Chapter 2

Global Value Chains and Africa’s Integration into the Global Economy
2.1 Global Value Chains: What They Are and How Africa Can Benefit

As a concept “global value chains” derives from the observation that all production entails a number of steps and actors, with each instance delivering on the basis of its own resource endowment, and existing logistical capacity, or geography, and the speed at which it can get to market, at the country level. Therefore, elements of the final product can be produced in many parts of the world and assembled into the final product in other parts, according to demand conditions, cost of production and ease of market access. For Africa, and indeed for the Bank Group, the key question is how to exploit current and emerging global value chains, while avoiding pitfalls.

Africa has posted annual growth rates of about 6 percent during much of the past decade. Of the 10 fastest growing economies in the world during this period, 6 were from Africa. As noted in Chapter 1, the natural resource boom and associated activities have been key factors, with demand from the emerging economies spurring South-South trade and investment, and creating potential for links to global value chains. With a large and expanding group of middle income consumers and increasingly interlocking regional economies, Africa could well become a global growth pole in its own right within a generation. But alongside Africa’s promising prospects are concerns over rising inequality and limited economic inclusion for the poorer majority. The pursuit of GVCs can be an important additional instrument in Africa’s broader search for structural transformation and sustainable development.

The emergence of GVCs in the world today is a direct response to technological innovations and competitive pressures arising from globalization. Many firms in the world have increased their cross-border collaboration, in many cases even directly integrating their production into that of other companies, to enjoy economies of agglomeration. GVCs are thus networks of borderless business systems that comprise a range of activities performed by firms in different geographical locations—regionally or globally. Each firm is assigned a specific role in the process, to bring products or services to market from conception to final use. Upstream activities, like mining, are typically only a small component of the chain, with considerably more value to be garnered ahead during further processing. The goal for

In the pursuit of Africa’s industrialization and further integration into the global economy, the logic of global value chains (GVCs) dictates that being part of the chain of production and maximizing on the component over which countries and their firms enjoy comparative advantage can be of greater value than controlling the entire production process. However, joining existing GVCs will not in itself guarantee immediate benefits nor will global value chains be a panacea for existing weaknesses in economic management and strategic planning. Countries will need to examine the costs and benefits carefully to avoid being locked into low productivity value chains and therefore into low-level development trajectories. Success will require an innovative and far-sighted approach on the part of policymakers, development partners and the private sector to take full advantage of Africa’s vast natural resources, its youthful population and its growing middle class to industrialize and diversify its economies. Above all, countries will need to learn how to best position themselves, including through collaboration with their neighbours, to draw maximum advantage from links to the rapidly changing global economy. This chapter discusses global value chains as an additional avenue for Africa’s development and the benefits of linking to the global economy. It also looks at the structural and policy challenges that must be addressed, including risks to self-determination, regional integration and the environment. The chapter also underscores the importance of adequate preparation, and of the support of governments for success.
countries is to participate more actively in these downstream activities that create more opportunities for value addition. Figure 2.1 presents components of a typical value chain.

Global value chains have been exploited to considerable advantage by multinational companies (MNCs) and global conglomerates for a number of business and strategic goals. Companies like the US aircraft manufacturer Boeing have been able to outsource the bulk of their production to specialized companies across the world, including developing countries. The individual companies are in turn able to outsource to even smaller companies in their host countries. Ultimately, modern planes are produced not by one, but by many companies, each coming on board within a specific global value chain, including, for instance, power systems, computer systems, and steering and navigation systems. The ultimate producer of the product is an assembler of the final product from the pieces produced by other firms around the world—but its own involvement has important implications for product design, quality and branding, which in turn raises the prestige of the brand, and strengthens the whole of the value chain.

For a country to link profitably to a regional or global value chain, improved logistics and good information networks are required. Countries and regions that have invested in new transport, information and communication technologies are best placed to benefit from trade in goods and services, owing to lower costs of transport, and access to information. This has facilitated the spatial division of labour among global value chain participants, with certain production processes located in particular geographical locations according to their competitive advantage.

### 2.2 Development Impact of GVCs

Global value chains have become a key feature of international trade. Major manufacturers source intermediate inputs from a variety of companies spread all over the world. Experiences have shown that linking up to GVCs has notable development impact, including in technological and skills development. But there are potential risks too, including being locked into low-productivity chains and exposure to environmental and social distress in the absence of adequate regulatory measures and preparation.

Although the practice of global value chains has been highlighted in recent years, the concept itself is not new, linked in previous decades to the activities of multinational corporations, which control global trade. The source of contention then was that much of the value in the chain was realized in the richer
countries where the MNCs had their headquarters. The major difference today is that considerable emphasis is placed on value chain governance, which is having some impact, notably in the garment industry. Apart from the potential for increasing trade and development, experience from other developing areas indicates that participation in GVCs has helped countries to vastly expand capacities at all levels, including technology adaptation, skills enhancement, and marketing. This in turn creates a firmer basis for longer-term industrial upgrading. Indeed participation in GVCs is strongly correlated with growth performance, within regions where they have taken hold, notably in Asia, with growth gaps between participants and non-participants of up to 2 percent of GDP.

Despite offering exciting opportunities, participation in GVCs involves some risks, including being trapped in low level value chains that could delay graduation to more productive levels, disruption of regional integration initiatives and negative environmental and social impacts. African governments, like their counterparts in other developing regions, notably Asia, must undertake cost-benefit analyses and other measures to assess the benefits that could derive from their pursuit of GVCs as a development vehicle, with the factors listed below as a guide.

- The GVCs’ contribution to job creation and growth will be quite limited if the country is unable to capture a substantial share of the value-added created in the chain. Undue focus on upstream activities could lock the country into low productivity chains with limited potential for economic transformation.
- In the absence of active public interest, assessment and follow-up, mere participation in the GVCs will not lead to technology dissemination, nor will it lead to the generation of enhanced technological skills. Therefore, GVCs should be seen as part of a broader policy effort for economic and industrial development.
- Environmental and social impacts of GVC activities—including working conditions and job security, and health and occupational safety—should be concerns for the whole chain. But this is often not the case, with participants downstream able to extricate themselves from such responsibilities.
- GVCs have the potential to distort regional arrangements and associated value chains, choosing to locate where incentives, such as tax holidays, are most attractive. This poses the risk of regional races to the bottom, reducing the impact of job creation and distorting regional cooperation.

To avoid pitfalls, participation in global value chains requires thoughtful preparation and planning by both firms and countries: from research and development to industrial policies and support for physical infrastructure. As isolated projects sponsored by individual firms or government departments, GVC projects have performed far below expectation in many African countries. The involvement of African firms in GVCs as defined above is relatively low, and even then, mostly on the lower rungs of the ladder in the extractive industries and agriculture. Therefore, the bulk of the value-added in the chains still accrues to firms in richer countries—examples include cocoa, coffee and tea within the agricultural sector, and copper and iron ore in
mining. Part of the problem has tended to be the lopsided tariff structures and the use of trade-distorting subsidies in global trade that would, for example, allow tariff-free entry for raw cocoa beans and impose prohibitive tariffs for semi-processed cocoa paste or copper bars and wire. Serious impediments to full participation in the past include weak implementation, and in instances, the absence of industrial policies and strategies for taking advantage of the available opportunities.

Today, a confluence of factors, including cost considerations, strategic location, and Africa’s emergence as a serious consumer of goods and services make it a place where GVCs could thrive. Africa has an indisputable comparative advantage in natural resources; they could provide a viable entry point into GVCs. Additionally, given its current level of development, Africa must attract labour-intensive industries, possibly from Asia, where rising production costs are forcing firms to search for cheaper locations for parts of their production.

In pursuing GVCs, lessons from Asia point to the need for specialized skills involving technical training, and the pursuit of science and technology. Such skills are prerequisite for involvement in high-level global value chains associated with industries such as information technology, electronics and pharmaceuticals. Most importantly, however, countries must learn to trade competitively. Examples from across the world indicate that regional trade is the basis for strong global value chain development. Africa, which has the lowest level of intra-regional trade, will start from a low base. But it is precisely for this reason that it could benefit greatly from a rolling-out of global value chains, especially for products targeted at the continent itself.

Specifically, Africa must raise its share in the global trade in services, including tourism. The continent accounts for only about 3 to 5 percent of global tourism, or about 60 million visitors per year. Although many global hotel chains are setting up in Africa, much more could be done to attract domestic and regional tourism and to improve linkages to the rest of the economy, especially the food sector. The experience of India and the Philippines shows that many African countries could enhance their capabilities and scale up their involvement in service value chains, which range from basic to sophisticated outsourcing services within IT, banking, administrative support, legal services, and health insurance services. For example between 2008 and 2009, India exported USD 26.6 billion in computer-based support services. Indeed the country is now one of the global leaders in the provision of business process outsourcing services, a market that was valued at USD 304 billion in 2013. Many African countries have shown interest in providing these types of services and are creating the required infrastructure.

Therefore, apart from exploiting their comparative advantages in the natural resources sector, notably agriculture and mining, African countries should strive for niche areas that will place them higher up in the GVC and enable them to reap gains from trade. As noted above, this will only be successful if GVCs are seen as part of a broader strategy for enabling countries to benefit fully from the new opportunities in the global economy. GVCs have to be accompanied by skills and infrastructure development and good economic management.

2.3 Financing and Governance

Access to finance for companies is a key constraint to the expansion of GVCs in many African countries. Many indigenous firms have historically been relegated to the informal sector. However, financial sector reforms have been useful in providing new financing modalities, although a substantial financing gap remains. On the other hand, the governance of GVCs remains a key challenge, especially owing to lack of regulatory frameworks on labour standards and the environment, and the ability of MNCs to bring pressure to bear and to cut deals at the local level. The adoption
of a number of international best practices could help in addressing these and related issues.

**Global Value Chain Financing**

Cost competitiveness, including in financing, is a crucial factor for successful participation in global value chains. Many large corporations, retailers and traders at the top of global value chains have succeeded in building strong networks for financing their operations over the years. However, in the high-risk environment in which many African countries operate, there are very few financing outlets for firms. Resources in government-sponsored agencies, notably development banks, are rationed to a great extent, while the situation at commercial banks and similar institutions is equally stringent. Many local firms, especially small and medium-sized enterprises (SMEs), are relegated to the informal sector, where borrowing costs are much higher.

Governments in many African countries have embarked on a number of reforms within their financial sectors with the goal of cutting the cost of doing business. A recent innovation has been the creation of central registries for borrowers in the belief that this would ultimately lower the risk of lending and hence the cost of borrowing. The impact, however, has so far been limited, and rates continue to be very high. Within the natural resources sector, governments and the private sector are developing a number of modalities. In many cases and as part of the Public Private Partnership (PPP) contract, the governments encourage the main contractors, often foreign firms, to take on smaller local firms as suppliers or subcontractors. They believe that this type of indirect financing will not only encourage learning-by-doing, but will also enable the local firms to raise their local profile and enhance their access to financing at reasonable cost. In other sectors, such as cut flowers, which are exported directly, governments in many African countries provided soft loans to farmers in the earlier stages, to help them learn the trade. This has not prevented the bulk of the flower-exporting firms from collapse—as lack of finance was clearly not the only constraint. Those that have remained viable, following consolidation, have been able to sustain the sector’s expansion and have become quite profitable.

Still, a general absence of long-term credit and venture capital financing in many African countries implies that access to value chain financing will vary from country to country and from situation to situation, depending on local circumstances. Current examples include small loans for inputs from government or donor agencies for the crafts industry, to complex loan products and related marketing services from collaborating foreign companies in mining.

Whatever their size, value chain financing structures are crucial to the survival of the chain and its local impact. It can help reduce costs, improve risk management and build trust along the whole chain. Since GVCs cannot develop in isolation from the rest of the economy, chain financing is also critical for the development of the financial sector more generally, as it adds depth and sophistication to financial products and advisory services.

**Global Value Chain Governance**

Global value chains have expanded in the last decade, with unprecedented levels of geographical dispersal and transnational coordination in the organization of corporate activities. Equally, so have concerns over value chain governance. Value chains previously organized and regulated in domestic settings have become integrated into global management systems through complex inter- and intra-firm network arrangements. The governance of these chains, notably in the area of natural resource exploitation, including production location decisions, contractual and technical arrangements, and value distribution, now extend beyond the control of governments, and sub-national institutions. Real control tends to increasingly gravitate towards transnational management spheres, with opaque accountability to governments in the host country of the chain in question.

Therefore, there is an underlying fear that unbridled profit making and shareholder value considerations could circumscribe existing social and environmental regulations, which are often weak and poorly enforced at the national level—leading to exploitation and environmental degradation especially in parts of the global industries based in Low-Income Countries (LICs). Stakeholder groups have accused MNCs of neglecting international labour conventions at the local level. They have also been blamed for the displacement of rural families from land with little or no compensation, and in the horticultural industry, of exhausting and polluting water resources with pesticides and other dangerous chemicals.

African governments can respond to these challenges by making efforts to reach formal agreements over global value chains, for example with key transnational companies to set a precedent, subject to open scrutiny by domestic and other stakeholders.

At the international level, a number of institutions and instruments could help countries establish domestic compliance agencies with respect to supporting responsible business conduct in GVCs. They include the ILO Tripartite Declaration, the United Nations Global Compact, and the OECD Guidelines for Multinational Enterprises. The International Conference on the Great Lakes Region-OECD-UN Forum on Due Diligence offers a good example of how to coordinate the actions of business, civil society, home and host-state governments, as well as donor agencies, to ensure adherence to good business practices in mineral supply chains.
2.4 Pathway to Job Creation and Industrialization?

Examples from across Africa indicate that GVCs can indeed create jobs, and provide profitable local niches. However, whether they can, on their own, tip African countries towards industrialization and economic diversification, is not clear. This is because industrialization emerges from the confluence of policies and other actions by stakeholders—including appropriate infrastructure development as well as availability of skilled labour. Actions by a few successful firms might not be enough to generate momentum, hence the need for a joint, big push from the government and the private sector.

The attraction of global value chains to Africa’s policymakers lies partly in their variety and in the range of economic issues that they could help resolve. Firms participating in these chains could range from micro-enterprises employing a limited number of employees to multinational corporations with thousands of employees. The environments in which they undertake their activities, even within a single country, are equally wide ranging. A global value chain, such as in the beer industry, might involve a direct link between rural producers and urban processing at the domestic level in a developing country and via global transport links and marketing, to supermarkets and consumers in developed countries. There is inevitably a feedback loop in terms of investment and inputs from the developed country to the industry of the developing one. Important dynamics lie within such chains and they could be harnessed for development.

Africa’s main interest in GVCs ultimately lies in their potential for industrialization and job creation, especially for its youthful population. The natural point of reference is Asia, which undertook policies specifically targeted at industrialization—among them, special economic zones (SEZs) that helped plug those economies into global value chains. The SEZs, popularized by China, were areas within countries set up under special regulations and economic incentives designated for promoting industrialization. SEZs were often established along the coast to maximize export opportunities, but there are also a number of cases of inland SEZs, including in a number of African countries. Most often, the goal is to organize production around processing and manufacturing activities, especially for the export market. Another important goal is job creation. With China and other Asian countries moving to higher-value industrial and service production, Africa could potentially benefit from the inevitable shift of some of the manufacturing capacity from China to countries with lower costs of production and access to markets. Parts of Africa seem to satisfy both criteria. Examples include Chinese investment in Egypt’s electronics industry for the production of TVs, and a Hong Kong-based company investing in the production of plastics, steel, ceramic tiles, and leather in Nigeria. Similar examples are found across Africa.

Economic Diversification and Job Creation

Africa’s recent growth, powered by natural resources, has not led to significant job creation. The generation of an adequate number of jobs will require structural transformation. This would involve targeted actions at national and regional levels to establish production and trade links, and synergies between different actors along the entire economy through the provision of incentives for bolstering private sector investments and competitiveness.

With regard to leveraging GVCs to create jobs, add value and upgrade skills, Africa has had some notable examples. They demonstrate the importance of comparative advantage as determined by logistics, geography, and market proximity, but also the importance of active government support and advocacy. Two examples provided here include the production of flowers in Kenya (Box 2.1) and the auto-parts industry in Morocco (Box 2.2). Box 2.3 describes GVC opportunities in the mining, oil and gas sectors in Africa.

Box 2.1
Kenya Flower Industry

Kenya’s flower industry is one of the largest in the world and is a key foreign exchange earner. The country is now a lead exporter of cut rose flowers to the European Union with a market share of about 38 percent. Approximately 65 percent of its exported flowers are sold through Dutch auctions to the United Kingdom, Japan, USA, Russia, France and Germany. In 2013, exports from the cut flower sector are expected to reach some USD 1 billion, compared to USD 692 million in 2011.

Kenya’s cut-flower industry has performed well in terms of employment, attracting investment, and adoption of efficient production methods. The bulk of cut flower processing is done in Kenya and the industry now employs close to half a million people. Notably, smallholder farmers in the flower industry tend to profit more than those in the tea and coffee sectors.

The country has invested heavily in greenhouses, machinery, irrigation systems, and in cold storage facilities. This vertically-integrated value chain has allowed quick adjustment to market conditions and the rapid response to changing consumer preferences and international competition. The cut-flower business associations in the country have not only become strong industry lobbyists, but also act as important agencies of self-regulation, introducing codes of practice benchmarked to international best practices. The associations work closely with government in promoting an enabling environment for the development of the sector.
Though attractive as a concept, Special Economic Zones (SEZs) have had a difficult history in Africa, mostly because in the past they were seen in many countries as bureaucratic initiatives, and not businesses ventures that would return a profit or pay their way. Coupled with controls in the rest of the economy, SEZs failed to deliver. However, in the much changed policy environment of today, with a firm belief in the value of competition and real business incentives in much of Africa, SEZs could have a new lease of life. They have recently gained attention in terms of economic diversification and job creation. China is playing a large role in the development of African SEZs, and the United States and the European Union are also lending support.

Preliminary evidence from the new round of SEZs in Africa indicates that they are creating new jobs, with workers in these zones paid better than workers employed elsewhere. Ethiopia is a good example—it has prioritized light manufacturing growth, including the leather industry, as part of its economic transformation program. For example, a SEZ run by a Chinese firm outside the capital, Addis Ababa, is producing designer shoes for the US and EU markets. Up to 25,000 jobs have been created by linking production directly to global value chains. In Ghana, the Tema Free Zone, a 480-hectare industrial park outside the capital, Accra, has created 30,000 jobs. Smaller companies use the zone as a platform to link to global production networks.

Global Value Chains and Industrial Development

Industrialization is a challenge and an opportunity for Africa. Many countries are looking closely at the opportunities offered by GVCs. At the lower end of the spectrum, African countries are well integrated through their supply of basic inputs and raw materials. More than 70 percent of Africa’s exports are intermediate inputs from the extractive industries, for global production of such items as copper wire, steel and petroleum. Africa’s ambition is to surpass this stage, and ensure more value addition to their production processes via fully-fledged industrialization. Today, for example, Africa only adds value to 14 percent of its exports compared with 27 percent for emerging Asia and 31 percent for developed economies.
While Africa is the world’s largest producer of cocoa beans, 90 percent of the crop is exported in raw or semi-processed form. The grinding of cocoa is done abroad. Cocoa growers in West Africa receive approximately 5 percent of the price of the finished chocolate bar. The bulk of the value in the cocoa value chain accrues to firms outside producing countries.

Retaining more value from its natural resources within Africa is important for the continent’s future development and prosperity. The issue is how to position production on the continent in such a way as to create a profitable link with the much bigger and stronger chains in the global economy.

In sum, how global value chains in Africa can serve as vehicles for economic transformation is an important issue—the further example of Lesotho is described in Box 2.4. Manufacturing and related investments within value chains can be critical sources of demand for other sectors of the economy such as transport, banking, insurance and communication services. They are highly important for Low-Income Countries. They can create a basis for the development of agro-processing, with considerable impact on job creation and reducing rural poverty.

### 2.5 GVCs and Industrialization: Key Features for Public Policy

**Success in the pursuit of GVCs for industrialization and structural transformation will require well-defined actions by governments to create an enabling and competitive environment. GVCs will not happen in a vacuum and governments will play a key role in formulating regulations, providing infrastructure and ensuring that GVCs are well linked to the rest of the economy. Information and knowledge on GVCs and trade more generally will be crucial for planning and implementation.**

The sections above have looked at a number of factors related to the GVCs and how they can impact development in Africa by unlocking its global potential, especially through the export of goods and services with higher value added. In this subsequent section, we discuss four implications for public policy.

**The role of the state.** Experience shows that breaking into global markets does not simply happen by accident. It is the product of careful planning, execution, and monitoring, involving close collaboration between the government and the private sector. The case of Morocco in the auto-parts industry, detailed above, is a good example. It requires sequenced movement from national competences to regional and global ones. In all cases, a degree of experimentation will be required, and success is not always assured. But there are rewards to patience, flexibility and good execution. The role of the state will also be crucial in reducing the cost of doing business through physical infrastructure provision, especially power, and ensuring an adequate pool of skilled and educated people.

**Competitive environment.** The “new” industrial policy sees a crucial role for the government in promoting industrialization, but the creation of a competitive environment is still the most important factor in the process. African countries need to know (i) what works “locally” in efforts to improve the performance of existing industries, including issues of infrastructure provision, access to financing, and ways of establishing effective PPPs, (ii) what works “regionally and globally” including “strategic bets” on new regional industries, and (iii) how to create international coalitions to enable Africa to make a real breakthrough in global trade. That will make it possible for the continent to grow sectors where it enjoys a comparative advantage—notably agro-processing.

**Leveraging knowledge.** The emergence of a knowledge-based economy is the real difference between past industrialization strategies and those of today. There is real time information on the many changes taking place in the global economy, making the process of adoption rapid, but also providing the opportunity for rapid learning-by-doing and helping countries to leapfrog to more sophisticated and productive niches. This will dismantle barriers to entry, promote local research and development, and encourage cross-fertilization of ideas across countries, and regions.

**Trade as gate opener.** Unlocking Africa’s potential will depend to a large extent on the Continent’s ability to trade globally and regionally. Integration into global value chains...
will require the expansion of trade networks to benefit from scale economies. Simplifying trade and tariff policies between African countries is also important.

2.6 Conclusion

This chapter has shown that GVCs have potential in Africa. However, their full potential will not be realized, while African countries are hampered by trade and investment difficulties, including those with their immediate neighbours. It is important to underline the importance of lowering trade barriers, investing in people, building high quality infrastructure to foster competition and enforcing contract compliance within the private sector, while still considering social risk management and environmental safeguards.

GVCs, however, are only one element in a much broader strategy for Africa’s transformation. They must, at a minimum, directly support Africa’s most important sectors, namely agriculture, mining, oil and gas, manufacturing, and the SME sector. Today, Africa is in a much better position to design initiatives that will foster participation in GVCs than in the past, particularly given the economic changes on the continent, including its rising importance as a global consumer. To have lasting impact however, GVCs must be able to help countries create jobs. This will be the best way to ensure that the benefits of growth are widely shared. The next chapter looks at how the Bank is supporting GVCs through its projects and programs and how it envisages their integration in its Ten-Year Strategy.