



# Policy Brief

## Boosting trade facilitation and rethinking the foundations of Africa's export diversification

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# 1. Introduction

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Over the last two decades and till the year 2019, African economies have experienced a sturdy growth, averaging 4.3 percent (United Nations, 2023). However, the periods of growth were interrupted by shocks, amplified by the lack of diversity of African exports products.

An UNCTAD report published in 2022 qualifies 80 percent of African economies as un-diversified for their dependence on primary commodity exports in the agricultural, mining, and extractive industries (UNCTAD, 2022). The high concentration of exports on a small number of commodities can create - especially during times of global shocks - disruptions to trade, export revenues, macroeconomic stability, supply and demand shocks as well as commodity prices volatility.

For African economies to strengthen their resilience, particularly in the commodity sector, the latter need to diversify through value addition, technology upgrading, and structural transformation. Through export revenues stabilization, diversification makes countries less vulnerable to adverse shocks. Furthermore, the stability of export earnings and increased purchasing power that result from export diversification can lead to increased investment and hence rapid economic growth.

Although some African countries have added new product lines to their export basket, there has not been sufficient progress in orienting the industrial sector towards high value-added manufactured goods that are critical for a successful growth and effective integration into

the high-value segments of regional and global value chains.

The full implementation of the African Continental Free Trade Area Agreement (AfCFTA) is anticipated to deliver increased production, more trade and investment levels with additional benefits, including the creation of decent jobs, higher incomes and therefore the opportunity for an inclusive growth. Through legal provisions attached to the protocol on trade in goods, AfCFTA is expected to impact on the time and costs of doing business by simplifying, modernizing, and harmonizing import and export procedures.

The two main objectives of this policy brief<sup>1</sup> are to shed light on the importance of diversifying exports through the implementation of trade facilitation measures, as well as highlighting key avenues and opportunities for African economies to achieve higher levels of diversification and competitiveness.

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<sup>1</sup> This policy brief is based on findings from various editions of UNCTAD's Economic Development in Africa Report (EDAR) and research carried out by the Common Fund for Commodities and the AfCFTA Secretariat.

## 2. Commodity dependence of African economies or the “Dutch disease” curse

Most African economies are dependent on primary commodity exports in agriculture, mining, and quarrying sectors (UNCTAD, 2022). This reliance on mineral resources is not necessarily a problem, especially in times of price booms in international markets. Natural resources can be a blessing even, provided strong financial services (van der Ploeg, 2011).

However, two essential elements should be kept in mind. Firstly, dependence on commodities impacts export diversification and economy’s resilience to price fluctuations on international markets. According to UNCTAD studies, African countries dependent on fuel and mining commodities scored the lowest on export diversification, with a Theil index score of 7

in 2018 and 6.2 in 2019. As measured by the Theil index, the five countries with the lowest diversification were Mali, Chad, Libya, Angola, and Guinea-Bissau. In contrast, some African countries have displayed remarkable progress in their diversification efforts. For example, Rwanda, Burundi, and Ethiopia were among the five countries with the greatest improvement in 2018-2019 compared to the reference period twenty years earlier. Overall, only 6 out of the 54 African countries (Egypt, Kenya, Mauritius, Morocco, South Africa, Tunisia) scored below 4 on the Theil index between 2018 and 2019 (see Figure 1).

**FIGURE 1: AFRICAN COUNTRIES EXPORT DIVERSIFICATION BY THEIL INDEX (2018-2019)**

Theil index <b>BELOW 4</b>	Egypt, Kenya, Mauritius, Morocco, South Africa, Tunisia
Theil index <b>BETWEEN 4 AND 6</b>	Benin, Cabo Verde, Cote d'Ivoire, Djibouti, Eswatini, Ethiopia, Gambia, Lesotho, Madagascar, Mauritania, Mozambique, Namibia, Rwanda, Senegal, Sierra Leone, Tanzania, Togo, Uganda
Theil index <b>BETWEEN 6 AND 7</b>	Algeria, Burkina Faso, Burundi, Cameroon, Central African Republic, Comoros, Democratic Republic of Congo, Ghana, Liberia, Malawi, Niger, São Tomé and Príncipe, Seychelles, Somalia, Sudan, Zambia
Theil index <b>ABOVE 7</b>	Angola, Botswana, Chad, Congo, Equatorial Guinea, Gabon, Guinea, Guinea-Bissau, Libya, Mali, Nigeria

Source: UNCTAD (2022)

Note: The Theil index is the main indicator to identify exports diversification trends. The index ranges from below 4 to above 7. The higher the Theil index is, the more unequal the export distribution is, and the less diversified the exports are.

During the fall in commodity prices from 2014 to 2016, fuel and mineral exporting countries in Africa suffered declines in revenue and saw their exchange rates depreciate. Due to a fall in crude oil prices, Nigeria's exchange rate index depreciated by 5% in 2014. Overall, poorly diversified economies are more exposed to specific sectoral shocks, such as fluctuations in commodity prices or technological changes that reduce demand for their products. The volatility arising from a lack of diversification bears negative consequences for any country's economy, performance and development. Without diversification, private and public investments become pro-cyclical and therefore volatile. Lower domestic yields, which result from a negative price shock, reduce the expected return on investment and, on the other hand, extend financial constraints on the economy. Moreover, potential investors may consider non-diversified economies to be riskier, regardless of the current value of commodity prices,

thus reducing the country's attractiveness to foreign direct investments.

Secondly, a natural resource boom, especially during periods of high commodity prices, can be a curse instead of a blessing as the spike in prices tends to reduce the competitiveness of domestically produced tradable products, resulting in most cases in the appreciation of national currencies. Consequently, commodity-dependent countries will reduce the production of non-resource tradables and increase the production of non-tradables. In addition, natural resources may change monetary, fiscal and industrial policies with a new focus on the natural resource sector (Mien and Goujon, 2022).

### 3. Advocating for export diversification

Generally speaking, economic development is closely linked to the growth of trade and exports, which can create jobs and improve people's quality of life. Without a dynamic expansion of exports, the growth of a country's economy unavoidably weakens. Exports spill positive externalities onto other sectors and result in improved efficiency in the allocation of resources as well as in the ability to manage comparative advantages. Moreover, exporting allows countries to alleviate foreign exchange shortages, thus enabling the import of intermediate inputs required for domestic production.

Foreign direct investments and foreign loans are also stimulated by the increase in exports. Indeed, investors' and creditors' decisions are based on

the creditworthiness of a country, especially on the amount of its export earnings. Exports impact also job creation capacity, which, coupled with the economy's current productivity levels, results in increased outputs and incomes.

The impact of ongoing crises, i.e., the war in Ukraine, the lingering effects of COVID-19 and the continuing effects of climate change, have now brought to light more than ever the need for diversification of exports. Export diversification would strengthen the resilience of African economies and provide buffers of alternative sources of revenue during periods of crisis. A salient option for African countries is export diversification through diversification of trade in services, which is a low-hanging fruit (see Box 1).

#### BOX 1 | SERVICES: A GAME CHANGER?

A low level of diversification with a high dependency on commodities prevents African countries from fully participating in the regional and global value chains (R&GVC) which, combined, represent 70% of the Global Trade.

The AfCFTA ambitions to become the backdrop against which regional value chains development and exports' diversification could be promoted and extended beyond primary products and low-value services. The Free Trade Area could enhance opportunities for Medium and Small Enterprises (MSME) growth, productive self-employment and therefore, contribute to effective reductions in widespread informality on the continent.

In addition to the industrial sector- seen as the traditional path for structural transformations- the services' sector, by complementing the industrial sector, could provide an additional opportunity for diversification.

According to the 2022 UNCTAD report, the drivers for diversification are the distance between trading partners, trade costs such as tariffs as well as sharing borders, and languages. Often forgotten, or undermined, the diversification of services can be an important driver of trade diversification but has received very little attention in the discourse. For instance, UNCTAD (2022) finds that between 2005 and 2019, the services sector accounted for only about 17 percent of total exports. In addition, for countries like Sierra Leone where services played an important role in export diversification, such services tended to be of low value addition in the travel and transport sectors. Fully harnessed, the services sector could become a game changer in the diversification of African economies.

Export diversification can be defined as changing the composition and structure of a country's exports. The process may occur by exporting new products (product diversification) or by exporting to new markets (geographic diversification) - or by doing both simultaneously.

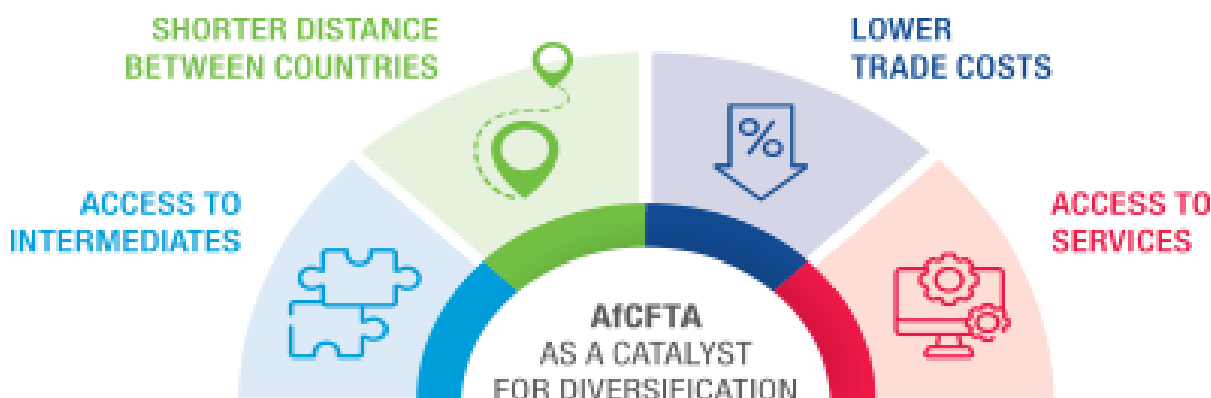
Countries with a restricted basket of export goods often suffer from price instability of these products in the international markets. Now, the change in the total value of exports has a direct impact on the income of export-oriented producers. This, in turn, tends to affect exporters' consumption and investment expenditure, which also has repercussions on the income of other economic sectors in the country. These direct and indirect effects on income tend to negatively

influence the willingness and ability of farmers and entrepreneurs to make investments. By stabilizing export earnings, diversification makes countries less vulnerable to adverse shocks.

Furthermore, the stability of export earnings and increased purchasing power in the country that result from export diversification can lead to increased investment and thus rapid economic growth. Export diversification can result in improved allocation based on the country's relative advantages in the international trading system. Increased capacity utilization of industry, realization of economies of scale and job creation result in a multiplier effect that increases demand for inputs and final products as well as total factor productivity.

## 4. Enhancing AfCFTA's role in export diversification and trade facilitation

The AfCFTA is expected to promote export diversification by increasing market access, providing a framework for coordinated and harmonized policies on investment, competition and intellectual property rights, facilitating more efficient logistics through investment in customs and transport infrastructure, promoting economic empowerment of women and youth, and supporting coordinated regional production (UNCTAD, 2022).



SOURCE: UNCTAD (2022)

The establishment of the AfCFTA will enable African companies to gain access to new markets, thus enabling the pursuit of growth objectives and/or geographic diversification of the companies' business base. This will result in extending the normal product life cycle and smoothing out seasonal fluctuations in production, as well as obtaining increased commercial margins, allowing for the broadening of research, innovation and product development bases.

Furthermore, allowing the expansion of a company or industry's productive capacity results in a smaller increase in total production costs in relation to the total quantity produced (economy of scale). Finally, the participation of firms in export

activity is likely to protect them more efficiently from fluctuations in economic cycles, because of the diversification of their sales destinations. Different countries experience different phases of the business cycle. In some countries, booming phases offset crises in other trading partners. This acts as a buffer for exporting companies, which would incur greater losses if they directed their production only to the domestic market.

The AfCFTA Agreement contains provisions aimed at simplifying, modernizing and harmonizing import and export procedures. Long, complex and burdensome procedures cause failures in export operations, resulting in financial losses and negative attitudes towards international activities

among both existing and potential exporters. Over-regulation can lead to additional costs for businesses in terms of time and money and is usually associated with inefficiency of public institutions.

African countries should also pursue their administrative reforms. Clear, transparent and predictable business regulations are essential for economic diversification. Business regulations - such

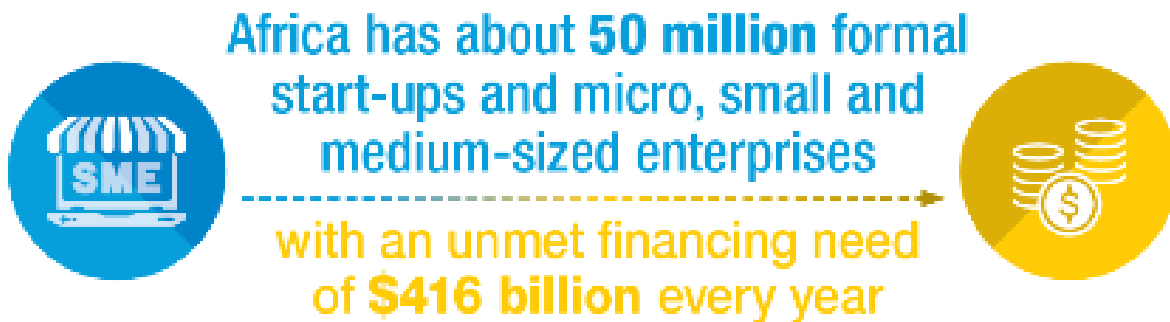
as the procedures and licenses required to start a business, contract procedure, and insolvency - are an essential part of the incentive framework for investments in new activities. In terms of export competitiveness, compliance with excessive regulatory procedures, related to paying taxes, obtaining licenses or handling procedures for cross-border trade, can hinder the competitiveness of firms in international markets.



## 5. Women, Youth and SMEs: Maximizing opportunities and strengths of African economies

Recent shocks and disruptions had adverse effects on Small and Medium Enterprises (SMEs), with the impact being more pronounced [when compared to larger firms](#). In Africa, the entrepreneurial ecosystem, expanded in recent decades, where small and medium enterprises account for over 90 per cent of enterprises and are responsible for about 60 per cent of jobs across

the continent, thus representing highly important drivers of socio-economic development and growth (EDAR, 2022). While women make up most of entrepreneurs, many business owners in Africa are also younger than in other developing regions, with an average age of 31 years (African Development Bank, 2017).



Source: UNCTAD (2022) based on IFC data

Despite the positive influence MSMEs (Micro, Small and Medium Enterprises) play in the development of African economies, they face tremendous and restrictive obstacles that hinder their integration into regional/global value chains, thus limiting their business growth which keeps them in the informal sector and leaves them vulnerable to various shocks, leading to a short business life span, particularly in the early stages (UNCTAD, 2022). Credit constraints are often identified as a major obstacle to their growth. According to UNCTAD (2022), the continent's MSMEs face a financing gap of over USD 416 billion, which has likely been widened

by the recent confluence of supply chain shocks and disruptions.

The challenges in accessing finance are most acute for women entrepreneurs and young adults (even more so for young women), particularly those in the informal sector. According to the African Development Bank (2023), African women entrepreneurs face an estimated US\$42 billion funding gap compared to men. The barriers women face put them at a competitive disadvantage (such as unequal legal frameworks, social norms, gender disparities

in education, resources, assets and network, time and care constraints), also negatively impact their business performance and growth, causing women entrepreneurs to run smaller businesses with fewer employees, lower profits and sales. Women also lack credit history (therefore seen as riskier by private lenders), which reduces the affordability of loans. Consequently, many of them struggle to navigate unpredictable rapid changes in the business environment.

With concerted efforts by African policymakers and transformative partnerships with the international community, challenges can be transformed into opportunities. Creating opportunities for the private sector, particularly for African MSMEs, is critical to unlocking the region's potential. Equally important is the promotion of inclusive economic development, innovation and pro-poor policies. With restricted access to finance, weak integration into regional and global markets, a limited skills base and an informal sector representing 36% of Africa's GDP (Gross Domestic Product) from 2010 to 2018<sup>1</sup>, it has become virtually impossible for MSMEs to fully exploit their potential and be competitive in their operations.

To fully unleash its potential, the African Continental Free Trade Area should develop policies on:

**A) COMPLEMENTARY MEASURES TARGETING WOMEN AND YOUTH:** The AU Agenda 2063 flagship projects on finance and trade facilitation, the continued implementation of the African Women's Decade on Financial Inclusion and Economic Inclusion 2020 to 2030 and the AfCFTA Protocol on Women and Youth in Trade have the potential to increase the effective and impactful participation of women, youth and local businesses, particularly those in the informal sector. Policy interventions should seek to build on emerging opportunities and address structural barriers to women and young adults, to include ensuring equal access to resources and educational opportunities, such as technical

education and the development of vocational and specialized skills, including digital skills and literacy.

**B) AFFORDABLE AND ACCESSIBLE FINANCING:** The design of innovative solutions aimed at providing sustainable financing solutions and interventions that are available, affordable and accessible, particularly for women and youth, can increase the operational efficiency and competitiveness of SMEs, which could be a game changer for export diversification. Financial technology has the potential to help African countries achieve financial and social inclusion by reducing inefficiencies in the conventional banking industry and creating economic prospects that improve affordability and social progress. Africa needs to invest more to work out a SME-smallholder nexus where funding for SMEs will leverage millions of Agri-entrepreneurs in Africa. SMEs need long term affordable and de-risked financing. Developing nations often pay up to eight times more in borrowing costs than developed countries. Africa should tackle high borrowing costs and rapidly rising debt distress by increasing affordable and long-term financing. In February 2023, the United Nations Secretary General called for a “new Bretton Wood moment” placing finance front and centre on the sustainability roadmap. ‘The financial architecture does not need a simple evolution; it needs a radical transformation.’

**C) PRIVATE SECTOR AS A DRIVER OF TRANSFORMATIVE GROWTH:** Strengthening MSME value chains and boosting productivity through digitization, technology adoption and adaptation could contribute to higher levels of diversification and integration and enhance the resilience of African economies in the post-pandemic recovery.

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<sup>1</sup> The vast majority of entrepreneurs on the continent operate in the informal sector, are driven by necessity (as merely a means of economic survival), due to being unable to find paid employment in the formal sector, rather than being truly innovative, opportunity-driven, and competitive (UNCTAD, 2021).

## 6. Conclusion and policy recommendations

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For African economies to better manage shocks, and develop resilience, it is imperative that appropriate policies for economic and hence export diversification are adopted. As noted in section 5 above, adopting policies that strengthen the position of women and young entrepreneurs could also go a long way in reducing vulnerability and improving quality of life. Leveraging opportunities under the AfCFTA, increasing the growth of knowledge-intensive services, and enhancing the role of SMEs as a driver of export diversification provide an opportunity for African countries to diversify their economies. UNCTAD (2022)

recommends the following policies for export diversification in Africa:

- i. Identify strategic products and sectors.
- ii. Analyze demand opportunities.
- iii. Explore market access conditions.
- iv. Determine strategic opportunities to ensure competitiveness.



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