Issues in Promoting Local Content in Africa's Extractive Industries: Lessons from Asia and Prospects for South-South Trade Promotion

By

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Ladies and Gentlemen.

It is great a honour for me to be present at this Afrexim Bank's Advisory Board for Trade Development and speak at this seminar on the topic '***Promoting Local Content in Africa's Extractive Industries: Lessons from Asia and Prospects for South-South Trade Promotion***'. I would like to compliment Afrexim Bank for choosing a very appropriate topic at a very appropriate time.

In recent years, underpinned by continued world economic growth and sustained demand, prices of gas and oil, as also that of other products of the extractive industry such as minerals and metals, have witnessed significant and sustained rise. This in turn has benefited a number of resource-rich developing economies in providing a boost to their economic activities and growth. Further, there is also the prospect that these trends will be sustained in the medium to long term.

Since 2002, global prices of oil and non-fuel primary commodities have witnessed sustained rise. In the case of oil, global prices registered a rise of 2.5% in 2002, which further rose by 41.3% in 2005, and in 2006 is expected to rise by 14.8%. Similarly, in the case of non-fuel primary commodities, global prices rose by 1.7% in 2002, and further by 10.3% in 2005, and is expected to rise by 10.2% in 2006.

According to International Energy Agency, over the next 25 years, global demand for energy may rise as much as 50%, with 75% of this demand driven by developing world. 60% of the increase in demand is anticipated to be met through oil and gas. Further, strong economic growth in many parts of the world would continue to drive demand for metals and minerals.

For resource-rich developing economies, such a trend would provide opportunities to build upon the revenues generated from sustained global demand to drive domestic economic growth. For such economies, and in particular the higher the proportion of national income dependent upon products of the extractive industries, the more important it is for governments to be able to manage the effects of a natural resource boom.

NATURAL RESOURCE BOOM AND IMPLICATIONS: THE CASE FOR AFRICA

The sustained rise in global prices of oil as also non-fuel primary commodities witnessed in recent years has benefited countries in the African region. For the region as a whole, real GDP growth stood at a robust 5.2% in 2005, as compared to 5.5% in 2004. Besides improved macroeconomic policies and structural reforms in many countries, high commodity prices and capacity increases in oil producing countries have underpinned the continued economic momentum in economic activity in the region.

The economic outlook for the African region remains positive, with real GDP growth projected at 5.7% in 2006, and at 5.5% in 2007, underlined by high commodity prices as also supportive macroeconomic policies. The acceleration in economic growth is largely due to oil-producing countries, where capacity increases in countries such as Angola and the Republic of Congo and new production in Mauritania are expected to provide substantial boost to overall economic activity. In the non-oil producing countries, GDP growth is also expected to pick up, supported by continued rise in non-oil commodity prices. For major oil producers such as Angola, Chad, Congo Republic, Equatorial Guinea and Nigeria, economic growth during 2005 was well above the regional average.

IMPORTANCE OF LOCAL CONTENT

The extractive industry deals with Non-Renewable Natural Resources (NRNR) and encounters periodical boom and bust cycles in international demand and prices. If the wealth generated out of the extractive industry is not wisely invested in developing an industrial and manufacturing infrastructure, the long term implication can be economic disaster. Extractive industry does not result in sustainable development. The three pillars of ‘sustainable development’ are economic development, social equity and environmental protection. While extractive industry does provide economic development to limited sections of the society in short bursts, it does not generate large employment

that can be sustained over a long period and it also causes environmental degradation due to pollution of air, water and soil.

The protagonists of extractive industry argue that extractive industry creates jobs and increases growth in midstream and downstream businesses as well. It is true that small scale mining provides roughly 13 million jobs worldwide, while large scale mining employs about two to three million workers. But linkage to downstream businesses is often a fallacy. As a means to protect their own manufacturing firms against competition, industrialised countries often place higher tariffs on processed goods than on raw materials. For example, the OECD nations levy no tariffs on the import of many raw materials, such as crude oil, iron ore, copper, zinc, tin, etc. which are imported from developing countries. Yet if resource rich countries add value to raw materials in a processed form, they are met with stiff tariffs and non-tariff barriers.

An example of how progressive stages of value addition can enhance revenue generation is brought out by the following simple example. In the case of iron ore, the average export price is around US$ 50-70 per MT. If the same iron ore is converted into downstream steel products, the export price is phenomenal. Round steel products (construction steel) sell for US$ 550 plus per MT, hot rolled coils sell for US$ 550 per MT, cold rolled coils sell for US$ 625 per MT and galvanized and coloured steel sell for US$ 700 per MT. Thus, resource rich countries lose out terribly in the bargain. A 1.5 mn MT of steel plant can be set up at a project cost of US$ 1.5 bn which can generate export revenues of around US$ 800 mn per year. With a profit margin of around 25%, the payback period for the project is around 7-8 years. In addition, such a manufacturing venture creates a large pool of skilled workforce and spins off number of ancillary and supporting industries as well.

Another example can be drawn from the oil industry. 90% of the global refining capacity is located in non-OPEC countries. USA has the largest number (about 150) of refineries accounting for 20% of world refining capacity. While Saudi Arabia is the largest producer of crude oil in the world, USA has the world's largest refining capacity. In the case of Africa, more and more nations like Angola, Chad, Equatorial Guinea, Sudan are striking oil and becoming major exporters of crude oil. However, there are no major steps to set up refineries in these countries. Resource hungry nations including China are increasing

their presence and visibility in Sub-Saharan Africa in aggressive manner in recent times heralding a phase of economic invasion on Africa's 'non-renewable' natural resources.

A recent study by Roosevelt Institution points out that the World Bank used its leverage to promote extractive industries through trade and investment liberalization, privatization of state-owned companies, and institutions and capacity building meant to improve the investment climate for the transnational corporations. These interventions were based on the belief that resource wealth serve as a source of economic development and poverty reduction, but have since shown how difficult it is to convert resource wealth into broad based improvements in economic growth and human development. The Study further points out that in comparison to resource poor countries, countries highly dependent on oil and mineral extraction generally grow more slowly, have lower standard of living and suffer from other economic maladies. For example, though Nigeria has generated more than US$ 300 bn in oil revenues, its per capita income remains less than US$ 1 per day.

EXTRACTIVE INDUSTRY IN INDIA

India, along with China, is emerging as a major consumer of oil to keep pace with the economic growth which is growing at around 8% per annum. Local production of crude oil is only 34 mn MT which hardly satisfies 30% of its energy (oil) requirements. Thus, India imports 70% of its crude oil requirements from oil rich countries in West Asia and North Africa and recently from Sub-Saharan Africa as well. But, India has its own strong infrastructure for oil refining as well as downstream petrochemical industry. Though India produces only 34 mn MT of crude oil annually, it has 18 refineries (17 in State sector and 1 in private sector) with combined refining capacity of 127 mn MT per annum. After meeting its own demand for refined petroleum products, India exports petroleum products worth about US$ 12 bn to various countries including Brazil, Sri Lanka and UAE. Government of India has issued licence to private sector to set up fresh refining capacity upto another 80 mn MT in the coming years. As hunt for more crude oil is on both domestically and abroad, infrastructure for midstream and downstream businesses are being strengthened well in advance.

As regards other minerals, iron ore is important from India's point of view. The country at present has mining capacity of 120 mn MT per annum and steps are on for increasing the capacity to around 180 mn MT per annum, due to boom in demand and prices of steel worldwide. Currently, India produces around 40 mn MT of steel products per annum which is mostly comsumed domestically and some quantity exported. India does not import steel, except for very special varieties. Thus, the excess iron ore is exported and the major destination is China where the demand for steel has been growing phenomenally. Foreign Direct Investment into India in steel sector is promising. World's leading steel majors Mittal Arcelor (UK) and Posco (Korea) are likely to invest US$ 10 – 20 bn in this sector. The provincial government of the region where the iron ore deposits exist have been insisting that the companies must produce value added steel products for domestic and export market and only a very limited quantity of iron ore will be allowed to be exported. Thus, governmental intervention and pressure are being exerted to ensure that the non-renewable natural resources are not flittered away cheaply. China has unsatiable appetite for natural resources like iron ore. It imports close to 250 mn MT of iron ore per annum worth US$ 18 bn from various countries in Asia, Africa, Latin America. The question is why cannot Africa demand that the foreign investors should set up manufacturing facilities and export only value added products from their countries and not the natural resources. After all, crude oil cannot be fed directly into automobiles nor iron ore can be used in construction industry. Before Africa's non-renewable natural resources are fully depleted, manufacturing facilities must be set up for downstream products so that labour skills are upgraded, technology transfer occurs and local contractors develop project execution capabilities. Countries like Australia and Brazil can afford to export raw materials because they already have a strong industrial infrastructure and not solely dependent on natural resources unlike African countries. With the above background, let us now examine Africa's trade with Asia, and with China and India in particular.

AFRICA'S TRADE REORIENTATION TOWARDS THE ASIAN DRIVERS

In recent years, an important development that has characterized South-South trade and investment relations has been the growing cooperation between the Asian region, India and China in particular, with the African region. The symbiotic commercial relations that have developed between countries from both regions can be assessed from the fact that both regions have emerged as important trading partners for each other, thereby leading

to enhanced two-way trade flows. An analysis of the trend in bilateral trade flows (presented in **Tables 1 & 2**, and **Charts 1 & 2)** would attest to the tremendous growth in Africa's trade relations with the Asian region, and with India and China in particular.

Africa's Exports to Asia

The synergy in Africa-Asian trade relations can be assessed from the fact that, while Africa's total exports rose from US$ 98.6 bn in 1990 to US$ 289.7 bn in 2005, depicting a three-fold rise, Africa's total exports to the Asian region have risen almost 10-fold from US$ 3.6 bn to US$ 35.3 bn during the same period (Table 1 & Chart 1).

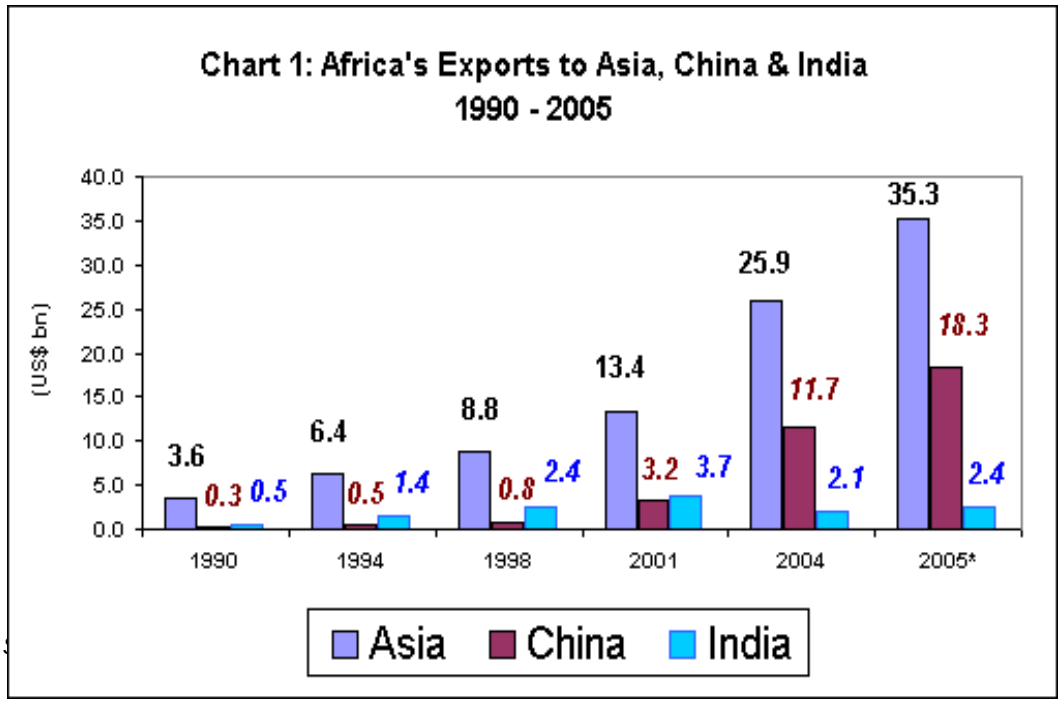
Reflecting these trends, the share of the Asian region in Africa's total exports has risen from 3.7% in 1990 to a significant 12.2% in 2005, attesting to the increased importance of Asia as Africa's export markets.

Table 1: Africa's Exports to Asia, China & India

US$ bn

	1990	*1994*	*1998*	*2001*	*2004*	*2005**
Total Exports	**98.6**	**97.6**	**101.5**	**135.0**	**221.6**	**289.7**
Asia	**3.6**	**6.4**	**8.8**	**13.4**	**25.9**	**35.3**
% share in Africa's Total Exports	*3.7*	*6.5*	*8.6*	*9.9*	*11.7*	*12.2*
China	**0.3**	**0.5**	**0.8**	**3.2**	**11.7**	**18.3**
% share in Africa's Total Exports	*0.3*	*0.5*	*0.8*	*2.4*	*5.3*	*6.3*
% share in Africa's Exports to Asia	*8.5*	*8.1*	*9.1*	*23.8*	*45.0*	*51.7*
India	**0.5**	**1.4**	**2.4**	**3.7**	**2.1**	**2.4**
% share in Africa's Total Exports	*0.5*	*1.5*	*2.4*	*2.7*	*1.0*	*0.8*
% share in Africa's Exports to Asia	*13.9*	*22.6*	*27.9*	*27.4*	*8.2*	*6.9*

*Source: IMF, Direction of Trade Statistics, *- estimates*



Among the Asian countries, both China and India, along with South Korea and Indonesia are the leading markets for Africa. The rise in Africa's exports to China have in fact been significant, increasing from US$0.3 bn in 1990 to US$ 18.3 bn in 2005, and accounted for as much as 52% of Africa's total exports to the Asian region in 2005. The sharp upward trend has been noticeable from 2004 onwards, when Africa's exports to China increased significantly while exports to India witnessed a contraction. In the case of India, Africa's total exports rose from US$ 0.5 bn in 1990 to reach a peak of US$ 3.7 bn in 2001, before contracting to US$ 2.4 bn in 2005

Africa's Imports from Asia

The synergy is bilateral trade relations between Africa and China & India can also be assessed from the robust trends in Africa's imports from the two Asian countries (**Table 2 & Chart 2**).

Underlying the seven-fold rise in Africa's imports from the Asian region during 1990 to 2005, well above the 3-fold rise in Africa's global imports, has been the tremendous increase in imports from China and India, with the result that both China and India are

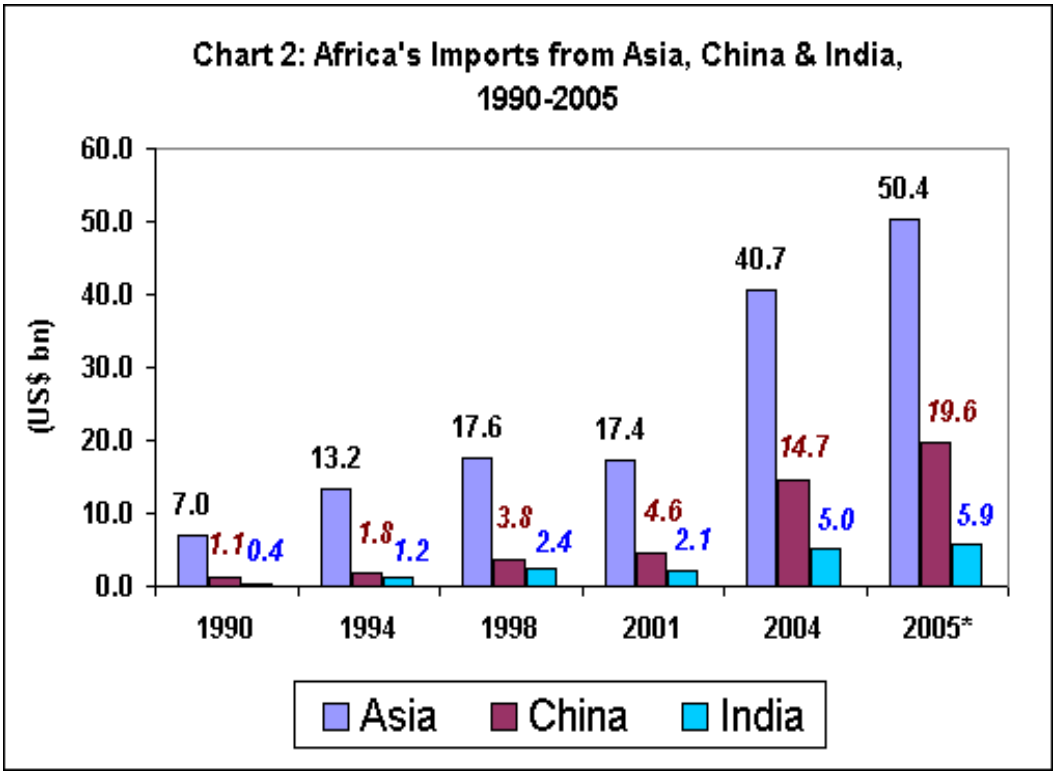
the two largest import sources for Africa in the Asian region. In 2005, both countries together accounted for around 51% of Africa's total imports from the Asian region (China - 39.0% & India - 11.7%).

Table 2: Africa's Imports from Asia, China & India

US$ bn

	1990	*1994*	*1998*	*2001*	*2004*	*2005**
Total Imports	**98.5**	**115.1**	**131.4**	**129.1**	**233.1**	**275.3**
Asia	**7.0**	**13.2**	**17.6**	**17.4**	**40.7**	**50.4**
% share in Africa's Total Imports	*7.1*	*11.5*	*13.4*	*13.5*	*17.5*	*18.3*
China	**1.1**	**1.8**	**3.8**	**4.6**	**14.7**	**19.6**
% share in Africa's Total Imports	*1.1*	*1.6*	*2.9*	*3.6*	*6.3*	*7.1*
% share in Africa's Imports from Asia	*15.2*	*13.6*	*21.5*	*26.5*	*36.1*	*39.0*
India	**0.4**	**1.2**	**2.4**	**2.1**	**5.0**	**5.9**
% share in Africa's Total Imports	*0.5*	*1.1*	*1.8*	*1.7*	*2.2*	*2.1*
% share in Africa's Imports from Asia	*6.4*	*9.4*	*13.5*	*12.4*	*12.3*	*11.7*

*Source: IMF, Direction of Trade Statistics, *- estimates*



*Source: IMF, Direction of Trade Statistics, *- estimates*

IMPORTANCE OF EXTRACTIVE INDUSTRIES IN CHINA AND INDIA'S TRADE WITH AFRICA

The surge in trade between China and India and Africa witnessed in recent years has been mainly driven by commodities, particularly products of the extractive industries such as oil and metals.

While both China and India's exports baskets to Africa comprise mainly manufactured products, China and India's import baskets from Africa are dominated by extractive mining products. While electrical and electronic equipments, machinery, transport equipments, articles of apparel are some of China's major exports to Africa, India's major exports to Africa include petroleum products, cereals, transport vehicles, articles of iron and steel, machinery, and pharmaceuticals. Both China and India's export basket to Africa is well diversified, with no single export item exceeding 15% of each country's total exports to Africa.

In contrast, both China and India's import baskets from Africa are dominated by extractive mining products, and the African region has emerged as a major supplier. In the case of China, the importance of extractive mining products in total imports from Africa can be assessed from the fact that the top three items of imports are all extractive mining products, viz, crude oil, ores and slag, and precious stones and metals, accounting for 65% (US$ 10.1 bn), 9% (US$ 1.4%) and 5% (US$ 742 mn) of China's total imports from Africa (US$ 15.6 bn) in 2004. In the case of India, the import basket from Africa are dominated by precious stones and metals, accounting for 43% (US$ 1.7 bn) of total imports from Africa, while stones, lime and cement, crude oil, and ores and slag are also important items of imports.

In the case of crude oil in particular, the Africa region has emerged as a major supplier to China, accounting for around 21% (US$ 10.1 bn) of China's global oil imports (US$ 48.0 bn). Angola also accounts for as much as 46.5% (US$ 4.7 bn) of China's total oil imports in 2004, and Angola has emerged as the second largest supplier to China, after Saudi Arabia. Other countries such as Sudan, Congo, Equatorial Guinea, Nigeria and Libya are also emerging as important supplier to China.

Not only have Africa countries been exporting increasing volumes of extractive mining products to China and India, but they have also succeeded in turning China, and to a lesser extent India, into major markets for their extractive exports[1].

- In the case of China, crude oil is the leading exports to China for Angola, Sudan, Nigeria, Congo, and Gabon, and accounts for as much as 99.9%, 98.8%, 88.9%, 85.9% and 54.8%, respectively, of their total exports to China. Further, metals ranks first in exports of Congo D.R., Ghana and South Africa to China (accounting for 99.6%, 59.8%, and 45.6%, respectively, of total exports to China);

- In the case of India, crude oil accounts for 99% and 85%, respectively, of Nigeria's and Gabon's exports to India; metals constitute almost half of total exports to India for Congo, Sudan, and Cameroon; and Senegal's production of phosphoric acid is almost entirely exported to India.

BUOYANT FDI IN AFRICA SUSTAINED BY EXTRACTIVE INDUSTRIES

According to the World Investment Report 2005 (UNCTAD), the global FDI flows in 2004 amounted to US$ 648 bn of which an amount of US$ 233 bn (36% of total) flowed into developing countries. Out of this, an amount of US$ 18 bn came to Africa which works out to 2.8% of global FDI inflows and 7.8% of FDI flows to developing countries.

FDI inflows into Africa, after rising from US$ 13 bn in 2002 to US$ 18 bn in 2003, was sustained at US$ 18 bn during 2004. The rise in FDI inflows into Africa has been boosted by high global prices for minerals such as copper, diamonds, gold and platinum, and in particular for oil, along with improved profitability of investment in natural resources. Continued high demand for commodities, as also more stable policy environment, among others, are expected to boost FDI in Africa in the near future.

Most of the investment inflows into Africa have been in natural resource exploitation, spurred by the rising commodity prices. Rising oil prices have contributed to relatively high levels of FDI inflows to the major oil-producing Africa countries, especially Sudan and Equatorial Guinea. As a result, the composition of FDI inflows to Africa, during 2004 and 2003, has been significantly in favour of natural resources, particularly in the

[1] OECD

petroleum industry. The share of petroleum industry in total FDI inflows in 2004 amounted to 94% in Equatorial Guinea, 93% in Angola, 90% in Nigeria and 64% in Egypt.

Between the period 1996-2005, the total FDI from India into Africa amounted to US$ 2.4 bn accounting for almost 16% of India's overseas direct investment (ODI). In the case of China, FDI into Africa amounted to US$ 1.1 bn, accounting for 10% of China total ODI during this period. While Indian investment has gone into various segments of industries including oil, China FDI has been predominantly only in oil and other extractive sectors.

POTENTIAL OF AFRICA'S EXTRACTIVE INDUSTRIES

Sizeable resource potential remains untapped in Africa. New oilfields are starting to come on-stream in Angola and elsewhere in the Gulf of Guinea where tremendous reserves exists. Similarly, oil has started to flow in Chad's pipelines, while substantial oil reserves are believed to exist in the Mali-Mauritania border. Driven by high international prices, exploration for gold is gaining momentum in Burkina Faso, while considerable scope exists for further developing gold extraction in Mali, as also increasing efficiency in exploitation for diamonds in Botswana. Further, the immense mineral potential of Congo D.R. remains largely underexploited. Similarly, potential for iron ore mining exists in Cote d'Ivoire, Burkina Faso, Mauritania and Sierra Leone.

Sustained rise in global prices of these resources, in large part due to increased demands for the Asian drivers such as China and India, has enhanced the potential for the sector in Africa. The current buoyancy in global demand and prices presents an opportunity for Africa to move away from mere extraction and export of natural resources to creating an industrial infrastructure for producing value added products through suitable legislative intervention and tax sops on foreign direct investment into their countries.

TRANSFORMING NATURAL RESOURCE WEALTH TO SUSTAINABLE DEVELOPMENT: THE CASE FOR AFRICA

Sustaining the robust economic activity in Africa, witnessed in recent years, would call for efforts on various fronts. For the region as a whole, while conducive macroeconomic policies and progress with structural reforms have improved economic prospects, further reforms would be called for to strengthen and improve investment environment and infrastructure and foster private sector-led growth.

With economic fortunes of many countries in the region dependent on the extractive industries, it is important for resource-dependent countries to get the choice of industrial and economic policy right, adopt correct sequencing and alignment of such policies with global value chains, and support these endeavours with fiscal prudence, adequate institutional capacity and civil society participation.

Unlike other sectors, benefits from extractive industries often take the form of revenues channeled through (central) governments, and may account for the largest portion of government income. The challenge here would be to ensure the sound use of such revenues, which would best be ensured by sound governance and transparency and accountability in revenue usage.

Countries would need to decide on the best way to exploit their natural resources. Governments may or may not have integrated extractive industries into their national development plans. They would need to think about how to capture the most value added from these industries: whether to use local expertise for development, or grant licenses to foreign companies

EXTRACTIVE INDUSTRIES AND SOUTH-SOUTH TRADE: PROSPECTS

The emergence of Asian economies such as China and India as key drivers of global growth and their increased demands for commodities for sustaining robust growth, on one hand, and recent rise in global prices and demand for commodities upon which many developing countries are dependent on the other, would serve to highlight the symbiotic as also synergetic relations that have emerged in South-South trade relations in recent years.

With bulk of the sustained FDI inflows into Africa witnessed in recent years has been into the extractive industries, continued high demand for commodities are expected to boost FDI in Africa in the near future. At the same time, global prices of oil as also non-fuel primary commodities are expected to remain high in the near term. Thus, a boom cycle is in place and expected to continue. These developments augur well for countries in Africa which are resource rich.

At the same time, global GDP growth, which registered a robust 4.8% growth in 2005, is forecast to be sustained at 4.9% in 2006 and at 4.7% in 2007, with developing countries registering above global average. In 2005, developing countries registered a 7.2% growth, which is expected to remain robust at 6.9% in 2006 and at 6.6% in 2007, according to the IMF. Developing economies in Asia, China and India in particular, are projected to provide boost to overall growth of developing countries.

With continued robust growth expected in Asia in the near future, and in China and India in particular which have emerged as major markets for Africa's exports of extractive mining products, one can expect increased trend in Africa's exports to Asia to meet rising demand in China and India.

An interesting aspect that may merit attention is that despite strong economic and industrial growth in both China and India, agriculture remains the predominant employer in both the countries. In the case of China, while agriculture constitutes only 15% of GDP, nearly 50% of the population is employed in agriculture. In India, agriculture constitutes 22% of GDP, but over 60% of population is employed in this sector. This indicates that there is large disguised unemployment in both countries despite strong economic growth. In fact, a research paper indicates that only one out of three Chinese (33%) and one out of four Indians (25%) have been impacted by the ongoing globalisation process. A major section in both countries is outside the globalisation process. Viewed from above facts, it may seem that both China and India are more akin to Africa than OECD nations. But what sets apart China and India from Africa is the strong, diversified industrial infrastructure, high quality educational and medical infrastructure, skill level of the work force, advancement in information technology, and sound macro and micro economic policies.

CONCLUSION

Africa must reorient its strategies. It should not squander away its precious, non-renewable natural resources for short term gains and limited prosperity. Africa must work towards sustainable development by giving equal importance to social equity and environmental protection. Steps must be taken to enhance the local content in its extractive industry through appropriate regulations, to diversify the industrial infrastructure by partnering with foreign companies for technology, skill upgradation, to develop local contractors with project execution capability. Surplus generated from extractive industry should be invested to develop top quality professional educational institutions, secondary and tertiary medical facilities, and for development of small scale grassroot business enterprises to address unemployment. The IMF (2005) report says that Africa's already weak human capital base severely limits its growth prospects. Continent's slow growing rural based economies do not generate modern sector jobs for graduates. India's accelerated growth was achieved not by employing more capital or skills, but by more efficiently utilising that which already existed. The same baseline conditions simply do not exist in Africa. Most African countries are trapped in a vicious circle. Low skills hold back economic growth; but poor growth limits financial and political resources needed if the skills issue was to be addressed. There is an opportunity now to break this vicious circle and convert into virtuous circle. With buoyancy in global trade and higher prices for primary commodities, most African economies are healthy at the moment. With judicious policy intervention and careful selection of FDI into extractive industry, the situation can be dramatically improved.

I would like to end my presentation with the popular African proverb. It says "***the best time to plant a tree was 20 years ago. The second best time is NOW***".

Thank you.