



## ECA POLICY BRIEF

### Broadening the participation of the local private sector in Africa's construction and energy sectors through modern industrial policy

Expanding the role of local players in major infrastructure projects is a major challenge in Africa. The domestic private sector is notably absent in the construction and energy sectors, which are fundamental to the achievement of Africa's transformational goals. The construction sector provides critical support for social and economic development, while the energy sector is arguably the infrastructure sector where private investment is most needed for industrial development in Africa. Interventionist industrial policies are needed not only to boost the level of investment in these sectors, but also to lay the foundation for the growth of private entrepreneurship and to enhance the contribution of the local private sector to sustainable and inclusive development. The benefits, in terms of jobs and broader economic development, are beyond question. While African Governments are beginning to think about how to use modern industrial policy to promote local businesses, they should do more to help local businesses to compete effectively for public-private partnerships in infrastructure provision. This is the conclusion of the Economic Commission for Africa (ECA) 2015 report on *Enhancing domestic private sector development in Africa: construction and*

*energy sectors*. This policy brief outlines some of its key messages and recommendations.

#### Understanding modern industrial policy

The general drift towards deindustrialization in Africa in recent decades, has resulted in the revival of industrial policy as a legitimate development and economic revitalization strategy. Modern industrial policy (which has been implemented in countries and economic regions such as Australia, the European Union, the Republic of Korea, Malaysia, and the United States of America) distinguishes itself from discredited traditional industrial policy by embedding private initiatives under a framework of public action aimed at encouraging diversification, upgrading and technological dynamism.<sup>1</sup> Its central aim is to strengthen economic sectors that can ensure long-term prosperity. For developing countries, the realization that structural transformation is neither spontaneous nor rapidly achievable without policy inducement, makes the use of industrial policy an imperative. There is often a series of bottlenecks and distortions that are present in these economies, which need to be tackled first in order to unleash structural transformation. For instance, asymmetric information in financial markets undermines banking sectors' responsiveness to the needs of the real economic sector, such that small- and medium-sized enterprises are starved of credit and there is inadequate provision of long-term lending for investments in economic

<sup>1</sup> Jesus Felipe, ed., *Development and Modern Industrial Policy in Practice: Issues and Country Experience* (Manila, Philippines, Asian Development Bank, 2015).

infrastructure, which are critical for industrialization and structural transformation.

Some of the key aspects of new industrial policy include: its design around the core objective of creating and maintaining a regulatory environment in which industry can thrive; its tendency to advocate for a level playing field for domestic companies on international and domestic markets; and a strategic and forward-looking policy for innovation. Moreover, modern industrial policy typically extends beyond the manufacturing or industry sector to cover the service sector, and involves the use of both vertical and horizontal policy instruments.

Implementing modern industrial policy implies a high level of institutional development and coordination, including through enhanced public-private dialogue. Indeed, the report of ECA and the African Union Commission (2014)<sup>2</sup> underlines the primacy of institutional dynamics and challenges in the implementation of industrial policy in Africa. That report identifies dynamic and embedded industrial policy institutions, and high-level political support and institutionalized dialogue with the private sector as key factors to help Africa avoid past inadequacies in industrial policy design.

### The construction sector in Africa is underperforming and local participation in the construction industry is still nascent

Construction investment, as a share of gross domestic product, has been increasing in Africa and other developing and emerging regions – in line with expectations that surges in population and urbanization (resulting from internal migration) typically drive earlier stages of economic growth. Africa's current average urbanization rate stands at 3.5 per cent compared to the world average of 2 per cent. Yet, the 2015 report notes that Africa invests much less in infrastructure and residential or non-residential construction than other regions, including Oceania, a region with only about 3 per cent of Africa's population.

Why should Governments care about the extent of local participation in the construction sector? Construction is of strategic interest because it is both a critical infrastructure service, and it serves as a barometer of an economy's health. Many Governments use investment in construction as a strategic economic stimulant to reignite growth and stimulate employment during economic downturns. However, when a country imports most of the skills and materials used in construction, the sector's strategic policy value weakens considerably. The status of local participation in the construction industry in Africa tends to support the case for new industrial policy interventions.

**Table 1:** African construction and materials firms ranked in the 250 top companies

Country	No. of firms	Total market capital (millions of US dollars)
Egypt	9	13 898
South Africa	6	3 307
Morocco	4	5 305
Nigeria	3	25 094
Kenya	1	845
Zambia	1	748
United Republic of Tanzania	1	273

Source: Adapted from, *Enhancing domestic private sector development in Africa: construction and energy sectors* (ECA, 2015).

Data on African construction sector projects (projects involving mostly infrastructure investment over \$50 million in size) in 2013, confirm that 57 per cent of infrastructure projects were owned by Governments. However, only about 6 per cent of the funding for these projects is from Governments. Moreover, most (52 per cent) of the construction was carried out by international private companies from Europe, the United States of America and China. African construction companies generally remain too few (see table 1), too small and too underresourced to compete effectively with international private companies for Government and development finance institution infrastructure projects. Only about 16 per cent of construction is accounted for by domestic private sector construction companies.

<sup>2</sup> *Economic Report on Africa: Dynamic Industrial Policy in Africa* (Economic Commission for Africa and African Union Commission, 2014)

**Notwithstanding the massive efforts to promote public-private partnerships in Africa, the energy sector receives a small amount and the role of domestic private companies remains smaller than in any other infrastructure sectors**

The energy sector in Africa is arguably the sector where investment is needed most. Power plays a central role in sustainable development and poverty alleviation efforts on the continent. Energy services enable basic human needs and they also contribute to both economic transformation and social development by promoting manufacturing, supporting information and communication technology investments, and improving education and public health.

It is, however, rather worrying to note that in the context of structural transformation, the data suggest that with only about 30 per cent of ownership accounted for by the private sector (both foreign and domestic), very little investment is being directed at industrial development. This apparent bias is explained by the tendency of Governments, donors and development finance institutions to spend up to 50 per cent of their construction funding on transport. The private sector spends an overwhelming share of its funding on more lucrative information and communications technology. The energy sector, which the report argues – represents the single biggest infrastructure threat to industrialization in Africa, and where the greatest funding gaps exist – attracts only about one quarter of Government infrastructure spending on construction. Donors and development finance institutions, on the other hand, allocate almost a third of funding not directed to transport, water and sanitation. This seems to suggest that while significant network and linkage effects can be expected from Africa's boom in transport infrastructure investment, balancing the scales in favour of the energy sector is also warranted.

Table 2 reveals that from 1995 to 2012, 141 power projects were concluded in 35 African countries. Investments in those projects represented about 10 per cent of total private infrastructure investment in Africa over the period reviewed. Notwithstanding the massive promotion efforts, public-private partnerships struggle to provide more than a tiny portion of the infrastructure investment: only about 10 per cent of all private investment in infrastructure goes to power and the role of domestic private

companies in such projects is smaller than in any other infrastructure sector.

**Table 2:** New public-private partnership and private participation in infrastructure projects in Africa's energy sector, 1995–2012

	PPPs:				Other PPI:				Totals					
	Brownfield Concessions		Greenfield Concessions		Rental Contracts		Mgmt/Lease Contracts		Divestiture (full/partial)		Merchant Projects			
	US\$ millions	No.	US\$ millions	No.	US\$ millions	No.	US\$ millions	No.	US\$ millions	No.	US\$ millions	No.		
<b>Electricity:</b>														
Generation	524	5	11 457	71	158	24	-	1	1 020	5	-	1	13 159	107
Distribution, transmission & generation	1 304	7	-	0	-	0	-	6	-	1	-	0	1 304	14
Distribution & generation	74	2	22	1	-	0	-	2	-	0	-	0	96	5
Distribution & transmission	-	1	-	0	-	0	-	1	274	1	-	0	274	3
Distribution	87	2	-	0	-	0	5	2	-	0	-	0	92	4
Transmission	-	0	110	1	-	0	-	0	-	0	-	0	110	1
<b>Natural Gas:</b>														
Distribution	-	0	55	1	-	0	-	0	16	1	-	0	71	2
Distribution & transmission	-	0	1 234	2	-	0	-	0	-	0	-	0	1 234	2
Transmission	-	0	944	3	-	0	-	0	-	0	-	0	944	3
<b>Totals</b>	<b>1 989</b>	<b>17</b>	<b>13 821</b>	<b>79</b>	<b>158</b>	<b>24</b>	<b>5</b>	<b>12</b>	<b>1 310</b>	<b>8</b>	<b>-</b>	<b>1</b>	<b>17 284</b>	<b>141</b>

**Source:** Enhancing domestic private sector development in Africa: construction and energy sectors (ECA, 2015).

**Abbreviations:** PPP, public-private partnerships; PPI, private participation in infrastructure.

**Success factors in enhancing local participation in the construction and energy sectors: a catalytic industrial policy approach**

An active industrial policy can shape markets and outcomes through a combination of supply and demand policies in order to assist local firms in the construction and energy sectors to play a more active role in structural transformation and inclusive economic development. There are several measures that Governments can use to help facilitate the operation and growth of domestic construction and energy industries. Government initiatives to develop domestic construction industries might also be useful in preparing domestic firms to participate in public-private partnerships in the energy sector. Typical supply-side measures include, capacity-building and training to impart basic skills, business strategy know-how, and understanding of more sophisticated contractual arrangements such as public-private partnerships.

Success factors in catalysing domestic participation in the two sectors are not limited to improving internal conditions in private. Governments will also need to meet challenges at the policy level. Two broad demand-side policies are identified to confront the bias in favour of larger projects that use the latest technology and materials, and target international contractors. One option for Governments is to ensure a “level playing field” on which domestic firms compete for work through giving special consideration

to contractors that are domestic firms, or that include domestic firms as partners or subcontractors.

African Governments can go a step further by creating strong preferences for local firms over international competitors in tendering processes. These industrial policy tools, are not sanctioned by the World Trade Organization and other proponents of global free trade, who consider public procurement as a neutral technical tool. However, an increasing number of developing countries have reserved the right to use public procurement as an industrial policy instrument to help local companies participate more frequently in construction projects and in public-private partnerships. These "localization strategies" (inclusive of the import substitution policies) have been mainly designed to resuscitate and stimulate domestic productivity.

Policy implementation remains a central issue in broadening local private sector participation in the construction and energy sectors in Africa. It is critically important to develop commercially viable public-private partnerships in sectors such as energy, but the need to improve the ability of Governments to manage construction and rehabilitation of infrastructure is arguably more urgent and a bigger challenge. The success of African Governments in meeting this challenge will not only depend on tackling the issues of poor infrastructure construction planning, management and coordination, but also on their ability to form effective partnerships with the private sector.

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