



The EC Communication on Trade, Growth and Development

– Comment

Oliver Morrissey

While the EC Communication reiterates worthy commitments, it is based on a somewhat optimistic view of how integration, investment and trade are related to promote economic growth. In this view, export opportunities (such as those provided by trade preferences) are realised and attract more investment which enhances productivity and further increases exports. Regional integration is beneficial as it provides more trade opportunities and regional efficiency gains, attracting more investment that generates more benefits. A virtual trade–investment–integration cycle emerges and growth follows.

However, there is very little evidence to support this view for countries in sub-Saharan Africa. Many such countries have posted good growth rates over the past decade; in most, this is attributable largely to a stable macroeconomic environment; in only a few (mostly those exporting mineral commodities to China) have exports played a major role. The majority continue to exhibit a structural weakness: they are over-reliant on primary commodity exports with too little local processing value-added and relatively small manufacturing sectors.

Trade preferences can be viewed as part of the problem. As EU preferences for sub-Saharan Africa are most pronounced for unprocessed commodities, they reinforce the structural deficiencies (and preference margins have steadily been eroded over time). Integration involving countries with productive structures geared to unprocessed exports generate limited intra-regional trade, and foreign investment is attracted into the same extractive sectors. Thus, features of integration, trade and investment have prevented the virtuous cycle. If future integration and investment are to help in breaking out of this cycle, the problems

of the past must be recognised by emphasising intra-regional trade and investment to generate linkages with domestic productive activities.

Although promoting regional integration is an objective of Economic Partnership Agreements (EPAs), relatively limited attention has been given to how the structure of agreements could support and facilitate regional integration. The introduction of reciprocity under an EPA may reduce intra-regional trade within sub-Saharan African regions, either directly if the elimination of the tariffs on European imports displaces existing regional suppliers or indirectly if imports from the EU displace domestic production and reduce regional production capacity and future prospects for intra-regional exporting. If the EU is to persist with the EPA strategy, it must recognise regional needs.

These threats to intra-regional trade can be offset in a number of ways. Sub-Saharan African regions will be tempted to draw up long lists of sensitive products for which tariff elimination on EU imports is postponed. If these are chosen to serve the protection interests of individual countries, they will undermine both the EPAs and the region's integration. If products traded within the region are deemed sensitive for EPAs, this may support regional integration. This could be underpinned if the EU provides 'aid for regional trade' and support for measures that enhance sub-Saharan African export capacity for both intra- and extra-regional trade. This support will be more effective if it is directed at products with the potential for intra-regional trade and local value-added productivity to encourage productivity and technology gains. In order for exporters to benefit from spillovers, they must increase processed exports; supporting this through EPAs will involve different types of preferences and more favourable rules of origin.

For example, although northern Ghana may not have

sufficient local production of tomatoes to support a canning factory, the region may have. Weak intra-regional transport and distribution infrastructure is recognised as a constraint throughout sub-Saharan Africa. There is a willingness to address this, but projects should be identified where there is the potential to encourage processing. This will mostly be in agri-processing but would then be consistent with existing intra-regional trade; the level of actual and potential cross-border trade should not be underestimated, even if it is under-recorded.

In addition to addressing the types of goods that are traded, there should be consideration of the sectors in which there is investment (and domestic is as important as foreign). The emphasis on investment in the Communication is largely that gains from integration are enhanced if appropriate measures are in place to encourage Foreign Direct Investment (FDI). FDI is likely to benefit sub-Saharan African countries only if it provides both linkages to and spillovers for domestic activities, both of which have been lacking in the region. Linkages can arise through employment, demand for inputs from local suppliers and supply of inputs to local producers; the linkages can then generate spillovers. Foreign firms may train workers and enhance their skills, but this benefits local firms only if workers move, and there is only limited labour mobility between firms in the region. Even if foreign firms supply/demand inputs to/from local producers, the linkage may not generate spillovers, because the foreign firm does not build a 'transfer relationship' with local firms or local firms have no capability to benefit from the know-how transfer. Domestic investment associated with clusters is more likely to generate spillovers. In general, FDI in manufacturing provides the strongest linkages and spillovers. The domestic manufacturing sector is quite small in sub-Saharan Africa, with little FDI in manufacturing, so actual linkages are few and spillovers are rare. Most FDI to the region is in the resource extraction sectors; this provides employment but few linkages to domestic firms and even fewer, if any, spillover opportunities. There will only be spillovers from FDI if the foreign firm or investor has technology and know-how that could be of use to local firms and is willing to transfer some of this. Arguably, sub-Saharan African countries need some mechanism to facilitate the transfer and utilisation of know-how by local firms to ensure effective spillovers. This suggests a role for government in promoting industrial policy.

A particular policy weakness evident in most sub-Saharan African countries is the absence of a coherent industrial policy that supports local firms in acquiring the capabilities to benefit from technology and know-how transfer. Similar deficiencies are evident in agriculture, where policies have failed to embed productivity and technology gains. These two deficiencies can be addressed through policies that focus on developing agri-business. Some countries have pockets of activity, such as cut flowers, horticulture and fruits, where foreign investors have had an impact. Too often, this is limited to providing information on foreign markets and paving the way for export activities, without also enhancing technology and productivity to ensure sustainable benefits. In the absence of such sector policies, countries have been unable to promote linkages from FDI, and have not supported an environment for spillovers to occur. Incorporating investment incentives into regional integration agreements may attract some additional FDI, but does not ensure linkages and spillovers to generate sustainable benefits. If the EU really wants to promote growth-enhancing trade in sub-Saharan Africa, it needs to support countries in devising appropriate sector policies conducive to productivity gains and intra-regional trade. Agri-business offers the best potential if there is coordinated support to increasing agricultural production and promoting cross-border trade to provide the supply of inputs for successful processing activities. The particular crops and regions will be country specific, but the principle applies broadly across the region.