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Economic development in Africa: Strengthening regional economic integration for Africa's development

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Overview

Executive summary

This year's *Economic Development in Africa* report examines regional integration in Africa and its potential to effectively address long-standing structural weaknesses of African economies and to improve national and regional economic performance. It analyses key features and patterns of intra-African integration in trade (goods and services), investment and migration. It identifies some of the key opportunities that African countries could exploit or capitalize upon in their development. Finally, it makes policy suggestions for helping regional economic integration form a building block for Africa's effective integration into the world economy. Regional integration is essential for sustained development on the continent, especially within the context of crisis. When designed and implemented within a broader development strategy to promote economic diversification, structural changes and technological development, regional integration could enhance the productive capacities of African economies, create economies of scale, improve competitiveness and serve as a launching pad for African economies' effective participation in the global economy. The level of intra-African trade in goods remains low in comparison with intraregional trade in other regions, representing 8.7 per cent of the region's total exports and 9.6 per cent of total imports, respectively. The proportion of Africa's intraregional trade has increased considerably over the years. In 1978, intra-African exports accounted for 2.9 per cent of total African exports. The obstacles hampering intra-African trade consist mainly of extremely high transport costs due to poor infrastructure. The small

[1] This overview should be read in conjunction with the full report (UNCTAD/ALDC/AFRICA/2009).

share of intra-African foreign direct investment (FDI), estimated at 13 per cent of total foreign investment flows to Africa is attributable to the low level of income, lack of adequate transport and communication infrastructure, limited skilled labour and weak economic links and contacts among investors within the region. Intra-African services trade, labour mobility and migration are emerging issues that require attention from policymakers. Services are an important source of export earnings for a large number of African economies and a factor of their competitiveness. Yet the development of service industries may require financial, human and technological resources that are not available locally. African policymakers should adopt a regional approach when forging new policies for the development of services. The restricted movement of labour across national boundaries is a major constraint to regional integration in Africa. For significant progress to be made, stronger political will be needed to overcome factors limiting this form of integration. Forging ahead with this agenda may also imply amending and harmonizing national laws and investment codes (including mining codes), particularly their provisions dealing with the free movement of labour.

I. Experience with regional integration in Africa: challenges and opportunities

1. In the last decades, African countries have viewed regional integration as a major instrument for economic progress, resulting in the forging of different regional integration initiatives by countries in the continent. The Abuja Treaty (established in 1991) establishing the African Economic Community (AEC) committed the continent to a path of economic integration.

2. The various regional economic cooperation initiatives, while moving at different paces in terms of the implementation of the provisions of their respective treaties, are showing some progress, even if it is slow. Some of the main challenges relate to the lack of political will on the part of some governments to enforce the necessary reforms in their respective countries, including making the needed amendments to their laws and regulations and the workings of their institutions. There are also challenges related to economic preparedness, as members of economic communities are not always as close economically as they are geographically. The idea of regionalism has to also be marketed at home, which is easier for some countries than others.

3. Recognizing the challenges of globalization, African leaders have consistently expressed their desire to deepen regional integration, including through the creation of a common market for goods, services, capital and labour, and the harmonization of rules. There have been positive developments in this direction. In the interim, several concrete cooperation initiatives are being undertaken to facilitate trade by forging regional and subregional cooperation schemes in the area of key infrastructure services such as transportation, tourism, energy and telecommunications, as well as initiatives to better facilitate investment and the movement of people within the community.

4. Regional integration, when designed and implemented within a broader development strategy to promote economic diversification, structural changes and technological development, could enhance the productive capacities of African economies, create economies of scale, improve competitiveness and serve as a launching pad for African economies’ effective participation in the global economy.

5. African countries have also been involved in a number of external partnerships, which the continent has endeavoured to deal with collectively. Among these external

partnerships are: (a) multilateral partnerships in the framework of the World Trade Organization (WTO); (b) the African, Caribbean and Pacific Group of States (ACP)–European Union (EU) partnership, through Economic Partnership Agreements (EPAs); and (c) a growing number of bilateral initiatives in support of African development, such as the African Growth and Opportunity Act (AGOA, United States), the Tokyo International Conference on African Development (TICAD, Japan), and initiatives from Brazil, China, India and Turkey. African countries have been trying to bring such initiatives into a continental framework under the African Union, to bring about greater synergy and ensure a mutually beneficial outcome for partner countries.

II. Expanding intra-African trade in goods for Africa's growth

6. Despite the long history of regional integration on the continent, the level of intra-African trade remains low in comparison with intraregional trade in other regions, both developed and developing. Over the period 2004–2006, intra-African exports represented 8.7 per cent of the region's total exports, while intra-African imports represented 9.6 per cent of total imports. This proportion was substantially higher for sub-Saharan Africa (around 12 per cent) than for North Africa (around 3 per cent). Nonetheless, even the sub-Saharan African proportion of intraregional trade remains far below that of other regions.

7. Though the proportion of Africa's intraregional trade remains low in comparison, it has increased considerably over the years, albeit from a very low level. This proportion has gone through several distinct phases. It was initially stable through to the early 1970s before plunging during that decade to a low point reached in 1978, with intra-African exports worth only 2.9 per cent of total African exports. From there, it recovered slowly until the mid-1980s, then increased sharply in the second half of the 1980s and the first half of the 1990s. Overall, taking the increase from the levels in the first three years of the 1960s to the level of 2004–2006, the increase is greater in Africa than in all other regions except developing Asia. Within Africa, North Africa has systematically had a much lower proportion of intraregional trade than sub-Saharan Africa. Sub-Saharan Africa, in contrast, has had an impressive record of growth of its intraregional exports.

8. Although the aggregate level of intra-African trade is low in comparison with other regions, intra-African trade is important for many African countries taken individually. Two countries are particularly important to intra-African trade. South Africa's exports to the region alone represent almost a quarter of the total, while Nigeria's are worth roughly half that proportion. There are also many countries in the region that depend on intra-African trade to a much greater extent. Five African countries have exports to Africa that are more than half of their total exports; while a further 14 countries export more than a quarter of their exports to Africa.

9. The analysis of why intra-African trade is so low relative to its potential reveals the influence of extremely high transport costs caused by poor hard and soft infrastructure. The term "hard infrastructure" refers to the physical infrastructure that is often missing or is of poor quality in many African countries. "Soft infrastructure" refers to issues such as the policy and regulatory environment, the transparency and predictability of trade and business administration and the quality of the business environment more generally. This is particularly true for landlocked countries, which are constrained by their own poor infrastructure as well as their neighbours'. Inefficient and multiple border procedures, and the political instability and unpredictability, as well as uncertainty, of trade policies also hamper intra-African trade by raising trade costs, despite remarkable progress achieved in these areas in the recent past.

10. In every subregion, trade takes place around a few influential countries. This suggests the existence of "trade poles" that could become development poles, provided that complementary policy measures regarding infrastructure and productive capacity development are adopted by African governments. For example, in the ECOWAS (Economic Community of West African States) region, the annual average value of intra-group exports between 2004 and 2006 was $5.4 billion, which represented around 9.4 per cent of ECOWAS total exports. The main exporters within the group are Côte d'Ivoire and Nigeria, which together account for over 70 per cent of total intra-group exports.

11. The pattern of trade within Africa and between Africa and the rest of the world is different. While manufactured products dominate intra-African exports, exports to the rest of the world are mainly primary commodities. Also, whereas Africa's exports to the rest of the world are highly concentrated around a few products, intra-African trade is much more diversified. In terms of exports, the composition of intra-African exports is fairly evenly distributed between fuels, non-fuel primary products and manufactured goods. Non-fuel primary exports represent 30 per cent of the total, 11 per cent of which represents exports of ores and minerals. Hence, agricultural product exports account for only 19 per cent of total intra-African exports, despite the fact that agriculture accounts for nearly 30 per cent of the production of goods in Africa. This is in contrast to manufacturing, which accounts for 21 per cent of the production of goods but 40 per cent of exports. Similarly, the composition of imports from the rest of the world is more concentrated than that of intra-African imports.

12. Overall, the more diversified nature of intra-African trade, when compared with its exports to the rest of the world, suggests that expanding intra-African trade could yield significant benefits to African countries in terms of diversifying their production to non-traditional products and especially manufactures.

13. The evolution of intra-African trade in the foreseeable future will depend on a number of processes taking place both within and outside Africa. Generally, African economies are affected by the same factors affecting the world economy, the most prominent currently being the global economic crisis. As Africa's global export markets shrink, the continent's export revenue will drop. Therefore, it is even more urgent for African countries to take steps to develop their intraregional trade in order to offset losses from their traditional export markets. Processes such as the EPA negotiations, the WTO Doha Round of multilateral trade negotiations and AGOA – as well as recent bilateral and multilateral agreements between Africa and economic powerhouses such as China and the United States – are expected to have a notable effect on the future of intra-African trade.

III. Intra-African investment

14. Africa has a long tradition of cross-border investments but the lack of reliable data has constrained detailed analysis. The scanty data available indicates that intra-African investment represents 13 per cent of total inward foreign direct investment (FDI). This level is less than half the figure for the Association of Southeast Asian Nations (ASEAN) region, where intraregional FDI is estimated at 30 per cent of total FDI.

15. Key factors explaining the low level of intra-African FDI include the lack of an adequate transport and communication infrastructure, the lack of skilled labour and weak economic links and contacts among investors within the region. The low level of domestic investment in Africa is also partly responsible for the limited intraregional investment. Indeed, the 2009 *Economic Development in Africa* report found that private domestic investment drives foreign investment.

16. The factors that push African investors to invest in other African countries include (a) the need to avoid overdependence on the home market; (b) the rising costs of production

in the home economy (this is one reason why Mauritius delocalized to Madagascar); (c) pressure from domestic and global competition; and (d) opportunities in host countries, such as the privatization of state-owned enterprises. Geographical proximity and cultural affinity as well as regional integration schemes facilitate investment from within Africa. Investors from Africa enjoy an information advantage relative to non-African investors, who are constrained by the severe information deficit on Africa.

17. Intra-African investments come from three main poles. The West African pole, dominated by Nigeria, has developed recently and is very active in mergers and acquisitions in Africa's banking sector. The Northern pole comprises Egypt, the Libyan Arab Jamahiriya and Morocco. North African investments across Africa are also gaining importance in areas such as banking, transport and telecommunications. The Southern African pole, dominated by South Africa since the end of apartheid, is very active in areas such as banking and mining. Other important African investors include Mauritius, which accounted for 15 per cent of total FDI inflows in Madagascar and 23 per cent in Mozambique during the period 2004–2006. Kenyan investments made up 10 per cent of Uganda's FDI during the fiscal years 2000–2002, while Egyptian investments were 19 per cent of Algeria's inward investment in the period 1999–2001.

18. Intra-African investment has become a very important source of investment for a few African countries. This is particularly the case in Southern Africa, given the prominence of South Africa as the main source of intra-African foreign investment. In this light, countries such as Botswana, Madagascar, Malawi and Mozambique benefit from their proximity to South Africa. South African investments are not limited to Southern Africa, however.

19. Intra-African investment favours some sectors, such as the services sector, where it accounts for 36 per cent of deals carried out in Africa, followed by manufacturing (30 per cent) and the primary sector (26 per cent). Intra-African investments made up only 19 per cent of total investment deals in the agriculture sector. Intra-African investment favours smaller projects in services and manufacturing, given the relatively small size of investors and recipients. In contrast, investment from outside Africa is highest in the primary sector, where it accounts for 74 per cent of all deals over the period 1987–2008. Investments in this sector are usually large and, in the case of mining, highly capital intensive, using sophisticated technologies. These types of investments are beyond the reach of most African investors. In fact, in the mining sector, which is the largest FDI recipient, intraregional FDI is confined to South African mining transnational corporations (TNCs).

20. Given the general need for more investment in Africa, the *Economic Development in Africa* report argues that intra-African investment should play a bigger role. Examples from West Africa and South Africa highlight the potential for increasing intra-African investment. Having a sound financial sector appears to be a prerequisite for increasing the flows of investment within Africa.

IV. Emerging issues in regional trade integration in Africa: services, labour mobility and migration

21. Services represent, or have the potential to become, significant sources of export earnings for a large number of African economies. Tourism, construction, ports and logistics services relating to road and rail transport offer important export potential for many countries. Also, considering that professional and transport services, telecommunications, banking and insurance – the so-called "producer services" – are inputs into other economic activities, they either facilitate or hinder trade and production in other economic sectors, depending on the efficiency with which they are made available to users.

This is why the report argues that the efficient production of services and their trade should be considered as important as the production and trade of goods. Currently, most African countries are unable to provide domestically the quantity or quality of producer services demanded by local producers and exporters, thus undermining competitiveness.

22. Yet the development of service industries may require financial, human and technological resources that are not available in most African countries. This may be the case because markets are too small and financial and human resources are too restricted. Also, monopolistic situations that prevailed in the past have protected current operators from competition. In line with this observation, there is a growing understanding that regional integration could be a critical element to take into consideration, as policymakers turn their attention to forging new policies for the development of services.

23. Furthermore, regional services trade offers a supportive environment for national firms by accelerating learning curves, building supply capacities and enhancing international competitiveness. Regional services trade also plays a catalytic role in generating employment and furthering the development of growing regional services industries and firms. By allowing for economies of scale in the production of services, regional integration may support the development of regional infrastructure in key sectors such as transportation, communications and energy.

24. In an increasingly integrated world, international migration is bound to continue and will likely expand. This is particularly true in the African region, where movements of people have been commonplace, particularly among contiguous states and countries within the subregion. Recognizing the importance of the free movement of people, the Abuja Treaty of June 1991 establishing the AEC, urged member states to adopt employment policies that allow the free movement of persons within the community.

25. While labour mobility is included in the protocol and objectives of several African regional economic communities (RECs), many practical obstacles still hamper its effective realization. As a result, labour markets remain fragmented, acting as a barrier to the free movement of labour among countries. Overall, the African regional organizations have taken steps to facilitate short-term stays in member countries, but the establishment of large economic unions within which citizens could move and work freely remains a longer-term goal.

26. The RECs fall short of implementing provisions or protocols for the free movement of people, for various economic, political and social-cultural reasons. The realities, however, point toward the need for greater mobility and thus call for the harmonization of laws and regulations on labour mobility, so as to better manage migration to maximize its development impacts. This will promote a truly positive agenda for intra-African migration/labour mobility needed for the continent to mitigate the adverse consequences of the North–South brain drain.

V. Strengthening regional integration in Africa: some policy recommendations

27. The potential for increasing intra-African trade remains untapped. Therefore, governments in Africa should deepen regional economic integration in a way that helps rather than frustrates Africa's participation in the world economy. Regional integration should be used as a building block for Africa's effective integration into the global economy. It is encouraging to note that the EU–ACP Economic Partnership Agreements currently under negotiation across Africa seem to share this objective.

28. African governments need to address several domestic measures that impede the development of regional trade. Countries should undertake a thorough review of their trade sector, identify its weaknesses and adopt a strategy to put in place the right trade facilitation measures. For example, there are cases where trade can be speeded up through the simplification of administrative procedures combined with some basic investment in trade facilitation technologies. Moreover, introducing competition in the transport sector could reduce transport costs considerably.

29. The importance of infrastructure for Africa's economic integration is well recognized. Some financing modalities have been set up to address the infrastructure constraint. Africa should take maximum advantage of opportunities for infrastructure finance, such as those under the Infrastructure Consortium for Africa (ICA), launched in 2005 to support the scaling up of investment for infrastructure development in Africa. Public–private partnerships should be promoted.

30. African governments' efforts should foster investment in viable regional projects that can exploit scale economies. Given Africa's infrastructural gap and its negative effect on regional integration, regional infrastructure projects are among the best candidates for these regional FDI projects. Moreover, given the importance of agriculture in most African economies, investment in the agricultural sector, at both the production and processing levels, should form part of the development strategy at the regional level.

31. African countries have deepened regional economic integration by including services in regional integration programmes, with relevant provisions such as the free movement of capital and labour, the right of establishment and national treatment. For a more inclusive integration, the RECs should set up a mechanism for consultation with associations of providers of trade in services, with a view to ensuring their involvement in the integration process of the region, increasing the intraregional FDI flows and boosting private sector development, particularly in the transport sector.

32. Regional integration arrangements could be a way of building and enhancing industries' competitiveness. Regional cooperation among contiguous states also provides opportunities for modernizing and expanding vital infrastructure networks such as roads, ports, railways and communications facilities, among others. Regional integration has enabled landlocked countries to become transit countries as a result of the intensification of intraregional trade flows. The RECs should accelerate their efforts aimed at harmonizing and improving transit/transport agreements in each subregion. They should also rely more on ICT (information and communication technology) tools to reduce transaction costs.

33. There is a need to develop, among others, a common migration policy among African countries. This could consist in harmonizing labour migration policies and creating regional approaches to labour migration issues. The regional consultative processes – which serve as a forum to exchange views on migration issues and the development of a common regional migration policy – are a step in the right direction and must be sustained and strengthened.

34. In addition, governments should integrate and mainstream labour migration in national employment, labour market and development policy. This means instituting clear and transparent policies on migration that are linked to development strategies (e.g. the Millennium Development Goals and Poverty Reduction Strategy Papers).

35. Intraregional and interregional cooperation and partnerships (including both South–South and South–North) should be strengthened to advance and systematize data collection on and analysis of labour demand and supply in countries of origin and destination. This could provide a sound basis for a more fruitful, cooperative exchange of skills among African countries.