of a Chinese worker. Also factors like high cost of transport eat into the competitiveness of African firms.

Regional value chains can be a solution for this. Proximity to markets and possibly lower standards, lower administrative burdens, may lower barriers for entry for African firms. Encouragingly, some indications of such developments have been observed. Trade in intermediate goods has been the most dynamic part of Africa's exports, growing from an average of \$84 billion in 2000–2002 to \$356 billion 10 years later. The proportion of intermediate goods imported from other African countries is still very low, with about 88% coming from outside the continent. This represents underused opportunities, as intra-African trade overall is much more diverse than Africa's trade with the rest of the world, with two thirds of trade consisting of industrial goods.

Regional value chains have been developed in e.g. leather between COMESA countries. A driver of the value chains has been the commitment of the regional economic communities, for example through the sectoral (sub)regional strategies and regional clustering. The COMESA leather strategy resulted in an increase in leather exports of 50% in five years and even more in terms of value added. Similar regional sectoral strategies have also been developed by e.g. SADC (Southern African Development Community).

Promoting these opportunities will be important especially for those countries that face most challenges when it comes to the global trading environment, most notably the LLDCs. Trade costs are high across the continent, but impact LLDCs disproportionately. These countries will find it most difficult to link with global value chains.

Active trade policy will be key for overcoming these barriers, supported by a comprehensive developmental policy framework. Four areas can be highlighted:

1. **Smart trade policy:** Tariff structures need to reflect the industrialization aims of the country. Lowering protection on intermediate goods should be used to cut costs of

industrialization and foster domestic value addition in the context of regional value chains. Over the last decade, intermediates accounted for a stable share of 60 per cent of Africa's merchandise exports. The trade weighted applied tariff on industrial products in LDCs is 18 per cent for intermediates and 12 per cent for finished goods. This goes contrary to the needs of countries wishing to engage in value chains.

2. **Trade facilitation:** NTBs are much more significant in increasing trade costs than tariffs, and harm LLDCs in particular. Measures on trade facilitation are crucial. Trade facilitation is an area where a lot of work is already being carried out by various organizations.
3. **Improvement of infrastructure:** While progress has been made, the needs of African countries in terms of infrastructure are still considerable. For example, it has been estimated that improving road quality in the ECOWAS region to the level of South Africa would boost intra-ECOWAS trade by more than 5 per cent (from 2012's level).
4. **Human capital:** Progress has been made on education in most African countries. However, this has been in primary education, with secondary education enrollment levels and completion rates lagging behind. There is a lack of investment in tertiary education. As a consequence, workers do not have the skills required for structural transformation, which requires a higher level of analytical ability. For regional value chains to emerge, there is a need for the ability to innovate and carry out R&D.

Progress has been made in terms of promoting free movement of goods within the regional economic communities, including tariff reductions, facilitation of trade and improvement of infrastructure. The momentum at the moment for pushing ahead with this agenda is particularly strong with the negotiations of the Continental Free Trade Area ongoing. ECA research has shown that introducing the CFTA as planned in 2017 would bring significant benefits in terms of intra-African trade, and that when accompanied by trade facilitation measures intra-African trade could double in 10 years. Majority of this benefit would be in industrial products. The opportunities for development of regional value chains would also be promoted through the liberalization of services, which is also within the scope of the CFTA.

The challenges presented are relevant to all African countries. In the case of LLDCs, the challenges are greater. At the same time, the regional market is even more an opportunity. Therefore reducing cost of trade within Africa is of utmost importance, because that can allow the LLDCs to tap into value chains and accelerate the structural transformation process. National policy is very important, but it will need to come with a firm commitment to the regional integration processes which create the environment in which value chains can emerge and thrive.