T20 Policy Brief

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Task Force 04

TRADE AND INVESTMENT FOR SUSTAINABLE AND INCLUSIVE GROWTH

Maximizing Private Sector Participation in Africa and the Pacific to Boost Value Chain (Regional and/or Global) Integration

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Abstract[1]

Trade liberalization has eased cross-border production through lower transport costs, advancement in information and communication technology, and continued innovation in logistics. Further to this, cross-border production (and supply) has rapidly expanded in many industries in recent decades, largely driven by Transnational Corporations (TNCs) within the remit of increased bilateral and plurilateral trade and investment arrangements, the resultant effect is markets dominated by TNCs causing an imbalance and fragmentation of Value Chains (VCs).

The brief opines that fuller participation of VCs is dependent on the deliberate inclusion of Medium, Small, and Micro Enterprises (MSMEs) a majority of which emanate from the global south with a narrower focus on Africa and the Pacific(A&P), noting over the years their participation has been minimal thus creating a lacuna notwithstanding they inform a greater part of the A&P economies. Thus, the recommendations in this brief wholistically suggest the need to recalibrate the current trajectory for greater gains to trade.

While VCs account for almost 50% of global trade today and have aided developing economies in accelerating socio-economic growth and reducing poverty margins, there are prevailing inhibitors such as Trade, Political conflict even systemic issues affecting greater participation. For succinct recommendations, the arguments advanced in this policy brief will generally address prevalent challenges in value chain integration and

[1] The Analysis in this paper do not represent the organizations represented by the Authors but are personal professional views all sources of information are duly acknowledged.

how best to improve and integrate the private sector, and the salient role of multilateral/ regional institutions in leveraging greater participation of the private sector.

Africa and the Pacific are marred with a myriad of issues in their quest for economic prosperity and sustainable development due to physical and geographic underpinnings such as size; the tyranny of distance or remoteness and dispersion. The size of their domestic markets constrains economic activities thus affecting economies of scale, specialization, and industrialization.

A keen analysis of the African and Pacific value chain systems suggests the need for a consistent engagement with the private sector at every step whether at the primary or secondary stage. Furthermore, while it is important to acknowledge the role of the private sector in value chain development or integration from the lens of increased competitiveness, employment creation, and provision of effective technologies (e-commerce/ digital trade), more weight should also be given to governance of the success of which harbors a significant opportunity for capacity building of private sector within the value chain through lead actors which allow them to strengthen their participation and positions on the same.

Governance is imperative as it addresses the ability or lack thereof to exert control along the chain for a particular purpose, thus the key parameters for fuller private sector participation would be;

i) Participation in the production end of the chain .

ii) Participation in the production processes

iii) Contributing to the volume of production

Value chain governance participation by the Pacific and Africa's private sector will enable them to be rule makers, price-makers monitors, and facilitators of compliance with rules that pertain to their sphere of influence, while the policymakers and legislators set the policies and laws respectively the lead actors close to the market remain in the private sector.

Owing to their practical understanding of market systems and dynamics, applying a private sector approach will enable them to explicitly coordinate the activities of the value chain (supply or production) ranging from costing, quality, adoption of specific equipment, skill, and business processes thus increasing participation and improving trade competitiveness of all sectors or industries.

An all-participatory approach comprising of the market, relational, and modular value chain governance particularly in sensitive sectors such as fisheries, textiles, and cosmetics may require a blend of modular and relational governance approaches for the following reasons:

i) To boost markets in the outer islands often disconnected due to tyranny of distance and connectivity limitations, a good example being the fisheries sector in which there is a clear price disparity between outer island fish and those in the main towns.

ii) The uncertainty associated with weather /climate patterns would require a definite modus operandi for consistent supply and revenue flow, especially for small island states in the Pacific

iii) To ascertain the quality and safety of products

A well-defined value chain governance system guarantees fuller participation as demonstrated in i-iii above because the entire private sector structure would be integrated into the same.

For example, in the Pacific large volumes of fish are caught in the outer islands but fetch low prices or profits because of the disparity in income levels and inadequate infrastructure in terms of transport and storage to extend the customer base to bigger cities/towns, setting up of modern fish markets equipped with cabins, refrigeration, storage facilities, live catch handling areas, would be an ideal structure to implement value chain governance in which case could either be modular or relational.

Benefits for Private Sector Participation in Value Chains Outlined

- ✓ Value Chains can augment Africa and the Pacific's existing participation in regional and global trade. Global markets remain essential for productive transformation in terms of higher-quality inputs and opportunities for upgrading. Thus, a value chain can enable progressive entry into the global market.
- ✓ Offers opportunities for adding value to selected sectors such as Agriculture and Fisheries and further increases backward participation in global value chains.
- ✓ Creation of new competitive advantages through increased consumers, skills, suppliers, and other resources needed to develop and scale up knowledge and labor-intensive sectors.
- ✓ For smaller economies, a value chain system will enable them to benefit from across larger markets, enhancing local productive capacities by attracting new intra-regional investments and gaining efficiency from specialization.
- ✓ The development and discovery of new productive capabilities through physical, cultural, and institutional proximity and access to existing networks of contact, thus reducing the costs of firms to experiment in regional and continental markets.
- ✓ Offers opportunities to transform African and Pacific economies by developing and expanding new activities and building dynamic and competitive manufacturing, agriculture, and service sectors. They also play a significant role in offering local producers, including small- and medium-sized enterprises (SMEs), opportunities to access fast-growing and more easily accessible markets.

- ✓ Reduction of costs of cross-border trade through consolidated trade procedures, establishing one-stop shops to reduce the administrative workload, facilitating. cross-border mobile payments and adapting the requirements for documentation and formalities to small-scale traders.
- ✓ Creation of employment, especially for smaller economies which are expected to capture greater gains from trade liberalization. Projections from the World Bank also suggest there will be a large job reallocation across sectors, with a net increase in the volume of workers in energy-intensive manufacturing, public services, trade, and recreational and other services. Institutions to safeguard labor regulations will be increasingly necessary to ensure quality job creation in regional value chains.

Prevailing Challenges for the G20s Intervention

- ✓ Non-inclusion of value chain development in national development plans, many times there is a disconnect between the regional and national plans and priorities to the extent that value chain development may be recognized in regional strategies but is not reflected in national documents.
- ✓ Risk of environmental challenges from participation in value chains, ranging from more frequent and longer droughts to soil toxicity caused by metals, dyes, and bleaching agents used in the textiles industry to coastal habitat degradation from intensified aquaculture.
- ✓ High costs of trade can be a barrier to value chain development as they restrict production networks because of costs. They are more detrimental for backward participation than forward participation this was exacerbated further due to the recent COVID-19 crisis.
- ✓ Rudimentary productivity levels, skills, and organizational capability required to export directly or form strategic partnerships with multinational enterprises. High costs of exporting and importing activities imply the minimum efficient scale needed for internationalization.

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Diagnosis

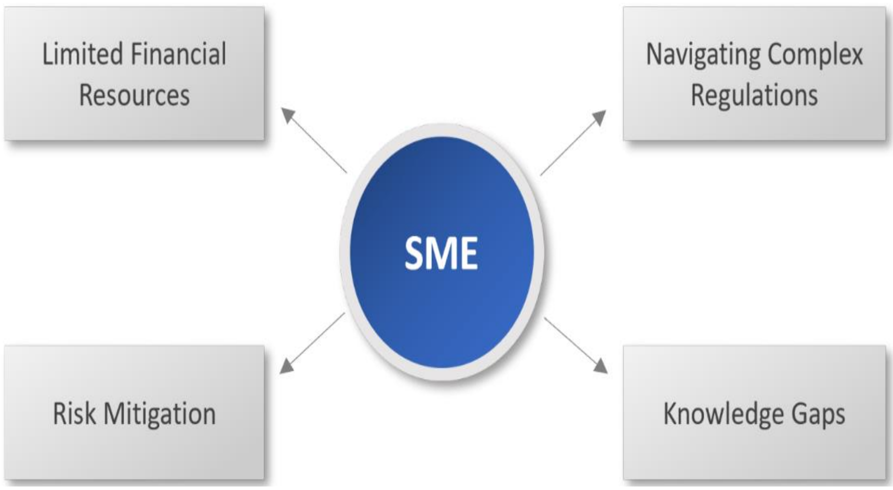
Despite the political goodwill by several African and Pacific States, there have been imminent systemic implementation gaps owing to limited financial, and for the Pacific, both financial and human resources. Naturally, this has been because of the fight against the COVID-19 pandemic which significantly reduced the fiscal space available both to African and Pacific governments.

Additionally, the disaggregation of production processes owing to inadequate private sector participation in building trade capacity calls for reforms in the value chain systems that can be triggered through public-private partnerships, importantly breaking away from the traditional Trans National Corporations(TNCs) and including more Micro, Small, and Medium Enterprises(MSMEs) as the business architecture of Africa and Pacific is dominated by MSMEs that would add value to employment creation, product and market diversification if well utilized.

It is critical therefore to foster more public-private partnerships and diverse forms of financing assistance for more efficient use of available resources to address trade capacity shortfalls. Although there are notable gains from participation in the global trading system the same remains uneven with minimal if no access to potential gains notwithstanding trade remains the core engine of growth in both regions. A robust Aid for Trade Strategy to ensure a consistent engagement of the private sector resulting in new economic opportunities, especially for the landlocked and small island states, is also key.

In essence, the main problem is not a lack of initiative or political goodwill in Africa and the Pacific but an implementation gap owing to a lack of adequate resources and institutional mechanisms for monitoring and evaluating implementation, and while it may be ideal to vouch for more external financial aid the bigger picture is to remain afloat sustainably, a reality that can only materialize through adopting a bigger percentage of domestic resource mobilization through proper structures that can enable the private sector fully participate.

The present architecture of global institutions calls for consideration to embrace deeper reforms further noting that they are a priority discussion in the G20, it is imperative, for instance, to consider recalibrating the present financial architecture of the Bretton Woods Institutions to include robust and simplified Trade Finance products for MSMEs, presently Trade Finance for MSMEs is still branded a high credit risk compared to TNCs an issue that can be mitigated with proper guarantee mechanisms through national institutions such as cooperative societies.



The diagram depicts the present structure of operationalization in so far as Trade Finance for MSMEs is concerned, aside from limited financial resources owing to the absence of proper risk-mitigating structures, there is also the issue of complex regulations that hinder access due to low financial literacy levels, minimal or lack of risk mitigation structures which posits a threat to financial institutions as there is no clear guarantee mechanism, and knowledge gaps in terms of trade finance products or the importance of trade finance.

Discussion on the architecture of global institutions in the G20 is timely as it presents an opportunity to address structural gaps and reconsider introducing flexible modalities for greater access to finance for trade, thus echoing the discourse in national and regional jurisdictions noting that Africa has taken strides through the establishment of the regional banking institutes-the African Development Bank and the Africa Export-Import Bank in Abidjan and Cairo respectively, while the Pacific although not having a distinct regional financial institution, has actively engaged in discussions on Trade Finance evidenced by the *1st Pacific Virtual Trade Finance Symposium convened in March 2021 sponsored by the Pacific Islands Forum Secretariat(PIFS)* and subsequent discussions on correspondent banking.

Regional Economic Blocs have accelerated their commitments to identifying and developing value chains based on comparative advantages, for instance, the Southern Africa Development Community (SADC)Regional Industrialization Roadmap of 2015-2063 aspires to develop six regional value chains.

The regional level offers the opportunity to identify value chains based on comparative advantages, such as those mentioned in Annex 2.A1. For instance, the Southern African Development Community (SADC) Regional Industrialization Roadmap 2015-2063; Since 2014, the Economic Community of West African States (ECOWAS) and the West African Economic and Monetary Union (WAEMU) have adopted the West Africa Competitiveness Programme, a six-year plan to support eight selected value chains at the national and regional levels and last but not least following the development of the East African Community (EAC) Cotton, Textiles and Apparel Strategy, the industry emerged as priority sector within national development plans of member countries, with the common target to build a globally competitive textiles and apparel industry.

Recommendations

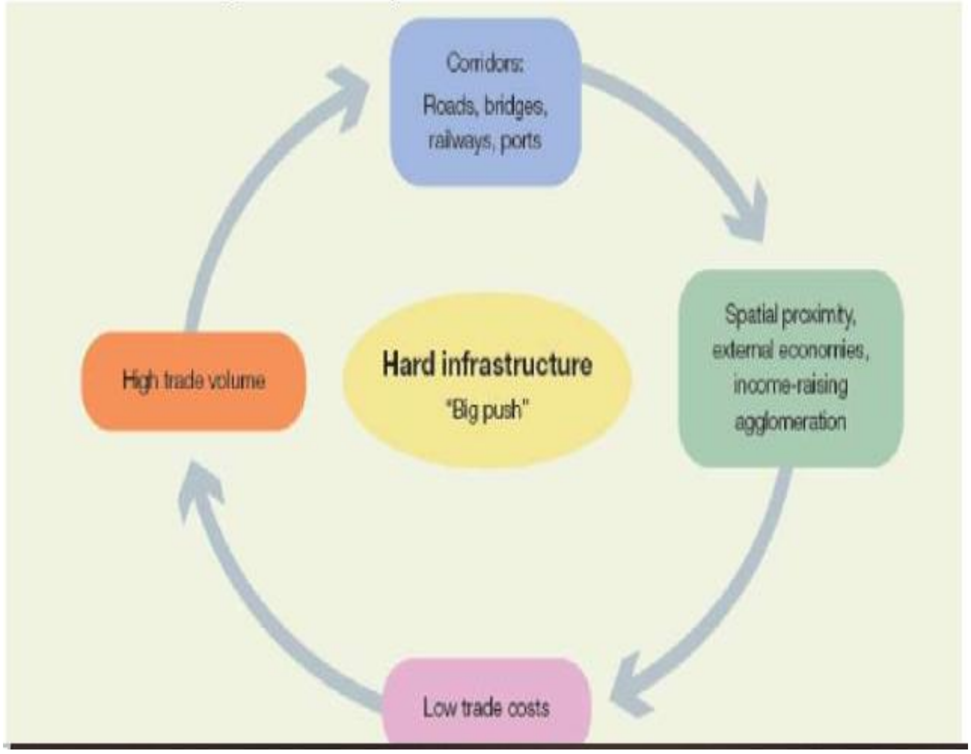
Below are key recommendations for consideration and onward implementation by the G20:

✓ Scaling up trade finance and logistics noting that members of the G20 are also members of the World Trade Organization (WTO) the WTO- Trade Facilitation Agreement (TFA) which needs not only increased funding but accessibility to improve on the logistics importantly port management. Logistics costs in Africa and the Pacific remain higher than the world on average in addition to the trade finance gap. For example, Africa's trade finance gap broadly measured by the total value of rejected applications for banks' trade finance stood at USD 81.8 billion in 2019 thus reducing the ability of the private sector to compete in international markets.

✓ Provide support, as part of the global institutional reforms agenda in the G20, for the setting up of a Pacific Regional Bank, specifically the Pacific Export and Import Bank (PEXIM) that can extend assistance to the small island nations. Except for the big economies in Melanesia and partly Polynesia, there is a big financial infrastructural gap in Micronesia with some members even lacking reserve and national banks mostly due to capacity constraints.

✓ Increased collaboration on safety and quality (quality infrastructure) and hard infrastructure in the form of roads, sea vessels (boats, ferries), and storage facilities for marginalized or outer markets to reduce trade costs for the private sector as indicated in the diagram below;

Hard infrastructure (virtuous circle)



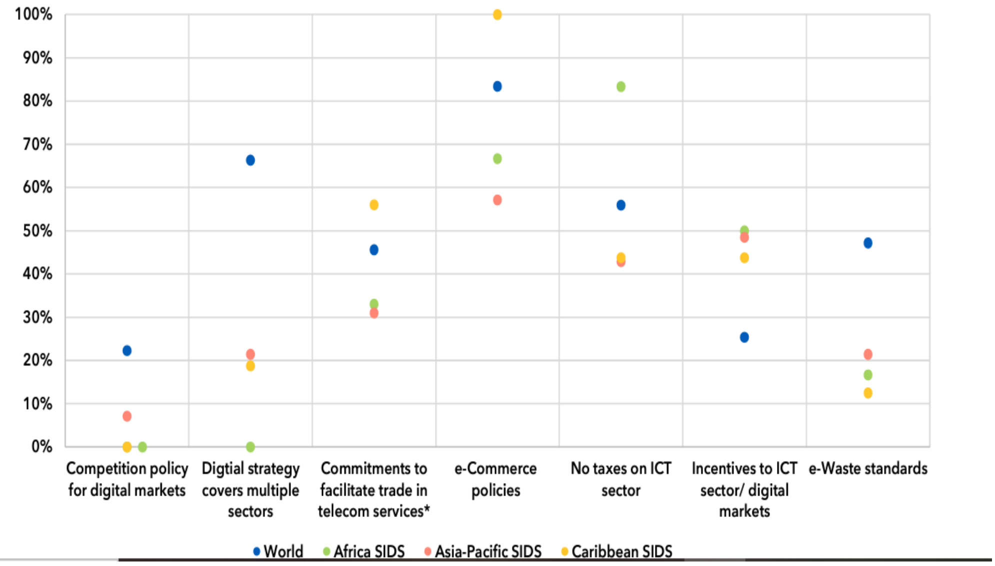
Soft infrastructure (vicious circle)

Source: AfDB, 2019.

✓ Enhance the use of digital infrastructure through setting up of e-commerce websites unique to both regions and mobile application systems for markets and price notifications. This can assume a regional payment system approach (Africa and the Pacific) that extends to smaller amounts to reach sufficient scale and include more small and medium enterprises. The small island states might benefit through this approach as it will scale up domestic retail payments, the Common Market for Eastern and Southern Africa (COMESA) through its Business Council is aiming to develop a low-value regional digital payment scheme to reinforce smaller firms' inclusion and further harmonize regulations by bringing together regional financial services regulators.

✓ Concerted efforts in developing intra-regional Internet infrastructure, policies, regulations, and cross-border data flow are a necessity for Africa and the Pacific. Leaving no one behind should be the policy objective to be considered for streamlining. For example, while almost half of SIDS were equipped with universal access or service policies in 2023, only 14 percent of SIDS had specific policy instruments or initiatives for connecting women and girls or persons with disabilities, and a mere 8 percent specifically for connecting young people. (see diagram below).

Key digital economy policy instruments, 2023



Analysis of Diagram

The diagram reveals a new generation of digital economy policies that reflect a holistic view of the economy and society by further addressing digital technologies and markets as an ecosystem that leads the way to accelerated development, economic transformation, diversification, and growth. From the diagram, there is still uneven integration of digital economy policies in Africa and the Pacific, thus calling for greater support to adopt key digital economies policy instruments, such as tailored competition policies and e-waste standards.

Possible Scenario of Outcomes-Initiating the Policy Porosity Approach (PAPA)

The brief proceeds on the premise that the recommendations herein are novel, however, there are structures already in place at the regional level both in the Pacific and Africa, as such it would be erroneous to assume that all recommendations would be easily absorbed and implemented.

Suffice it to say before progressing with the implementation of one or all of the recommendations the brief has initiated an approach referred to as the Policy Porosity Approach (PAPA) which entails:

- ✓ Understanding the geopolitical and structural factors that shape Africa and the Pacific
- ✓ Identifying the existing policies, regulations, and incentives and exploring dialogue mechanisms to augment rather than re-invent what is already in existence.
- ✓ Choosing through mutual dialogue a feasible framework in Africa and the Pacific to implement, for instance, the Pacific has a regional aid for trade strategy (Pacific Aid for Trade Strategy) that has identified priorities within which the recommendations can be synchronized.

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