

The global economy: Can African firms break in?

Introduction

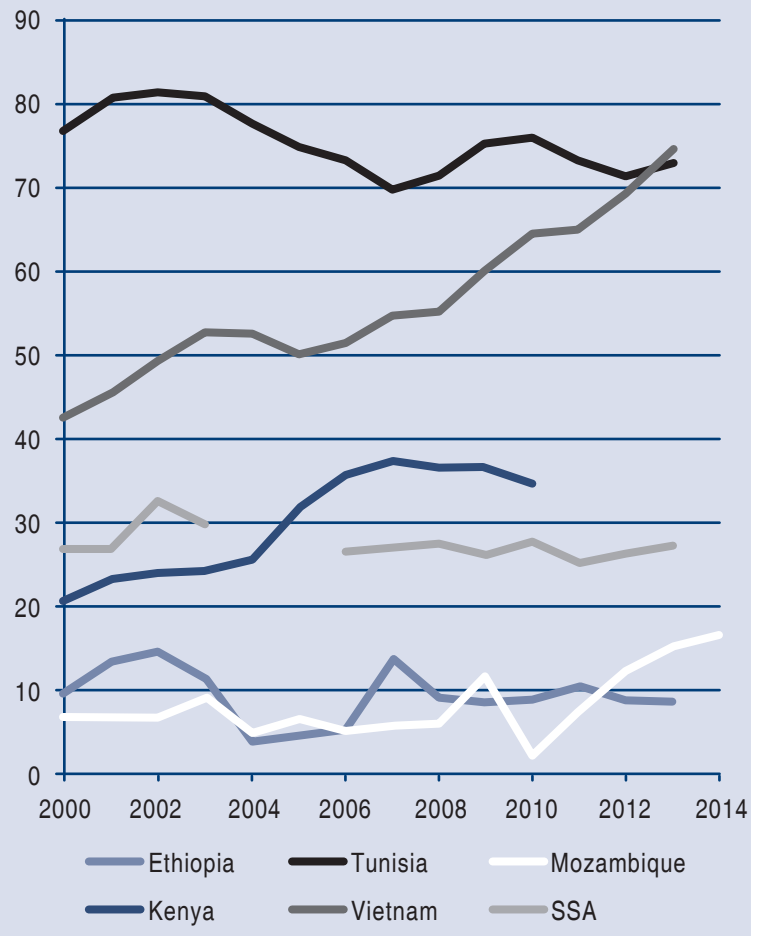
The emerging Asian economies have been considerably more successful in manufactured exports than countries in sub-Saharan Africa. Vietnam, for example, saw manufactured exports per capita rise from current \$80 in 2000 to \$1,100 in 2013, a rise by nearly 1,300 percent. Over the same period, manufactured exports per capita from the region grew from current \$38 to \$120, i.e., a comparably modest rise of slightly more than 200 percent. Figure 1 shows how the share of share of manufactured exports in total merchandise exports has changed in a selection of the countries that were studied as part of the Learning to Compete (L2C) project, and for the region on the whole. In Vietnam there has been rapid structural change and a remarkable orientation of exports towards manufactured products, while in sub-Saharan Africa the norm has been status quo.

Africa has a chance to break into global markets in industry, but low wages alone will not be enough. Some African firms have productivity levels that, when combined with low wages, make them competitive with Chinese and Vietnamese producers—but this is the exception rather than the rule. On average, Africa's firms are less productive than their Asian competitors, and closing the industrial productivity gap between Africa and the rest of the world is essential if it has any hope of breaking into global manufacturing and staying there. Firm-level studies conducted as part of the L2C project provide important insights into what types of challenges African firms are faced with, and how policy can facilitate.

Challenges facing African firms

Careful microeconomic research based on firm-level data from Ethiopia, Mozambique, Kenya, Tunisia, and Vietnam has highlighted two common challenges that prevent African firms from entering the exports market. The first relates to the **productivity gap** referred to above. The firm-level data show very clearly that high productivity is a key factor enabling firms to enter the exports market and compete internationally. A productivity boost for a particular firm considerably increases the likelihood that the firm will export in the near future. This result holds in high-productivity environments, such as Vietnam, as well as in low-

Figure 1. Percentage of manufacturing exports in total merchandise exports



productivity economies, such as Ethiopia. And since most Vietnamese firms are more productive than their Ethiopian counterparts, export performance at the national level is much stronger in Vietnam than in Ethiopia. The second challenge is posed by high **entry costs**. The firm-level data indicate non-negligible costs of entering the exports markets across all countries under study, but these costs appear to be particularly high in sub-Saharan Africa. Poor infrastructure, high transport costs, and a general lack of knowledge of potential markets abroad are important determinants of these entry costs.

Addressing the challenges

Clearly, the higher the costs of entering the exports market, the higher the economic returns required for entry to be profitable. Two obvious implications follow. The first is that, if entry costs can be reduced, exporting would increase. A lot can be done on this issue. That better roads, ports, and airports would help is supported by several studies, including a recent firm-level analysis of the connections between road infrastructure and enterprise dynamics in Ethiopia. L2C research on Mozambique indicates that export promotion institutes can play an important role in overcoming various information deficits for potential exporters at relatively low cost. The second implication is that anything that affects productivity positively will have positive knock-on effects on exporting. The literature on the determinants of productivity in developing countries identifies a broad range of relevant issues, both at the macro and the micro levels. The L2C research has shown that economies of agglomeration, spillovers from foreign direct investment, and skills can play important roles in this context.

Attempts at addressing the challenges posed by productivity gaps and high entry costs must also recognize the fact that the decision to enter the exports market is similar to a decision to invest under uncertainty more generally. In particular, entering the exports market is associated with considerable initial costs, while the returns may be modest initially and then rise over time. In fact, because of so called “learning-by-exporting” effects, it may take several years until the full returns associated with entering the exports market accrue. One of the main goals of the L2C research on firm-level exports has been to map out these dynamics and shed some light on the extent to which African firms learn from exporting. The results indicate that learning-by-exporting effects are larger for African firms than for firms in other regions, and that the productivity gains accumulate gradually over time. This suggests that African firms have a lot to gain from exporting, but also, and perhaps more importantly, that policymakers need to be watchful of market failures that may disincentivize firms from entering the exports market in the first place. Credit constraints and costly insurance of economic risks are two examples. Providing affordable credit and insurance may therefore facilitate for firms to enter the exports market.

Taken together, the L2C research on productivity and exports imply the existence of a **virtuous circle**: Higher productivity raises exports since productivity raises competitiveness, and exports raise productivity because firms learn by exporting. When these two effects work together, they can be powerful drivers of productivity gains, growth, and job creation.

The L2C Project

Learning to Compete (L2C) is a comparative, country-based research project that seeks to answer a simple but perplexing question: Why is there so little industry in Africa? The research project—led by Senior Fellow John Page, in collaboration with the United Nations University World Institute for Development Economics Research (UNU-WIDER) and the African Development Bank—utilizes both qualitative and quantitative research methods in nine African countries and two south East Asian nations to produce a cross-cutting analysis of the challenges to industrial development in Africa.