United Nations TD/B/62/4

United Nations Conference on Trade and Development

Distr.: General
6 July 2015

Original: English

Trade and Development Board
Sixty-second session
Geneva, 14–25 September 2015
Item 5 of the provisional agenda

Economic development in Africa: Unlocking the potential of Africa's services trade for growth and development

Overview

Executive summary

Africa finds itself at an important crossroads in terms of defining and shaping its transformational agenda. The services sector can and must form part of this process, given the role it plays in Africa's economy. The *Economic Development in Africa Report 2015* examines some of the major policy issues that underlie the continent's services sector and provides policy guidance on how services could contribute to regional integration in Africa and generate inclusive growth and employment. It analyses Africa's services sectors' regulatory and institutional frameworks, liberalization and growth at the regional level, and how services trade agreements and regulations (for example, the General Agreement on Trade in Services and a continental free trade area) interface with the domestic regulation of services.

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Introduction

1. Africa's services sector holds tremendous economic promise. It contributes to almost half of the continent's output, and a number of African countries have emerged as services-oriented economies. Indeed, growth in services has been vibrant in Africa, at more than twice the average rate for the world during 2009–2012. The sector's performance has undoubtedly contributed to Africa's growth trajectory of the past decade.

2. The services economy in Africa is a vital source of income and employment. In some countries, as much as two thirds of the workforce is engaged in services. Overall, the services sector in Africa accounted for one third of formal employment during 2009–2012. If the informal sector were included, the relevance of services would be even greater. Furthermore, as Africa's middle class continues to grow, and given current population and urbanization trends (Africa's population is forecast to double by 2025), this sector is expected to expand.

3. Equally important is the sector's contribution to Africa's trade. African services exports and imports totalled $271 billion in 2012. Though Africa is a marginal player in global services trade, with an export share of only 2.2 per cent, the services sector represents an important source of export revenue that should be further exploited if Africa is to assume a role as a global player in services trade.

4. Services also have a vital role to play in the context of Africa's development strategy, whether it is based on the exploitation of its natural resource base[1] or on labour-intensive light industry and manufacturing.[2] For either approach to succeed, exploiting the services potential of Africa will be critical to sustainable development. Indeed, as the most dominant sector in many African economies, services need to support the process of structural transformation, characterized by a shift from low- to high-productivity activities, and a declining share of agriculture in output and employment, as well as an increasing share of manufacturing and modern services in output. There are some dynamic emerging subsectors within the services sector with the potential to generate growth, trade and employment opportunities, which have yet to be tapped. For instance, logistics and distribution could greatly benefit Africa's agriculture (including agribusiness and food trade) and manufacturing sectors. Therefore, African policymakers need to place greater emphasis on how to move towards the provision of more sophisticated services where there is greater value addition and which offer opportunities for technology transfer and linkage development with other sectors of the economy.

5. Some services sectors are also considered to be the backbone of economic activity and have a bearing on social development. In particular, infrastructure services – encompassing transport, telecommunications, water, energy and financial services – are of critical importance to economic development and could contribute to addressing Africa's physical infrastructure deficit, inclusive growth and better social welfare. Infrastructure services also provide and support basic services (i.e. electricity, gas and potable water), which will be critical to the achievement of future post-2015 sustainable development goals. Lastly, infrastructure services are essential to the development of other service

[1] African Development Bank, Organization for Economic Cooperation and Development, United Nations Development Programme, Economic Commission for Africa, 2013, *African Economic Outlook 2013: Structural Transformation and Natural Resources* (Organization for Economic Cooperation and Development (OECD), Paris).

[2] AE Harrison, JY Lin and LC Xu, 2014, Explaining Africa's (dis)advantage, *World Development*, 63(C): 59–77; JY Lin and D Rosenblatt, 2012, Shifting patterns of economic growth and rethinking development, Policy Research Working Paper Series No. 6040 (World Bank).

sectors, including tourism, distribution (wholesale, retail), information and communications technology services, and business process outsourcing services. For infrastructure services to contribute successfully to the economic and social development of Africa, the institutional and regulatory environment must be supportive.

6. The continent is already tapping into some of the opportunities the services sector has to offer. For example, some African economies have been developing their services industries with relative success and are supplying services across Africa. Known examples of emerging regional services are the financial and banking services industries of Mauritius and Nigeria, the commercial and cargo air transport industry in Ethiopia and South Africa, the educational services industries of Ghana and Uganda, the telecommunications services of Egypt and the port services industries of Djibouti and Kenya.

7. Major challenges persist, however, especially as Africa seeks to move away from consumption-based growth to more durable sources of growth. The continent will need to shift away from relying on subsistence and non-tradable services to services which generate greater value addition and growth. A key policy question is, therefore, how Africa can translate services-led growth into durable employment and greater value addition for its development. Africa is showing immense potential in some of the services subsectors that contribute to trade in goods and, through these subsectors, the continent has an opportunity to link to global value chains. Equally, some countries have managed to develop their services beyond national confines and are supplying these services to other African countries.

8. In this context, the focus of this overview is to present the major regulatory and policy constraints that frustrate the development of Africa's services trade and how services can help Africa to integrate more beneficially into the world economy and generate growth and development that are sustainable and more inclusive. The following section recapitulates some of the main findings, key messages and policy recommendations emanating from the *Economic Development in Africa Report 2015*.

I. Main findings

A. Rapid rate of growth in Africa's services sector

9. Africa's rapid growth rate in services is comparable to that of the developing world and has a great potential to drive overall growth in the future. During 2009–2012 the services sector in Africa grew at a rate of 4.6 per cent, compared to 5.4 per cent in the developing world. The fastest growing services subsectors were transport, storage and communications, which are important for Africa's economic development. Broader economic growth and increased export revenue in the past decade, largely due to the commodity boom drove these encouraging trends. Regional trade in services has also increased tremendously especially along the three main lines of finance, telecommunications and retail.

10. Many African countries have undergone a process of shifting from agriculture to mainly non-tradable services, without going through a process of manufacturing development marked by significant productivity improvements, formal job creation, exports of sophisticated goods and the application of technology to the wider economy. From the period 2001–2004 to the period 2009–2012, of the 45 countries where the share of services in output rose, 30 experienced a contraction in manufacturing. This suggests that the complementarities between the two sectors are yet to be fully developed in some countries.

11. Weighted real gross domestic product (GDP) growth rates were calculated for each African country, and the contribution of the services sector to real growth was assessed. This exercise confirmed the importance of services acting as a cushion for the national economy at times of global economic shocks. For the period from 2009 to 2012, the services sector was the most significant driver of economic growth in 30 out of 54 African countries, accounting for more than 50 per cent of real economic growth. It accounted for more than 70 per cent of total real economic growth in 12 countries, of which 7 had services accounting for more than 50 per cent of their GDP.

12. The share of services in Africa's real output rose from 45.8 per cent to 49.0 per cent from the period 2001–2004 to the period 2009–2012. Within the categories of exports specializations, the shares of services in real output was highest among manufactures exporters (which consist of Lesotho and Tunisia) at 61.7 per cent, followed by services exporters at 57.0 per cent, and was lowest for fuel exporters at 33.9 per cent.

B. Rising services sector employment in Africa

13. The services sector accounted for 32.4 per cent of total employment in Africa as compared to 56.5 per cent in agriculture and 11.0 per cent in industry during 2009–2012.[3] Since 2001, the services share of employment has risen steadily while those of manufacturing and agriculture have stagnated. However, countries that are services-oriented do not necessarily source a large share of their formal employment from the services sector. In some countries where the services sector contributed more than 40 per cent to GDP over the period 2009–2012 (e.g. Ethiopia, Mozambique, Rwanda and Zambia), the services sector accounted for less than 20 per cent of total employment. This may be due to the nature of the services sector in these economies and the consequent labour intensity. For the services sector to increase its contribution to employment, the informal sector, which accounts for between 60 to 80 per cent of total employment in Africa, needs to be addressed.

C. Africa, a marginal player in global services exports and imports

14. Global exports of services in 2012 were $4.4 trillion, and for developing countries they were $1.3 trillion (at current prices). Total imports of services amounted to an estimated $173 billion in 2012 for Africa while exports of services totalled an estimated $98 billion.[4] In 2012 Africa accounted for only 2.2 per cent of the world's total exports of services compared to 3.6 per cent for developing America, and 24.3 per cent for developing Asia. The continent accounted for 4.0 per cent of total world's services imports compared to 5.2 per cent for developing America and 27.9 per cent for developing Asia. Only 11 African countries have consistently been net services exporters since 2005, 9 of which are dependent on exports of travel (mainly tourism) services. Africa continues to capture a small share of global trade in services because of a lack of strategic support to the sector, hence the need for the continent to build and expand on services trade activities that may generate greater value added.

[3] International Labour Organization, 2014, Global employment trends database, available at http://www.ilo.org/empelm/units/employment-trends/lang--en/index.htm (accessed 24 February 2015).

[4] UNCTADStat database, available at http://unctadstat/EN/Index.html (accessed February 2015).

D. Improved coordination, key to unlocking financial services potential in Africa

15. Since the 1990s the ownership structure of African banks has been radically transformed. Foreign bank ownership in Africa has almost doubled since 1995, rising from 120 to 227 banks by 2009. In Africa foreign bank assets as a share of total bank assets in 2009 was 58 per cent; the OECD equivalent was 38 per cent. Since the global financial crisis, there has been a trend in Africa towards both greater cross-border activity and consolidation in the banking sector.

16. Given the rising prevalence of cross-border banking, for Africa's largest cross-border banks countries will need to consider establishing bank-specific supervisory colleges and strengthen national and regional cross-border supervisory practices. This will require improved central bank coordination, resolution frameworks and stronger burden-sharing arrangements. For those countries and banks where systemic cross-border risks are identified, this may also require greater pan-African coordination and monitoring through the Financial Stability Board Regional Consultative Group for Sub-Saharan Africa and the Community of African Banking Supervisors.

17. While most African countries initiated financial sector liberalization in the context of structural adjustment programmes during the 1980s and 1990s, the liberalization of financial services is now conducted in the context of the General Agreement on Trade in Services (GATS). Indeed, financial services represent the third most committed services sector in African GATS schedules, after tourism and business services. A total of 20 African member States have made important commitments that are specific to financial services. Most limitations in Africa pertain to authorization and licensing requirements, as well as limitations on the form, amount or control of the investment of foreign banks mostly in mode 3 and mode 4. These two modes are conduits for investment and employment decisions on foreign banking activity in a given market and can influence the decision of a foreign bank seeking local presence abroad. Hence, they are critical elements that also reflect the level of restrictiveness foreign banking faces in Africa and have influenced the international banking scene taking shape in the continent today.

E. African countries – a need to explore potential global and regional value chains in goods and services

18. Services are also enablers of many production and sales processes. There are important input–output linkages between manufacturing and services. For example, in South Africa, of all domestically produced intermediate inputs into manufacturing, 31.4 per cent are purchased from the services sector while 18.6 per cent of all domestically sourced intermediate inputs into services come from manufacturing. There is significant scope for African countries to position themselves as reliable and competitive services suppliers in manufacturing value chains. Global value chains can offer significant new opportunities for structural transformation in Africa. About 60 per cent of global trade consists of trade in intermediate goods and services that are incorporated at various stages in the production process of goods and services for final consumption.[5]

[5] UNCTAD, 2013, *World Investment Report 2013 – Global Value Chains: Investment and Trade for Development* (United Nations publication, Sales No. E.13.II.D.5, New York and Geneva).

II. Main messages and recommendations

19. The policy analysis and discussion outlined in this overview can be recast in six main messages. First, the services sector has the potential to become a significant driver of sustained economic growth and structural transformation in Africa. This would, however, require policies to be aligned to build complementarities between the services sector and other sectors of the economy especially manufacturing. Several services are likely to exert positive spillover effects on other sectors of the economy (e.g. information and communications technology, finance and infrastructure, but also distribution and logistics). Africa must make greater efforts to link these services and industries, that is, to prioritize those services that are relevant for a value chain that is strategically important to a certain country. (For example, Botswana has generated higher benefits from its diamonds industry since it promoted downstream linkages with cutting and polishing activities; similarly the Nigerian oil industry has created some strong upstream linkages with exploration, project and construction services). A precondition for this requires a proactive policy response from African Governments, with measures tailored to support businesses in the services sector and forging public–private partnerships.

20. Second, services provision remains suboptimal and is delivered at a high cost. Various regulatory and policy shortcomings prevail, which explain these inefficiencies and impede Africa from fully capitalizing on its services sector potential. For Africa to better harness the potential of its services economy, regulation of and policies for infrastructure services need to better target existing market failures including issues of accessibility, quality, affordability and competition. Indeed, because infrastructure services have a strong bearing on the cost structure of many of Africa's exports, including commodities and manufactures, improving the quality and quantity of such services will enhance the continent's competitiveness. This is all the more important if the continent is to achieve structural transformation.

21. Third, for Africa to build on established intra-African trade – which has a more sophisticated composition than its commodity exports to the rest of the world and a higher intensity of services component – the link between human capital and high value added services (i.e. having good software developers, well-trained financial expertise etc.) needs to be better supported. This requires stronger State intervention in developing technical training systems and subsidizing higher education. Without this State support, it will be difficult for most African countries to exploit "knowledge-intensive trade" opportunities and to insert themselves as service suppliers into both higher value global and regional value chains for goods and services.

22. The fourth message relates to the regulatory challenges and opportunities of liberalizing services trade. Although African countries have made efforts to regulate services trade at the national, regional and global levels, a policy disconnect prevails between these three levels, hampering Africa's opportunities to tap into the benefits of greater services trade. Policymakers and negotiators at these three levels need to cooperate and engage to bridge this divide, so that Africa may better harness the gains of greater services trade and market integration.

23. The fifth message places emphasis on the potential role of services enhancing existing regional integration efforts and processes. In order to boost the prospective benefits of greater intra-African trade, the continental free trade area (CFTA) negotiations need to incorporate services trade. The impact of a continent-wide free trade area will only be meaningful for Africa if services are opened up in parallel with trade in goods.

24. Finally, recent studies suggest that the informal sector ranges from 50 to 80 per cent of GDP in Africa. It inhibits enterprise development and the continent's services trade

potential. Specific measures are required to support the formalization of informal service providers with a view to enhancing their productivity. This can be achieved, for example, through the modernization of transport and logistics value chains by addressing the efficacy and fairness of the tax system, lowering corruption and regulatory burdens, providing small business support services, improving access to credit for small firms and enforcing compliance with regulatory frameworks to improve the efficiency and accountability of public institutions.

25. In addition to these key messages, the report makes specific policy recommendations on how to better harness Africa's services trade potential and the related developmental, employment and growth benefits. The main policy recommendations are discussed below.

26. From the non-exhaustive mapping exercise of existing services trade policies in the African continent at the national, regional and global levels, it became apparent that a disconnect between these three levels exist, which needs to be bridged if Africa is to harness the benefits of greater trade in services.

27. The following policy recommendations are aimed at bridging this hiatus in a practical manner:

(a) Make use of multi-stakeholder consultations for policy processes at all levels

28. African countries have made strides to regulate services trade at the national, regional and global levels. Nonetheless, a policy disconnect prevails between these three levels, hampering Africa's opportunities to tap into the benefits of greater services trade. Policymakers and negotiators at these three levels need to link and engage to bridge this divide, so that Africa may better harness the gains of greater services trade and market integration.

29. Efforts to align the different levels of policy will require political will, considerable resources and a sensitization and advocacy agenda. African member States and regional economic communities have a number of tools available (such as multi-stakeholder consultation processes, interministerial and parliamentary coordination groups and working parties, focus groups, and surveys) to inform and support these policy processes. This exercise needs to start early on, at a policy design stage which embraces multi-stakeholder approaches and consultation.

(b) Increase efforts to operationalize and implement existing African Union decisions and institutions on trade

30. National and regional efforts to transpose African Union decisions must be doubled up, as evidence on the ground suggests that part of the disconnect between policies and realities lies in the absence of operationalization and mainstreaming of services trade into existing policy instruments, including monitoring and evaluation. The national mapping of services policies exercise suggests that there is a poor formulation of a services development strategy at both the national and regional economic community levels, which could trump any efforts at the continental level to develop a pan-African strategy for services. In parallel, existing institutions, such as the High-Level African Trade Committee, need to be vested with sufficient resources and autonomy to implement a services trade agenda that is coherent and coordinated at the three policy levels.

(c) Include services trade in any strategy on continental free trade area negotiations

31. In order to boost the prospective benefits of greater intra-African trade, the CFTA negotiations need to incorporate services trade. The impact of a continent-wide free trade area will only be meaningful for Africa if services are opened up in conjunction with

liberalizing trade in goods, especially as many services are critical trade enablers and have the potential to create important backward and forward linkages in the services economy that give rise to employment and growth opportunities.

32. There are also several policy recommendations that address the financial sector, as this services subsector has evolved rapidly in recent years. As Africa becomes increasingly integrated into global financial markets through foreign banking, there are several potential pitfalls that African policymakers and regulators need to both avoid and consider when exploring opportunities to harness greater capital flows towards improving productive capacity and economic diversification for a transformational agenda in the continent. African policymakers must improve the prudential regulation of the sector.

(d) Address structural impediments to finance

33. An imperative for realizing the benefits of a prosperous and efficient financial services sector is that Africa tackles critical structural impediments that burden financial sector development, growth and inclusion. These impediments include poor infrastructure, monopolies and inadequate regulation of the sector. Many African member States still need to introduce policies which foster greater domestic competition and address financial market concentration. Greater financial sector diversification and competition through better regulation could also reduce the impact of external shocks. Measures to help banks deal with regulatory hurdles that constrain access to finance might include making more State benefits available electronically and providing official identification cards to make it easier for banks to verify the identity of potential customers, thereby easing access to financial services for the unbanked.

34. In tackling the chronic undersupply of financial services in rural areas, regulation can also be instrumental to tackle financial market information asymmetries and moral hazard while supporting government efforts to improve financial inclusion, integrity and stability. Major possible reform areas include improving property rights regimes; using the extensive rural branch networks of State and development banks to extend access quickly and relatively cheaply to rural financial services; developing regulatory systems that engender confidence in the role of non-bank financial institutions in rural savings mobilization and as channels for rural payments and transfer of remittances; diversifying the supply of financial products and services in the banking sector; and regionalizing financial markets through legal harmonization and cross-listing at the regional level.

(e) Align regional and multilateral regulatory frameworks for financial services

35. Africa could also benefit from improved regulation by ensuring there is greater consistency in the regional and multilateral frameworks that already exist for financial services. For example, prudential regulation appears to be overlooked in many African GATS schedules of commitments; this is an area where African countries wishing to regulate the entry of foreign banks should be able to exercise discretion on the basis of their prudential regulation. In addition, countries which are yet to liberalize their financial services sector, have to make sure they use the flexibilities the system has to offer, by inscribing prudential carve-outs as most favoured nation exemptions. The definition of these carve-outs will require greater coordination between trade policymakers and central banks as well as other financial sector authorities and stakeholders.

36. Furthermore, greater efforts to align the sector with existing regional regulation, such as the protocols covering aspects of financial sector integration and/or investment, such as the Arab Maghreb Union, East African Community, Economic Community of West African States and Southern African Development Community, will be required. As the continent makes greater progress in regional integration, here too, the formulation of carve-

outs will be required to cater to financial integration and the emergence of a regional banking sector.

37. The above-mentioned disconnect is counterproductive especially with respect to regulatory issues and frustrates deeper regional trade. For instance, financial services regulatory frameworks in some countries (e.g. in a regional economic community) are contrary to regional financial services and investment protocols which are supposed to be binding on member States of that regional economic community. A national strategy or plan that incorporates financial services must be aligned to regional plans, as per the country's regional economic community membership, and also to global issues. In addition, these strategies must clearly define services as per the four modes of GATS and also identify embedded and embodied services as a way to properly diagnose and understand the services sectors they deal with or plan for.

Conclusion

38. Promoting the integrated treatment of trade, investment, finance and technology for inclusive and sustainable development could be a key sub-theme of the fourteenth session of the United Nations Conference on Trade and Development (UNCTAD XIV). Fostering the contribution to growth, trade and development of services in Africa is one of the key means through which UNCTAD XIV can begin to realize this objective and support regional integration processes in Africa en route to a CFTA. The African Union has committed itself to the creation of a CFTA which encompasses free trade in both goods and services by 2017. This report welcomes the commitment to a CFTA but notes that African countries have not fully reaped the gains from services trade through the GATS and bilateral investment treaties. Furthermore, the report stresses the need for Governments to address a major policy disconnect between national, regional and global levels, which needs to be bridged if Africa is to harness the benefits of greater trade in services. Finally, it stresses that the services sector has the potential to become a significant driver of sustained economic growth and structural transformation in Africa, if effective regulatory frameworks and policies are aligned to build complementarities between the services sector and other sectors of the economy, especially manufacturing.