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AFRICA UNITED

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Africa attracts flows from foreign investors and announced a free trade area. This would imply significant export gains for manufacturers and food exporters

Trade liberalization in context

44 African economies signed in March an ambitious treaty in order to form the African Continental Free Trade Area (AfCFTA). The goal is to eliminate tariffs on 90% of goods. The rationale behind more regional integration is to trade between equals and limit the share of vertical trade (exports of commodities and imports of capital). It should help ascend the value chain and increase the share of manufactured goods in African exports, since manufactured goods represent 43% of intra-African exports and less than 20% of African exports to other regions (75% is driven by commodities). The current predominance of commodity exports makes growth procyclical to commodity prices. Sizeable output volatility deters economic development.

More trade openness should imply some economies of scale, through the relocation of production activities in regional hubs, although with some limitations explained by remaining capital controls. One may easily infer some welfare gains for the consumer. However, such economies of scale will also imply some losers. The recent period of low commodity prices was abruptly felt by countries with fixed exchange rates, as they lost competitiveness after other currencies depreciated (like the Nigerian Naira or the Ghanaian Cedi). In economies with low labor productivity, the likely impact of lower import tariffs is worrying trade unions. It explains why Nigeria and South Africa did not sign the free trade agreement yet, since these organizations are directly involved in political parties in these countries.

A free trade area will increase intra-African exports

We expect African exports to increase by a wide margin, based on two different scenarios. The first one is without AfCFTA and is driven by current development trends and foreign investor appetite for Africa. After China, Turkey developed a strategic partnership with African economies, and India is about to do so. In this first scenario, African exports would grow but trade would remain quite vertical, as commodity exports would keep the lion share of total exports. Based on our country scenario (on nominal GDP growth, exports and exchange rates), we estimate that African exports of goods and services would increase by +7% per year and reach USD 1275bn by 2030. But, intra-African exports would stick with their 19% share of the total.

The second scenario adds an AfCFTA impact on exports. Continental exports would grow by about +8% per year and reach USD 1415bn by 2030. This scenario yields also to very different structures of trade. Intra-African exports would reach 27% of the total, about the current ASEAN intra-regional trade share. Under this second scenario, intra-African exports would grow by about +11% per year (+7% with the first scenario). Manufactured goods would also represent a higher share of total exports in this second scenario, jumping to 28% (USD 398bn) from 24% (USD 308bn) in the first scenario. It also means that the trade impact of an AfCFTA would be asymmetric. Manufactured goods and service exporters will make the bulk of additional export gains (South Africa, East Africa), while many oil exporters would not see key differences, as e.g. Nigeria, Algeria or Gabon. Additionally, food exporters will also be big winners (Ghana, Zambia, and Côte d'Ivoire), since current barriers to food exports are among the biggest barriers to trade in Africa.

Issues for implementation

Infrastructure development is among preconditions to a stronger intra-African trade. Export logistics are frequently organized in order to trade with other regions. Physical integration is increasing in East Africa, but is still in its infancy. Upgrading it would mean key infrastructure investment. E.g. Kenya would need USD 117bn investment in roads and railways (76.5% of its actual GDP) to close by 2030 its transportation infrastructure gap with Thailand. Moreover, this development would imply other basic needs (investment in the digital economy, water, sanitation, power). Power generation would make the bulk of it: USD 84bn (55% of actual Kenya GDP).

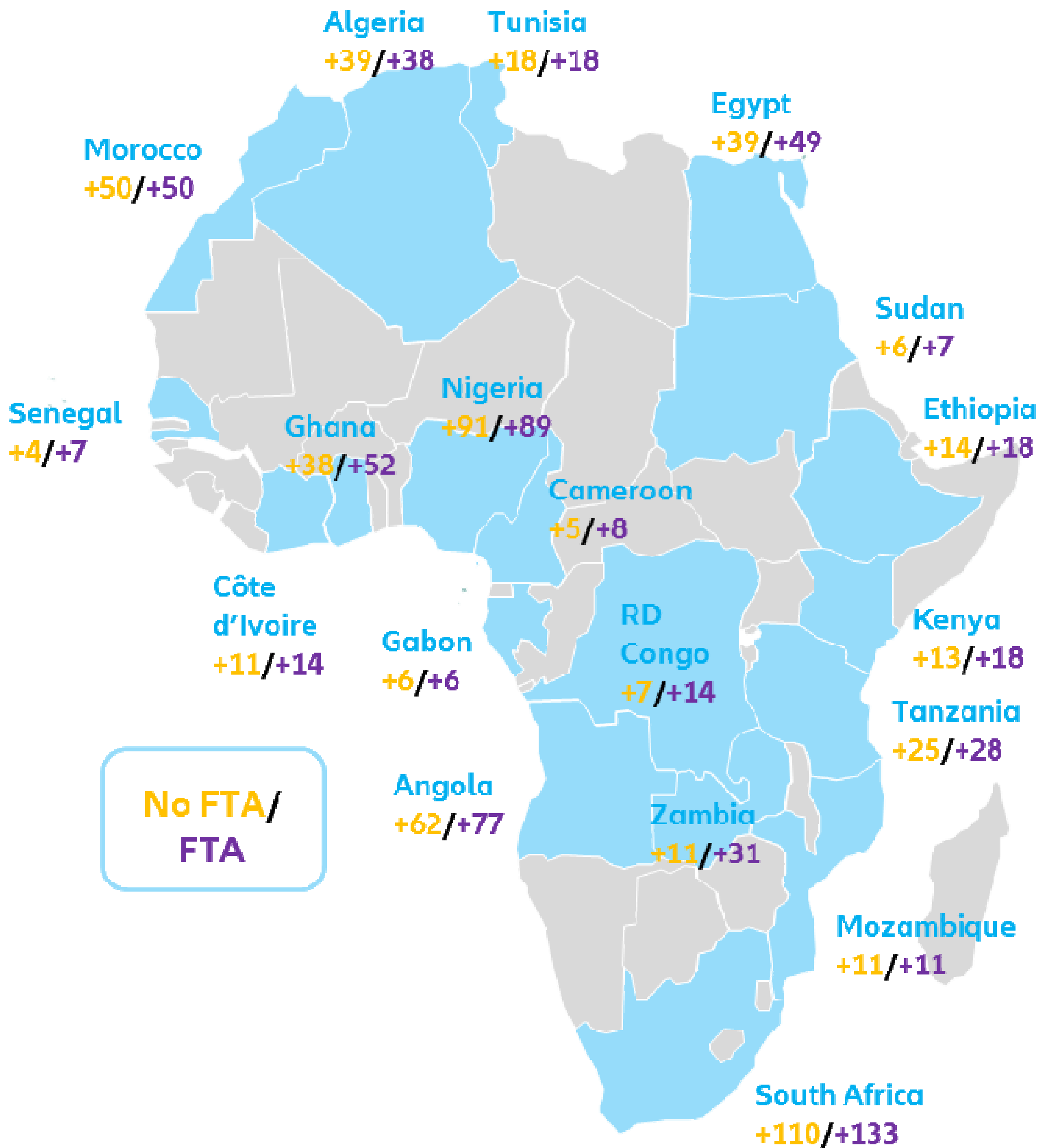
Attracting the right kind of financing would be another issue. Increasing foreign direct investment from the current USD 50bn would require many reforms since the current business climate is still detrimental, despite some progresses made. Fiscal revenues will also have to be increased in order to channel more funds to infrastructure financing. It means that new taxes will have to be raised (VAT, income tax) to replace old ones, as import tariffs currently represents 9% of fiscal revenues in Africa according to the UNCTAD.

Stéphane Colliac

Allianz

EULER HERMES

Chart 1: Additional exports of goods & services in 2030, compared to 2017 (USD billion)



Sources: Euler Hermes, Allianz Research