

IGC Panel 1: Using Trade to Promote Firm Productivity and Growth

On 15 December, the IGC hosted a panel on “Using Trade to Promote Firm Productivity and Growth.” Richard Newfarmer (the IGC’s Country Director for Rwanda, Uganda, and South Sudan) facilitated the panel, with Bernard Hoekman and Garth Frazer presenting recent research findings on the role of services as an input into manufacturing and on Rwanda’s international trade after the introduction of the Common External Tariff (CET), respectively, and Patrick Lowe leading a discussion of the policy implications of these research findings.

Hoekman’s research on the role that services play as an input into, and a determinant of, manufacturing reveals a strong (statistically significant) relationship between services productivity and downstream manufacturing productivity, with this relationship being stronger among manufacturing firms that rely more heavily on services inputs. Therefore, services matter for firm productivity and competitiveness. The strength of the relationship between productivity in services and manufacturing in East African countries was found to be comparable to the global average. Hoekman also found that some sectors experience higher barriers to trade than others, with professional and transportation services being particularly restricted. Importantly, Hoekman’s findings show that reducing services trade restrictiveness improves a country’s export performance only if there is good governance in the country in question.

Frazer’s research examined the effect that the establishment of the Common External Tariff (CET) has had on Rwanda’s international trade. The CET eliminated tariffs on trade within the East African Community (EAC) and set a common tariff on goods imported from non-EAC countries. Frazer found that the CET relative to Rwanda’s higher tariff before joining the EAC, and reduced the costs of local production and increased Rwanda’s exports, although exports remain concentrated in coffee, tea, and minerals, and diversification into more labour intensive sectors, such as manufacturing, is still needed. The research showed that the bulk of exporting firms are large and experienced exporters, and that the export gains achieved from the lower tariffs under the CET came solely from firms that do at least some importing of goods and/or services.

While there has been considerable improvement in reducing non-trade barriers along the Northern Corridor route within the EAC, Frazer’s research determined that high transportation costs remain a key challenge for landlocked Rwanda, with it costing about USD 4000 to ship a single container from Kigali to either Dar es Salaam or Mombasa (and vice versa). Rwandan firms’ ability to import goods is also restricted by only one firm doing pre-shipment inspection and verification of containers destined for Rwanda, with this lack of competition allowing for considerably inefficiency in the process. While trade costs remain so high for Rwanda, imports and exports to and from Rwandan firms will remain constrained.

Lowe, in discussing Hoekman and Frazer’s research findings, noted that there is a lot of outsourcing with services that has not been captured in the research, and that unbundling is necessary to better understand this. Information was also not provided from the studies on other important aspects, such as the impact of policy inconsistency, factor market problems (e.g. conditions for investment and work permits), and ineffective policy implementation on reducing productivity. Newfarmer added that IGC research has shown that another drain on productivity and competitiveness in Rwanda is the ability of larger firms to price products and services in such a manner as to shut competitors out of the market, and that these dynamics need to be taken into account in research.

IGC Panel 2: Harnessing Manufacturing to Africa's Trade and Growth: From Lagging to Leading Sector

On 16 December, the IGC hosted a panel on "Harnessing Manufacturing to Africa's Trade and Growth: From Lagging to Leading Sector." Richard Newfarmer (the IGC's Country Director for Rwanda, Uganda, and South Sudan) facilitated the panel, with John Page (the IGC's Country Director for Tanzania) speaking on the Learning to Compete Initiative, and Jaime de Melo presenting recent research findings on industrial and structural transformation in sub-Saharan Africa. Dr. Stephen Karingi of the UN's Economic Commission for Africa (UNECA) discussed Page and de Melo's findings and elaborated on the policy significance of such findings.

The Learning to Compete Initiative is funded by the Brookings Institute, the African Development Bank and UNU-WIDER, and was launched to examine why there is so little industry in Africa. Page noted that today, the value addition in manufacturing comprises, on average, 10 percent of the GDP of African countries, which is the same as it was in 1972. In 2015, the manufacturing output for African countries was about half that of the developing world average, while Africa's per capita manufacturing output was a mere 10 percent of the developing world average. It is evident that Africa has too little industry and, consequently, has a lowered GDP and is missing out on the potential of industry to employ and skill people, which is vital in Africa's context where only one fifth of people are employed in the formal sector.

The project studied firm-level business knowledge in five countries (three Asian countries and two African countries) and explored what determined firms' location decisions and productivity. It found that competition in exports tend to be drivers of productivity and that 'learning by exporting' adds additional benefit to exporting firms. The study showed that while firms within a specific sector in Asia tended to cluster together in order to agglomerate exports and capabilities, this was not seen in Africa, which partly explains the divergence in Asia and Africa's industrial growth. Page noted that the study found that more productive firms opted into exporting, as they were more competitive and, also, that firms that exported raised their productivity more than firms that did not export, through 'learning by exporting', with larger firms learning more from this than smaller firms.

The study furnished some surprising results, including that African exporters are born global (i.e. that they start out exporting rather than serving the domestic market), and that very few firms switch from serving domestic markets to exporting, or vice versa. Exporting activity was also seen to be very persistent as firms that do export tend to do so year after year. Page noted that there is a 'missing middle' in African manufacturing where there is a lack of competent firms in the range of 50 to 70 employees, possibly due to inadequate managerial and supervisory capabilities in small firms that hinders their growth into larger firms. This 'missing middle' in Africa's manufacturing sector is a notable problem as it is firms with 50 to 70 employees that tend to be the most dynamic in Asian countries. They also found very little interaction between local firms in African countries compared to the strong firm networks seen in Asian economies.

Importantly, Page noted that he and his fellow researchers believe that it is realistic to think that Africa could break into the manufacturing sector globally, as changes in China's economy result in offloading of low wage activities to African countries, or less developed Asian countries, such as Myanmar. Since much trade today is in tasks, rather than in finished goods, this gives Africa an opportunity to get more involved in the sector globally. Page stated that while good business environments are necessary, they are not sufficient to push industrialisation forward in Africa – rather, political support and a strong push towards greater industrialisation is needed. Given that Africa has more landlocked countries than any other continent, regional integration is of crucial

importance, and cooperation between governments at the highest levels is necessary to make this happen. It would also be hugely beneficial if African economies are able to achieve agglomeration through developing clustered industry sectors to enable economies of scale and improved availability of specialised skills.

De Melo's research compared growth in resource-rich and resource-poor countries, and found that growth is low in resource-poor countries, but that having resources only helps growth in resource-rich countries to an extent. He found that resource-rich countries in Africa are less diversified per capita than resource-poor countries, which tend to be of comparable diversification to other countries. It was also seen that as distortions in markets decline, growth improves, and that although export surges (largely from natural resources) have ratchet effects on real exchange rate depreciation, it's possible to overcome the anti-competitive effects of such export surges on manufacturing and other industry sectors. The study found that, in sub-Saharan Africa, industrialisation is poverty-reducing mainly in countries with high initial poverty rates, where labour has not yet shifted to higher productivity sectors. The lack of employment creation in manufacturing in Africa can be explained by Africa's high labour costs, which are higher than those of countries at comparable GDP levels.

In Dr. Stephen Karingi's discussion of Page and de Melo's studies, he gave a different perspective on where Africa is as a continent. He noted that we need to take manufacturing sector development seriously because of the dire need for jobs in Africa and the ability of the manufacturing sector to create many jobs. By 2030, Africa's working age population is going to increase by about percent (to some 793 million people), and by 2035, Africa's labour force will be the largest in the world, larger even than India and China. However, Africa's labour force will be more educated and healthier than the populations of India and China, and this gives Africa a noteworthy opportunity to succeed.

Indeed, if you exclude North Africa from the equation, labour participation rates in Africa are higher than the global average (according to ILO data). However, formal employment rates are relatively low, and the real wage growth and productivity of Africa's labour force is also comparatively low. Africa has high employment vulnerability, with 80 percent of those employed working in vulnerable employment situations, and women being disproportionately affected by employment vulnerability. Further, an estimated 76.6 percent of Africans work in the informal sector, where they are mostly self-employed with very volatile incomes – this figure is high compared to the global average of 45.3 percent.

Karingi noted that Page and de Melo's work touched on explanations for this, namely the lack of structural transformation and little movement of labour from low productivity labour in the agricultural sector to more productive labour in manufacturing. Indeed, there is evidence of labour having moved from higher to lower productivity employment, such as from agriculture to services (services in Africa tend to be low-tech and unproductive). Labour costs in Africa are, in fact, nearly 80 percent higher than in other developing countries, due to low labour productivity rather than nominality of wages.

While most people are employed in agriculture, the sector is more vulnerable (at 88 percent) than the manufacturing sector (at 50 percent) – reducing employment vulnerability is another reason to increase the share of manufacturing in African economies. Also, large informal sectors make it difficult to reduce poverty, even when economy is growing. Although poverty is falling in Africa, it's not falling as much as we would have expected during a decade where Africa saw good economic growth.

Looking forward, Karingi identified the following key points: first, we need to focus on vertical, targeted policy interventions; second, we need to look at how we can use strategic policies to industrialise through trade; third, the greening of industrialisation offers Africa an opportunity to leap-frog other regions in the manufacturing sector by using renewable energy; fourthly, it is necessary to improve the economic market space by furthering free trade efforts in Africa; and, finally, Africa needs to effectively use donor aid to fund development and make it possible to raise greater domestic revenues.