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Economic Development In Africa: Salient Trends and Priorities

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Abstract

Economic growth of African countries accelerated since the 2000s, and caught up with that of other developing regions. Rising prices of commodities, particularly minerals and metals as well as fuels, which comprise a large part of Africa's exports, had an important influence on this positive picture. However, as growth fades in China which was instrumental in stimulating demand and pushing up the commodity prices, Africa's economy will be negatively affected. A majority of Africa's international trade is with developing countries. African countries must reduce dependence on commodities and search for alternative development paths. This is a return to the pre-2000s, when commodity prices were considerably lower. Diversification, improving productivity and the quality of African products, as well as more effective participation in global value chains appear as the policy objectives to follow. Given the low levels of income, foreign direct investment can be instrumental in African development. Foreign direct investment has been mostly flowing into natural resources but intra-

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African investment favours manufactures and services. These sectors are closely related to the demands of the rising middle class. The allocation of natural resource rents to productive investments is also important. Better governance would help in this respect as well as in stimulating foreign direct investment. Education is an important component of all development policies.

Keywords: *Africa, economic development, commodities, natural resources, diversification, foreign direct investment, global value chains*

INTRODUCTION

Although it is often done, generalizing and talking about the development of Africa, or even of Sub-Saharan Africa (SSA), as if it were a homogeneous group of countries is very difficult, if not impossible. Some are large and some are small; some are coastal and others are landlocked. There are numerous countries whose economies depend on minerals or other natural resources for the generation of income, employment and foreign exchange. Across the continent, there are peoples with different socio-economic, political, and institutional histories, and all of them hold particular aspirations for the future. While cognizant of this complication, this paper attempts to identify a few common threads that are currently relevant for a significant group of SSA countries, particularly as they strive to participate effectively in the modern globalized world and draw from current economic realities to benefit their development.

In spite of the potential instructive value of individual success stories and stories of failure, this paper refrains from providing specific country examples. They can be found in some of the references provided below. The focus is on a few interrelated meso-level issues, which need to be tackled with priority from the point of view of attaining sustained and sustainable development for a significant number of African, and particularly SSA, countries. These reflect global and regional realities in the second decade of the 21st century, when a period of relatively rapid global and regional growth spearheaded by China is ending. Among these issues, dependence on commodities (particularly minerals) and the consequent necessity of diversification has a long history, as does the need to attract investment funds and the constraints on doing so. These reflect some policy and institutional failures as well as resource endowments in these countries. They can be addressed to a limited extent by domestic measures in African countries. Another important issue that affects African development is the proliferation of global value chains (GVCs) and the prerequisites for effective participation in them. This is a relatively recent change in the fundamentals of international economic relations and remains outside the control of African countries. The impact on SSA of China's growth performance, which is currently slowing down, is an underlying theme that is also of relatively recent origin and outside the control of African countries. The best that African countries can do in the case of these new realities is to focus on how to adjust to them. The interrelated nature of all of these issues and the fact that they are by no means exhaustive cannot be overemphasized.

The basic argument of this paper is that African countries need to (a) either obtain more retained value added out of their commodity sectors or diversify (but preferably do both), and (b) prepare themselves for a situation where Chinese demand for commodities will not be as powerful an engine of growth as it was before. In this process, attracting funds for investment in physical and institutional infrastructure as well as human capital is a requirement, and effective participation in GVCs is a necessity for structural transformation. Due to lack of time and space, this paper and the presentation upon which it is based do not discuss the services sector, though it is crucial for development.

AFRICA'S DEPENDENCE ON COMMODITIES

It is important to establish the place that commodities occupy in African economies, because it is on this basis that the development process, including diversification into more productive activities (whether commodity-based or otherwise), needs to be built.

By commodities, we mean agriculture, mining, fisheries, and forestry, including simple processing activities in these sectors. The share of commodity sectors in GDP and in export earnings is a significant indicator of dependence on commodities and where the domestic potential lies for the generation of savings and foreign exchange. Additionally, employment generation is a crucial indicator of a sector’s importance in an economy. In this respect, agriculture, particularly small-scale agriculture, plays a significant positive role. Mining, however, often exhibits an enclave nature. It is not generally a labour

intensive activity, and the number of people working in the mining sector underestimates its macro-level importance for the country. In fact, from an employment perspective, using the savings generated by the mining sector for developing labour intensive and high productivity activities is a fundamental goal to be pursued.

In general, African countries are more dependent than developing countries in other regions on agriculture and natural resource based activities for employment, income, and foreign exchange generation. Table 1 compares African countries with other developing countries in general in terms of the share of agriculture, mining, construction, and utilities in GDP.[2] While dependence on agriculture is a common trait for many developing countries in all regions of the world, the portion of GDP provided by the mineral sector and utilities generally larger for African countries than for other developing countries. In spite of considerable differences among individual countries, Africa is by far the most commodity-dependent and least industrialized region of the world in terms of the share of agriculture, mining, forestry, and utilities in GDP. Only developing Oceania, a region dominated by small island states, is slightly less industrialized than Africa, and only Western Asia, dominated by major oil exporters, has a higher proportion of mining and utilities in its GDP than Africa. Therefore, any fluctuation in the demand for the products of the mining sector (including fuels)

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[2] *This information has been extracted from UNCTAD, http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx , accessed 25 August 2015. Agriculture is ISIC Rev.3, divisions 01-05; manufacturing is ISIC Rev.3, divisions 15-37, the group mining, and utilities is ISIC Rev. 3, divisions 10-14 and 38-44. Construction is ISIC Rev. 3, division 45 and Services is ISIC Rev.3 divisions 50-99.*

emanating from the world economic situation has greater incidence in Africa than in most other regions.

Table 1. GDP by main sectors (percent of GDP)

2013			2010			2000			1995			
Middle Africa	Africa	Developing	Middle Africa	Africa	Developing	Middle Africa	Africa	Developing economies	Middle Africa	Africa	Developing economies	
11,7	16,1	9,2	12,8	15,8	9,4	15,2	15	10	28,3	16,7	11,7	Agriculture, hunting, forestry, fishing
7,9	10,1	20,4	8,2	10,4	21,2	9	13,2	15,4	9,6	14,5	17,1	Manufacturing
44,6	18,3	11,6	42,7	19	11,3	41,4	16,1	15,5	23,7	12,3	12	Mining and utilities
6,4	5,5	6,4	6,2	5,3	6,3	2,5	4,3	5,5	3,1	4,3	6	Construction
29,4	49,9	52,5	30,1	49,6	51,9	31,9	51,4	53,6	35,4	52,2	53,3	Services

Calculated from UNCTAD, UNCTADStats http://unctadstat.unctad.org, accessed 25 August 2015.

The importance of natural resources for African countries can also be observed from a different point of view, namely the share of total natural resource rents as a proportion of GDP. Total natural resource rents, calculated as the sum of oil, natural gas, coal, mineral, and forest rents but excluding some mineral resources such as diamonds, uranium, and lithium,.[3] as a proportion of GDP are the highest for the Middle East and North Africa, which is dominated by oil and gas, but SSA follows close behind. One of the particular characteristics of natural resource rents (and not only mineral rents) is that they are not really the outcome of free market forces but are normally negotiated between the buyers and those owning or extracting the resources. In most cases, the owners are national governments, and so the level of these appropriated rents (including through concessions and taxation) and their domestic distribution and eventual use are subject to governmental decisions. Transparency, democratic legitimacy, and accountability are crucial in these respects. From 1990 to 2000 and 2010, natural resource rents as per cent of GDP have risen, respectively, from 13.0 to 13.5 and 17.7 in 44 SSA countries for which data are available. The corresponding percentages for 130 other countries are 7.3, 8.0, and 7.9 (Lee & Gueye, p. 6). This proportional increase is the result of the expansion of natural

[3] This is because information about reserves and the costs of production is not generally available for these minerals. As a result, rents are underestimated, and this omission can be significant.

resource exploitation as well as favourable prices. Thus, many economies (and governments) have generated considerable earnings through these activities. In many cases, mining investments and activities have dominated economies.

Diversification

Given this dependence on commodities and coupled with the traditional problems associated with the commodities sector – such as fluctuating prices, low productivity and the dominance of large firms in uncompetitive markets, as well as stagnant demand (contradicted at least temporarily by the expansion of Chinese demand) – diversification is an attractive policy objective for African countries. Nevertheless, even if constraints such as lack of skills and investable funds or market access and entry problems may be overcome and a supportive economic and institutional environment may be provided, diversification is fraught with difficulties. Provision of information to businesses is particularly important for encouraging initial entrepreneurs to undertake the necessary risks associated with developing and producing new products, entering (or creating) new markets, and embarking upon a discovery process. Therefore, temporary incentives and support practices (including financial), which were all amply used in the past, may be necessary (Rodrik, 2005).

What is important from the point of view of diversification is not only the production of items that were not produced and exported before but also the creation of 'better' products – those that create a higher

proportion of value added in the country and generate forward and backward linkages and positive externalities. Improving the quality of the product, differentiating the product so that it earns a premium, and supplying more of the associated services domestically are all different components of reducing the negative aspects of dependency on commodities (Arda, 2014, p. 197). One of the most obvious but difficult ways to add value to commodities is to differentiate one's product from the competitor's and display a real or perceived superiority of one's product. Though this is difficult, trademarks make it possible on a firm basis. Differentiation can also be envisaged by origin, but just like a trademark, success in this area calls for a strong, difficult, and possibly expensive marketing effort. Differentiation through fair trade or organic certification may be potentially more promising, as it requires less marketing skill, because certification largely takes care of that. 'Fair trade' certification is another means for differentiation and the retention of a higher value added. Seventeen agricultural products along with gold, all of which are among the commodities produced and exported by African countries, are subject to Fair Trade certification (Arda, 2014, p. 221).

Meeting the quality standards and other exigencies of buyers has become, arguably, the most important barrier to entering markets for African countries. Even when market 'access' is assured in terms of overcoming governmental trade barriers and exigencies, such as those implemented within the SPS agreement, private standards may prevent successful market 'entry'.

Diversification within the commodity sector, be it horizontal or vertical, may increase the apparent importance of commodities in the economy, but if it means moving away from low-value items with declining demand, it cannot be construed as perpetuating commodity dependence. It can cover the more positive aspects of manufacturing, such as the benefits attributable to better stability, stronger linkages, spillover effects, and positive externalities from higher skill content in sophisticated commodity production or manufacturing. Moreover, some low-skilled manufacturing activities (like basic garment making) are low-value-added and less productive than some high-value agricultural activities and are shown to be subject to serious deterioration in terms of trade, largely because of massive competition.

While vertical diversification into processing often seems as an attractive option, the critical concern is the optimal use of society's resources, which may not always be the case with vertical diversification. The optimal point of entry into GVCs may not always mean the more processed item. Further processing of mineral resources, in particular, often requires extensive funding and complementary inputs such as energy, which may not be readily available. Moreover, where semi-fabricated metal products are concerned, logistics and the ability to ship a wide range of products to different locations appears to be a significant constraint for African suppliers. Thus, emphasizing this connectivity along both information and physical lines is an important objective for African countries to pursue.

RELATIVELY RAPID GROWTH OF AFRICAN ECONOMIES

Recently, Africa's growth performance has been positive compared to earlier periods and to other regions of the world except Asia, which reflects China's phenomenal growth. In the 1980-2000 period, Africa lagged behind all other regions, including the developed countries. Since 2000, however, this has changed, and Africa's growth is on par with other developing countries, with 2011 being an exception principally owing to the impact of the Arab Spring. Middle African countries – which, as a group, had lagged far behind all other regions and Africa as a whole in the 1980-2000 period – have surpassed Africa as a group since then.

Commodity prices

Although economic reforms in some African countries cannot be overlooked, favourable conditions in global commodity markets were prompted particularly by Chinese demand, and Africa's commodity trade with China itself has been among the principal drivers of the relatively rapid GDP growth in Africa in the first fifteen years of the 21st century. It is difficult, however, to say that this growth was accompanied by a structural transformation and development into a more productive economy.

The growth in Africa (and other commodity dependent regions) should be seen in light of the increase in commodity prices.[4] After steadily

[4] *The price indices are based on US Dollar prices and reflect to some extent the variations in exchange rates. This has to be taken into account when assessing the actual impacts.*

falling between 1980 and 2000 for all commodity groups, the trend reversed for about a decade before beginning to decline again. The growth rates quoted here reflect the period of high and rising prices. The influence of Chinese demand on both the rise and the subsequent fall, which continues unabated in 2015, is undisputed. While Africa has benefited from the increase in commodity prices, it is Middle Africa which has experienced the most favourable impact, as its economy is much more dependent on the kind of products whose prices have risen the most until the last few years. It is also noteworthy, however, that these are also the items whose prices have recently declined the most, and they continue to do so. It is also noteworthy that these are the product groups for which the importance of China as a destination of world trade has grown the most since 2000. Africa's share in world exports is the biggest in the two groups whose prices have increased the most, namely minerals, ores and metals, and fuels. In fact, for the first group, its share in world exports has slightly increased.

Over the last 15 years or so there has been an unprecedented boom in commodity prices, particularly in mineral and fuel prices, as a consequence of rising demand. Although agricultural prices rose as well, for most of the post-2000 period, this trend has not approached the increase in mineral and fuel prices. Moreover, given that the continent as a whole and many African countries are net food importers, the increase in food prices cannot be considered to present an overall favourable situation for Africa. A similar comment can also be made for fuel, but as a continent (even only looking at SSA), Africa is a large

net fuel exporter. Both the international and domestic distribution and utilization of gains from high prices is a crucial matter as far as poverty reduction and development are concerned. Although the earnings of African countries have increased, it is difficult to say that these countries have made the best use of the last commodity boom for developmental purposes.

Commodities in Africa's trade

As seen in Table 2, the importance of commodities in African exports has grown from 74.2 per cent in 1995 to 81.5 per cent in 2014, partly as a result of favourable price movements. The biggest increase has been in fuels, even with prices declining near the end of 2014. Ores and metals have maintained their importance in spite of the large increase for fuels, meaning that their export values also increased considerably. In the countries that possess these resources, agricultural products have lost whatever importance they once held. Africa's share in world exports of all product groups has remained roughly the same during the boom period. Between 1995 and 2013, the only notable increase was for minerals, ores and metals which went up from 6.2 per cent of world exports to 7.6 per cent.

Table 2: Export structure by commodity group, per cent of total

	1995		2000		2005		2014	
	Developing economies	Africa	Developing economies	Africa	Developing economies	Africa	Developing economies	Africa
All food items	10,1	15,1	6,9	10,3	6,2	7,9	7,0	10,0
Agricultural raw materials	2,8	5,2	1,6	3,8	1,3	2,6	1,2	2,5
Ores and metals	3,8	8,8	2,9	6,4	3,6	6,4	3,6	8,8
Fuels	15,2	38,3	19,8	52,6	22,5	61,0	21,5	55,3
Pearls, precious stones and non-monetary gold	1,6	6,8	1,3	5,7	1,5	4,4	2,6	4,9
Manufactured goods	66,5	25,8	67,4	21,1	64,9	17,7	64,2	18,5

NOTE: All food items (SITC 0 + 1 + 22 + 4), Agricultural raw materials (SITC 2 less 22, 27 and 28) Ores and metals (SITC 27 + 28 + 68), Fuels (SITC 3), Pearls, precious stones and non-monetary gold (SITC 667 + 971), Manufactured goods (SITC 5 to 8 less 667 and 68)

Calculated from UNCTAD, UNCTADStats http://unctadstat.unctad.org, accessed 25 August 2015.

In spite of the weight that minerals and fuels have gained, agriculture is the mainstay of many African countries' economies in terms of export earnings and in most countries as a source of employment. While it shows much potential, and while some discussion will be made below when talking about GVCs, the potential is limited. Development calls for an industrialization of the economy, and thus, for diversification (which can fall outside of or within agriculture) towards higher value added products or processing activities, including operations such as bar coding for retail markets. Moreover, Africa is home to the largest reserves of uncultivated lands in the world. Thus, there are two ways of turning agriculture into an engine of growth and development. One is to improve productivity, and the other is to bring more of the land into sustainable cultivation. The ecological impacts and sustainability, both economic and environmental, of bringing land into cultivation make this option a difficult one. Improving productivity, including through irrigation and carefully increasing input use, seems to be the preferable option in most cases. There is also the potential of increasing value added by diversifying into products with higher value, as well as local processing. Any move from low productivity to high productivity almost certainly involves industrialization, which also creates products that are tradable (unlike most services) and generates (or saves) foreign exchange. Linkage with markets is crucial in all cases. The traditional crops that are exported as undifferentiated homogeneous commodities, such as coffee and cocoa, do not display much potential. Demand for agricultural raw materials, foodstuffs, and feedstuffs are likely to grow

as the world becomes richer and as poorer communities start to eat more nutritious foods such as meat.

CHINA IN AFRICA: TRADE

China's growth has made it a very large importer of many products, including commodities, which is important from the point of view of many African countries. Between 1995 and 2013, for fuels, food, and metals, ores and minerals the share of China in world imports went up, respectively, from 1.5 to 8.7 per cent, 2.3 to 6.7 per cent and 2.5 to 19.5 per cent (UNCTAD 2014a Table 2.2a).

Looking at Africa's main trading partners in Table 3, it is seen that developing countries have overtaken developed countries, and that China has taken the lead, followed by India and other large emerging economies. According to data in UNCTADStat website, other large developing countries such as Brazil have lagged behind. Turkey's share in Africa's exports has remained steady at around one per cent, and its share as an origin of imports for Africa has barely surpassed two per cent. While China's importance as a destination for African exports has surged, fuel and mineral exporters have always composed the largest part of this trade. According to data on UNCTADStat website, however, some countries that had hardly exported to China in 2000 – such as Botswana, Burkina Faso, Somalia, Niger, Mali, and Ethiopia – had increased their exports to China markedly by 2014. The largest proportional increase in exports going to China has taken place in Africa among all developing regions.

Table 3: Africa's export destinations and import origins

Destinations of exports as % of total exports					
	1995	2000	2005	2010	2014
Africa	12,4	9,4	8,9	13,4	14,9
Developing economies	25,6	27,5	28,7	42,8	50,7
China	1,2	3,2	6,6	11,8	16,0
India	2,2	2,8	1,6	5,5	6,5
Origin of imports as % of total imports					
	1995	2000	2005	2010	2014
Africa	11,4	13,6	13,0	14,3	12,9
Developing economies	32,0	36,7	42,7	49,9	53,0
China	2,6	3,4	7,0	11,6	16,3
India	1,4	1,6	2,3	3,6	5,0

Calculated from UNCTAD, UNCTADStats http://unctadstat.unctad.org, accessed 25 August 2015.

THE NEED TO INCREASE INVESTMENTS AND ATTRACT FOREIGN DIRECT INVESTMENT

Development needs investment, and the amount of investment depends on both the savings rate and the level of income. In Africa, due to low levels of income, there is little income left for savings and investment. It is generally accepted that if Africa is to make significant progress in reducing poverty, it will have to sustain average growth rates of about seven per cent and above in the medium to long term, and this will

require investment rates of at least 25 per cent of GDP. In spite of some increase since 2010, over the past two decades the average investment rate in Africa has hovered around 18 per cent, which is well below the 25 per cent threshold, and so it is not surprising that the continent has not achieved the seven per cent average growth rate required to make significant progress in reducing poverty (UNCTAD, 2015, p. 4).

While the level of investment is important for the development process, it is a necessary but not a sufficient condition for economic transformation and sustained growth. In the African context, given the basis upon which development will proceed, investment must be allocated to strategic or priority sectors, particularly infrastructure, agribusiness, and manufacturing. Moreover, particularly in the area of public investments, the quality or productivity of investment must be improved to avoid resource waste and achieve maximum impact (UNCTAD, 2015, p. 6). Finally, investment in human capital and institutions is crucial in order to upgrade skills and productivity as well as to improve the environment. The aim is not only to attract foreign investment but also to induce domestic entrepreneurs to invest and to increase government resources through taxation. In recognition of the low levels of public funds generated through taxation in many developing countries, in particular African countries. The generation of domestic resources, just like diversification and a focus on high value added sectors, is an important element of the Sustainable Development Goals (SDGs), particularly Goal 8 related to decent work and economic growth.

With the low income levels in Africa, outside sources of finance comprise a large part of the available investable funds. As seen in Table 4, while oil-rich Africa has increased the ratio of domestic savings to Gross Capital Formation (GCF) and has surplus savings, domestic savings have declined as a ratio of GCF in other parts of Africa. For these countries, overseas development assistance (ODA) remains the principal source of GCF, and foreign direct investment (FDI) has also increased in prominence.

Table 4: Sources of investment financing by categories of countries

Category	Domestic saving/ GCF	ODA/GCF	FDI/GCF
Averages for the period 2000–2012			
Non-oil Africa	17.2	78.0	24.0
Oil-rich Africa	158.8	34.9	27.8
Non-Africa	59.9	23.1	18.8
Africa	52.6	68.8	25.0
Averages over the period 1970–2012			
Non-oil Africa	27.6	81.2	11.5
Oil-rich Africa	110.1	35.3	15.5
Non-Africa	61.4	25.5	12.4
Africa	48.4	70.7	12.5

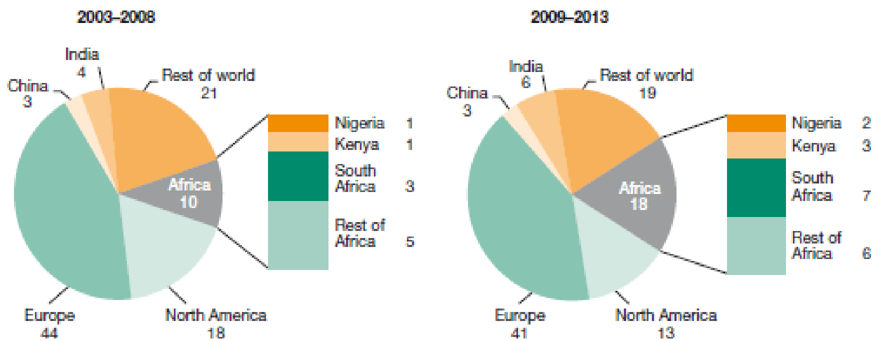
NOTE: GCF = gross capital formation

Source: UNCTAD 2015, Computed based on data from World Development Indicators.

Foreign direct investment in Africa

At a time when FDI is becoming an increasingly important source of investment in Africa, it is somewhat striking that greenfield investments in Africa originating from other African countries (principally South Africa, Kenya, and Nigeria) have become proportionally more important over time, as have investments from India. In spite of much writing on the subject, Chinese investments in greenfield projects lag behind. As can be seen in Figure 1, both Europe and the US have also become proportionally less important in this area.

Figure 1. *Geographical distribution of sources of greenfield investments in Africa by number of projects 2003-2008 and 2009-2013 (per cent)*



Source: UNCTAD 2014 p.42

It is also significant that compared with other foreign investment, intra-African projects are concentrated in manufacturing and services. Ninety

seven per cent of intra-African investments target non-primary sectors, compared with 76 per cent of investments from the rest of the world, with a particularly high difference in the share that targets the manufacturing sector. This directly contributes to the structural transformation of African economies. Smaller African economies rely more heavily on regional FDI. Thus, although in dollar terms the amount of FDI from non-African countries going to non-primary sectors (both services and manufacturing) is larger, a considerably greater proportion of intra-African FDI is directed to the structural transformation of Africa. From the point of view of the African firms investing in other African countries, this helps them enhance their competitiveness by increasing their scale, developing their production know-how, and preparing for global endeavors, following the example of Anglo American and South African Breweries (now SABMiller) (UNCTAD, 2014, pp. 39-41).

Many of the mega projects are in the extractive sectors. Negotiating the financing of mega projects so that the country obtains significant benefits is a complicated matter and is prone to irregularities and corruption. There are many fiscal and legal intricacies as well as uncertainties about the future. These may lead to suboptimal results without any wrongdoing. Moreover, the 'benefits' themselves are not easy to define, as they concern a variety of areas such as foreign exchange, fiscal revenues, and positive externalities such as the construction of roads to far-away projects. There is also the issue of

divergent time preference rates among the stakeholders, which can generate serious disagreements (Arda, 2014, p. 217).
Foreign investment comes to extractive industries and natural resource based sectors basically as a function of endowments, and Africa is well endowed in this respect. Naturally, policies and the general business environment play important but secondary roles. Attracting foreign exchange to non-extractive sectors, however, is a function of a wide variety of variables. Liberal foreign investment regimes help, but if they are to generate noticeable outcomes, they must be accompanied – if not preceded – by the establishment of proper regulatory and institutional frameworks, including such aspects as accountability, predictability, clarity, transparency, fairness, rule of law, and the absence of corruption (UNCTAD, 2012, p. 107). It is in such areas that many African counties must take significant strides in order to attract FDI, particularly from the developed countries.

In a recent study, the ease of doing business, the existence of a stable political environment, and the strong presence of rule of law were identified as the three most important factors influencing the selection of FDI location. Regarding specific rule of law conditions, the absence of corruption (both public and private) is felt to be the main factor, followed by political and social stability and the physical security of in-country personnel (The Economist Intelligence Unit, p. 8).

From the point of view of the most important factor in selecting the location of FDI, namely ease of doing business, the situation of African

countries is not very promising, although even some low ranking countries are favourable with regard to some indicators (World Bank Group, 2015).The best ranking African country is Mauritius, at 32th out of 189 countries. Botswana and South Africa are, respectively 72nd and 73rd).[5] Eleven out of the fifteen worst ranking, however, are African countries, although two of them – Democratic Republic of the Congo and Congo, which ranked 184th and 176th respectively – received about 2 billion USD of FDI each in 2013, making them 8th and 9th among all African countries. As the rankings are based on starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts, and resolving insolvency, these issues all stand out as priority areas for improvements in individual African countries.

It is difficult to measure and make conjectures about how to increase the second important factor for attracting FDI, namely political stability. Arguably, democracy helps. The most important aspect of rule of law, which is the third item affecting investment decisions, is the absence of corruption. This condition does not bode well for Africa's attractiveness as a destination for FDI. According to the Corruption Perception Index, [6], in 2014 only six African countries were among the 60 countries (that is, among the top one third of 179 included) with the least perceived corruption, namely Botswana (31st); Cape Verde (42nd);

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[5] *Turkey is ranked 55th.*

[6] *(https://www.transparency.org/cpi2014/results*

Mauritius (47th); Lesotho, Namibia, and Rwanda (all ranked equally at 55th); and finally Ghana at a close 61st.[7] Somalia, Sudan, South Sudan, Libya, and Eritrea are among the bottom ten.

In the real world, however, unlike the responses to surveys, these considerations do not seem to have had much impact. Or rather, the perception of corruption and the perceived difficulty of doing business do not seem to prevent investments by foreign firms. Other considerations seem to trump these. But a cursory examination of the evidence on FDI and corruption show that not only the “uncorrupt” countries but also both Somalia and Sudan have received considerable FDI. In fact, an examination of the amount of FDI received in 2013 as a proportion of GDP does not reveal a significant relation with either the Ease of Doing Business indicator or corruption perceptions. Improving rule of law, reducing corruption, and having a good business environment, however, are laudable objectives in and of themselves, whether they attract foreign investment or not. They would improve the functioning of the economy and the lives of citizens.

Large scale, natural resource based activities that are generally oriented towards exports, such as mining, forestry, and fisheries, are often undertaken with the involvement of large foreign firms. The retention of resource rents in the country and their conversion into productive investments depend crucially on concessions and foreign investment

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[7] *Turkey was 67th.*

agreements. Owing to the large size of these rents, transparency and good governance – starting from negotiating the agreement through its implementation and oversight – are extremely important. National governance structures are of primary importance, but the Extractive Industries Transparency Initiative (EITI)[8] has become a significant instrument of international governance. Its members "disclose information on tax payments, licences, contracts, production and other key elements around resource extraction." While the use of resource rents is the prerogative of the government, international governance (for example, through EITI) helps improve transparency, preventing (or at least, reducing) abuses and increasing the availability of resources for public benefit (Cortez & Arda, 2014, pp. 15-16). There are 18 EITI compliant African countries and three African candidates. The emphasis on EITI compliance is partly meant to stimulate FDI.

China as a foreign direct investor in Africa

While China's importance in Africa's trade has burgeoned, its place in investment is not as large. It has, nevertheless, been the subject of much discussion because of observations (supported by the discourse of the Chinese government) that Chinese investments, unlike those of some Western countries, are not conditional upon good governance or similar considerations. There is also the impression that the purpose of Chinese investments are basically for natural resource exploitation. When looking at the frequency (not the amount) of investments, it is observed

[8] *http://eiti.org/*

that services are the most common sector, and there are significant investments in manufacturing as well. In terms of countries, Chinese investments are in resource-rich countries like Nigeria and South Africa, but also in non-resource-rich countries like Ethiopia, Kenya, and Uganda. In terms of resources committed, however, many of the large Chinese investments are in energy and minerals, along the same lines as Western investments.

One important difference between Chinese FDI and that from developed countries concerns governance: all other things equal, Western investment is concentrated in African countries with better property rights and rule of law; Chinese FDI is indifferent to the property rights/rule of law environment, and on the other hand tends to favor politically stable countries. This difference makes sense given that a significant part of the volume of Chinese investment is tied up in state-to-state resource deals. China is apparently more concerned with the political stability of the government than with the environment of rule of law in the domestic economy. Chinese investment tends to compose a large share of total investment in countries with poor rule of law (Chen, Dollar, & Tang, 2015b).

Expanding middle classes as a source of dynamism

As can be deduced from Table 3, industrialized countries are no more the biggest trading partners of African countries. The stimulus to the positive growth rates of recent years has come from China and to some extent other developing countries such as India. This is the case for both

exports, which stimulate production, and for imports, which provide cheap products, particularly but not only as consumption goods for the growing middle classes. The growth in Africa's own share as an export destination is also remarkable. This is an indication of the future potential of Africa as a source of demand, which is expanding due to increasing incomes, a growing population, and urbanization. The growing middle class has also been a factor for attracting FDI, even though recent news that Nestlé "is cutting 15 per cent of its workforce across 21 African countries because it says it overestimated the rise of the middle class" seems to contradict this impression. However, rather than disproving the growing importance of the African middle class, this episode is probably a case of a mismatch between the business model of a large company and local conditions in sub-Saharan markets, which are dominated by family businesses thriving on local know-how and the sale of cheap products tailored to individual countries (Manson, 2015).

Estimates about the size of the middle classes vary. Although in sheer numbers Africa's middle class will continue to be dwarfed by those in other parts of the world, it is expected to almost double between 2009 and 2020, and almost double again by 2030 (UNDP, p. 14). With this enlargement of a consuming public that is increasingly integrated with international markets, regional demand – both domestic and across countries – will become an important source of growth for Africa (and other regions). This may provide a comparative advantage to local enterprises, both producers and traders, who are more familiar with

local tastes and customs than global firms, as exemplified by the Nestlé story. Nevertheless, the dominance of GVCs, from electronics to basic foods, by global firms is an important factor to take into account, especially for African firms with intentions to grow and become international players. This requires upgrading their skills not only for export expansion but also domestic competitiveness.

GLOBAL VALUE CHAINS AND AFRICA

The dominance of world production and trade by GVCs rather than vertically integrated firms and factories is a relatively recent phenomenon, spearheaded by breakthroughs in information and communication technologies and transportation. The world trade of parts and components comprising the links of global supply chains has steadily increased over the past decades. Currently, more than one quarter of world imports in manufactured goods is represented by intermediate imports (parts and components). Before the rise of global supply chains, nations had to build a deep and wide industrial base, either through the import substitution or export promotion routes, before becoming competitive. It is often argued that nowadays joining supply chains is a drastically faster and surer route to industrialization than the old import-substitution route (Elms & Low, 2013). However, the point at which a country (in fact, a firm) joins the value chain is an important variable in determining the benefits obtained.

Not only is the production process divided into distinct stages undertaken in different places, even finished products, such as garments

and food items, are traded within organized supply chains culminating at the retail end. In order to reach markets, many food items need to be part of the supply chains of supermarket chains. In this context, the organization of the domestic portion of the supply chain is crucially important for exporters. In many African countries, this is where developments are urgently needed. Most commodities pass through a complicated processing phase before reaching the final consumer. Even fresh fruit and vegetables require a cold chain and appropriate handling before being shipped out of the exporting country. The design and implementation of commodity development policies need to display a full consciousness of the complexities, intricacies, and interrelationships within that supply chain, both inside the exporting country and beyond. Production *per se* is not sufficient; what is needed is production that meets many exigencies, whether they are official or private standards – the latter becoming more important as production is internationalized. The provision of a wide variety of services ranging from information to quality control and financing is also indispensable. The chain is as strong as its weakest link, and development strategies should emphasize unlocking the bottlenecks (Arda, 2014, p. 212).

A key issue for developing countries is that gains in GVCs are often distributed very unequally. Especially disadvantaged are the stages that can be undertaken at almost any place on Earth. For instance, more than 95 per cent of personnel in the apparel value chain are employed in assembly line positions, mostly located in developing countries, yet

they receive less than 10 per cent of the product's value (Cortez & Arda, 2014).

In all sectors and not only in mining, value-added capture depends on the market structure, the extent of the competition, and the organization of the value chain. GVCs have provided opportunities for suppliers in developed countries that can meet exigencies and also increase the benefits that are appropriated by the lead firms and importing countries. For instance, in the coffee value chain, the share of total value of the final product going to major corporations from consuming countries has increased from 50 per cent to 75 per cent, while that retained by primary coffee producers has declined from about 20 per cent to 10 per cent since the 1970s (Food and Agriculture Organization, 2013). However, certain commodities, such as fruit and vegetables, as well as cut flowers generate relatively high value added, particularly when they undergo some transformation or preparation for the retail sector in importing countries (such as packaging). These items also have considerable linkages with the rest of the economy, which has a positive impact on development. Product differentiation through various means of certification (such as "organic" or "fair trade"), performing tasks associated with the retail end of the chain (such as packaging and bar coding), and quality assurance by trusted entities also augment retained value added. Export bans for unprocessed commodities, such as timber, have also helped in increasing processing and value added. However, such bans may generate the risk of some producers quitting the country. The possibility of facing World Trade Organization (WTO) disputes and trade barriers also arises. The danger remains that joining GVCs

could lead to a “shallow” industrialization, with countries – particularly low-income and LDCs – being unable to forge the necessary production linkages with the rest of the economy. With undeveloped or incipient production and technological structures, countries remain stuck in unprocessed low value commodities or simple assembling activities in the supply chain (where competition is intense and returns are low) (Cortez & Arda, 2014, pp. 8-11).

Based on this observation, African countries should aim to compete not only on cheap labour but also on skills and other specific attributes. Policies to upgrade skills are indispensable, but gains from process and product upgrading often do not accrue entirely for developing country suppliers or workers. At least some of the gains of such upgrading generally go to lead firms, because they typically command large bargaining power and can squeeze any of the supplier’s potential profits resulting from the upgrading process. Any upgrading and improved productivity is naturally beneficial, including through external economies. When the supplier also serves other parts of the domestic economy, it also benefits from an improved product and/or more competitive pricing. In the current international setting, with light manufacturing dominated by Asian countries, even African economies that are not heavily commodity dependent but further along the way in terms of industrialization are forced to rely more on the longer-term fundamentals of education and institutions (Rodrik, 2015). Improvements in skills and institutions are necessary for attracting

foreign investment and for creating the conditions of effective entry into GVCs not based solely on low wages.

FDI is often a catalyst for entering GVCs. But if the country wants to be more than a supplier of cheap labour in the GVC, the country itself has to undertake the necessary steps so that a sufficiently strong foundation with a minimum domestic manufacturing base or an efficient agriculture is available (beyond infrastructure and a disciplined labour force). It is unlikely that this required minimum base will be developed by the foreign investors, as the existence of that base is one of the reasons why FDI goes to that country in the first place. Moving forward, the question for developing countries as far as GVCs are concerned is how to integrate into the supply chain in a way that allows for the absorption of a growing labour force at increasing levels of productivity and incomes. For the successful emerging economies, joining a GVC or attracting multinational companies and FDI have not been ends in and of themselves but part of a clearly drafted strategy (Cortez & Arda, 2014, pp. 10-11).

Currently, as would be expected because of low industrialization, trade in intermediate products within Africa is much lower than all other regions. As industrialization progresses and regional value chains are developed, intra-African trade could also see a boost.

CONCLUSION

Africa and its commodity dependent countries are facing a difficult time, as they have experienced almost continuously over decades. This time the difficulties come as a period of relative dynamism spearheaded by China is ending and international production and trade relations are increasingly dominated by GVCs. Therefore, diversification and industrialization, the traditional development priorities have to be placed in this framework. African countries must adjust their development policies and priorities to these new trends. Another aspect of the new development environment for Africa is the internal dynamism of the continent manifested in the increasing intra-African trade and investment relations, as well as the potential generated by the growing middle class. Emphasis on and investments in human resources and institutions are prerequisites for success.

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