Common Market for
Eastern and Southern Africa


# GLOBAL VALUE CHAIN AS A VEHICLE FOR **DEVELOPMENT IN AFRICA**

## Implication of COVID 19 in the Future of Global Value Chain

Special Report

**By Ibrahim A. Zeidy,**
Director, COMESA Monetary Institute

The objective of this paper is to present the prospects of the value chain for Africa's development. It presents the following in six sections: the benefits and costs of GVC for developing countries; the drivers of participation in GVC; the efforts by some African countries to get into the global value chain; the constraints for developing GVC in Africa; the implication of COVID 19 for the future of GVCs; the requirements for enhancing participation in the global value chain in Africa and ideas for action to enhance GVC in Africa.

# GLOBAL VALUE CHAIN AS A VEHICLE FOR **DEVELOPMENT IN AFRICA**

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## Introduction

Global value chains (GVCs) have become a dominant feature of world trade and investment, encompassing developing, emerging, and developed economies starting in the 1980s. The process of producing goods, from raw materials to finished products, is increasingly fragmented and carried out wherever the necessary skills and materials are available at competitive cost and quality.

Companies, both large and small, can participate in GVCs by engaging in one of the many types of activities performed in a coordinated fashion across several countries to bring a product from conception to end-use. These activities might include farming, extraction of natural resources, research and development, different types of manufacturing, design, management, marketing, distribution, post-sale services, and many others. Participating in GVCs does not necessarily mean directly trading goods or services across borders, but rather is linked to such activities through the process of value creation. Depending on the type of product and geographical location of different activities, some value chains will be regional, while others will have a truly global nature.

Countries in Asia and Latin America which were tightly integrated into global value chains (GVCs) have reaped significant benefits in terms of productivity improvements, job creation, and poverty reduction. Countries in Africa that had weak links into GVCs or were mostly operating at the lower end of the value chain providing primary raw materials have not benefited as much from this trade-led growth.

Regional Organisations in Africa are beginning to take initiatives on industrialization. For example, The Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC), and Southern Africa Development Community (SADC) have industrialization strategies, independently and as part of their Joint Tripartite Free Trade Area arrangement. The 26 member countries of the Tripartite Arrangement seek to strengthen co-ordination in industrial policy. This includes developing and upgrading Regional Value Chains (RVCs), which would enhance production capacity and competitiveness.

The African Continental Free Trade Area (AfCFTA) also offers a tremendous opportunity to integrate Africa's firms into the global supply chains and create new ones for the region. Well-developed regional

and global value chains in Africa are important for the economic gains from the production of industrial and consumer products. They are also crucial for the long-term sustainability of social sector programs in health, nutrition, and education which depend on medicines, health products, food and books.
The objective of this paper is to present the prospects of the value chain for Africa's development. This paper presents the following in six sections: the benefits and costs of GVC for developing countries; the drivers of participation in GVC; the efforts by some African countries to get into the global value chain; the constraints for developing GVC in Africa; the implication of COVID 19 for the future of GVCs; the requirements for enhancing participation in the global value chain in Africa and ideas for action to enhance GVC in Africa.

## 1. Benefits and Costs of Global Value Chains

### i. Benefits

A potential benefit of GVC is that developing countries no longer need to create entire industries to industrialize and be competitive in world markets. Instead, firms in developing countries can provide specific skills or products to GVCs. Further, it is possible for low-wage countries to produce or at least produce high-quality manufactured goods. Through participation in GVCs, and the exposure to international markets and foreign competitors, the potential for technology transfer and spillover effects arises. Such effects can take several forms, for example by providing access to best practice management and business methods. This can be achieved through use of high quality and high-tech intermediates; developed country intellectual property and trademark; lead-firm knowledge and technology-sharing; skills demand and upgrading, and through learning from customers. Such effects can impact upon local firms not engaged in GVCs as well as those that are involved.

Another obvious efficiency gain for Sub-Saharan Africa is that regional value chains are built on comparative and competitive advantages offered by two or more countries in an agro-ecological zone. This results in economies of scale in the provision of support services and infrastructure required for connecting domestic private sector service providers to regional and global supply chains. it improves not only the competitiveness of national economies but also regional logistics strategies and trade arrangements.

### ii. Cost

While potentially offering new and more rapid opportunities to develop, a concern for developing countries that become integrated into GVCs is that they become trapped in low value-added segments, where there is little possibility for innovation or technology transfer. As such, an important question that needs to be addressed is whether countries can upgrade within GVCs, which is usually taken to mean that countries – or firms within countries – can gain competitiveness in higher value-added processes and raise domestic labour productivity and skills. A further aspect related to relevant upgrading is whether GVC participation benefits the domestic society as a whole, through increased employment and wages, better living conditions, and economic security.

The other cost is the creation or over-reliance on external investors, foreign technology, and capacity which are key for the expansion of global value chains.

## 2. Drivers of Participation in GVC[1]

Global value chain (GVC) participation is determined by fundamentals such as factor endowments, market size, geography, and institutional quality, but these fundamentals need not dictate destiny. Choosing the right policies can shape each one of these fundamentals and thus GVC participation.

### (i) Factor endowments

Low-skilled labor and foreign capital are central to backward participation in GVCs at the early stages. An abundance of natural resources drives GVC integration forward. Foreign capital, whether efficiency-seeking or resource-seeking, can enhance host country integration in GVCs.

### (ii) Market size

Small countries are more dependent on imported inputs and foreign markets. Trade liberalization can expand the effective market size and promote participation in GVCs.

### (iii) Geography

Overcoming remoteness by improving connectivity can promote GVC participation. Trade in parts and

1 *World Bank Group: 2020 World Development Report, "Trading for Development, in the Age of Global Value chain" pp63-77,*

components within international production networks is highly sensitive to logistics performance and uncertainty in bilateral international transport times.

### (iv) Institutional quality

Regional Integration can enhance institutional quality and increase GVC participation. Deep regional integration covers legal and regulatory frameworks, harmonize customs procedures, and set rules on intellectual property, among others.

## 3. Efforts by some African Countries to get into the Global Value Chain

Although African countries are trying to revive national and regional level industrialization through value chains, this is characterized by the dominance of agricultural and raw materials. Cocoa, rice, cassava, pineapples, peanuts, and cotton are all dynamic products that have created value chains in Africa. The activities are smallholder based and labour intensive. Upgraded technology is however needed.

Success stories abound in many parts of Africa. For example, North and Sub-Saharan Africa have managed to join GVCs in the apparel, food, and automotive industries and in some business services. But Africa remains a small actor in the global economy, accounting for just three percent of global trade in intermediate goods. African exports tend to enter at the very beginning of GVCs. A high share serves as inputs for other countries' exports, reflecting the still-predominant role of agriculture and natural resources in African exports. Botswana, the Democratic Republic of Congo, and Nigeria have become integrated into GVCs through exports of oil and other natural resources. But Ethiopia, Kenya, and Tanzania have seen faster GVC integration, sourcing foreign inputs for their export-oriented businesses. Most of their integration has occurred in agribusiness and apparel (especially in Ethiopia and Kenya), in manufacturing (in Tanzania), and to a lesser extent, in transport and tourism. Morocco's efforts to attract major manufacturers in the automotive industries over the past decade are paying off. A new Peugeot facility opened in 2019, following in the footsteps of another French automaker, Renault- Nissan. Overall, GVC participation in some of these Sub-Saharan countries (Ethiopia, Kenya, South Africa, and Tanzania) grew by 10 percentage points or more, approaching what Poland or Vietnam—now success stories—

experienced in the late 1990s and 2000s.[2]

At a regional level, a study by UNCTAD identifies three trade blocs in Africa that have the potential for forming Regional Value Chains (RVCs) in Leather. These are COMESA, ECOWAS and Southern Africa Customs Union (SACU). These three trade blocs together contribute around 98 percent of exports and 99 percent of Sub Sahara Africa (SSA's) imports of leather and leather products. It comprises 40 countries (out of a total of 48 countries in SSA). Using these three trade blocs, the study identifies potential RVCs that can be formed in leather and leather products (LLP).[3]

To enhance RVCs in leather COMESA Secretariat, working in partnership with the International Trade Centre (ITC), has developed a Strategy for the leather sector whose main objective is to transform the sector from the production and marketing of raw materials to value-added products. This is a result-oriented strategy, which should inform the industrialization agenda of the leather sector in COMESA for the foreseeable future.[4]

African countries have responded to GVCs, mainly through regional communities that are meant to facilitate the structural reforms and manage the economic and trade liberalization required to open up to the globalized world. In this regard, It is worth noting that the 26 member countries of COMESA, the EAC, and SADC under the Tripartite arrangement are seeking to strengthen co-ordination in industrial policy. This includes developing and upgrading regional value chains. The African Continental Free Trade Area (AfCFTA) is also a great enabler to achieve this.

The 15 member ECOWAS group cuts across West African countries with English, French and Portuguese speaking backgrounds having similar programmes. Regional mobilization could create sizeable markets and innovative policies needed to strengthen indigenous smallholder activities that could grow into the medium-sized enterprises to fill the gap between multinational corporations and smallholder enterprises. Regional communities may need to develop regional and global value chains at the same time. As they deepen their capacities for global chains, the regional versions can create

*2 World Bank Group: 2020 World Development Report, "Trading for Development, in the Age of Global Value chain" pp63-77,*
*3 UNCTAD "Identifying Regional Value chains in Leather and Leather products in Africa", 2017, p11*
*4 ITC, COMESA, ALLPI "COMESA Regional Strategy for Leather Value Chain (Medium Term 2012-2016, June 2011.*

complementarities and benefits for member countries in terms of local sourcing, productivity, capacity growth, economies of scale, dismantling of monopolies, and the reduction of external shocks associated with global chains. In particular, after the implementation of the AfCFTA, the African market offers a great hitherto unexploited potential for the development of intra-regional value chains.

## 4. Constraints for the Development of GVC in Africa

Even though Africa continues to receive investment in agriculture-based value chains, the continent's contribution to the global value chains is minimal. Some of the key constraints are:

i. Lack of reliable planning of value chain activities. There is no clear link with innovative policies and regulatory development to allow the continent to scale up value chains,

ii. Remoteness, and size,

iii. High costs of logistics between countries constitute one of the biggest barriers to firms in Africa in finding space in global value chains or upgrading their place in the value chain,

iv. Formal and informal logistics industry protectionist schemes, poor access to capital, and other forms of entry barriers prevent more efficient firms from entering the logistics market. In most countries, there are many transport service providers and market entry for new players is expensive and prohibitive. As a result, the incumbents face little pressure to enhance their efficiency,

v. Weak infrastructure,

vi. Low entrepreneurial base,

vii. Ideally, activities in the value chain are distributed in different countries driven by economies of scale, specialization, cost, and availability of labor and capital. While there has been considerable research on factors of comparative advantage that drive a firm's choice to locate a certain stage of production in one country vs another, there is limited contextual and empirical understanding of this for Africa. Technical analysis of regional value chain formation drivers and study of RVC governance approaches will help regional and global development banks to structure investments and policy reforms targeted towards the development of specific RVCs,

viii. Difficulties in developing the knowledge economy have also hindered attracting investment for global value chains in the higher value stages of manufacturing or services,

ix. Unlike the East Asian countries that have higher shares of regional value chains – such as Japan investing in Chinese Taipei, Malaysia, Singapore, Thailand in the early 1980s – Africa does not have robust clusters to foster regional value chains,

x. Lack of tools to communicate and translate the market intelligence to market participants such as farmers and processors etc.

xi. Poor quality control mechanisms; and

xii Wrong price incentives, incorrect quality standards.

## 5. The Implications of COVID 19 for the Future of GVCs in Africa

The following are the key implications of COVID 19 for the future of GVC in developing countries.[5] Increasing the calls for a national re-examination of established economic models, in particular to the international production of goods. In some developed countries, leading government politicians have called for a rethinking of their companies' approaches to international outsourcing of production, to avoid future supply bottlenecks while increasing the resilience of supply chains. For example, the French Minister of Economy and Finance has called for EU governments to rethink their approach to value chains to assure "sovereign" and "independent" supplies. In the meantime, this view has gained further traction among some of the other high-level policymakers and commentators.

*5 Industrial Analytics Platform, Adnan Seric, Holger Gorg, Saskia Mosle and Michael Windisch " Managing COVID 19: How the Pandemic Disrupts global Value Chain" Iap-unido.org/article/manging-covid-19-how-pandemic-disrupts-gobal-value-chain, 17th April 2020*

These calls for “sovereign” or “national” supply chains suggest that companies ought to re-think the spread of production across the globe. In the past, outsourcing was in many cases driven by multinational firms’ desire to optimize their operations by minimizing costs. If anything, COVID-19 shows that it may perhaps be too simplistic to base decisions about production locations solely on such easily observable economic factors. Many companies may not fully appreciate their vulnerability to global shocks through their supply chain relationships and the costs this imposes. This may no doubt be reflected in companies’ future risk assessments before they decide to relocate production or when they re-consider their location choices.

A substantive nationalization or regionalization of supply chains, however, has the risk to further reduce the diversification of suppliers in the world economy and reduces opportunities for developing and emerging economies, especially those outside Southeast Asia, to benefit from GVC-associated capital flows and access to international markets, human capital and knowledge. Such a development will almost certainly deal a significant blow to developing countries’ industrialization efforts and impede the socio-economic progress that has been recorded in many developing regions over the past years. The disruption of GVCs due to COVID-19 may, therefore, leave a longer-term legacy: a significant reduction in developing countries’ potential to industrialize through linkages into GVCs for many years to come. The COVID-19 pandemic calls for increasing our effort towards strengthening multilateral approaches to policymaking and assisting countries in opening up other ways to enable inclusive and sustainable industrial development.

## 6. Requirements for Enhancing Participation in Global Value Chain in Africa

The following are key requirements:[6]

i. Sufficient infrastructure and adequate logistics capacity are essential to participating in GVC and attracting lead firms;

ii. Enhancing regional integration and increasing openness to trade;

iii. Increasing capacity to respond to the global value chain. This requires skills, productive

6 *AfDB, OECD, UNDP “African Economic Outlook, 2014, PP185-195*

capacity, and entrepreneurs. Given the rising complexity and competition in global supply network multinational enterprises increasingly choose locations based on the presence of skilled labour force.

iv. GVC participation and upgrading require partnerships with international lead firms. African countries must attract them to invest and build linkages with local firms.

v. To ensure inclusiveness and sustainability, global value chain policies must be based on a strong social and environmental framework, which includes, improving access to jobs, increasing training and mentorship opportunities, offering supportive services such as child care, social services and environmental safeguards to reduce the potential negative impacts of GVC participation. Beyond necessity, going social and going green offers the African countries with opportunities to diversify as consumers increasingly value socially and environmentally certified products.

## 7. Ideas for Action to Enhance GVC in Africa

The following are some ideas for action by global and regional development agencies to enhance GVC:[7]

i. Introducing new digital technologies have the potential to lower logistics and coordination costs and bring in new forms of competition to the logistics industry. Some have already started operating in sub-Saharan Africa, even though at a relatively small scale. Priority lending windows by development finance institutions to firms which can reduce logistics costs and strengthen regional value chains will help invigorate the ecosystem for RVC development.

ii. Generating robust and up-to-date market information: Firms decide where to locate intermediate good and finished product factories and how to organize the interfaces along the global supply chain based on demand projections for the different markets, labor and transportation costs, human capital, and production economics. Managers of global firms

7 *Prashant Yadav and W. Gyunde Moore" Development: Gloomy Global Trends, Optimism in Africa and Some Ideas for Action, cgdev.org/blog/ valu-chain-vehicles-development-gloomy-global-trends-optimism-africa-and some ideas –for-action, October 11, 2019*

(and high productivity regional firms) depend on granular, high-frequency data to make such decisions. Over time, specialized for-profit entities may emerge to provide such information services for firms across the regional value chains. In the interim, it is worth exploring if such entities can be incubated/accelerated using social impact/development capital.

iii. Rigorous research to guide global and regional policy dimensions: Technical analysis of regional value chain formation drivers and study of RVC governance approaches will help regional and global development banks to structure investments and policy reforms targeted towards the development of specific RVCs.

iv. Integrating firms in Africa at higher levels into global value chains and helping to create a strong regional value chain is a huge opportunity for economic growth, poverty reduction, and social sector sustainability. But realizing this vision will require early investments in a few areas by global and regional development banks. Coordination across 54 countries on a variety of policy issues is never easy. Reconciling national development priorities with regional objectives has sometimes proven to be difficult. The AfCFTA has strong political momentum and provides a clear window of opportunity to improve regional value chains and better integration in global value chains. World Bank World Development Report (WDR2020) is a timely reminder that we need to act promptly to integrate countries in Africa into the global economy, more strongly and equitably, before this opportunity passes.

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