Africa needs export diversification

The need for economic diversification in the continent is high, more so given that the growth cycle is at a low point, says Dr Martyn Davies, managing director: emerging markets and Africa, Deloitte Africa.

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Economic history has shown that without diversification into manufacturing and services, and away from simple resource extraction, the long-term development prospects of countries are always bleak.

For the most part, African governments have not taken advantage of the last decade's growth spurt to move toward diversification – neither in their economic structures, nor in their export baskets. Resource-endowed countries are anything but examples of sustainable or inclusive growth. Davies further added that, wealth is unable to trickle down into broader society from narrow extractive industries, especially in the face of rent-seeking governments.

"Nigeria is the leading example of a resource exporter where the disconnect between previously high headline growth figures and developmental reality has been stark. The country has never been as dependent on oil as it has been in recent years, with over 90% of its export earnings coming from oil," Davies mentions.

For Africa, as a whole, the figures are troubling as commodity exports on average account for 80% of total merchandise exports. In almost half of Africa's economies, commodity exports earn 90% or more of merchandise export earnings. And for three-quarters of African countries, commodity exports make up 70% or more of export earnings.

Davies affirms that, due to this lack of diversification, most of Africa's economies remain dependent on the vagaries of commodity prices in the international market and often on the price of a single resource.

However, there are a handful of countries, such as Madagascar, Senegal, and Morocco and several economies in East Africa, that have avoided the pitfall of over-dependence on revenues generated by a single merchandise export, either through good fortune or as a result of strategic policy implementation. Their relatively more diversified export baskets have cushioned them from external shocks, giving rise to a more stable growth track record.

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Even within oil-exporting countries, those with less dependence on the commodity (such as Egypt, Cameroon, and Senegal), still have a reasonably healthy growth outlook. Similarly, Côte d'Ivoire earns significant foreign exchange revenues from its oil exports, but the country's main export earnings stem from cocoa. The country's economic growth is also benefitting from a degree of catch up after social unrest ended in 2011. By contrast, Nigeria and Angola's high dependence on oil exports is set to translate into very weak growth over the 2016-18 period.

"To a lesser extent, countries that have a high dependence on a single non-oil export commodity are also projected to expand at lower rates. Botswana's dependence on diamond mining is a point of concern, while Zambia's over-reliance on copper has also limited the economy's growth prospects."

There are several countries in the East Africa region that have actively promoted export diversification. The strong growth outlook for East Africa in Ethiopia, Kenya, Rwanda, Tanzania, and Uganda is testament to this. Their growth prospects are supported by political stability and pragmatic pro-business policy.

A recipe for diversification?

In order to move from what has been a resource-driven business model for most African economies towards a more diversified and sustainable one, a number of policies need to be put in place. Although there is no simple recipe for success, some of the ingredients for successful economic diversification include: the quality and quantity of physical infrastructure investments in key sectors; effective trade and industrial policies; improving macroeconomic fundamentals through sound fiscal and monetary policies; productivity growth supported by human capital, skills and technology; a broader enabling environment for both local and international investors; and good governance.

"Among these, two particularly important elements are talent and skills development, and the basic building blocks of infrastructure development. Sustained and sizeable investment in people to generate, retain and create opportunities for talent in domestic economies is essential. Sufficient investment in physical infrastructure, including transport, power, communications and technology, is also a necessity."

However, it is ultimately governance that will determine how resource rents are re-invested into the human capital that is needed to make African economies grow sustainably, with equitable development models, rather than remaining dependent on cyclically-driven commodity prices.

Manufacturing investment from China

Davies shares his insights on the outlook of investment within China. He references that a possible driver of economic transformation into manufactures and higher value-added exports is the enormous opportunity presented by the shifting value chain of production in Asia.

“The rising cost pressures on China’s light industrial manufacturing sector will cause manufacturing capacity to be relocated to lower-cost foreign economies. As this shift in production out of China’s south-eastern provinces takes place, forward-looking African countries could emerge as ‘new Vietnams’ – offering low-cost destinations for manufacturing investment from China.”

East Africa is well-positioned to assume this role, with Ethiopia the leading candidate. Ethiopia is already attracting low-end manufacturing from China, including shoe, steel, cement and light vehicle production. The country’s rather authoritarian development model is conducive to attracting Asian investment seeking a stable manufacturing platform in Africa – both for export and to supply Africa’s own growing consumer economy.

In turn, Kenya is no stranger to Chinese investment, with Asian companies establishing production facilities in the East African country’s dedicated export processing zones. Factories in several sectors, including automobiles and textiles, are set to receive further investments as Chinese companies accelerate their value-chain relocation strategies.

The tens of millions of jobs expected to move offshore in the coming decade due to rising Chinese production costs is a big opportunity for Africa. Reform-minded and progressive African states could seize this opportunity and generate a 19th century style industrial revolution, creating large amounts of employment and new industries in their own economies. Coupling this with the disruptors of the fourth industrial revolution – so-called ‘Industry 4.0’ – Africa could achieve the manufacturing competitiveness of early adopters of smart technologies, machines, factories, products and services. African countries require suitably qualified workforces in order to take advantage of this potential seismic economic shift.

Countries that recognise the need for economic transformation and successfully implement diversification drives into manufacturing and services-based activities, will be primed to move towards a more sustainable and ultimately more inclusive growth trajectory.

“The imperative to diversify and industrialise economies is clear, otherwise economies remain dependent on the vagaries of commodity prices in the international market and often on the price of a single resource”. Governments must realise that they should adopt pro-industry policies and build more efficient infrastructure as foundations for economic and export diversification. It is not about state intervention, but rather state enablement of business that is the ultimate determinant of development, concludes Davies.