DYNAMIC INDUSTRIAL POLICY IN AFRICA

EXECUTIVE SUMMARY

ECONOMIC REPORT ON AFRICA

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INDUSTRIALIZING FOR STRUCTURAL TRANSFORMATION IN AFRICA

One of the most puzzling paradoxes over the last decade is that Africa has benefited from unprecedented growth while a large part of its population remained trapped in economic poverty, facing rampant unemployment and inequality. The continent has averaged 5 per cent a year growth over the last decade, with some countries returning more than 7 per cent. Underpinning this growth were relatively high commodity prices, increased domestic demand (due especially to increased private investment in infrastructure and energy) and improved economic governance and management.

The contribution from industrialization was minimal, however. The continuing apparent disconnect between strong commodity-driven economic growth and employment and social development has been exacerbated by the failure of most African economies to structurally transform. The failure to experience inclusive growth has been reinforced by several developments in the world economy—particularly volatile commodity prices—highlighting the perils of strong economic growth without concurrent industrial development and structural transformation.

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Structural transformation is associated with the reallocation of resources, especially through new investment, from low- to higher productivity activities, typically from agriculture to industry and modern services, leading to higher economy-wide productivity and progressively raising income. Much of Africa, however, has seen the opposite, as resources moved from higher to lower productivity sectors, slowing growth in national productivity. Factors of production such as labour have shifted notably from agriculture and manufacturing to services—harming productivity and in some cases curtailing employment in both agriculture and manufacturing and frequently cutting the contribution of manufacturing to the continent's GDP and employment over the last decade.

Partly for this reason, African countries remain marginal players in domestic and international markets for their manufactured goods, with a negligible share of manufactured exports in world exports, compared even against other developing countries

All this is worrying, as industry—manufacturing particularly—has traditionally been a source of substantial employment generation in developed countries and more recently in developing economies. Industrialization is thus a precondition for Africa to achieve inclusive economic growth.

Africa's share in global trade is also way below potential, at around 3.3 per cent, and its exports are dominated by oil, metals and minerals. Intra-African trade remains low versus other regions (about 11.5 per cent in 2012, though informal trade lifts the figure) and is hindered by steep intra-African trade barriers. Yet intra-African trade is far more industrialized than Africa's trade with the rest of the world, suggesting that boosting intra-African trade can contribute to industrialization. Other encouraging news, given the crucial role of services in development, is the buoyant expansion of Africa's service exports: exports of commercial services, for example, have nearly tripled in the last decade.

But we cannot forget that a majority of Africans still depend on agriculture for their livelihoods, and thus enhancing its performance is central to sustainable poverty reduction. Beyond increased agricultural income, effects on the wider economy of a more prosperous agricultural sector include strengthened backward linkages and greater demand for industrial products.

Managing these change processes is fundamental to structural transformation and inclusive development. Economic advancement does not occur in a vacuum, despite the claims of some proponents of market reform, as market forces alone cannot sustain increases in a country's income and development. Countries that industrialized required far-sighted and cogent state efforts to address market failures and promote restructuring.

To enhance its industrial development, Africa too needs to follow this line, ensuring credible industrial policy and the right conditions for it, led by the state machinery of industrial policy organizations (IPOs)—though debate resounds on the best approach for developing countries (box 1).

Against this backdrop, the Economic Report on Africa 2014 focuses on how to build innovative, effective and flexible IPOs and mechanisms to enhance industrialization and structural transformation in Africa. It hones in on the answers to three basic questions:

- Why, along a broad historical perspective, has industrial policy been ineffective in Africa?
- How have IPOs operated and how have they affected industrial development in Africa?
- How do African countries formulate strategies for building and operating effective IPOs?

This report builds on previous work by the United Nations Economic Commission for Africa and the African Union Commission as published, for example, in two recent Economic Reports on Africa—2011, which focused on the role of the state in economic transformation, and 2013, which ran the theme of commodity-based industrialization.

Market failure is one of the most important reasons for limited economic transformation and slow growth in Africa, coupled with governments' inability to act. Three key types of market failure are commonly recognized. First, there are those that relate to self-discovery externalities where the social value of an activity exceeds its private worth. The key barrier is the information needed to determine how new products can be produced profitably in the economy.

Second, there are also failures linked to coordination externalities. "Lumpy" parallel investments are often needed to accompany economic activities upstream and downstream. Decentralized markets do a very poor job of coordinating these.

ERA 2014 focuses on how to build innovative, effective and flexible industrial policy institutions, processes and mechanisms to enhance industrialization and structural transformation in Africa.

The third aspect concerns the missing inputs from the public sector, which could include everything from transport to laws and to research and development specific to an industry.

African government intervention through industrial policy can help spur structural transformation by addressing these market failures. The approach followed by policymakers, academics and other industrial stakeholders has been to identify key general constraints and devise broad policy interventions to alleviate them. Unfortunately, these responses have rarely focused on the institutions governing industrial policy, or on the impact that weaknesses in these institutions have on their own ability to operate in a coordinated, dynamic framework. Indeed, weak institutional structures and poor policy design have been at the root of Africa's industrial policy problem throughout its post-independence history.

BOX 1: KEEP OR SHIFT—OR COMBINE EFFECTIVELY?

The question of whether developing countries should industrialize along their current comparative advantages or defy these static comparative advantages and shift resources to new high-tech industries at an early stage of development has long been debated. Lin (2012) argued that governments should first align their industrial policies with their resource base and level of development and subsequently invest in new industries as they accumulate human and physical capital. In contrast, Chang (2012) argued that in view of the high cost of moving capital from relatively low to high tech industries, industrial policy should encourage investment in high-productivity industries at an early stage of development.

The Economic Report on Africa 2013(ECA and AUC, 2013) argued, however, that these strategies are not mutually exclusive, and that commodity-based industrialization can be a stepping stone to diversifying over the long term and building competitive advantages in resource-rich countries.

Further, any policy mix of the two requires direct state interventions, hence more recently the debate has shifted to focusing on institutions and mechanisms that ensure these actions' effectiveness.

Thus once the need for intervention is accepted, the focus falls on how to design IPOs capable of supporting industrial transformation. So, beyond an analysis of the problems of industrialization in Africa, and based on the experience of successfully industrializing countries in the global south, this report offers an institutional framework for designing and implementing industrial policy in Africa. Many of the elements in this framework originated from 92 interviews held in 11 countries, with interviewees in four groups, depending on their level and type of involvement in industrial policy and business. Country case studies, too, provided many examples of how institutional frameworks operate and how failures were overcome or avoided. The findings and their policy implications are now summarized.

BUILDING DYNAMIC INDUSTRIAL POLICY FRAMEWORKS ORGANICALLY

Successful frameworks for industrial policy are organic and dynamic, and should avoid blueprints and goals that are largely donor driven. A blueprint approach is where industrial policy consists of standard packages of predefined policies copied from other country settings. Industrial policy should though be dynamic, and IPOs must have the ability and motivation to constantly adapt to the changing needs of the industrial sector. Some IPOs performed disappointingly and failed to respond to changing circumstances, while some lacked autonomy from overseeing ministries and failed to consult the private sector in strategy development. In other cases, priorities have been set by donors rather than arising organically from interaction of the key players in the economy. Corruption, lack of funding and poor operations further inhibit success.

ENSURING HIGH-LEVEL COORDINATION AND POLITICAL SUPPORT

The industrial policy framework requires top-level coordination to properly deal with potential problems that undermine the efficiency of industrial policy. Some countries suffer from coordination failure in the upper reaches of the government and bureaucracy, leading to IPOs disconnected from the private sector, communicating badly and lacking the backstop of political will—all of which may generate short-term shifts in policy and undermine the long-term investment climate. Worse, ministries (and their parastatals) may have conflicting goals, or policies may be designed along sectoral lines. And even with an apex coordinating unit, policy can fail because of a lack of political support for either the creation or implementation of political policy.

In contrast, successful governments often form high-level units with representatives from the private sector and state, involving the private sector in identifying recommendations for policy. The upper echelons of successful countries understand the need for systematic coordination and regularly incorporate the private sector and encourage super-ministerial collaboration.

LETTING THE PUBLIC AND PRIVATE SECTORS DIALOGUE

Such systematic private sector representation in IPOs allows governments and IPOs to remain adaptable to the changing needs of the private sector. Feedback points to the steps needed to resolve private sector concerns, such as financial shortages or lack of infrastructure. Successful industrial policy in African countries has rapidly created IPOs to fill the gaps, as seen by the private sector, in the industrial policy framework.

GRANTING EMBEDDED AUTONOMY TO BUREAUCRACIES

Successful IPOs have “embedded autonomy”. Embeddedness among IPO officials means that they understand the industry and have built relations with private stakeholders, improving their ability to collect information (and as seen, allowing businesses to be part of the policy loop).Autonomy is needed to ensure that bureaucrats are not “captured” by any special interest groups, to strive for the development goals of the whole country. Indeed, some claim that balancing autonomy and embeddedness on the part of government officials is far more important than the final policy choices.

Thus bureaucrats conducting industrial policy should be insulated from political pressure and selected through competitive recruitment and well-defined career paths that make politically motivated hiring and firing difficult—ideally, impossible.

TRANSCENDING ORGANIZATIONAL IMPERFECTIONS

Operational failures hinder IPOs due to poor target setting, monitoring processes and incentive structures. One crucial dimension is the failure to develop—and then monitor—contingent rents (policies to increase private sector profits that are linked to undertaking the expansion of production and investment), which incentivize the private sector to follow the IPO's interventions.

Operational failures can also arise from "structural hollowness"—a mismatch between resources and responsibilities. So although many African countries have no IPO or it has the wrong mandate, some operating IPOs cannot provide the services. The more successful economies carefully match the two sides, or have evolved to focus on a tighter range of services.

STARTING WITH POCKETS OF EFFICIENCY

From the above, it stands that IPOs should be developed in line with the political commitment they get, and their capacities and resources. But with little experience and a narrow funding base, most IPOs need to start slowly, developing "pockets of efficiency" to demonstrate the effectiveness of industrial policy and initiate the institutional processes that can be drawn on later if successful.

BUILDING COALITIONS

Still, these pockets need the support of the ruling elites that deem certain policies instrumental to strengthening their economic or political power. Thus successful industrial policy also requires a confluence of interests among the elites, which is particularly important when businesses pursue new economic activities where the risks are high, sunk costs large and the need for government support great.

PLANNING COHERENTLY FOR DEVELOPMENT

One way to coordinate industrial policy with other macroeconomic issues—exchange rate, monetary and fiscal policies; infrastructure strategy; and investment-climate measures—is through development planning. This is a purposive governmental mapping to coordinate economic decision making over the long run and to achieve a predetermined set of development objectives.

ENHANCING TECHNOLOGY TRANSFER, INNOVATION AND COMPETITIVENESS

Increasingly sophisticated productive capabilities are needed to produce internationally competitive goods and services. But although Africa is moving, many other economies are moving faster: the 2012-2013 Global Competitiveness Index places 14 of the 20 least competitive countries in Africa. It attributes this to weak institutions, infrastructure deficits, limited technological advancement and too few skills for a knowledge economy. African countries need to respond at once, and effectively.

> **Industrial policy should be dynamic and IPOs must have the ability and motivation to constantly adapt to the changing needs of the industrial sector**

CREATING POCKETS OF INFRASTRUCTURE

Industrial growth requires modern infrastructure and logistics. As with the earlier pockets of efficiency, governments with few resources should create "pockets of infrastructure" focused on sectoral or clustering needs of industrial expansion. Industrial parks are one approach, providing high potential for growth and value addition as well as for solid linkage development and related spillovers among companies, suppliers and service providers—even government institutions. Domestic technologies should play a key part here.

RESPONDING TO CLIMATE CHANGE

Climate change could hobble Africa's economic growth momentum as the continent attempts to switch to industrialization and economic transformation. But it could also provide an opportunity: Africa has vast renewable energy resources of hydropower, geothermal, biomass, wind and solar. And as Africa is not locked in any technology preferences, it can follow a green and clean industrializing energy pathway and leapfrog old carbon-intensive models.

FOCUSING ON GROWTH POLES

A key element of any regional strategy is a focus on growth poles, because economic growth usually occurs in regions or industries (poles) and not throughout the economy. In this approach, the growth pole consists of a concentration of productive economic activity in a region that can foster growth in peripheral regions through positive spillovers and backward and forward linkages. The objective of growth pole strategy is not to address market failures but to capitalize on resources already in place.

CAPITALIZING ON TRADE

Countries that industrialize, also trade. And as intra-African trade is far more oriented towards industrial products and diversified than extra-African trade, measures to boost the former can help the continent industrialize. African governments need to bring down the current very high trading costs, and make efforts to formalize informal traders, especially women. In addition, African countries need to boost the development impact of trade negotiations and agreements, continentally and globally. To this end, countries should develop greater capacity to coordinate, negotiate and lobby for lower tariffs on imported intermediate inputs.

FINANCING INDUSTRIALIZATION

Most of the above policy reforms, and all of industrialization, will cost. African economies therefore need to find new sources of finance and make better use of existing resources, as they already do with infrastructure investment.

The success of industrial policy projects depends heavily on African countries securing public and private finance in priority areas, especially infrastructure, education and technology acquisition. A further, untapped, area is the pharmaceutical industry, which is expected to burgeon in the next few years as Africans become richer and seek greater access to medicines. Governments should promote better access to credit, especially for small and medium-size enterprises, which will improve prospects for expanding and diversifying output.

FINALLY…..

The exact design of national industrial policy will vary among countries, based on the needs of the private sector, resource attributes and national development objectives. The key is to institutionalize industrial policy so it becomes part of the regular decision-making mechanism of government and becomes no different from more broadly accepted responsibilities such as monetary and fiscal policy. Doing this, African governments will have to ensure that the economic benefits are not captured by special interest groups, but are spread inclusively among the whole population.

The exact design of national industrial policy will vary depending on the needs of the private sector, resource endowment, and national development priorities, among other factors

Driven by rising commodity prices and domestic demand, improved macroeconomic management and stronger trade and investment ties with emerging economies, Africa has experienced robust growth over the past decade. Yet much of its population has not shared this expansion. Poverty remains rampant, inequality is worsening in many countries and viable employment and livelihood opportunities continue to elude millions of young people.

African countries need to transform their economic structures to generate inclusive and sustainable growth. Market failure is one of the most important reasons for the poor performance of industry—a key to economic transformation. Government intervention through industrial policy can help spur the structural transformation of African economies by addressing these market failures. However, it is important that African governments do not repeat the industrial policy errors of the past where they often followed a "blueprint approach" of adopting static formulaic interventionist packages, with little non-government stakeholder input.

Based on commissioned studies of 11 African countries and experiences from the global south, this report identifies the challenges and pitfalls faced in designing and implementing industrial policy and how they have been overcome. And it points to the key institutional features that allow industrial policy to be dynamically and organically connected to the processes and players underlying industrialization.

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