Accelerating Africa's economic transformation

The COVID-19 pandemic will likely exacerbate the move away from globalisation that began early this century and promote regionalisation around big economic blocs. ***Rabah Arezki*** *writes that African countries have an opportunity to deepen regional integration and create their own value chains, transforming the raw materials that Africa has in abundance. He says that agribusiness could be as pivotal for Africa as coal and steel for Europe because of the benefits of food security and jobs for the continent.*

When economists refer to "structural transformation," they usually mean the shift in factors of production—such as land, labour, and capital—from low-productivity sectors (typically agriculture) to high-productivity ones (such as manufacturing and high-quality services).

Few African economies have had success transforming structurally, and many appear stuck in low-productivity mode. The mega trends in automation and digitalisation have tested the premise that developing countries like those in Africa can follow the traditional path of industrialisation that advanced economies and China have followed. Digitalisation removes the compartmentalisation between different sectors, making it difficult to rely on old distinctions. For example, mining and agriculture sectors are subject to a wave of technological innovation in big data and high-tech services, which blur the traditional distinction between primary and tertiary sectors.

The COVID-19 pandemic will likely exacerbate the move away from globalisation that began early this century and promote regionalisation around big economic blocs—led by the United States, the European Union, and China. Regionalisation provides an opportunity for African countries to deepen regional integration and create their own value chains.

In addition to structural change, "transformation" can also refer to physical processing, which adds value to the raw materials that Africa has in abundance. Such a transformation entails a move up the value chain, which can help the continent mitigate the vagaries of commodity price fluctuations.

Whether it is cocoa, oil, metals, or wood, the lack of physical transformation is widespread and has frustrated the ability of the continent to create good jobs. Indeed, waves of mineral and hydrocarbon discoveries and an abundance of fertile land make Africa a prime source of natural resources for the rest of the world. But there are too few jobs in the primary sector, and many are low paid. Moreover, despite the abundance of its resources, the continent imports billions of dollars of processed food and refined products annually.

Attracting foreign or domestic investment in the processing of raw materials will create good jobs with decent wages and result in a bigger share of the ultimate value of the raw materials staying in the continent. Proactive policies to foster local content such as the one Gabon undertook in wood processing, diamond cutting in Botswana and oil extraction in Nigeria show that it is possible to move up that value chain.

Commodity producers have tried other approaches to maximising the value of their natural resource endowment. An important one is the cartel. In response to the unfair shake they believed they received from the exploitation of natural resources, developing countries have set up producer cartels, such as the Organization of the Petroleum Exporting Countries (OPEC). While these cartels may get higher prices for the primary commodity and add revenue to government coffers, in practice advanced economies eventually find alternative suppliers (for example, non-OPEC producers) or develop alternative products (such as synthetic palm oil or shale oil). Moreover, cartels do not resolve either a producer's exposure to the boom-bust price cycle in raw commodities or the need to create a large number of good jobs. Transformation appears indispensable to getting out of the development trap.

Why has it been so difficult to transform raw products in the continent? Trade theory helps explains why. When transportation costs are low, transformation activities cluster in advanced economies and developing countries are relegated to supplying raw materials. During the colonial era, that structure of interdependence was imposed through coercion and military might. At the onset of independence, many developing countries tried to escape that trap by adopting import substitution policies. But policies to encourage domestic production of goods that used to be imported largely failed, in part because of the lack of comparative advantage and ineffective state-owned enterprises. The paradigm has since shifted from import substitution to export promotion, which also has met with little success despite government efforts—such as establishing special zones with tax and other advantages for exporting firms. Fostering a vibrant private sector to promote good jobs while ensuring regulation to fight anti-competitive practices is the best approach. Indeed, fair competition through private sector will drive innovation and investment in ways that the public sector cannot–outside sectors where there are natural monopolies or in presence of externalities.

The continent has embarked on an ambitious Africa Continental Free Trade Area to stimulate trade in the continent. To promote a deep agreement that fosters investment in transformation, the agreement will have to coordinate trade, competition, and tax policies to ensure that are no loopholes. The agreement should leverage the rising demand from the African consumer to stimulate investment in the continent to serve that demand. Yet, the experience of the European Union, which started with a coal and steel community to promote narrow and deep agreement and eventually blossomed into a full-throated confederation, demonstrates the importance of avoiding shallow and broad agreements. Deepening the Africa Free Trade Agreement through focusing on transformation of agriculture products is the best way to start. Agribusiness could be indeed as pivotal for Africa as coal and steel for Europe because of the benefits of food security and jobs for the continent.

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Notes:

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