Africa—Missing Globalization's Rewards?

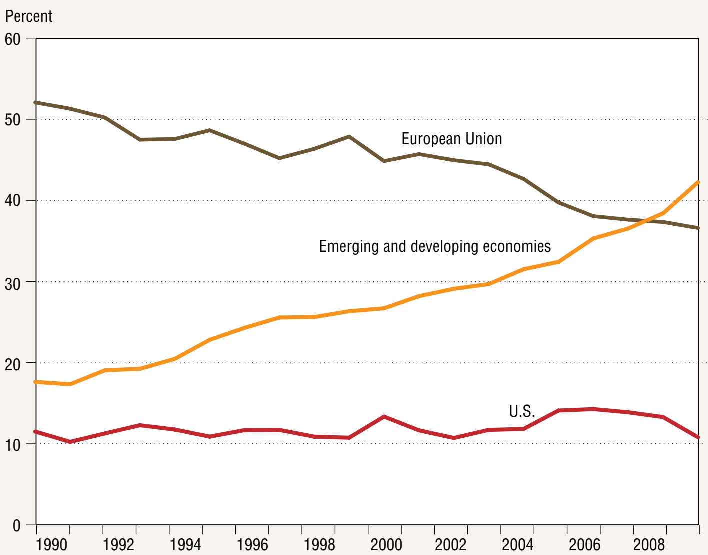
Globalization increases integration of world economies through trade, financial ties, information exchange, technology and the movement of people. The rising importance of world trade and capital flows reflects enhanced economic and financial linkages. Nations with superior access to world markets can more fully exploit their competitive advantages, opening their economies to international competition. With greater capital flows and freedom of capital movement, resources more effectively move to their most productive locations, contributing to rising living standards.

The African continent's economies have increasingly opened themselves to world trade, attracting foreign investment and adopting improved transportation and communication technologies. Still, growth has lagged behind other developing regions, and the continent remains relatively less integrated into the global economy. Africa's nations, by strengthening macroeconomic policies and pursuing structural reforms, can take fuller advantage of globalization and reduce the risks of marginalization.

This article evaluates the current and future direction of globalization in Africa and explores how the continent can improve its growth prospects and meet the United Nations' Millennium Development Goals by the 2015 target date.[1] Behind the continent's aggregate numbers reside its countries' varied experiences. Regional or country data are applied wherever available to illustrate intra-Africa divergence and to account for varying nation size. The continent's experience over the past two decades suggests that globalization is a necessary, though not sufficient, condition for growth and development.

Chart 1

Africa Increases Trade With Emerging and Developing Market Economies



NOTES: Trade is the sum of imports and exports. Data are in nominal terms, and the shares are the total of each region's imports and exports in Africa's total trade.

SOURCES: International Monetary Fund's Direction of Trade database; Haver Analytics.

African Trade—Avenue to Globalization

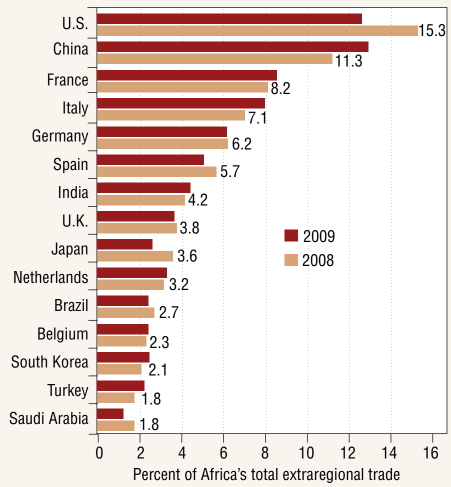
Before the 2008–09 global recession, the continent experienced one of its longest and most geographically widespread growth spurts; real gross domestic product (GDP) expanded at an average annual rate of 5.5 percent from 2000 to 2007, and real GDP per capita, a measure of the standard of living, grew an average 3.1 percent during the period. The performance was partly supported by increased trade. Africa's total merchandise trade (exports and imports combined) increased to more than $1.04 trillion in 2008 from $211 billion in 1990, before declining to $798 billion in 2009 amid the global slowdown. The continent's share of world trade grew modestly to 3.2 percent in 2008 from 2.7 percent in 1990, dipping slightly to 3 percent in 2009. The uptick (before the worldwide economic slump) was mainly driven by demand from rapidly growing developing countries, such as China, Brazil and India, and by rising oil and commodity prices.

However, the upsurge is confined to a handful of nations, and although total merchandise trade has increased across the continent, Africa's overall contribution to world trade (3 percent in 2009 and 3.2 percent in 2008) remains small and below that of other developing regions. By comparison, developing Asia accounted for 29 percent of global trade in 2009, up from 27 percent in 2008, while Latin America and the Caribbean contributed about 6 percent in both 2009 and 2008.[2] To gauge how much the regions trade relative to their economic sizes, it's helpful to view each economy's share of global GDP. In 2009, developing Asia accounted for 19 percent of world GDP, Latin America and the Caribbean, 7 percent, and Africa, 3 percent. With this comparison, Africa and Latin America trade with about the same level of intensity.

Africa still depends on the developed economies for trade, but recent expansion has increasingly involved exchanges with emerging countries. Such "South–South" cooperation is growing, and Africa has deepening linkages—through trade and financial flows—with economies such as China and India. Data before the slump indicate that total merchandise trade with other developing countries increased to $305 billion in 2008, from $21 billion in 1990, while with developed countries it rose to $619 billion, from $144 billion. Similarly, intra-African trade advanced to $115 billion in 2008, from $37 billion in 1995. Other (non-African) developing countries' share of Africa's total trade reached 38.3 percent in 2008, from 17.5 percent in 1990.

The continent's overall trade declined in 2009. Still, developed countries remain the region's largest trading partners even as their relative share of Africa's trade trended downward over the past 20 years. The European Union, for example, is Africa's main trade partner; however, its share diminished to less than 40 percent in 2008 from about 52 percent in the early 1990s (UNCTAD 2010) (*Chart 1*).

Chart 2
U.S. and China Lead Africa's Trading Partner List



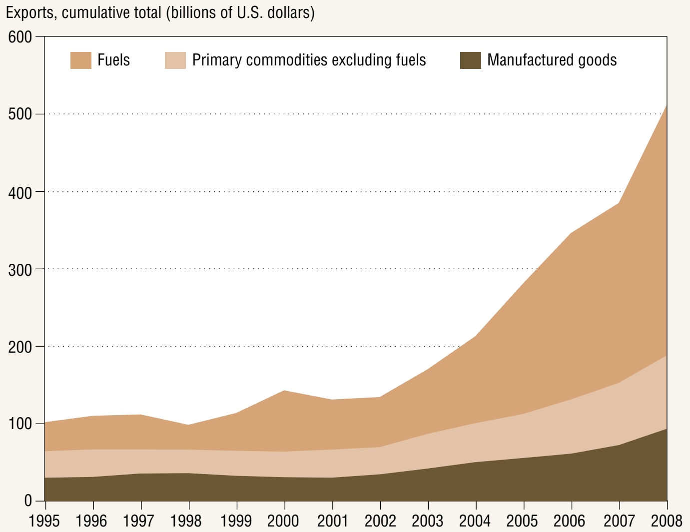
NOTE: Countries are ranked by their 2008 trade shares.

SOURCE: United Nations Conference on Trade and Development.

Developing Asia is increasingly important to the commercial dynamics of Africa. Its share of the continent's trade has steadily increased, from an average 14 percent from 1995 to 2000 to 20 percent between 2000 and 2008 and 28 percent in 2009. Total trade between these two regions, in nominal terms, jumped nearly tenfold from 2000 to 2008. China has taken the lead among countries, moving to the top spot in 2009, as trade with advanced economies fell more relative to other developing nations. China (which trailed only the United States in total trade in 2008) has also become the region's largest source of imports. Other countries, including Brazil, Saudi Arabia and Turkey, also boosted ties with Africa and were among the continent's top trading partners in 2008 and 2009 (*Chart 2*).

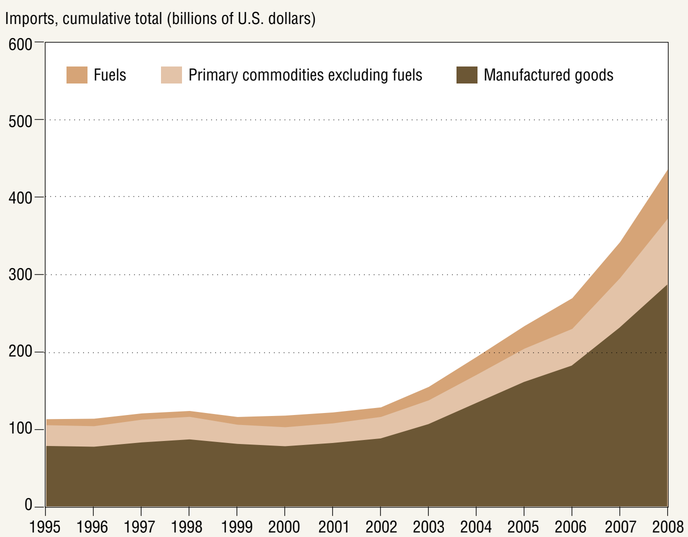
Commodities dominate Africa's foreign trade. Since 2002, primary exports increased significantly,

Chart 3
Fuels and Other Primary Commodities Dominate Africa's Exports



SOURCE: United Nations Conference on Trade and Development.

Chart 4
Africa's Imports Depend on Manufactured Goods



SOURCE: United Nations Conference on Trade and Development.

while manufactured goods rose by a lesser amount (*Chart 3*). In 2008, primary products accounted for 82 percent of Africa's exports, up from 70 percent in 1995. Fuels make up a large proportion of primary commodity exports, amid new demand from China, India, Brazil and other rapidly growing economies.

Among imports, manufactured products predominated, accounting for about 67 percent of the total amount from 1995 to 2008 (*Chart 4*). The significant increase in imports and exports after 2002 coincides with China's accession to the World Trade Organization, which lowered trade barriers and improved market access and capital flows.

Even as the continent remained commodity-dependent, it fell behind in exports of nonfuel primary commodities. The region also hasn't diversified into more high-value-added products such as manufactured goods. Primary commodities' production structures are poorly linked to the broader economy, generating fewer benefits than might otherwise be expected, according to a study by Sachs and Warner (1995). The continent's poor economic performance, or missed opportunity over the past two decades, reflects in part an inability to move beyond dependence on primary commodities for export earnings.

Additionally, world prices for the commodities Africa sells tend to be more volatile and out of producers' control than those for manufactured items. Moreover, studies show that manufactured goods have fairly high income elasticities of demand and tend to offer better growth prospects (Lall 2000). Across the continent, structural factors such as poor infrastructure, a high cost of doing business, limited investment in human capital and educational attainment, an unsettled political climate as well as an inability to take advantage of economies of scale are among constraints hindering development of a manufacturing sector and limiting growth. Thus, Africa's dependence on mostly unprocessed primary products has cost it the benefits it could have realized if it had attained the same level of industrialization as other developing economies.

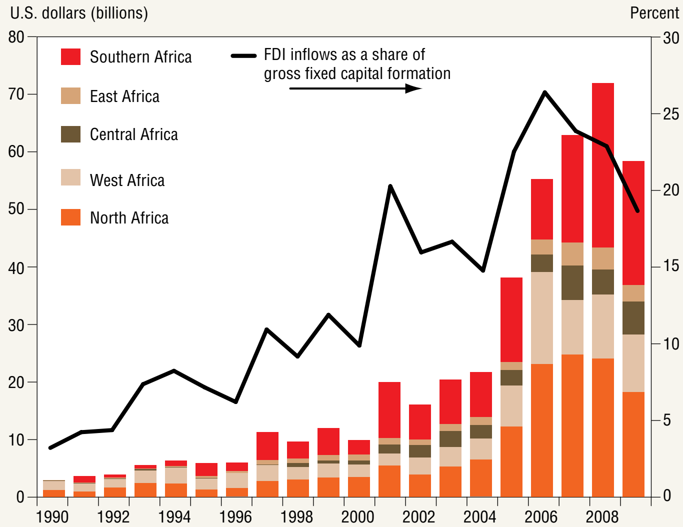
Financial Integration—Linking Through Capital Flows

Africa's trade increase was accompanied by a rise in foreign direct investment (FDI). Such inflows reached $72 billion in 2008, up from about $3 billion in 1990, before declining to $59 billion in 2009 amid recession-related commodity price declines (*Chart 5*). A key component of FDI is reinvested earnings; since FDI is mostly directed to the primary sector, which includes such activities as agriculture, forestry, mining, quarrying and oil extraction, falling commodity prices reduce profits and curtail FDI.

The significance of FDI to African economies—as measured by the ratio of FDI to the region's gross fixed capital formation—peaked at 27 percent in 2006, slipping to 19 percent in 2009. Since 2000, FDI inflows have accounted for about 20 percent of gross fixed capital formation. A decrease may affect the region's investment prospects and impact much-needed infrastructure expenditures. The extent of the FDI drop in 2009 varied across subregions.[3] East Africa declined 23 percent relative to 2008, while West Africa fell 10 percent. Flows to North Africa decreased by 24 percent, despite its more diversified FDI and sustained privatization programs that attracted foreign investment. The southern region, the continent's largest recipient of FDI, fell 25 percent. FDI rose only in Central Africa, up 30 percent, mostly due to large investments in Equatorial Guinea.[4]

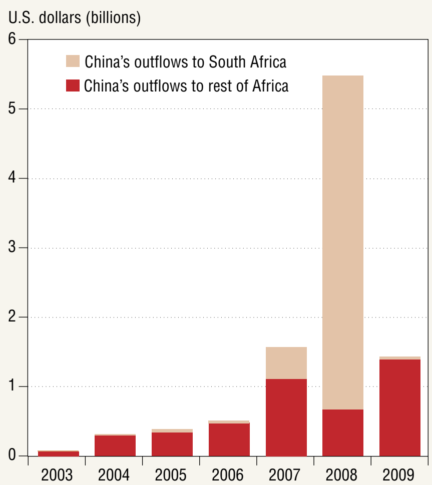
Before the recent downturn, FDI surged to record highs. Developing countries' investment in Africa is among the factors behind this upward trend. These nations increasingly compete for investment opportunities with developed countries that traditionally provided the bulk of capital. Asian developing countries in particular account for the largest share of South–South FDI flows. China has become an important investor in the continent, although the bulk of its investments have been regionally focused (*Chart 6*). In 2008, 87 percent of total Chinese outlays to the region went to South Africa, mostly for acquisition of part ownership of Standard and

Chart 5
Foreign Direct Investment Inflows Vary Across Subregions



SOURCE: United Nations Conference on Trade and Development.

Chart 6
China's 2008 Investment Concentrated in South Africa



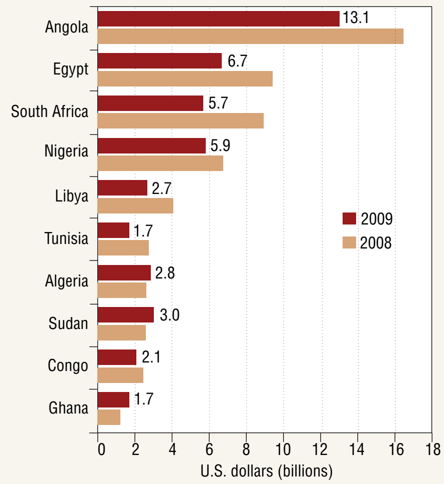
SOURCE: 2009 Statistical Bulletin of China's Foreign Direct Investment, Ministry of Commerce of People's Republic of China and National Bureau of Statistics.

(World Investment Report 2007). They initiated measures allowing foreign investors easier access and tax reductions to promote capital inflows. For example, Kenya strengthened its investment promotion agency, while Nigeria cut the average property registration time to 80 days from 274. Ethiopia set up an advisory council for investment promotion, and Egypt, Algeria, Tanzania and Uganda were among nations establishing special investment zones.

Conversely, some governments adopted less-favorable policies. Zambia introduced a tax regime in 2008 that boosted mining industry tax rates to 47 percent from 31.7 percent. Algeria and Egypt also raised investment-related taxes.

FDI returned to regions where political stability returned. Flows to Angola increased significantly following the end of violent conflict. With rich petroleum and diamond endowments, Angola is a top FDI recipient, ranking first in the continent in both 2008 and 2009 (*Chart 7*).

Chart 7
Top 10 Recipients of FDI Account for Three-Quarters of Total Inflows in 2009



NOTE: Countries are ranked according to the magnitude of their 2008 FDI inflows.

SOURCE: United Nations Conference on Trade and Development.

Chartered Bank by the government-owned Industrial and Commercial Bank of China (ICBC). Other investments have gone into resource extraction, construction and manufacturing. Capital is drawn to securing natural resources, gaining direct access to local markets and capitalizing on the favorable investment climate in some areas.

Other rapidly expanding economies—India, Malaysia, Turkey and Brazil—also increased investment in African natural resources. As a result, the region's largest natural resource producers—Angola, Libya, Nigeria and South Africa—consistently are among top FDI recipients (*Chart 7*).

African governments have become increasingly committed to policies intended to attract stable FDI and boost capital inflows. The United Nations Conference on Trade and Development's (UNCTAD) annual survey of changes to national laws and regulations shows that in 2006, 40 African countries introduced 57 measures affecting FDI, 49 of them designed to encourage investment

Africa holds 10 percent of the world's proven oil reserves, more than 80 percent of diamond holdings and a significant share of platinum and uranium stocks. South Africa alone has about 40 percent of the world's gold (UNCTAD 2009). Not surprisingly, most FDI has traditionally been concentrated in the primary sectors. However, the composition of FDI has changed in recent years. Collapsing commodity prices and diminished international financial resources during the recession cut funding directed toward primary goods. The service sector, led by the telecommunications industry, became the dominant FDI recipient. It attracted the largest share of cross-border mergers and acquisitions, with transactions such as Vodafone Group's $2.4 billion purchase of VenFin Ltd. in April 2006 in South Africa and India's Bharti Airtel acquisition of Kuwait's Zain's mobile phone networks in 15 African countries for $10.7 billion (World Investment Report 2010).

Even with recent investment, Africa's FDI growth did not keep pace with other regions. While

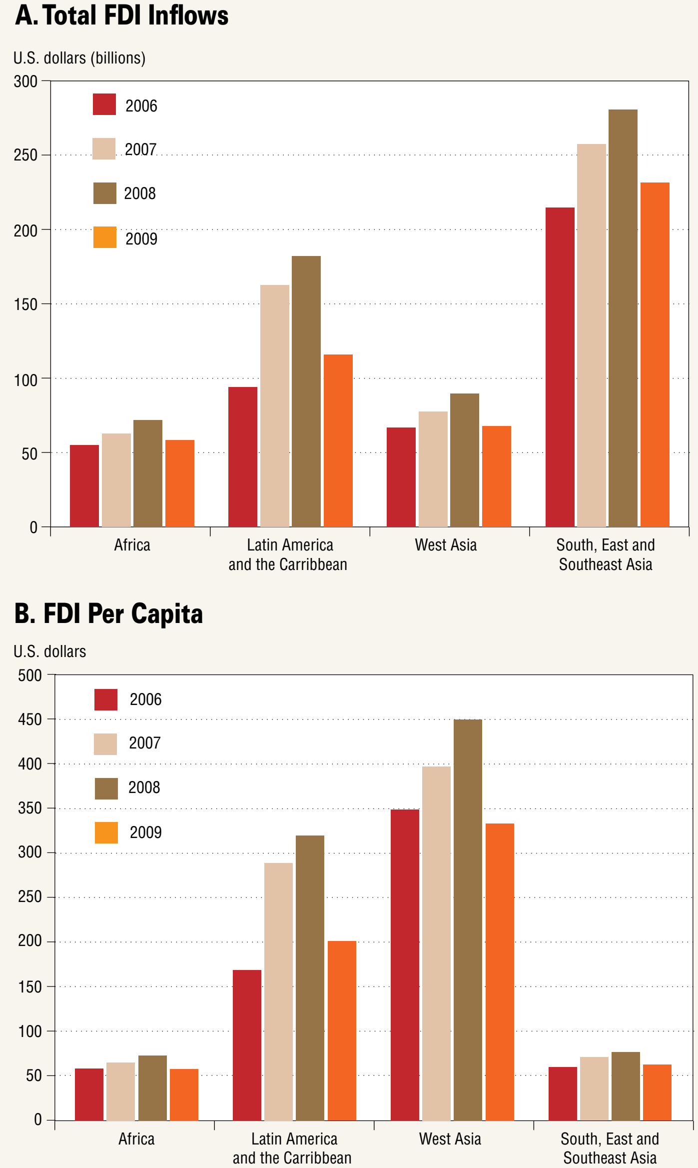
African investment rose 30 percent from 2006 to 2008, funding in Latin America and the Caribbean grew 94 percent (*Chart 8A*). Investment in all areas fell in 2009 amid the global slowdown. When accounting for regional sizes by using FDI per capita, investment in West Asia and Latin America and the Caribbean significantly exceeded the rest of the developing economies (*Chart 8B*). Africa still receives the least investment of its peers.

To put the investment totals in perspective, Africa's current share of global FDI remains lower than it was 40 years ago, when it peaked at 9.5 percent in 1970 (*Chart 9*). It trended downward until 2000, when it reached a recent-term low. In 2008, it stood at 4 percent, edging up to 5.3 percent in 2009, mainly because total FDI flows fell more worldwide than they did in Africa (a 37 percent drop globally compared with a 19 percent decline for Africa). Africa's modest share and its mostly declining piece of global FDI and exports over the past two decades partly reflect slow progress in developing a diverse production base and in creating larger regional markets. FDI is important for development because, besides serving as a capital source, it stimulates employment and productivity, promotes the transfer of technology and enhances economic growth. Studies have found that countries that are open to trade will attract more FDI; thus, countries wishing to boost investment should also increase trade (Asiedu 2004).

Africa's Development Lags

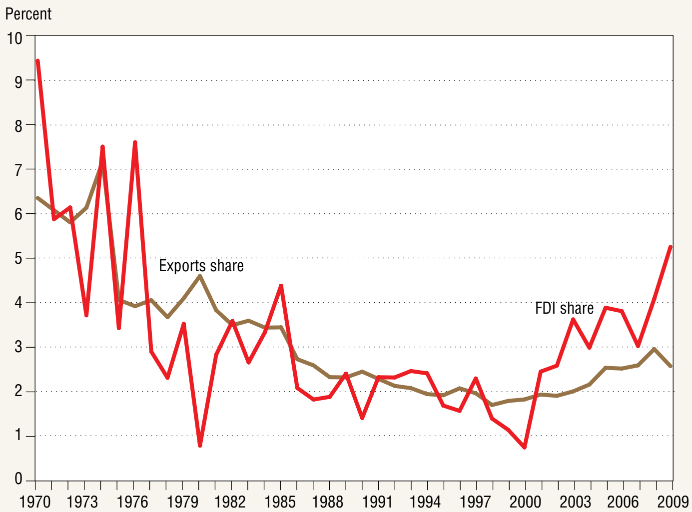
An International Monetary Fund statement on globalization's benefits cites "substantial evidence, from countries of different sizes and different regions, that as countries 'globalize,' their citizens benefit in the form of access to a wider variety of goods and services, lower prices, more and better-paying jobs, improved health and higher overall living standards" (IMF 2008). However, the trade and investment linkages in Africa have remained relatively unchanged since the 1990s even as globalization and economic

Chart 8
Africa's FDI Levels Remain Low



SOURCE: United Nations Conference on Trade and Development.

Chart 9
Africa's FDI and Exports Share of World Totals



SOURCES: United Nations Conference on Trade and Development; International Monetary Fund.

integration strengthened worldwide. Moreover, living standards have not noticeably progressed toward those of more advanced economies, nor has development accelerated. Per capita GDP—a rough estimate of average living standards—was little changed between 1990 and 2008, while other developing countries experienced significant improvement (*Chart 10*).

Over the past two decades, trade and FDI flows between Africa and the rest of the world have increased tenfold. However, among developing regions, these gains are relatively small, and more needs to be done to further integrate into the global economy and obtain globalization's benefits.

The neoclassical theory of growth suggests that initially laggard economies subsequently grow faster in per capita terms, catching up to those that started out ahead. According to the neoclassical model, poorer countries with lower capital-to-labor ratios will grow more rapidly than richer countries with higher capital-to-labor ratios. Convergence is expected because of a higher potential return on capital arising from capital scarcity and lower levels of capital per worker. That, in turn, accelerates capital accumulation and growth. Additionally, poorer countries would be expected to grow faster than rich ones as technological know-how flows from advanced nations to the laggards (Barro and Sala-i-Martin 1995).

Such theory not only provides a framework to think about African development, but also supplies insight into how different countries have fared given similar initial economic and developmental endowments. Ghana and Malaysia were analyzed as proxies for the performance of African nations relative to non-African developing countries in a study that attempted to control for institutional factors and differences in initial conditions (Asare and Wong 2004). Both nations are former British Empire colonies and attained independence in 1957. Each also began with a rich mix of resources, significant gold and foreign currency reserves, strong British legal and political institutions and similar educational systems. Malaysia had a per capita gross national product (GNP) of about $200 while Ghana's was $170 in 1958. The two countries have since followed very different paths. In 2000, Malaysia's per capita GNP was $3,884—about 14 times that of Ghana, at $285. Ghana has remained largely agricultural, with that sector accounting for about 36 percent of gross domestic output. Malaysia has become highly industrialized, with agriculture contributing only 14 percent to its gross domestic output.

Several factors may account for the countries' divergence, including the extent to which they diversified their economies, their political environments and the level of investment and commitment to develop human capital through education. While the neoclassical framework cannot explain this result, it helps provide reasons for the differences. Less-developed countries with low capital-to-labor ratios should have higher marginal returns on capital and foreign investment. That Africa, as a continent, has been unable to attract more FDI relative to other regions is symptomatic of deeper structural problems inhibiting the continent's economies from fully recognizing investment opportunities. Policy incentives and structural factors may have prevented not only the realization of higher returns on capital, but also reallocation of resources to sectors such as manufacturing at the same speed as in other developing areas.

Many emerging countries have not caught up to the per capita income levels of developed nations. Some diverged over time, as in the case of Ghana and Malaysia. Nations that pursued policies to incentivize investment, including some in Asia and Latin America, have grown rapidly and are moving toward industrial countries' standard of living. Moreover, nations that sought policies that facilitated (rather than impeded) reallocation of resources toward manufacturing, as well as favoring structural reforms, benefited more from greater access to world markets and subsequently grew faster. Africa's convergence process has mostly stalled except for isolated successes, such as Mauritius and Botswana. The divergence of Ghana and Malaysia, despite their similarity at the time of independence, lends support to the view that transparent and stable policies are needed for sustained economic success and global financial integration. Periods of political upheaval in Ghana during the past decade and its failure to diversify its economic structure and shift from mostly primary commodity exports to more value-added ones partly explain its performance. On the other hand, Malaysia is realizing benefits from globalization because it avoided the problems that hampered Ghana.

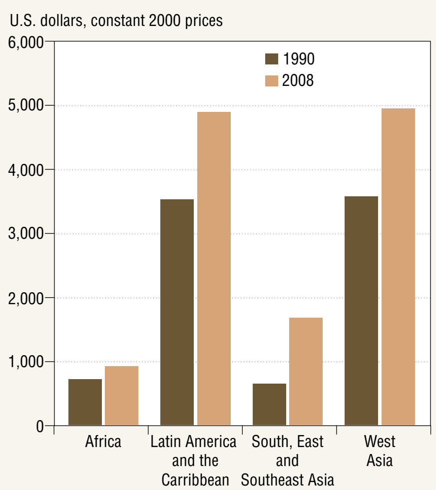
Globalization—A Necessary but Insufficient Condition for Development

Globalization creates new opportunities to access wider markets for trade, allocate capital inflows more effectively and improve the diffusion of technology. The developing world is becoming more integrated, though the pace varies across countries and regions. Globalization's impact on growth and poverty reduction has been unbalanced, even marginal in some areas. Economic openness alone is insufficient to sustain growth. Countries seeking to take full advantage of globalization must install sound macroeconomic policies in addition to stable regulatory and incentive frameworks and good governance.

In Africa, obstacles to stronger globalization and growth include inadequate infrastructure, substandard governance and a lack of policies to enhance outward-oriented trade and capital flows. A stable macroeconomic environment—characterized by low and predictable inflation, sustainable fiscal policies as well as relatively stable real exchange rates—is a prerequisite for high rates of investment and growth. Macroeconomic instability increases uncertainty, discouraging financial commitment.

Conversely, boosting growth in developing countries is a necessary condition for attainment of the U.N.'s 2015 Millennium Development Goals.

Chart 10
Africa's Real Per Capita GDP Ranks Comparatively Low



SOURCE: United Nations Conference on Trade and Development.

These objectives include eradication of extreme poverty and hunger, achievement of universal primary school education, improvement of overall health conditions and establishment of global partnerships to foster development. According to the U.N., robust growth in the first half of the past decade reduced the number of people living on less than $1.25 a day in developing regions to 1.4 billion in 2005 from 1.8 billion in 1990, while the poverty rate dropped to 27 percent from 46 percent. However, with exports, commodity prices and investment all declining during the economic crisis, growth slowed, which complicated goal attainment (U.N. 2010). To overcome the slowdown and to continue toward the targets, all regions, including Africa, must redouble efforts to ensure that they harness globalization's benefits.

Conclusion

The growing share of developing countries' trade with Africa has reduced Africa's relative dealings with developed nations. However, the continent still trades most with the developed economies. Trade in the region is geographically concentrated and reinforces commodity dependence, as primary products make up most exports, while manufactured goods are an increasingly large part of imports. This trade pattern—as well as weak infrastructure and inadequate policy reforms—has contributed to anemic economic performance. At current levels of trade, the continent remains far from achieving the growth rates deemed necessary to meet the U.N.'s development goals and improve the living standards for most of its population.

FDI remains concentrated in the primary sectors, although services have gained visibility. South–South capital flows have increased, with economies such as China, Brazil and India providing new investment. Some economies have opened to external trade and capital flows, but the continent remains in relative isolation compared with most other developing and emerging economies. Africa's performance over the past two decades indicates that despite globalization's importance for growth through increased trade and FDI, there must be more sound macroeconomic policies and structural reforms that promote investment, capital accumulation and economic integration to ensure sustainable growth. Without such measures, the continent can't take full advantage of greater economic openness.

—Janet Koech

Notes

[1] The Millennium Development Goals are eight international benchmarks that United Nations member states agreed to achieve by 2015.

[2] Economies classified by UNCTAD as "developing Asia" include four regions: West Asia, East Asia, South Asia and Southeast Asia. Individual groupings are as follows:
West Asia: Bahrain, Iraq, Jordan, Kuwait, Lebanon, Oman, Palestinian Territory, Qatar, Saudi Arabia, Syrian Arab Republic, Turkey, United Arab Emirates, Yemen.
East Asia: China, Hong Kong, Macao (China), Mongolia, North Korea, South Korea, Taiwan.
South Asia: Afghanistan, Bangladesh, Bhutan, India, Iran, Maldives, Nepal, Pakistan, Sri Lanka.
Southeast Asia: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste, Vietnam.

[3] African country groupings are as follows:
Southern Africa: Angola, Botswana, Lesotho, Malawi, Mozambique, Namibia, South Africa, Swaziland, Zambia, Zimbabwe.
East Africa: Comoros, Djibouti, Eretria, Ethiopia, Kenya, Madagascar, Mauritius, Seychelles, Somalia, Uganda, Tanzania.
Central Africa: Burundi, Cameroon, Central African Republic, Chad, Congo, Democratic Republic of Congo, Equatorial Guinea, Gabon, Rwanda, Sao Tome and Principe.
West Africa: Benin, Burkina Faso, Cape Verde, Gambia, Ghana, Guinea, Guinea-Bissau, Ivory Coast, Liberia, Mali, Mauritania, Niger, Nigeria, Saint Helena, Senegal, Sierra Leone, Togo.
North Africa: Algeria, Egypt, Libya, Morocco, Sudan, Tunisia.

[4] Commercial oil and gas reserves are the major attraction of FDI to Equatorial Guinea. The country also has substantial deposits of minerals, including gold, diamonds, bauxite, iron ore, titanium, copper, manganese and uranium. The U.S. is the largest foreign investor in Equatorial Guinea.

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