A CONCEPT PAPER

# AFREXIMBANK AFRICAN AUTOMOTIVE INDUSTRY FACILITY

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## INTRODUCTION

As a Pan-African Multilateral Trade Finance institution established under the auspices of African Governments and the private sector to promote and finance intra and extra-African trade, Afreximbank has been providing support towards the implementation of the African Continental Free Trade Agreement (AfCFTA). In 2020, Afreximbank in collaboration with the Association of African Automotive Manufacturers, developed its Automotive Strategy is conceptualised around three pillars:

- Pillar 1 – The overarching pillar of the strategy is to facilitate the emergence of regional automotive value chains and hubs with focus on value-added manufacturing created through joint ventures between global Original Equipment Manufacturers (OEMs), Tier 1 and Tier 2/3 suppliers and local partners. The regional value chains will be mainly operating through joint ventures between OEMs and their Tier 1 multinational suppliers, along with Tier 2/3 suppliers on the one hand, and their African partners, on the other hand.
- Pillar 2 – To support the emergence of these regional value chains, the Bank will deploy adequate financing through its programmes and initiatives, including lines of credit, direct financing, supply chain financing and guarantees, etc.
- Pillar 3 – To drive the adoption of coherent national, regional and continental policies and programmes and effective capacity building initiatives without, which the emergence of regional hubs in Africa would not be possible.

The Automotive Strategy seeks to catalyse the development of the automotive industry in Africa as the continent commences trade under the AfCFTA. The Programme aims at leveraging on the Bank's unique status as an investment-grade Pan-African Development Finance Institution to provide tailor-made financial and non-financial products and services founded on three strategic pillars. It is also

designed to support the emergence of a viable and sustainable automotive industry in Africa.

Under Pillar three, policy and capacity building, Afreximbank in collaboration with the AfCFTA Secretariat, the African Union Commission and African Association of Automotive Manufacturers developed a broader Concept Note on the Automotive Sector as the first step towards the development of a Continental Automotive Strategy/Pact. It is very clear that for the continent to develop a viable automotive sector, there is a need for a Continental Automotive Strategy/Pact and rules of origin are a critical element of the Continental Auto Strategy. Afreximbank is also working with AfCFTA Secretariat and AAAM to undertake a study on automotive regional value chains in West Africa and this study will also be expanded to the other four regions in 2022.

This paper provides a summary of the key issues in the broader Concept Paper on the Automotive Strategy in order to provide the broader context in which the discussions on rules of origin should also be looked at.

## THE STATUS OF THE AFRICAN AUTOMOTIVE SECTOR

The automotive industry currently plays a disproportionately small manufacturing role in Africa with basically only Morocco and South Africa having successfully and competitively industrialized their auto industries with production volumes in 2019 pre-covid of just above 1 million vehicles. Over a relatively short time frame of 6 years, Morocco more than doubled their production volumes to 400,000 vehicles per year with South Africa at just over 630,000, both countries exporting significant volumes of their productions as part of their auto programmes.

The economic benefits of having a full-fledged and integrated auto manufacturing sector are considerable. For instance, in the case of South Africa, 110,000 people are directly employed in the industry – 30,000 in the assembly of vehicles and 80,000 in the manufacturing of components while 900,000 persons are employed in the full value chain from mining, farming to retail, insurance and finance whilst contributing just under 7% of the GDP.

In 2019, total new vehicles sale in Africa was at just 1.163 million units, representing 1.3% of global demand while in contrast, Africa accounts for 17.2% of the world's population. These numbers become more glaring when broken down to regions within the continent thus:

- 536,000 in the SACU
- 533,000 in North Africa
- 92,000 in Sub Sahara Africa (SSA) (44 countries)

Furthermore, a lack of vehicle production exposes the continent to significant annual trade deficits. From available data, SSA (excluding South Africa) had an automotive sector trade deficit of US$6.7 billion in 2017. This level of deficit ensures the continent remains highly vulnerable to short term currency positions.

Africa cannot continue with the present automotive production and trade structures. They do not support industrialisation, technological development, and skills acquisition. The auto sector is currently a major drain of foreign exchange in several African countries, thus increasing the costs of, and crowding out other forms of, industrialisation. In addition, Africa has become the largest destination of pre-owned vehicles, which has severe consequences on not just industrialisation of the continent but also on the climatic as most of them have outdated emission levels. The absence of vehicle manufacture has the structural knock-on effect of limiting the possibilities of component manufacture and the development of regional value chains in Africa.

In spite of the current status, Africa presents a major opportunity in the global automotive sector when you consider the low motorization rate of 42 vehicles per 1000 persons vs the global average of 182 and the unprecedented population growth which is predicted to grow from 1.3bn to 2.5bn people by 2050. This demand will be supported by the growing middle class, the tech savvy population with over 1bn mobile subscribers, the high proportion of youth and high rates of urbanization. We must take advantage of the launch of AfCFTA and the commitment of the AfCFTA Secretariat to industrialize and grow the auto sector

in Africa, within the world's largest single market. This is a key enabler to the potential growth of the sector.

The design and implementation of a progressive and effective Continental Automotive Strategy could significantly increase the annual production and demand to 5 million new vehicles within 15 years. This scale will enable the real industrialisation of the auto sector with the development of competitive regional value chains through the various tiers of manufacture.

A well developed and integrated automotive industry will display effective policy ecosystems comprising incentives and regulatory frameworks, legislation providing certainty, market expansion and trade facilitation measures, vehicle and component standards, access to industrial infrastructure, skills and supplier development programmes, sound labour relations along with strong coordination structures.

Of immediate importance for the development of a Strategy are the negotiations on rules of origin (ROO) for the automotive sector within the AfCFTA. Due to the significant amount of policy work done already on the sector ROOs over the past year, there is a firm basis to believe that an operative ROO regime for the sector will soon be in place.

## SUPPORTING THE AFRICAN AUTOMOTIVE INDUSTRY

There are structural features of the global automotive sector and its global supply chain that pose very specific challenges for the development of the sector in the context of a free trade agreement (FTA). This is particularly the case in the current AfCFTA situation, where there is significant variation in industrial capacity among member states. Introduction of specific assistance programmes to boost development of the sector should therefore be conscientiously encouraged as a deliberate strategy especially to facilitate the development of countries that are not as advanced in the sector as others. This strategy was implemented in South America and Asia, where significant new automotive manufacturing has developed in recent decades.

The introduction of such cross-border strategies under the coordination of AfCFTA Secretariat will fast-track the development of the automotive sector and will balance the need to protect existing automotive capacity and provide a developmental path for new entrants to the sector. It will also modernise and improve the efficiency of the African vehicle fleet. This will allow industrialisation around the automotive sector to be effectively facilitated. The current modalities – very significant disparities in automotive manufacturing capacity and a very diverse vehicle fleet dominated by pre-owned imports into Africa, will not be able to achieve significant industrialisation in the automotive sector within the context of the AfCFTA. Indeed, there are significant risks that the existing limited, but important, capacity could be adversely affected.

It is imperative that we do not allow this opportunity to pass by, since if it does, an entirely sub-optimal situation, with respect to the automotive sector, will be perpetuated for many more decades. The reality is that a major advanced manufacturing sector is virtually absent from African economies, despite the globally significant resource base and populations. Accordingly, in any process of industrialisation in Africa the automotive sector should be receiving high priority attention. As an advanced manufacturing sector, it has economic and operational features that require economies of scale and a sophisticated regulatory environment. It is also not an industry that is usually located in all economies but tends toward regional and global patterns of production and trade. The development of the sector therefore requires a clear strategy that is firmly located within a sophisticated industrial partnership across the Continent given its potential to act as a catalyst in the broader industrialisation of the regions.

Such a focused strategy is possible and will benefit industrialisation, manufacturing and all users of the African vehicle fleet. While not all African economies are likely to become vehicle manufacturers, the strategy will open a range of new opportunities for many economies and fundamentally alters the efficiency, affordability and environmental impact of the African industries. It is important to note that the objective of any strategy to be adopted should not be

entirely to halt the pre-owned vehicle market but to alter its supply base and structurally improve its quality, safety and environmental impact.

## AFRICAN AUTOMOTIVE SECTOR UNDER AfCFTA

In developing an effective auto strategy for the continent and in continuing the work on the automotive ROO negotiations, there should be strong collaboration between AAAM, AU, Afreximbank and the Secretariat.

The AfCFTA Secretariat will be confronted with challenges in trying to facilitate automotive industrialisation. This, however, could be helped by working with partners and adopting a specific and well-designed strategy. These challenges are now clearly emerging in the ROO negotiations with the various positions being espoused by the countries. We shall therefore attempt to deal with this and come up with an outline of the basic architecture of a potentially effective strategy that could lead to the development of the sector.

Firstly, there must be a concrete programme of action that could advance this project. In the earlier analysis at the beginning of this paper, we highlighted the key challenges militating against the development of the African automotive sector. These include its present structure across Africa, which is sub-optimal for consumers, economies and existing limited manufacturing capacity in Africa (South Africa and Morocco). It is dominated by the boundless supply of pre-owned vehicles from the developed economies. This will only increase for internal combustion engines as electric vehicles are introduced.

The advent of the AfCFTA must, therefore, become an opportunity to change this situation with the introduction of very strong ROO to ensure the continental market is protected and growth in new volumes and in new centres encouraged. However, when the specific features of the automotive manufacturing sector are examined, another challenge emerges, which is that the complexity of automotive assembly and its extensive supply chain will not be developed through the use of just conventional ROO mechanisms alone.

If the various components required for the development of the auto sector must be fast-tracked, it is probably wisest to do it in a coherent continental approach for automotive manufacturing. We have positive precedents in policy programmes, which have worked well in South Africa and Morocco and a new programme in Ghana has attracted its first significant investments. These success stories all involved cross-border collaborations. This Concept Paper therefore makes the case for a strategy based on an Africa-wide pact. A compelling reason to support the automotive industry is that the very advanced manufacturing nature of the sector opens a developmental path for new entrants, while expanding production for existing capacity and opening new opportunities for all economies.

A vehicle is the assemblage of thousands of components and final assembly is in a production line with dedicated tooling. As such it supports a long line of supply chains ranging from sophisticated tech industries to even animal husbandry for hide production that feeds into leather components manufacturing as well as agriculture in terms of rubber cultivation for rubbers coverings and so on. Given this characteristic, it is therefore hardly possible for one country to have the capacity to sufficiently supply the auto industry. Thus, the automotive industry is a veritable driver of a well-developed regional value chain.

## CONCLUSION

The argument presented in this Concept Paper demonstrates that the position of the African automotive sector is clearly sub-optimal on many fronts and, if nothing is done, it will get worse. We also need to be mindful that the global auto industry is going through a major transformation to electric engines and self-driving vehicles. If Africa does not develop significant capacity soon, it will fall further behind.

However, there are many specific structural features of the automotive sector and its advanced manufacturing processes, which means that the conventional use of market access and rules of origin provisions will not contribute to the development of the sector in Africa but require concerted support in form of dedicated financing

and other incentives to woo investments in the sector. Accordingly, we need to ensure that the platform provided by AfCFTA Secretariat is applied to develop and implement a strategy for the development of the sector. This is possibly our last opportunity to do so.

This paper has provided the broader context in which the discussions on the rules of origin may need to be looked at as well as the other supporting work in terms of the development of the Continental Automotive Strategy and provision of automotive financing by a number of African institutions including the facility that has been developed by Afreximbank.

## AFREXIMBANK AFRICAN AUTOMOTIVE INDUSTRY FACILITY

To support the development of a viable automotive industry the Bank has set aside a total of $1billion for a special African Automotive Support Facility to drive the attainment of the automotive strategy.

The Facility is accessible to qualifying requests for developments of projects in the auto value chain. It is designed to foster the development of the sector, which will boost industrialisation in the Africa. This will be supported by the development of Rules of Origin (ROO) for the auto sector under the aegis of the AfCFTA Agreement, to ensure encouragement of Made In Africa and save the continent from dependence on importation of used cars and the predictable negative consequence on not just the economy, but on the climate and the environment. The Bank has also developed guidelines which allows it to prioritise financing to goods and services which comply with AfCFTA rules of origin and the automotive sector is one of the areas that will be prioritised by the Bank under this initiative.