3 Economic Integration in Africa: A Work in Progress

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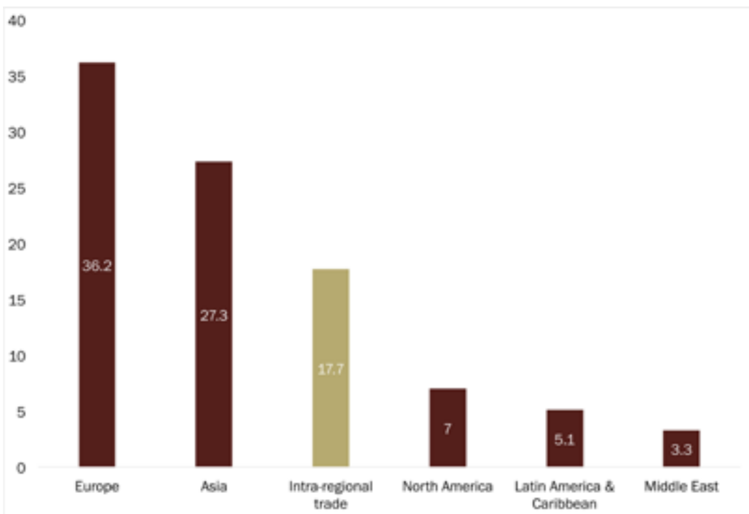
Introduction

Regional economic integration across the world accelerates growth and development by bringing a wide array of benefits associated with enhanced political cooperation, increased intra-regional trade, and job creation. Regions that are more integrated have proven to grow faster and have shown greater resilience in times of global economic downturns. As the world economy struggles to return to the high growth levels of a decade ago, stimulating internal and regional growth has become the main policy solution for many countries and regions. China is increasingly forging ties with its neighbors, India is doing the same, and even in the EU intra-regional trade is returning to its pre-financial crisis levels. In Africa, Morocco and South Africa are also aggressively adopting regional trade strategies. While Europe remains Africa's main export market, Africa's trade with the Atlantic nations of Europe is decreasing as Africa looks to trade more with itself. However, as Africa integrates into global value chains, trade with Europe can be expected to continue to increase while competition with Africa's other Atlantic neighbors south of the United States is likely to increase.

Improving Africa's Intra-Regional Trade and Business Climate

Regional integration is a key priority in Africa's development strategy, with free trade among members featured as an important cornerstone of the African Union's recently completed Agenda 2063 strategy. Intra-regional trade is expected to produce considerable productivity gains for the continent. In the African context, such gains will improve overall food security by bringing food and agriculture products from surplus areas to deficit areas at reduced cost. Emerging opportunities also exist for cross-border trade in

Figure 1: Destination share of Africa's exports, 2014



Source: WTO, International Trade Statistics, 2015 basic manufacturing such as metal and plastic products that are costly to import from the global marketplace. In a period of climate-sensitive energy production, regional integration of energy markets could substantially reduce the costs, reduce emissions, and improve access.

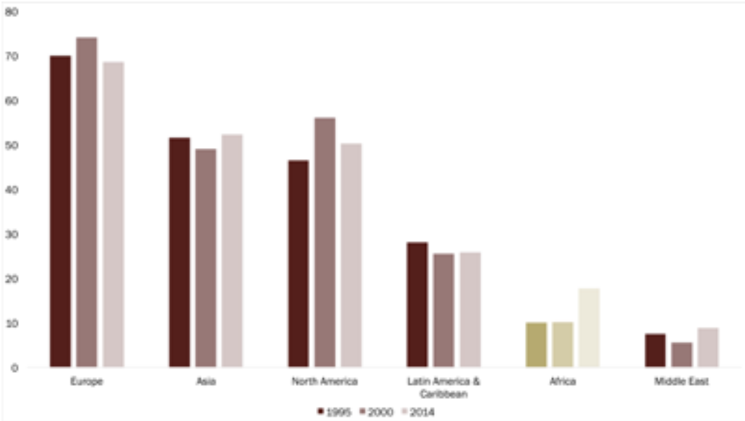
The role of the private sector in all markets where regional integration has taken hold and accelerated has been essential. Africa will be no exception. The private sector is essential for mobilizing private investment in tradeable goods, which will be critical to continued productivity growth, increased exports, and higher export sophistication, leading to more and better job creation. Regional integration also allows for the African private sector to innovate, grow, and transfer knowledge more rapidly while helping to improve its competitiveness globally. The potential for regional production value chains to participate in global value chains, similarly to those in East Asia, needs to be further exploited. Resource-rich economies on the continent can similarly develop regional value chains around commodities such as iron ore and gold. Inter-regional trade in services presents untapped potential for productivity improvements through private sector development and exports of professional services. Similarly, services exports offer an opportunity to improve critical public services for citizens such as in health care and education. The top exporters of services in the world are the EU, the United States, China, Japan, and India. Among the least developed countries, The Gambia and Cambodia had the highest ratios of commercial services exports to GDP in 2014.[1]

The small size of many countries and markets on the continent also calls for greater economic integration. More than half of the countries on the continent have a population of less than 10 million people. In order to benefit from economies of scale, regional trade is a must. The economic importance of cross-border trade in low income as well as fragile and conflict-affected states is particularly significant. Analysis on poverty suggests that small-scale cross-border trade has a strong impact on poverty reduction in countries. In addition, a sizable share of cross-border trade between African countries occurs in the form of small-scale transactions, which are not captured in official trade statistics, such as between Ghana and Liberia and Sierra Leone; Nigeria and Benin; or the Democratic Republic of Congo (DRC) and Rwanda, for example. Facilitating the transition of these traders – many of which are women – from the shadow economy to the formal economy would boost private sector participation, entrepreneurship, and trade.

Despite trade's significant role in boosting economic growth and poverty reduction, while improving food and energy security in Africa, the continent continues to trade little with itself (see Figure 2). Intra-regional trade in Africa is the second lowest among world regions, pointing to an important source of growth that remains unexploited. This is largely a result of a mix of trade policies that have been heavily focused on gaining access to developed economies and regional integration efforts that were not well designed or fully implemented. It is worth noting, however, that intra-regional trade has been rising

[1] *International Trade Statistics* (Geneva: World Trade Organization, 2015), 24, https://www.wto.org/english/res_e/statis_e/its2015_e/its2015_e.pdf.

Figure 2: Share of intra-regional trade by region, 1995, 2000, and 2014



Source: WTO, 2015

since the 2000s, backed by revamped internal efforts and unprecedented growth rates exhibited by African economies over the past decade.

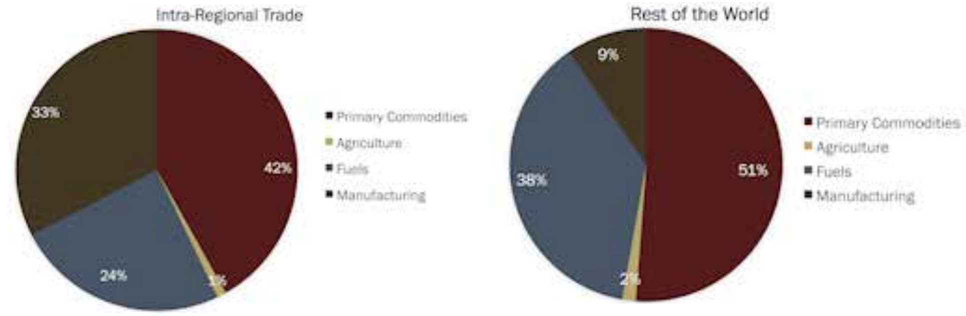
Starting from a very low base, Africa is the continent that has accelerated intra-regional trade the most since the early 2000s. For African countries, trade within Africa has reached 17.7 percent of the region's total exports in 2014, compared with only 10 percent in 1995 and 2000. However, the continent is still far behind the world leaders in intra-regional trade. Intra-regional trade accounts for a significant proportion of exports for Europen, Asian, and North American nations. In Europe, trade within the region has accounted for more than 70 percent of the region's total merchandise exports on average over the last 20 years. In Asia, 52 percent of its total exports were sold within Asia. North America's share of intra-regional trade was slightly lower, with 50 percent of its total exports being sold within the region. For the Middle East, trade within the region plays a minor role compared with its overall trade activity. In 2014, only $113 billion of exports were sold within the region out of total exports of $1.29 billion, representing 9 percent of the total.[2]

Intra-regional trade in Africa has been on the rise since 2008. However, the overall share of Africa's exports to the rest of the world represent a mere 3 percent of world exports. By contrast, Asia's contribution to world exports has greatly increased its importance as a trading region. In 2014, world merchandise exports to Asia amounted to $5.465 billion, almost one-third of the total world merchandise trade.[3] And despite efforts to diversify the export base, African exports remain highly concentrated in commodities, accounting for over half of the continent's exports, compared to just about 10 percent for Asia and advanced economies. The share of manufacturing in Africa's intra-regional trade has

[2] *International Trade Statistics*, 24.

[3] Ibid.

Figure 3: Africa's merchandise trade composition, 2014



Source: UNCTAD, 2014

always been higher than its share in Africa's extra-regional trade (see Figure 3). This signals the importance of manufacturing in strengthening regional integration in Africa through further boosting intra-African manufactures trade. Regional private sector champions in sectors such as cement and beverages account for this growth in intra-regional trade in manufacturing.

Europe has been the leading destination of global exports over the past 20 years. Nearly 37 percent of the world's merchandise trade begins or ends up in Europe. Two-thirds of this trade is among European economies, making its regional trade the biggest in the world. This, however, has not come at the cost of global trade relations. Europe also has strong trade ties with every other part of the world, importing more manufactured goods from Asia and Africa than the United States, and trading more with the developing world than any other region. Some of the significant aspects that have made European integration a success is the continued commitment to free trade. European economic integration has been an ongoing process since the early days of the European Coal and Steel Community after WWII and an exercise in creating greater economic and political cooperation through enhanced regional cooperation. The EU has also offered an anchor to structural reforms and comprehensive institutional harmonization through a series of treaties, laws, and regulations that govern the economic union.[4] For Africa to create laws and regulations that promote free trade between its countries, key trading blocs like the East African Community (EAC), Southern African Development Community (SADC), Economic Community of West African States (ECOWAS), Common Market for Eastern and Southern Africa (COMESA), and others will have to come together and constructively collaborate to review and revise existing tariffs and non-tariff barriers to trade, as well as establish new rules and regulations encouraging increased intra-African trade.

Improving the overall business climate is equally important for Africa. Countries are increasingly doing more collectively and individually to improve the business environment. A notable development on this front is the introduction of the African passport,

[4] Indermit S. Gill and Martin Raiser, *Golden Growth: Restoring the Lustre of the European Economic Model* (Washington, DC: The World Bank Group, April 2011), http://dx.doi.org/10.1596/978-0-8213-8965-2.

which is given to regional corporate heads and other institutional investors to facilitate travel on the continent. In addition to this, sub-Saharan Africa implemented a record of 80 World Bank Doing Business reforms in 37 of the region's 48 countries over the past year. This number is about one-third of the reforms recorded globally (283), and is 14 percent more than the number of reforms recorded last year (69). As a result, sub-Saharan Africa was once again the region with the highest number of reforms globally.[5]

Over the past year, Niger implemented the highest number of reforms (six), followed by Kenya with five reforms, while Rwanda, Cote d'Ivoire, Senegal, Mauritania, and Togo implemented four reforms each. Burkina Faso, Madagascar, Mali, Uganda, and Zimbabwe each implemented three reforms. Compared to other regions using the World Bank's Doing Business measurements, Africa's Distance to Frontier metric moved up at a pace of improvement three times that of OECD high-income economies.[6] Regional economic communities are increasing the collective pace of reform. For example, the Organization for the Harmonization of Business Law in Africa (OHADA) marks 2016 as a successful year, with all 18 member countries implementing a reform in the area of the World Bank's Resolving Insolvency metric, accounting for 18 out of 24 reforms recorded in this area globally.

Global Value Chains and Regional Supply Chains

According to the WTO, in 2011, 49 percent of world trade in goods and services took place within global value chains (GVCs), up from 36 percent in 1995. Africa captures a small but growing share of GVC trade. Africa's share in global trade in value added grew from 1.4 percent in 1995 to 2.2 percent in 2011. This represents an increase of almost 60 percent, whereas the established GVC regions in the United States, Asia, and Europe saw a relative decline in their shares. Africa's growth was also higher than that of Latin America and the Middle East, which play small roles in global value chains, but lower than South Asia's.

For Africa, the potential gains from increased regional integration could be further increased through integration in global value chains. Africa's progress in connecting to GVCs can further deepen the process of economic integration. GVCs offer many opportunities to transform Africa's economies by opening up new competitive activities and improving sector performance in manufacturing, agriculture, and services, while increasing diversification and technological sophistication of exports. Regional value chains can also play a significant role in offering opportunities for local producers – including small and medium-sized enterprises (SMEs) – to access fast-growing and more easily accessible markets across Africa.

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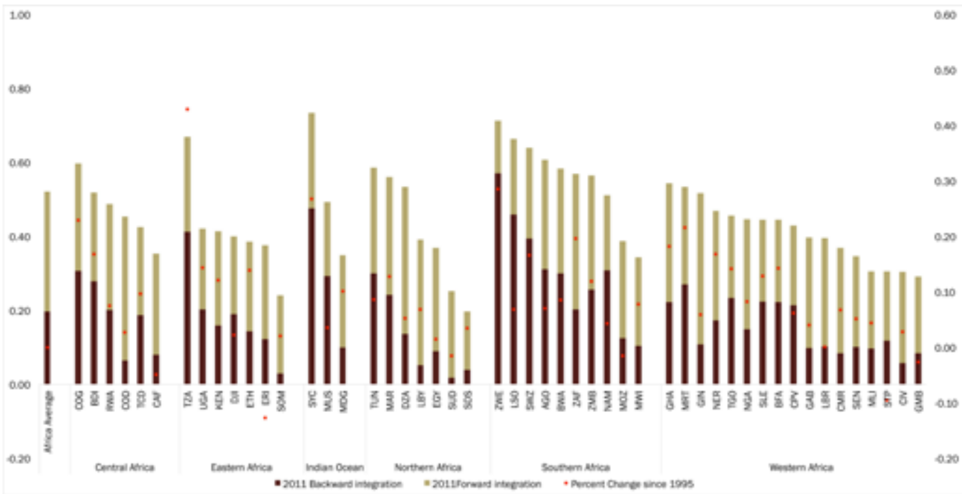
[5] *Doing Business 2017: Equal Opportunity for All* (Washington, DC: The World Bank Group, October 2016), http://www.doingbusiness.org/~/media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB17-Report.pdf.

[6] The Distance to Frontier score helps assess the absolute level of regulatory performance over time. It measures the distance of each economy to the "frontier," which represents the best performance observed on each of the indicators across all economies in the Doing Business sample since 2005. For more information, see http://www.doingbusiness.org/data/distance-to-frontier.

Figure 4: GVC participation of African countries in 2011



Source: AfDB, African Economic Outlook 2014

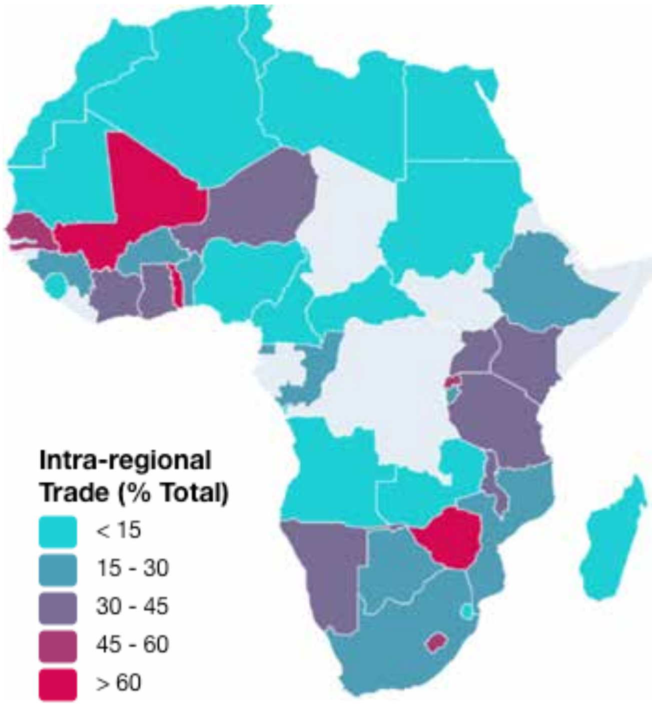
The Asian success story holds important lessons for Africa. The rapid advances of regional integration experienced in Asia have been the result of swift improvements in cross-border trade. By fostering regional integration, Asia has been able to create regional value chains and become more efficient, thereby enabling the region to become a key player in GVCs, which today increasingly characterize world trade. In 2011, close to half of world trade was undertaken through cross-border value chains. Some East Asian economies, including China, South Korea, and Thailand, have benefited from investments in infrastructure and resources, which made them known as "Factory Asia." A positive example of how quickly integration into regional supply chains can materialize is Cambodia, which despite being classified as a least-developed country, was able to increase its vertical specialization by an impressive 24 percent between 1995 and 2011.[7]

The process of GVC integration has consistently been associated with higher levels of activity and income growth over time, as demonstrated by the examples of South and East Asia as well as Eastern Europe. Africa's regional participation in GVCs is driven by Southern and Northern Africa, which account for the largest share of GVC trade, followed by West Africa, Eastern Africa, and Central Africa. Southern Africa and North Africa both account for the continent's largest share of both forward and backward value chain integration (see Figure 4). The continent exhibits large variations in total participation rates, as well as between forward and backward integration rates. The top five countries with the highest participation rates are Lesotho, the Seychelles, Swaziland, Tanzania, and

[7] *International Trade Statistics*, 18.

Zimbabwe. The bottom five countries are South Sudan, Somalia, Sudan, Benin, and The Gambia. The highest growth in total participation rate between 1995 and 2011 was marked by Tanzania, Seychelles, Zimbabwe, Republic of Congo, and Mauritania.[8]

Figure 5: Intra-regional exports as a share of total exports, 2014



Source: Author calculations based on UN Comtrade data as of 2014 or latest available year; Gray areas indicate missing data

What Does Regional Trade in Africa Look Like?

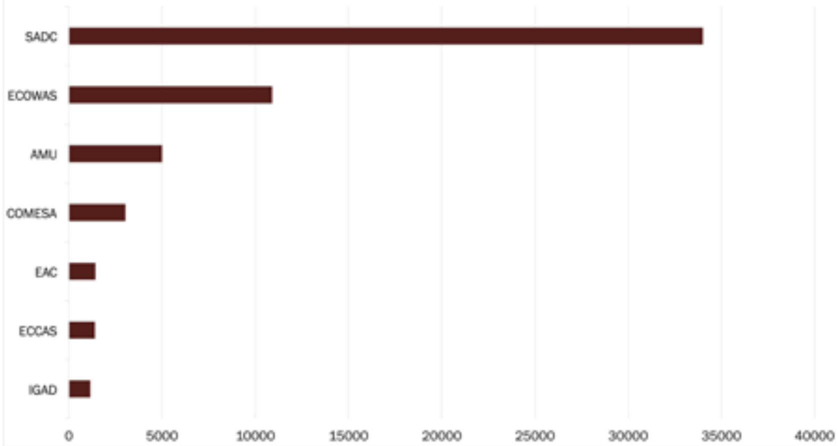
To measure trade integration of African countries, the ratios of intra-regional exports to total exports are examined as primary indicators of trade integration. As mentioned earlier, intra-regional trade is low in Africa relative to that of other regions. A high level of intra-African exports and imports indicates that a country has taken important steps to keep trade barriers with other African countries low (see Figure 5). Otherwise, the cost of trading would tend to render a country's products uncompetitive in other African markets and to reduce the proportion of a country's income spent on imports from the rest of Africa.[9]

West, Southern, and Eastern African countries appear to be the front-runners in terms of intra-regional trade. The trend in intra-regional trade has been shaped – in part – by the formation of economic communities. There are eight African Union-recognized regional economic communities: EAC, COMESA, Arab Maghreb Union (AMU), Community of Sahel-Saharan States (CEN-SAD), Economic

[8] African Development Bank, Organization for Economic Co-operation and Development, and United Nations Development Programme, *African Economic Outlook 2014: Global Value Chains and Africa's Industrialization* (Paris, France: OECD Publishing, 2014), http://www.afdb.org/en/knowledge/publications/african-economic-outlook/african-economic-outlook-2014/.

[9] UN Economic Commission for Africa, African Union, and African Development Bank Group, *Assessing Regional Integration in Africa VII: Innovation, Competitiveness and Regional Integration* (Addis Ababa, Ethiopia: ECA Printing and Publishing Unit, 2016), http://www.uneca.org/sites/default/files/PublicationFiles/aria7_eng_rev_30march.pdf.

Figure 6: Economic community trade, $ millions in 2014*



Source: UN Comtrade, 2014
Note: Unrecorded flows across borders within Africa are likely to be larger than elsewhere in the world, and the reported numbers may not be fully accurate

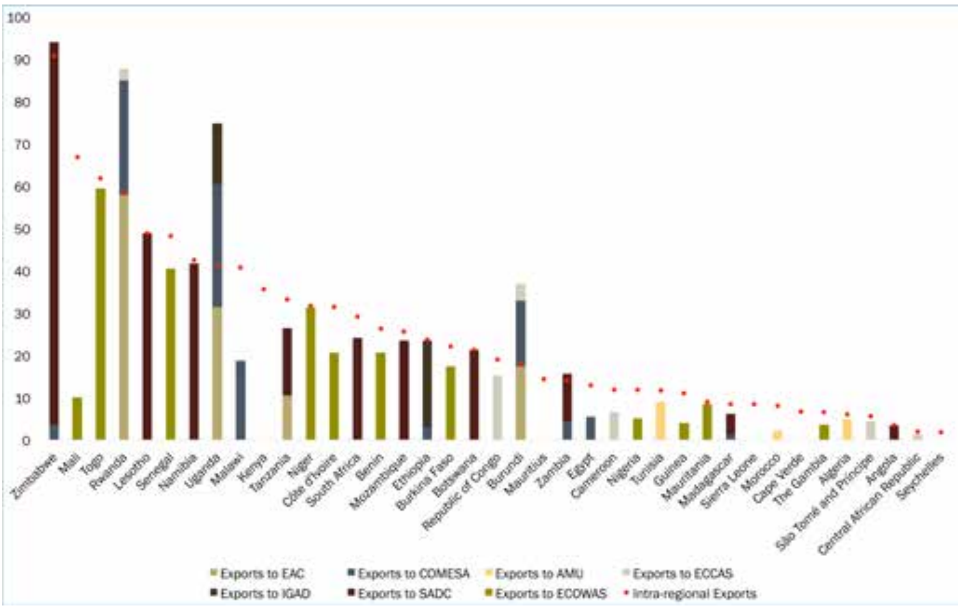
Community of Central African States (ECCAS), Intergovernmental Authority on Development (IGAD), SADC, and ECOWAS.

It is noteworthy that African regional trade exhibits large gaps among the different economic communities. Despite the existence of numerous intra-regional trade agreements, some economic unions lag behind in achieving greater trade integration among members – possibly because their overlapping country groupings greatly reduce their effectiveness. This is the case with IGAD, ECCAS, and COMESA.

SADC has the fifth-highest intra-regional trade ratio worldwide among 32 regional trading blocs. Some of Africa's regional economic communities, however, perform strongly against other regional integration blocs in Africa and worldwide. In particular, SADC is not only the best-performing economic community in Africa, but also among the best performers in the world. The UN Economic Commission for Africa (UNECA) reports that it enjoys an intra-regional trade of 6.6 percent to GDP. Countries in Southern Africa appear to have the highest volume of intra-regional trade. Many of the African states with the highest shares of intra-regional exports to total exports are members of SADC. The intensity of intra-regional trade in those countries is partly due to their proximity to the regional powerhouse that is South Africa as well as their membership in SADC.

For SADC countries such as Lesotho and Zimbabwe, South Africa is indeed the main trading partner. Most SADC countries' exports are directed to South Africa. However, for some of the other SADC members with similarly high shares on this metric, such as Namibia and Tanzania, this is not the case. This suggests that trade between SADC coun-

Figure 7: Intra-regional economic community trade



Source: UN Comtrade, 2014

tries and South Africa only partly explains the strong performance of SADC countries in intra-African exports.

ECOWAS is the second best in this breakdown in terms of trade volume. Despite strides toward increased economic integration, the share of regional trade in ECOWAS has remained more or less constant, and significantly below the 40 percent target that the bloc aspires to reach by 2030. However, this aggregate figure is very much dominated by Nigeria's weight in the region's total exports. These consist mainly of petroleum and commodity exports, which are largely directed toward the global market. The other ECOWAS commodity exporters – The Gambia and Guinea – join Nigeria with single digit numbers of intra-regional export shares (see Figure 7). As for the rest of ECOWAS member countries, regional trade plays a much more important role, with ratios as high as 59 percent in Togo, 41 percent in Senegal, and 31 percent in Niger.

Regarding trade composition, the export mix of goods to ECOWAS partners and to the rest of the world varies significantly among members. Thus, there does not seem to be a clear-cut pattern across countries in terms of what is exported regionally and what is exported globally. The main exception here is Nigeria, whose exports to all regions are strongly dominated by crude oil.

Development of regional value chains has been strongest in SADC and ECOWAS, measured as the imports and exports of intermediate and capital goods of each country with the rest of Africa as a share of GDP. This implies that these two regional economic communities may have stronger production networks than elsewhere in Africa.[10]

What Can Be Done to Improve Regional Integration and Trade?

Africa has not been able to fully benefit from the rapid expansion of global trade, and labor productivity has not risen as much as in other regions, contributing to a trade gap and low integration into GVCs – a key determinant in adding value to trade and supporting sustainable job creation. Further, where Africa registered some progress was in the areas of manufacturing, agriculture and agro-business, tourism, and transport, the last of which also showed the largest potential for deeper integration. To leverage this potential, findings emphasize the need to close the infrastructure gap, lower tariffs and non-tariff barriers, and improve the business climate and access to credit.[11]

Africa is expected to experience significant population growth in the coming years. But in order for the continent to be able to harness this demographic dividend, Africa has to be able to provide jobs for the people projected to enter the workforce.

Regional Integration and Energy

For Africa to increase trade with itself or the rest of the world, African countries need to do more to improve trade logistics, reduce travel times across borders, industrialize more rapidly, and reduce costs of outputs. A key component of this will be reducing the cost of energy and increasing generation capacity substantially.

The whole of sub-Saharan Africa, with a population of around 1 billion people, consumes only 145 terawatt hours of electricity a year – less than the consumption of one small U.S. state. This is roughly equivalent to one incandescent light bulb per person for three hours a day. Today, over 600 million are without electricity on the continent. In many countries, more than 75 percent of the population lacks access to affordable and reliable energy, including 70 million people in Ethiopia and 60 million people in DRC.[12]

Africa has abundant low-carbon, low-cost energy resources like wind, hydro, and solar. Yet, most countries continue to rely on high-cost thermal energy. However, in the absence of well-developed energy-generation projects, sufficiently large markets and longer tenor financing will substantially address these problems. Ultimately, what will make energy generation in Africa profitable is access by the private sector to larger markets through regional integration.

Most African power systems are too small to generate power efficiently. Currently, 21 out of 54 countries have under 200MW of installed capacity. As a result of these small sizes,

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[10] Ibid.

[11] Carlos Conde, Philipp Heinrigs, and Anthony O'Sullivan, "Tapping the Potential of Global Value Chains for Africa," in World Economic Forum, *The Africa Competitiveness Report 2015* (Geneva, Switzerland: World Economic Forum, 2015), http://reports.weforum.org/africa-competitiveness-report-2015/.

[12] International Energy Agency: *Africa Energy Outlook: A Focus on Energy Prospects in Sub-Saharan Africa* (Paris, France: OECD/IEA, 2014), https://www.iea.org/publications/freepublications/publication/WEO2014_AfricaEnergyOutlook.pdf.

the cost of generating power remains high on average, in some cases is over $0.25/kWh compared to less than $0.10 in other parts of the world.

Private sector investment in energy in Africa is a mere 1 percent of all such investments in other developing regions (compared to 34 percent for South Asia, 26 percent for Latin America and the Caribbean, or 25 percent for Europe and Central Asia). Six sub-Saharan African countries concentrate 80 percent of these investments (Nigeria, Uganda, Cameroon, Ghana, Kenya, and Tanzania), with many of these investments not regional in nature.

Regional trade in energy will be the big game-changer for Africa's clean energy future through the development of regional power pools. The establishment of regional power pools – where many countries within sub-regions pool together energy assets and trade amongst each other – has begun across the continent with the construction of cross-border transmission lines and the creation and strengthening of inter-governmental institutions such as the Senegal River Valley Authority, which manages energy generation projects for Senegal, Mali, Mauritania, and Guinea.

African regional power pools can substantially reduce the cost of electricity, connect markets with resources, improve balance of payments of energy exporting countries as they trade in foreign currency, and improve reliability of supply. For example, the Eastern Electricity Highway Project (connecting Ethiopia and Kenya) is a 500 kV high voltage direct current transmission line 1,000 km long, which is expected to reduce electricity prices by over 20 percent once completed, from $0.17/kWh to $0.14/kWh. By developing hydro and gas resources, the continent can also ensure it moves from a heavy fossil fuels-based energy generation model to a more diversified grid with substantially reduced carbon intensity.

Specific Policy Actions

Expanding Horizons Through Trade Liberalization

Higher trade openness would aid job creation to absorb the growing working age population, and allow Africa to benefit from technology transfers and integration into global value chains. Expanding intra-regional trade and regional markets could boost incentives for domestic production, especially in labor-intensive manufacturing sectors, and attract higher investment.

Continuing to work toward lowering tariffs in the region would further support the development of both global and regional trade. Bringing tariffs to the average global level could yield about 14 percent additional trade.[13] One consideration, however, is that taxes on trade still represent a substantial source of revenues for many countries in the region, and policies to lower tariffs need to go hand-in-hand with continued efforts to increase revenue mobilization from other sources. In addition, countries and the region must address issues of non-tariff barriers to trade, high costs of logistics, weak supply chain

[13] International Monetary Fund, *Regional Economic Outlook: Sub-Saharan Africa* (Washington, DC: IMF, April 2016), https://www.imf.org/external/pubs/ft/reo/2016/afr/eng/pdf/sreo0416.pdf.

management, and warehousing and refrigeration. Harmonizing quality standards remains important if there is to be venture capital integration in agro-processing, for example, which is the main sector for Western Africa.

Deepening Regional Economic Cooperation

At the regional level, deepening existing customs unions with further economic integration would help, as the SADC, EAC, and West African Economic and Monetary Union (WAEMU) have done. But having a single currency by itself is not enough, as evidenced by the Economic and Monetary Community of Central Africa (CEMAC), where intra-currency-union trade flows are not found to be significantly higher than regional flows outside the currency union. The creation of monetary unions must be complemented by mutually beneficial trade agreements, investments in institutions to regulate and facilitate trade, and improvement in skills.

Increasing Agricultural Productivity and Diversifying into Labor-intensive Activities Outside Agriculture

Agricultural productivity can be improved by increasing access to irrigation, increasing use of high-yield varieties, and improving market access. In addition, economic diversification would require reducing administrative burdens, simplifying regulations, promoting competition, and investing in human and physical capital.

Promoting Private Sector Development

This would allow the private sector to engage in new areas of economic activity. Private sector development could be facilitated by reforms that support a more business-friendly environment.

Improving Access to Credit

Access to credit for the private sector plays a paramount role for the region's trade. The IMF predicts that if Africa furthers financial deepening to the level observed elsewhere in the world, this would support an expansion of trade by as much as 29 percent. Such expansion would need, however, to be accompanied by adequate macro-economic management frameworks to carefully manage the corresponding risks.

Meeting Infrastructure Needs

Filling the infrastructure gaps in transport, telecommunications, and energy will be critical to expanding manufacturing and services, as well as reducing the cost of doing business. Landlocked countries with few natural resources remain more closed economies – with exports at only about 10 percent of GDP – and still struggle to increase trade integration, handicapped by poor transportation infrastructure and limited interest from emerging markets.

Conclusion

Overall, regional integration remains important for Africa. Regional trade and cooperation agreements have supported this agenda and should be deepened. In addition, while progress has been made in some regions, others continue to lag behind and the next step in the regional integration agenda will also have to focus on the inter-regional trade issues.

Regional integration is most advanced in the manufacturing sector. This is a significant dimension of the regional integration agenda as it means that countries can create regional value chains as they develop and move up the production value chain. To support this development, more work is needed to better understand the regional manufacturing value chains and have governments adopt policies that allow and support their development. Policies could include the adoption of specific regulations to facilitate these trade patterns and joint support with the private sector for technical and professional education in these value chains. While the continent is accelerating its pace of integration, it needs to do more to catch up to other regions.

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