



BOOSTING TRADE AND INVESTMENT:

A new agenda for regional and
international engagement

Intra-African trade: A path to economic diversification and inclusion

Vera Songwe

@ECA_Official - Executive Secretary, U.N. Economic Commission for Africa
Nonresident Fellow, Africa Growth Initiative, Global Economy and Development Program,
Brookings Institution

The debate on the benefits of trade has dominated this decade, and Africa has cast its vote for more and better trade with itself. In March 2018, African countries signed a landmark trade agreement, the African Continental Free Trade Area Agreement (AfCFTA), which commits countries to remove tariffs on 90 percent of goods, progressively liberalize trade in services, and address a host of other non-tariff barrier. If successfully implemented, the agreement will create a single African market of over a billion consumers with a total GDP of over \$3 trillion. This will make Africa the largest free trade area in the world.

What is less known about the AfCFTA is that its scope exceeds that of a traditional free trade area, which generally focus on trade in goods, to include trade in services, investment, intellectual property rights and competition policy, and possibly

e-commerce. The AfCFTA is complemented by other continental initiatives, including the Protocol on Free Movement of Persons, Right to Residence and Right to Establishment, and the Single African Air Transport Market (SAATM). The scale of AfCFTA's potential impact makes it vital to understand the main drivers of the agreement and the best methods to harness its opportunities and overcome its risks and challenges.

The signing of the AfCFTA in Kigali comes at a time when the benefits of trade are actively contested, and global powers that traditionally promoted trade as a

AfCFTA will be a game changer for stimulating intra-African trade.

crucial driver of growth are now calling into question its very tenets. This apprehension is not without cause. It is broadly recognized that, while globalization and trade produced the impressive economic expansion of the past three decades, the gains have not been fairly distributed. The World Bank population-weighted Gini index shows that inequality rose steeply between 1988 and 1998 and declined only moderately by 2013. Although global poverty has fallen, prosperity has not been fully shared.

Can Africa do better with trade? The share of intra-African exports as a percentage of total African exports has increased from about 10 percent in 1995 to around 17 percent in 2017, but it remains low compared to levels in Europe (69 percent), Asia (59 percent), and North America (31 percent). This is an important reason to expect that trade will be a key driver of growth in Africa. According to modeling results by the Economic Commission for Africa (ECA),¹ the AfCFTA is projected to increase the value of intra-African exports. AfCFTA will be a game changer for stimulating intra-African trade. It is projected, through the sole removal of tariffs on goods, to increase the value of intra-African trade by between 15 percent (or \$50 billion) and 25 percent (or \$70 billion), depending on liberalization efforts, in 2040, compared to a situation with no AfCFTA in place. Alternatively, the share of intra-African trade would increase by nearly 40 percent to over 50 percent, depending on the ambition of the liberalization, between the start of the implementation of the reform (2020) and 2040.²

Recent evidence by ECA shows that when African countries trade with themselves they exchange more manufactured and processed goods, have more knowledge transfer, and create more value. In fact, manufactured goods make up a much higher proportion of regional exports than those leaving the continent—41.9 compared to 14.8 percent in 2014. The real test of the AfCFTA, however, will be how quickly African countries can accelerate export diversification and product sophistication and make trade more inclusive.

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Trade diversification of exports is important as it allows countries to build resilience to movements in demand, due to economic downturns in importing countries but also price dips. In the case of commodity exporting countries it supports a shift from an over dependence on commodities to higher-value added products and services.³ Economic diversification allows for more inclusion of small and medium-sized enterprises and helps encourage innovation as more markets open. It is also productivity enhancing.

1 United Nations Economic Commission for Africa. 2018. "An Empirical assessment of AfCFTA Modalities on Goods." UNECA.

2 United Nations Economic Commission for Africa. 2015. "Industrializing through Trade: Economic Report on Africa 2015." UNECA.

3 Songwe, Vera, and Deborah Winkler. 2012. "Exports and Export Diversification in Sub-Saharan Africa: A Strategy for Post-Crisis Growth." Brookings Institution.

Between 1990 and 2014, as most fast-growing countries in the world diversified their economies, most African countries instead relied on rents from extractive industries. Figure 6.1 shows that, except for Rwanda, Senegal, and Sudan, African economies did not diversify their exports. Export diversification for the continent improved only marginally between 1990 and 2014. Exports from Central and Northern Africa became increasingly more concentrated, and even countries with diversified exports like Morocco and South Africa lost ground. In contrast, most East Asian economies were able to diversify exports at a rapid pace and converge to the levels of China and Korea (Figure 6.2). Against this backdrop, the AfCFTA is expected to enable countries to break into new African markets as they both diversify by export destination and type of goods produced.

The AfCFTA offers particular potential for agricultural products. In 2015, African countries spent about \$63 billion on food imports,⁴ largely from outside the continent. ECA's modeling projects that by 2040, the AfCFTA will increase intra-African trade in agricultural products by between 20 and 30 percent, with the highest gains in sugar, vegetables, fruit, nuts, beverages, and dairy products.⁵ The agreement is expected to expand access to markets at the regional and international levels, thus generating state revenue, increasing farmer income, and expanding both farmer and country capacity to invest in modernizing the agricultural sector through processing and mechanization. The AfCFTA as a result should stimulate demand for intra-African

food imports, supporting a predominantly women-led sector.

Diversification should also lead to increased sophistication of export products. Product sophistication refers to the share of value addition in a product, or product upgrading. Increased value addition and sophistication increases productivity and increases the overall value of exports.⁶

The AfCFTA will improve export sophistication across the continent by enabling more countries to integrate regional and global value chains.

Over the past three decades, exports from East Asia have increased in both diversity and quality. Within Asia, several countries, namely Korea, China, Vietnam, and Thailand, have converged toward the world's quality frontier largely as a result of integration in regional and global value chains (see Figure 6.3). The quality growth has been especially substantial in manufacturing, although the quality of commodities has also increased due to the development of vertically integrated industries. On the diversity criteria, African exports have generally lagged behind, and there is no evidence of quality convergence. The AfCFTA will improve export sophistication across the continent by enabling more countries to integrate regional and global value chains and consequently increase the quality of exports.

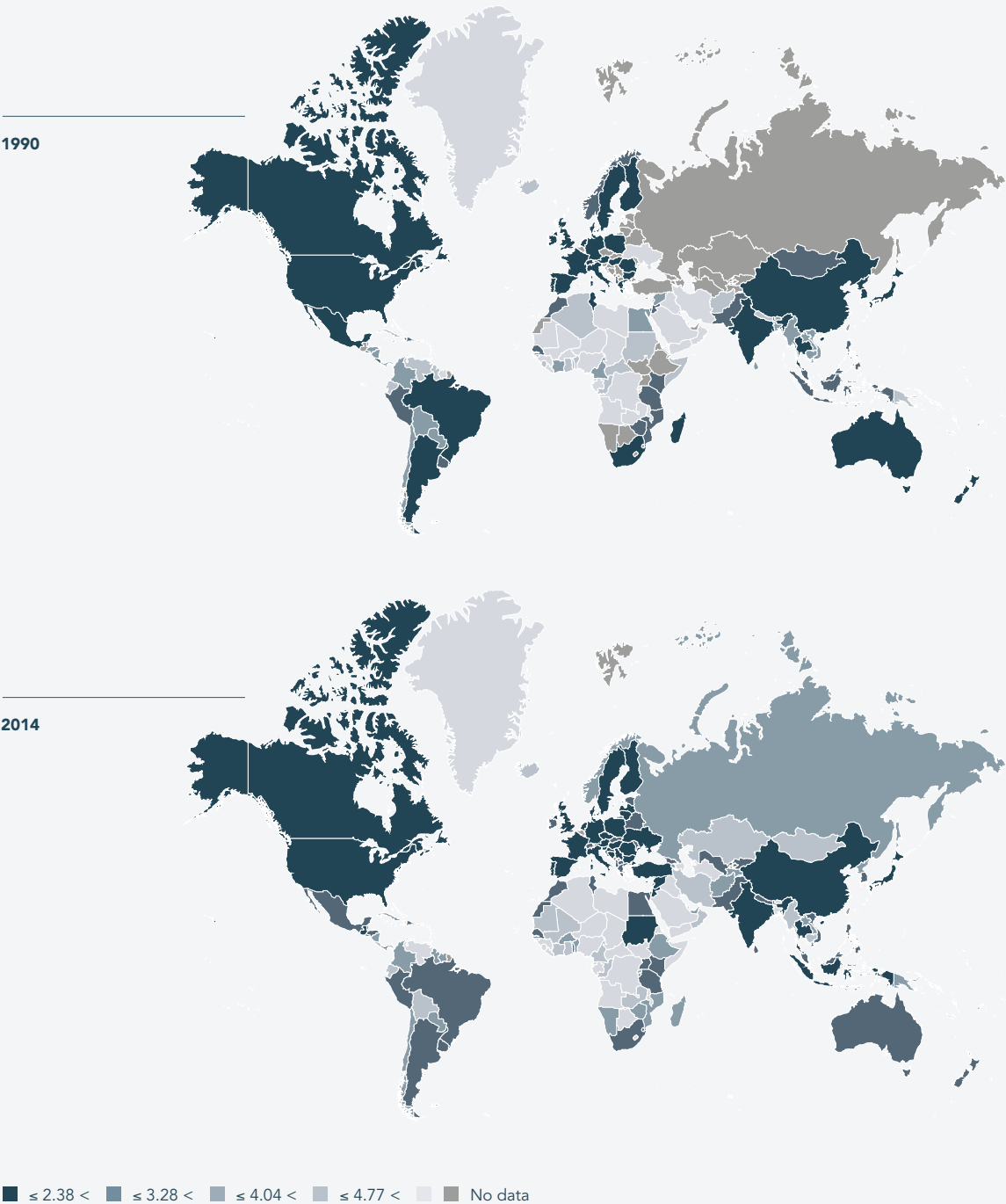
4 Agra. 2017. "Doubling Productivity and Incomes of Smallholder Farmers in Africa." AGRA: Growing Africa's Agriculture. August 23, 2017. <https://agra.org/doubling-productivity-and-incomes-of-smallholder-farmers-in-africa/>.

5 United Nations Economic Commission for Africa. 2018. "An Empirical assessment of the African Continental Free Trade Area Modalities on Goods." UNECA.

6 Hausmann, Ricardo, Jason Hwang, and Dani Rodrik. 2006. "What You Export Matters." *Journal of Economic Growth* 12 (1): 1–25. <https://doi.org/10.1007/s10887-006-9009-4>.

Figure 6.1 Export Diversification Index

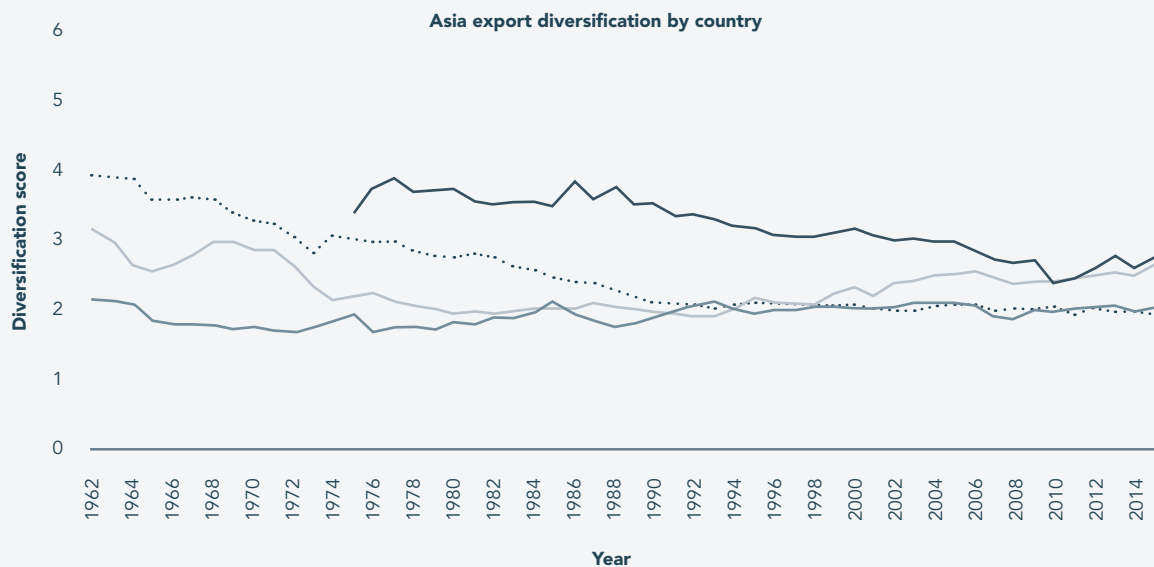
Between 1990 and 2014, export diversification in Africa improved only marginally. Only Rwanda, Senegal, and Sudan increased export diversification during this period while diversified exporters like Morocco and South Africa lost ground.



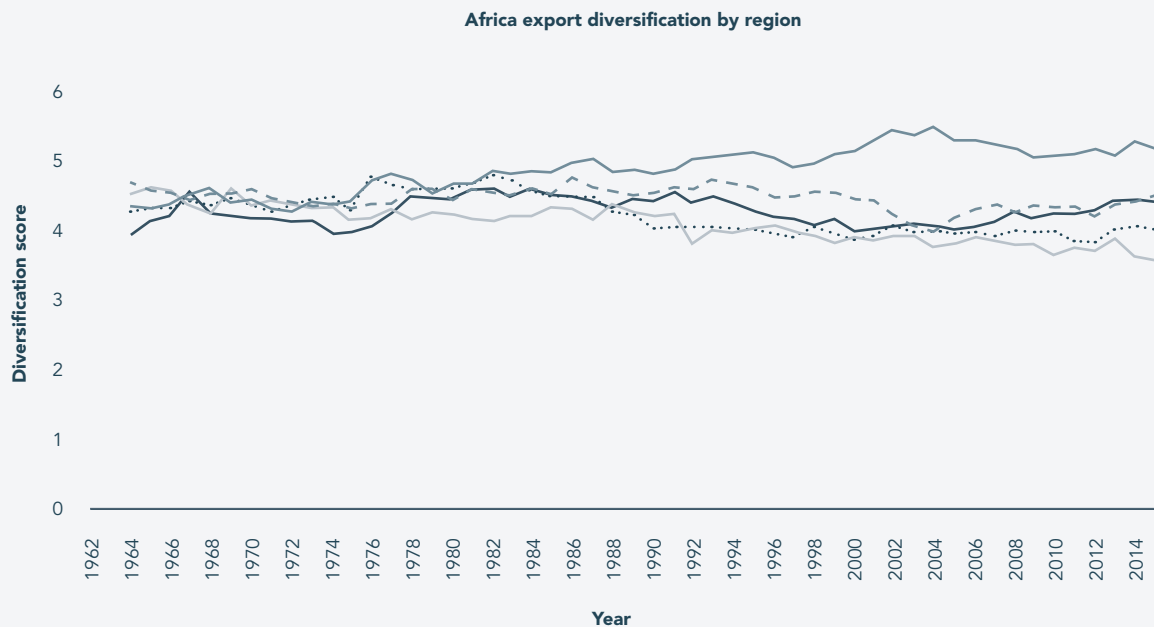
Note: Lower numbers (darker colors) indicate more diversified exports.
Source: IMF data and author's calculation

Figure 6.2 Export diversification in Asia versus Africa

African countries lag behind Asian countries in export diversification and have made limited progress in increasing diversification in recent years.



— China — Korea, Rep. ... Thailand — Vietnam



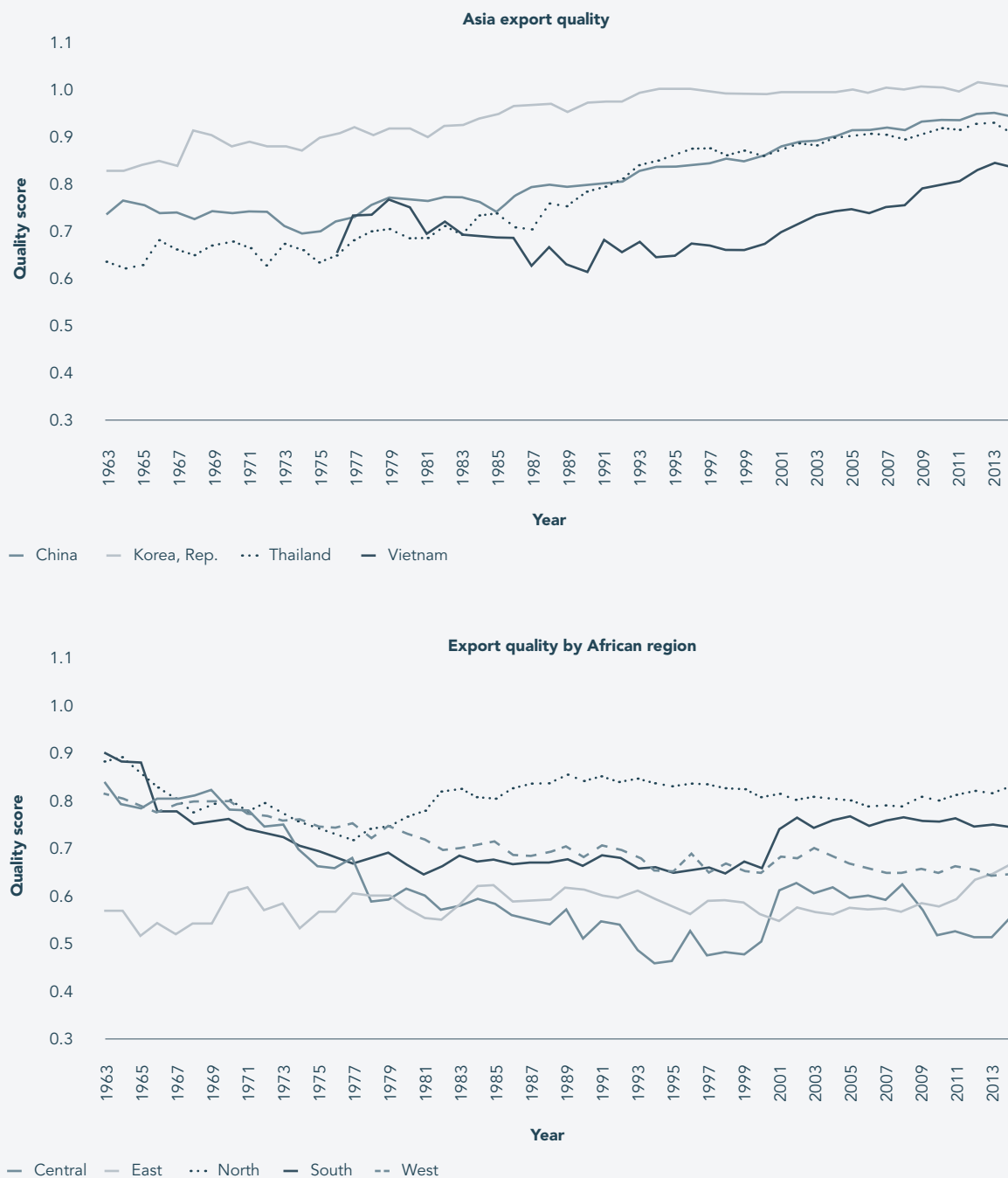
— Central — East ... North — South -- West

Note: Lower numbers indicate more diversified exports.

Source: IMF data and author's calculation.

Figure 6.3 Export quality in Asia versus Africa

Over the past three decades, the quality of exports from East Asia has improved. Within Asia, several countries, namely Korea, China, Vietnam, and Thailand, have converged toward the world's quality frontier. In comparison, there is no evidence of quality convergence for African countries.



Note: Higher numbers indicate higher quality exports.

Source: IMF data and author's calculation.

At the regional level, Southern African economies have, on average, the most sophisticated exports. Botswana and South Africa export the most sophisticated goods while Rwanda and Uganda have made the greatest improvements over the past three decades. However, quality improvement of the export basket has been sluggish elsewhere, with some reversals, and there is considerable cross-country heterogeneity within regions.

Analysis of sectoral quality shows that some richer and more open countries have well-established manufacturing exports, such as South Africa and Morocco. Like the East Asian economies, they may have reached a saturation point to quality improvement within existing sectors and may need to target new geographic markets that can provide greater scope for growth and innovation to improve their competitive advantage. Other countries, such as Botswana and Mali, have successfully moved up the value chain within their natural resource sectors. In these countries, knowledge transfers to other export sectors can unlock the potential of established or emerging industries.

Differences in export performance and product sophistication demonstrate that across the continent there is potential for increased diversification, the creation of regional vertically integrated industries, and the development of globally competitive regional value chains.

If the AfCFTA is to fulfill its potential in diversifying and transforming African economies in an inclusive manner, however, African countries must develop effective policies and strategies for exports, and identify new opportunities for diversification, industrialization, and value chain development. Furthermore, although the AfCFTA can address many important

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demand-side constraints to trade, particularly those linked to market size, supply-side constraints must also be addressed.

ECA's report on *Bringing the AfCFTA About* highlights that the AfCFTA potentially embodies a "win-win" approach such that all countries across Africa and vulnerable communities within these countries receive benefits from the agreement. However, to achieve this, the AfCFTA will require flanking policies and a strong focus on achieving tangible outcomes from its sister initiative, the Boosting Intra-African Trade (BIAT) Action Plan. BIAT offers a framework for addressing key constraints to intra-Africa trade and diversification under seven clusters: trade policy, trade facilitation, productive capacity, trade-related infrastructure, trade finance, trade information, and factor market integration. Particular attention should be attached to trade facilitation and building productive capacities. Trade facilitation is key to reducing non-tariff trade costs, and is important for ensuring inclusive benefits since landlocked countries and small, informal, and female traders are usually more burdened by inadequate trade facilitation. Additionally, building productive capacities through re-skilling programs will be crucial to ensuring that displaced workers and vulnerable persons are able to participate in welfare-enhancing

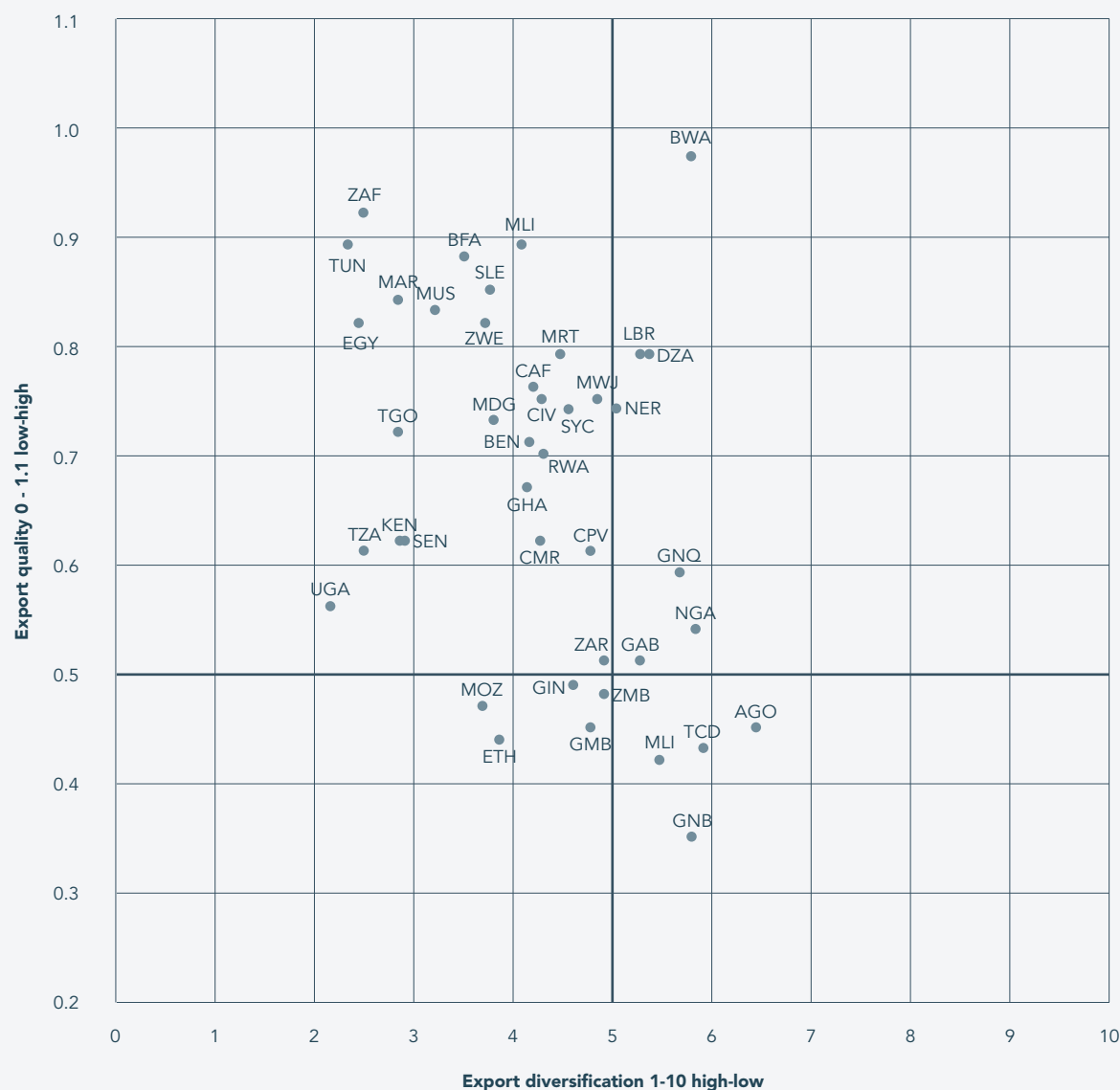
opportunities under the AfCFTA. In particular, Africans must be equipped with the skills needed to engage in skill-intensive manufacturing industries such as apparel and machinery.

It is promising that African countries are already strategizing on how to benefit

from the agreement and developing clear plans of action to take advantage of national, regional, and global markets in the AfCFTA context. The AfCFTA can play a game-changing role in Africa's economic diversification and inclusion. This is not an opportunity to be missed and 2019 will be a defining year.

Figure 6.4 Africa export quality versus diversification

Within Africa, more diversified exporters also rank higher in the export quality index as seen by the cluster of countries in the top left quadrant of the graph below.



Source: IMF data and author's calculations.

China's changing approach to Africa

Yun Sun

Nonresident Senior Fellow, Africa Growth Initiative, Global Economy and Development,
Brookings Institution

01.

The 2018 Beijing Forum on China–Africa Cooperation (FOCAC) Summit was the signature event that determined China's priorities toward Africa for the next three years. Deviating from its tradition of doubling or tripling its financial pledges, China's commitment remained the same as in 2015, \$60 billion. Judging from its volume and composition, China's commitment remains strong, but appears to be more cautious and calculating than its past pledges. The concessionality of the Chinese financing is being moderated, while China has grown visibly more focused on the commercial and viability aspects. From the traditional model of "resources for infrastructure," China appears to be morphing toward the next stage: equity investment by a more diverse group of investors supported by state development finance. Meanwhile, Africa still has major catching up to do to gain more Chinese investment and to diversify its trade relations with China.

What China offers Africa is not a blank check and a guaranteed result.

The Chinese narrative about its development efforts toward Africa is undergoing significant changes. Indeed, China has demonstrated an increasing interest in identifying its financial contribution as development finance, rather than development assistance. First, this is because China has failed to meet the prevailing criteria for official development assistance. Second, the reduced emphasis on the aid aspects also helps to square the circle between the self-serving, commercial aspects of the Chinese financing and the presumably altruistic intention of China as a responsible stakeholder.

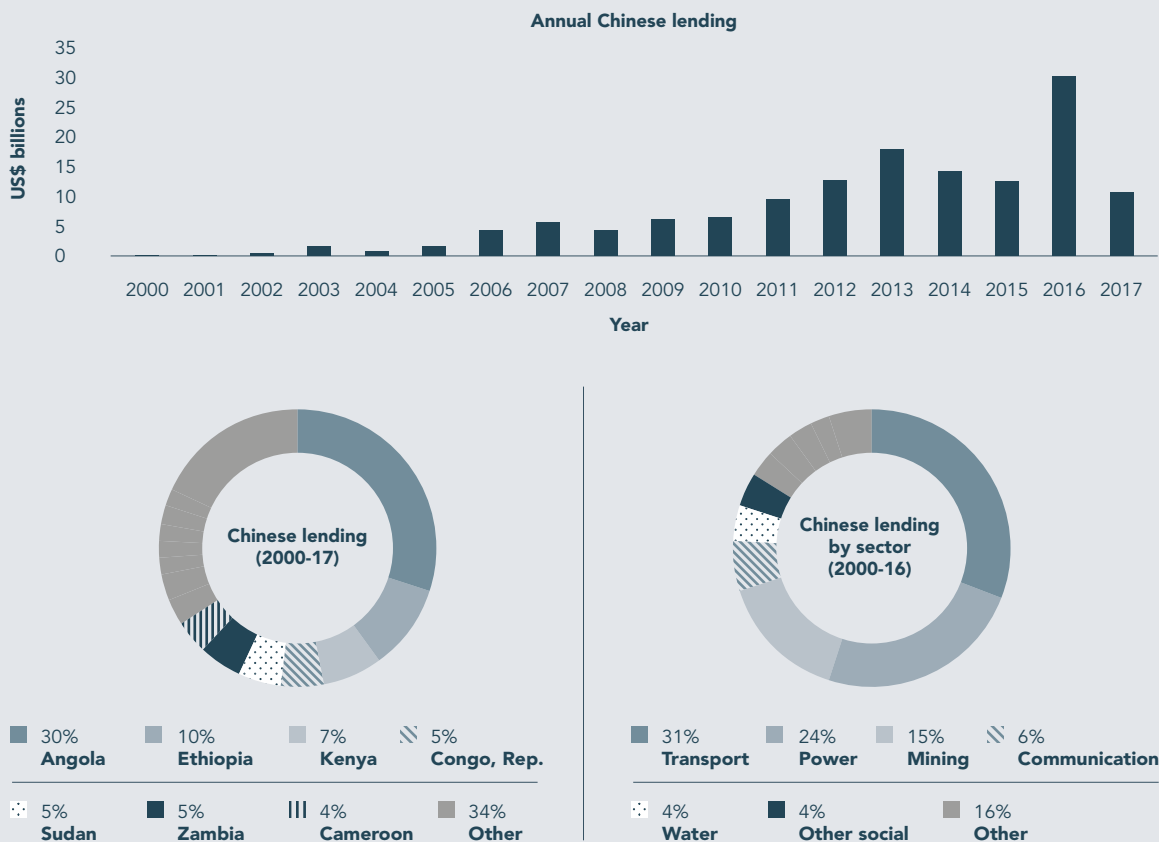
Indeed, what China offers Africa is not a blank check and a guaranteed result. Instead, Beijing offers Africa the opportunity to speed up its economic development based on the infrastructure China develops, to utilize the technologies, employment, and market opportunities China creates, and to stimulate the desire and competition

for growth through market-based rather than assistance-based approach. The Chinese financing is neither free nor altruistic. But that is not the point. The real point is: How can Africa better utilize the opportunities China creates and avoid the traps it brings? The answer to that question has not been China's priority, but instead it has focused on better decisionmaking, more disciplined domestic policy, and, most importantly, better governance.

As China expands its Belt and Road Initiative in Africa, government-level U.S.-China cooperation in Africa continues to be scarce. However, this trend contrasts sharply with the growing collaboration between Chinese and American companies in infrastructure projects on the continent. Indeed, although the Chinese projects and financing have the tradition of favoring Chinese contractors and providers, the technical advantages of some American companies have made them the beneficiary of the Chinese campaign.

Figure 6.5 Chinese lending in Africa

Chinese lending in Africa has increased significantly since 2010. Overall, between 2000 and 2017, China disbursed \$143 billion in loans to African countries. Further, at FOCAC 2018, China pledged an additional \$60 billion in aid, credit and loans to African countries over the next 3 years. Most of China's lending in Africa has been concentrated in a few countries including resource-rich countries such as Angola, Republic of Congo, Sudan, and Zambia.



Source: Johns Hopkins SAIS China-Africa Research Initiative.

Is the US keeping pace in Africa?

Witney Schneidman

@WitneySchneid - Nonresident Senior Fellow, Africa Growth Initiative,
Global Economy and Development, Brookings Institution

02.

What do India, Turkey, Japan, China, and the European Union have in common with Africa that the United States does not? Each country and the EU have held two or more summits with African heads of state. While there were positive aspects in the Trump administration's Africa strategy that was released late last year, there was no mention of a U.S.-Africa summit. Does this matter?

Frequently mistaken for little more than photo opportunities, summits foster regular interaction between governments, business, civil society, and other interested parties at various levels. Summits also signal a clear policy priority of participating governments. As a result, they are an important vehicle for advancing national interests.

Ongoing senior U.S. engagement with African leaders has been minimal at best during the current administration.

For example, over the course of six Africa-EU summits (the most recent being in Côte d'Ivoire in November 2017), European and African leaders have addressed a number of issues including trade, migration, peace and security, and technological innovation. The summit process has also brought together leaders from civil society, business, youth, and female entrepreneurs.

The results have been substantive: (1) The EU has developed a trade strategy that gives European companies and products preferential access to the region's market. (2) On the priority issue of immigration, the European Commission will soon build a \$5.8 million facility to improve the relationship between African diaspora organizations and their

country of origin. (3) Endorsing the recently concluded African Continental Free Trade Agreement, European Commission chief Jean-Claude Juncker said that he envisions the creation of a “continent-to-continent free trade agreement between the EU and Africa.”

The China story has generated even more substantial headlines. After sustained high-level engagement starting in 2000, the first formal summit, the Forum for China-Africa Cooperation (FOCAC), took place in 2006 in Beijing where President Hu Jintao pledged \$5 billion of concessionary loans to Africa. Over the course of five FOCAC summits in which virtually every African head of state has participated, China has become Africa’s largest trading partner and, at each of the past two summits, Chinese President Xi Jinping has pledged \$60 billion in financing. There are also a number of related meetings, such as between Chinese and African foreign ministers on the margins of the U.N. General Assembly and in the first ever China-Africa Defense and Security Forum.

In contrast to the EU and China, the U.S. held its first ministerial in 1999, when former Secretary of State Madeleine Albright and nine U.S. cabinet officials hosted 180 ministers from 43 African countries to discuss a “Partnership for the 21st Century.” While there were several subsequent meetings, the only summit occurred in 2014 when former President Barack Obama hosted leaders from 50 African states, resulting in \$14 billion worth of commitments from U.S. companies to invest in Africa. President Obama also convened a U.S.-Africa Business Forum several months before leaving office.

Apart from former Secretary of State Rex Tillerson’s meeting in Washington with 37 foreign ministers in 2017, President Donald Trump’s lunch for a group of Africa leaders on the margins of the U.N. General Assembly in 2017, and White House meetings with President Muhammadu Buhari of Nigeria and President Uhuru Kenyatta of Kenya, ongoing senior U.S. engagement with African leaders has been minimal at best during the current administration.

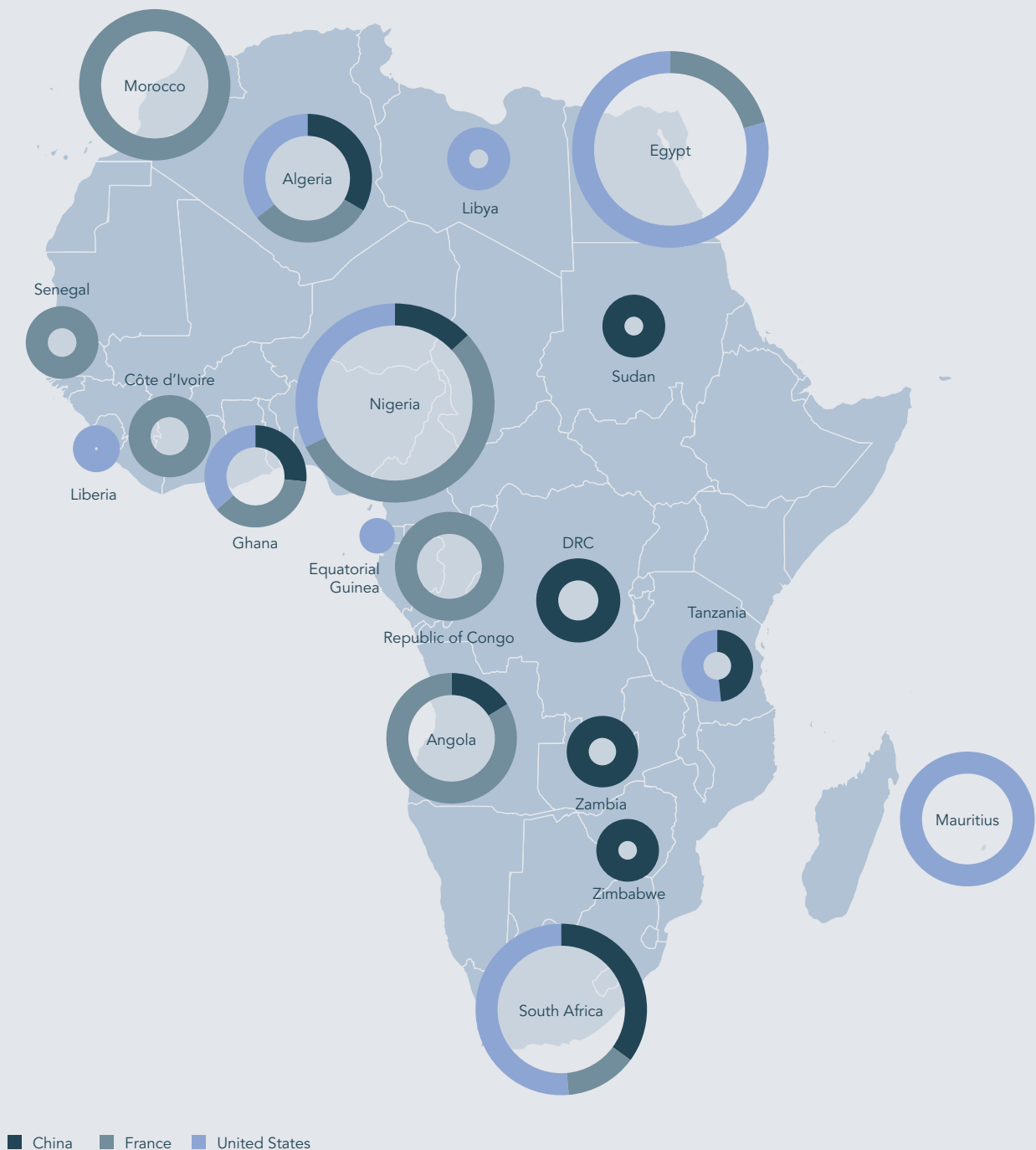
There is no question that the architecture of U.S. Africa policy is impactful. This includes the African Growth and Opportunity Act, the President’s Program for Emergency AIDS Relief, the President’s Malaria Initiative, the Young African Leaders Initiative, Power Africa, Feed the Future, the Trade and Investment Hubs, and the Millennium Challenge Corporation.

With the passage of the Better Utilization of Investments Leading to Development Act in October last year, which provides for the establishment of the \$60 billion U.S. Development Finance Corporation, the Trump administration has supported the emergence of an important new agency that is likely to boost U.S. investment in Africa. USAID’s Private Sector Engagement Policy is likely to further increase U.S. commercial engagement on the continent.

However, without the active engagement of the most senior levels of the U.S. government on a regular and sustained basis, the U.S.-African relationship will not achieve its full potential.

Figure 6.6 Top foreign direct investment host countries

The map below highlights the top 10 FDI destinations for China, France, and the United States. Four destinations (Algeria, Ghana, Nigeria, and South Africa) show up in the top 10 for all three countries. Chinese FDI in Africa is dispersed across more markets, with less than half its FDI stock in the top 10 countries compared to about 60 and 70 percent for France and the U.S., respectively. Resource-rich countries figure prominently in China's top 10 with Democratic Republic of Congo, Sudan, Zambia, and Zimbabwe. For France, Morocco (largest destination), Côte d'Ivoire, and Senegal highlight the influence of the country's historical ties on investment decisions. On the other hand, most U.S. FDI is located in established investment markets such as Algeria, Egypt, Mauritius, Nigeria, and South Africa.



Note: FDI data as of end 2015. Data is only shown for countries when they are in the top 10. For example, French and U.S. FDI in DRC is non-zero but is not shown as it is not a top 10 FDI destination in Africa for these countries.

Source: Johns Hopkins SAIS China-Africa Research Initiative; U.S. Bureau of Economic Analysis; OECD FDI Statistics.

Creating one market under the African Free Trade Area: Progress and challenges

H.E. Albert Muchanga

Commissioner for Trade and Industry, African Union Commission

03.

On March 21, 2018, in Kigali, Rwanda, Africa took the giant step of creating a large and integrated market by establishing the African Continental Free Trade Area (AfCFTA). As of November 2018, the agreement had 49 signatures and 12 ratifications (Chad, Côte D'Ivoire, eSwatini, Ghana, Guinea, Kenya, Mali, Niger, Rwanda, Sierra Leone, South Africa, and Uganda). Although a minimum of 22 ratifications are required for the agreement to enter into force, advocacy continues to push to have all African Union member-states onboard so that we can have a truly integrated market that completely removes the historical pattern of smallness, isolation, and fragmentation of our economies and the consequential lack of competitiveness. The stakeholders for the agreement are wide, including women, youth, private sector, civil society, academia, parliamentarians, and cooperating partners. A business guide and handbook to the AfCFTA have been published to assist in advocacy.

Preparatory work to make the market operate continues in areas like rules of origin, liberalization of trade in goods and services, and establishment of a digital payments and settlements systems. We are also developing regional value chains to supply the market and competitively link Africa to global value chains.

The African Union is taking action to break down barriers and improve the flow of goods, people, and capital.

The most critical challenge we face is to bring the AfCFTA into operation in 2019 and double intra-African trade by 2022 once tariff and non-tariff barriers are removed. We also face the challenge of bringing about win-win outcomes given that the AfCFTA will be a diverse membership of least-developed, landlocked, small-island, and lower and upper-middle countries, as well as countries in conflict.

There is the added political challenge. Some of our interlocutors who were skeptical that we would succeed in negotiating the agreement are now saying we lack the collective capacity to implement it. Strong political and popular will, focus, and resilience to generate tangible outcomes will enable us to meet these and other challenges.

Mandela once said, “It always seems impossible until it is done.” In that spirit, we will make the AfCFTA work.

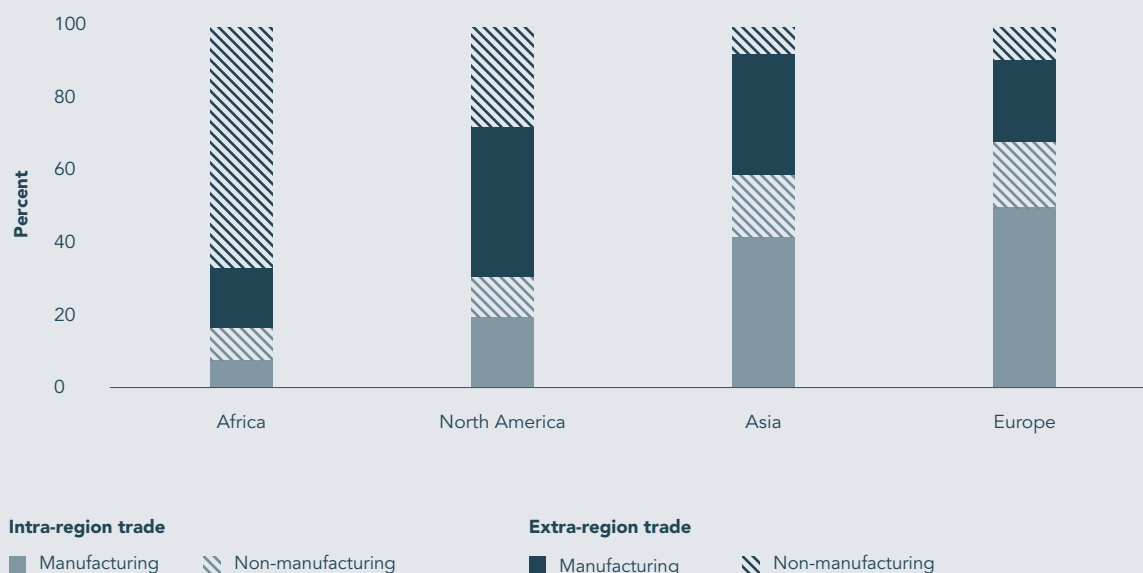
The AfCFTA is already moving toward an internal market free of physical, technical, or fiscal barriers.

Some of our plans for the implementation of the AfCFTA are as follows. Member states will formulate and implement national AfCFTA strategies. At the regional level, the African Union is taking action to break down barriers and improve the flow of goods, people, and capital. For instance, we are implementing the World Trade Organization’s Trade Facilitation Agreement through our Trade Facilitation Strategy to make Africa a better global competitor. Further, in January 2018, the AU launched the Single African Air Transport Market and opened for signature the Protocol to the Treaty Establishing the African Economic Community Relating to Free Movement of Persons, and Right of Residence and Right of Establishment. Work is underway to conclude by 2020 the negotiation of Protocols on Investment, Competition and Intellectual Property Rights. Through these, the AfCFTA is already moving toward an internal market free of physical, technical, or fiscal barriers.

What is more, the AfCFTA is on a historical fast track. We expect the AfCFTA to take effect faster than the five-year average for AU legal instruments to enter into force. With that, states will benefit sooner from the pooled and expanded sovereignty. We are confident that this landmark agreement will deliver decent livelihoods for all Africans in line with Agenda 2063.

Figure 6.7 Intra-regional trade and manufacturing exports in Africa

In 2017, intra-regional trade made up 17 percent of Africa's exports, far lower than the 59 percent in Asia and 69 percent in Europe. This indicates an absence of regional value chains and challenges of cross-border trade in Africa. Intra-regional trade is expected to increase with the upcoming implementation of the Continental Free Trade Agreement. Also, manufactured goods make up a smaller share of Africa's intra- and extra-regional exports. This reflects the region's limited integration into global value chains.



Source: UNCTAD.

EVENTS TO WATCH 2019

February
10-11

32nd Ordinary Session of the African Union

Addis Ababa, Ethiopia

The 32nd Ordinary Session of the Assembly of Heads of State and Government of the African Union will convene African heads of states and governments in Addis Ababa, Ethiopia to discuss the regional organization's priorities, including those under the 2019 theme: "Refugees, Returnees and Internally Displaced Persons: Towards Durable Solutions to Forced Displacement in Africa."

March
18-22

Africa Climate Week 2019

Accra, Ghana

Africa Climate Week 2019 will convene in the lead up to the U.N. Secretary-General's Climate Summit in September 2019, bringing together diverse actors from the public and private sectors.

March
20-26

52nd Session of the Economic Commission for Africa: Conference of African Ministers of Finance, Planning and Economic Development

Marrakech, Morocco

The 52nd session of the Economic Commission for Africa will focus on the theme of "fiscal policy, trade and the private sector in the digital era: a strategy for Africa."



August
28-30

Seventh Tokyo International Conference on African Development

Yokohama, Japan

The Seventh Tokyo International Conference on African Development (TICAD7) is an international conference on the topic of Africa's development led by the government of Japan in cooperation with the U.N., the U.N. Development Program, the World Bank, and the African Union Commission.

September
26

High-level Dialogue on Financing for Development

New York, United States

The U.N. General Assembly will hold a high-level dialogue on financing for development the day after the meeting of the U.N. High-level Political Forum on Sustainable Development under the General Assembly auspices.

ABOUT THE AFRICA GROWTH INITIATIVE

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Our interdisciplinary team of experts draws on the core strengths of Brookings—authoritative and nonpartisan research, a depth of practical expertise, and unparalleled convening power—to develop effective solutions that maintain the momentum and broaden the benefits of growth in Africa. AGI distinguishes itself by ensuring that the analysis it produces is:

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- **Collaborative:** AGI partners with experts throughout Brookings and the academic community, as well as with stakeholders around the world to draw on perspectives from business, government, and practitioners in the field.

OUR PRIORITIES

Pillar I: Sustainable Financing for Economic Development

AGI explores mechanisms for African governments to fill the gaps in their domestic resource mobilization policies and thus create more sustainable development financing overall through two main themes:

- Domestic resource mobilization (looking inward)
- Financial innovation (doing more with less)

Pillar II: Structural Economic Transformation

In order to build resilience against shocks and looming challenges linked to rapid population growth and high unemployment on the continent, AGI is committed to exploring pathways for structural economic transformation in Africa to achieve sustainable and inclusive growth.

- Maintaining the growth momentum (economic diversification and management of risks)
- Broadening the benefits (no one left behind)

Cross-cutting Pillar: Innovative Technologies for Economic Development (leapfrogging)

The potential for technology to leapfrog in African development cannot be overstated. Under this theme, AGI explores where the next technological innovation can be transformational and how they can be leveraged to deliver on development challenges in various areas.

Pillar III: US-Africa Relations (fit for the 21st century?)

AGI's relationships on the continent and strategic placement in Washington D.C. create opportunities for AGI to engage U.S. and multilateral policymakers on recommendations for an updated and mutually beneficial U.S.-Africa relationship.

- U.S.-Africa and China-Africa relations
- Nexus of economic development, security challenges, and humanitarian issues

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