UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
UNCTAD

No. 33
MAY 2015

POLICY BRIEF

STRENGTHENING THE PRIVATE SECTOR TO BOOST CONTINENTAL TRADE AND INTEGRATION IN AFRICA[1]

Regional trade has the potential to contribute to sustained growth, poverty reduction and inclusive development. It has played this role effectively in several countries in Asia and Latin America. But in Africa, the expected results have been slow to come to the fore. Of the many factors that account for this situation, the weakness of the African private sector is paramount and needs to be understood and effectively addressed.

Regional trade in Africa remains low in spite of efforts by African Governments to fast track the establishment of a continental free trade area and boost intraregional trade. Over the past decade, only about 12 per cent of Africa's total trade took place within the continent. One of the major reasons for the weakness in the continent's regional trade performance has been the lack of a private sector that is dynamic and vibrant enough to seize existing opportunities in the trading system. The African private sector faces several challenges. These include high and rising informality, small size of enterprises, weak inter-firm linkages, low level of export competitiveness and low innovation capabilities. These challenges are compounded by the fact that regional integration initiatives aimed at promoting trade tend to focus on processes, such as the removal of trade barriers, without the commensurate attention to the building of productive capacities and private sector development that would effectively address the consequent weaknesses. There is certainly a need to shift away from this linear and process-based approach towards a greater development focus.

The private sector has a crucial role to play in making regional integration work for Africa because, though trade agreements are signed by Governments, it is the private sector that understands the constraints facing enterprises and is in a position to take advantage of the opportunities created by such agreements and regional trade initiatives. For the objectives of regional integration in Africa to be realized, African Governments therefore have to create more space for the private sector to play an active role in the integration process instead of leaving the sector to act as a passive participant.

Steps taken by many African countries in the 1980s and 1990s to build the capacity of the private sector included reform of the business environment, such as the protection of property rights, relaxation of labour regulations and other structural adjustments. Yet the experience of the past three decades has shown that, while these reforms may be necessary, they are not sufficient to promote entrepreneurship, unlock private sector dynamism and boost productive capacity in the region. Against this backdrop, this policy brief identifies some

Key points

- African Governments should create more space for the private sector to play an active role in the regional integration and development process.
- Making regional integration work for Africa requires improving infrastructure, enhancing access to credit, facilitating cross-border trade, developing workforce skills, strengthening mechanisms for consultation with the private sector, and maintaining peace and security.

[1] This policy brief draws heavily from the UNCTAD *Economic Development in Africa Report 2013*, subtitled *Intra-African Trade: Unlocking Private Sector Dynamism.*

key elements of a credible policy package to promote private sector development and boost intra-African trade.

Invest in infrastructure

It is estimated that the poor infrastructure in Africa reduces the productivity of companies by 40 per cent and per capita output growth by about 2 percentage points. This is a huge drawback on the competitiveness of the private sector in Africa, as it limits access to markets, raises trade costs and reduces productivity. The result is that capacity to produce and trade is hampered, both regionally and globally. A recent study by the Africa Infrastructure Country Diagnostic shows an infrastructure funding gap of about $50 billion per year for sub-Saharan Africa alone. The African Union took a bold step to address this financial need when it launched its programme for infrastructure development in Kampala in July 2010. The programme emphasizes local ownership and is forward looking, covering the period from 2010 to 2040. It brings existing initiatives on infrastructure under one umbrella – for instance, the short-term action plan of the New Partnership for Africa's Development, the Partnership's medium- and long-term strategic framework and the African Union infrastructure master plan.

Given the limited financial resources available to Governments in most African countries, they will need to find ways to leverage private investment in infrastructure. Until recently, most of the private investment in Africa was in the telecommunications sector and not enough went into equally important areas such as energy and transport (see table). In this context, there is a need for African Governments to catalyse more private investments in the energy and transport sectors to boost regional trade. Governments should also explore new and innovative ways of attracting investment for infrastructure projects on the continent. For example, South Africa and Kenya have successfully used infrastructure bonds to finance road projects. Other African countries should explore this option while taking into account its potential impact on debt sustainability. Resource-rich African countries such as Botswana, Chad, Ghana, Libya and Nigeria have set up sovereign wealth funds. These resources could be leveraged to fund regional and continental infrastructure projects. Regional development finance institutions, such as the African Development Bank, also have an important role to play in financing infrastructure development, and this would certainly improve the operational and competitive environment for enterprises.

Make finance more accessible and less costly

Another vital area that needs to be creatively addressed in the capacitation of African enterprises is access to financial resources, which studies suggest is one of the major constraints to private sector development in Africa. Private firms in Africa have a hard time getting access to affordable finance for their businesses. Only about 23 per cent of African enterprises have access to loans or lines of credit compared to 46 per cent for non-African developing countries. It has been established that even this 23 per cent gets loans at interest rates that are 5–6 percentage points higher than their counterparts in other regions of the world. The high interest rates are also often coupled with forbidding collateral requirements. This scarcity of access to finance is especially serious for small and medium enterprises (SMEs) as banks tend to target large enterprises. Meeting the financing needs of SMEs is given low priority by domestic financial institutions. There are ways in which African Governments could work closely with the private sector to improve the financial infrastructure on the continent.

Private sector commitments to sub-Saharan African infrastructure, 2011

Sector	Share (%)	Total ($ millions)	No. of projects
Telecommunications	79	9,040	7
Energy	13	1,495	9
Transport	7	851	3
Water and sewerage	0	-	0
Total	100	11,387	19

Source: Infrastructure Consortium for Africa (2012).

For example, they could collaborate on reducing information asymmetry between lenders and borrowers through financing the establishment of private credit bureaux and public credit registries. Furthermore, the barriers of informality and small size that African SMEs come up against in their search for business finance can be tackled through business support services that facilitate their transition from informal to formal enterprises and enhance their access to credit. The private sector on its part needs to explore innovative and mutually beneficial methods to address the barriers inhibiting access to credit for SMEs. For example, both SMEs and the private sector as a whole could use value-chain financing and leasing of assets to overcome the problem of lack of collateral.

Value-chain finance has been successfully used in the agricultural sector in Ghana and Mozambique. In this model, also called "buyer and supplier finance", an input supplier provides inputs such as fertilizers on credit to a farmer or members of an agricultural cooperative group with the understanding that repayment will be made after the harvest. Regional development finance institutions can also play a crucial role in enhancing access to finance for SMEs, as their operations are usually subsidized by Governments and development agencies so that they can afford credit to SMEs at lower cost.

Africa needs a dynamic and vibrant private sector to seize existing opportunities in the trading system

While the problem of finance is more acute for SMEs, large firms in Africa also face significant financing challenges that have to be addressed. It is well known that financial institutions on the continent tend to offer short-term loans and are reluctant to provide long-term finance even for big businesses with adequate security assets. About 95 per cent of loans to firms in Africa are for five years or less. The consequent short duration of financial contracts in Africa is not conducive to promoting investment and building productive capacity. Governments need to use economic incentives, particularly guarantee schemes, to encourage financial institutions to lengthen the duration of their contracts, reduce fees and interest rate margins and make finance more accessible and affordable for domestic firms. Strengthening development banks and promoting the development of regional capital markets will also contribute to enhancing access to finance for businesses on the continent.

Another issue is the payment risk associated with regional trade – a major concern to exporting enterprises. Payment risk largely depends on the creditworthiness of the importer and the convertibility of the importer's currency. The multiplicity of inconvertible currencies in fragmented political units enhances risk and lowers confidence in intraregional deals. The formation of currency unions is one way through which African Governments could reduce payment risks associated with currency inconvertibility. Currency unions would also eliminate the transaction cost associated with using multiple currencies and thereby boost regional trade. African countries are strengthening efforts towards currency unification by putting in place the necessary institutions and rules that will guarantee full currency union in the medium to long term. They should in the short run consider strengthening cooperation in payments systems to reduce transaction costs and thus facilitate regional trade.

Strengthen mechanisms for consultation with the private sector

Although Governments and the business community should be equal stakeholders in trade matters, the sheer gap in communication between the two often becomes a formidable barrier to mutual understanding and effectiveness. The establishment of a credible mechanism for effective State–business relations is therefore needed to unlock private sector potential, build productive capacity and enhance prospects for boosting intra-African trade. In this regard, African Governments need to undertake regular consultations with the private sector for a better understanding of the constraints they face and how to address them. Such information is crucial in designing effective policies to promote entrepreneurship and boost intra-African trade. Purposeful and predictable leadership is needed to build trust between Governments and the private sector and create an environment that can enhance and sustain dialogue between them. Governments must make sure that dialogue with the private sector is done in such a way that it serves the interests of society as a whole. Checks and balances are also needed to ensure that close collaboration with the private sector does not exacerbate rent seeking behaviour. Transparency in dealings with the private sector and also the inclusion of civil society in dialogues between firms and Governments is a good way to reduce the scope for rent-seeking and corruption.

Facilitate cross-border trade

African countries are separated from each other by more than 100 bilateral borders. These borders constrain continental trade and integration given that they impose financial costs on traders and also create uncertainty. Measures such as the coordination of border controls, transit guarantee schemes or pre-arrival customs processing can facilitate cross-border trade but they also require collaboration among neighbouring countries. In fact, though, many African regional economic communities have already embarked on ambitious trade and transport facilitation programmes designed to promote cross-border trade.[2] It is important that these regional programmes be strengthened, and that the private sector is involved in their implementation.

Develop and strengthen workforce skills

The institutional and environmental factors outlined above and the strategies proposed for dealing with them are all important in the efforts to strengthen the private sector and boost regional trade. A critical consideration, however, is the human factor, particularly the quality of workforce skills. In an increasingly open and globalized economic system, domestic firms face intense competition not only in export markets but also in domestic markets. Their ability to withstand competition depends to a large part on their productivity drive and technological capabilities, which can be developed either through technology transfer or domestically through investment in education, training and research and development. Relative to other regions of the world, African countries are not investing enough in either education and training or research and development. There is a need to focus on increasing the availability of good-quality education; matching skills supply with the needs of the labour market; enabling workers and enterprises to adjust to changes in technology and markets; and anticipating and preparing for the skills of the future. The development of workforce skills, though, is not the responsibility of Governments alone. The private sector can also play a role through on-the-job staff training and also by contributing to financing research and training programmes in universities and research institutes.

Maintain peace and security

Achieving peace and security is the most pressing development challenge facing Africa and must be a key element in any credible policy package to strengthen private sector development and boost intra-African trade. Insecurity takes various forms, ranging from civil wars and political unrest to terrorism and piracy. While significant progress was made in the last decade, several countries have in recent years been involved in violent conflicts which have negative impact on infrastructure development, private investment and entrepreneurship. It also has serious consequences for country risk premiums and hence access to finance for intra-African trade. It is estimated that in a country in conflict, trade drops by as much as 12–25 percentage points in the first year of the conflict – and it can take up to 25 years before the country returns to pre-crisis levels. African Governments need to pay more attention to peace and security issues because they are necessary conditions for boosting regional trade and promoting private sector development on the continent.

[2] For example, the Common Market for Eastern and Southern Africa has a protocol on transit trade.

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Contact

Taffere Tesfachew
Director
Division for Africa,
Least Developed Countries and
Special Programmes
Tel. +41 22 917 5606
taffere.tesfachew@unctad.org

Press Office
+41 22 917 58 28
unctadpress@unctad.org
www.unctad.org

UNITED NATIONS
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UNCTAD/PRESS/PB/2015/5 (No. 33)