



## Making the most of Africa's commodities: industrializing for growth, jobs and economic transformation\*

### Africa's industrialization imperative

African countries are facing the key challenge of designing and implementing effective policies to promote industrialization and economic transformation at a critical juncture in their development trajectory. The global shift in production and trade patterns, the emergence of new growth poles in the south, the revolution in information and communication technology, changes in demography and rapid urbanization have all led to significant shifts in the global economic and geopolitical landscape. Those changes present African countries with unprecedented opportunities to embark on a bold agenda that will transform the continent and see it emerge as a global economic power.

Achieving the type of economic transformation that will assure a shift in the sectoral composition of output in favour of high-productivity activities, especially manufacturing and modern services, will create jobs and lift millions out of poverty. This will require more inclusive and equitable growth policies, based on the needs and priorities of Africans. Since 2000, Africa has recorded remarkable growth rates, averaging more than 5 per cent annually, after nearly two decades of stagnation. Those impressive growth rates are underpinned by a variety of factors, such as strengthened domestic demand associated with rising incomes and urbanization, increased public spending, closer trade and investment ties with emerging economies and post-conflict recovery in several countries. A number of African countries are now among the top ten fastest growing economies and have improved business environments.

However, those improvements have not yielded the social and economic transformation needed for the continent to benefit from globalization. African countries have long depended heavily on the production and export of primary commodities with little value addition, which has led to a lack of economic diversification and few forward and backward linkages to other sectors of the economy. This trend has been accentuated by a surge in commodity prices, largely driven by emerging economies, with the price of various metals doing especially well. Primary commodity production and exports entail huge forgone income, the export of jobs to countries that can add value and exposure to high risks owing to dependence on exhaustible commodities and fluctuations in commodity demand and prices (ECA and AUC 2013).

Commodity based industrialization is one approach to achieving economic transformation on the continent. Africa boasts significant human and natural resources that can be used to promote industrialization and structural economic transformation through value-addition strategies. It has about 12 per cent of the world's oil reserves, 42 per cent of its gold, 80–90 per cent of chromium and platinum group metals, 60 per cent of arable land and vast timber sources. In addition to natural resources, the continent will have the largest labour force in the coming decades, exceeding both China and India. This potential can only translate into meaningful dividends if the continent is able to stem the high levels of youth unemployment and create the jobs needed to lift millions out of poverty.

Africa must capitalize on its resource endowment and the commodity price boom. Resource based industrialization yields employment, income and dynamic benefits. For example, up to 90 per cent of the total income from coffee, calculated as the average retail price of a pound of roasted and ground coffee,

\* Contributed by Chigozirim Bodart, Macroeconomic Policy Division, United Nations Economic Commission for Africa (UNECA), based on the *Economic Report on Africa (2013)* of UNECA and the African Union Commission.

goes to consuming countries (Figure 1). By moving up the value chain and developing backward and forward linkages to the commodity sector, countries can maximize direct and indirect job creation effects. Successes from Asian and Latin American countries show that economies can use their commodities to enhance economic transformation. Chile has witnessed remarkable success in its salmon industry by developing its technological capabilities and skills and is now the world's second largest producer of Atlantic salmon. The plywood upgrading trajectory in Indonesia was the result of Government control of domestic and international marketing channels, using this as an avenue to move into high value-added regional markets. Brazil was able to combine interventionist policies with high domestic capabilities to boost its cocoa industry.

It is on this premise that the Economic Report on Africa 2013 focuses on the theme of "Making the most of Africa's commodities: industrializing for growth, jobs and economic transformation". Drawing from nine country case studies, the report examines key constraints and opportunities for African countries to make the most of their commodities by adding value through linkage development. It suggests a policy framework for African countries to promote value addition and economic transformation and to reduce their dependence on producing and exporting unprocessed commodities.

## Huge untapped opportunities for value addition

The country case studies examined the extent to which Africa is making the most of linkages in its soft and hard commodities to drive a new process of industrialization. In the soft commodities sector, the study analysed

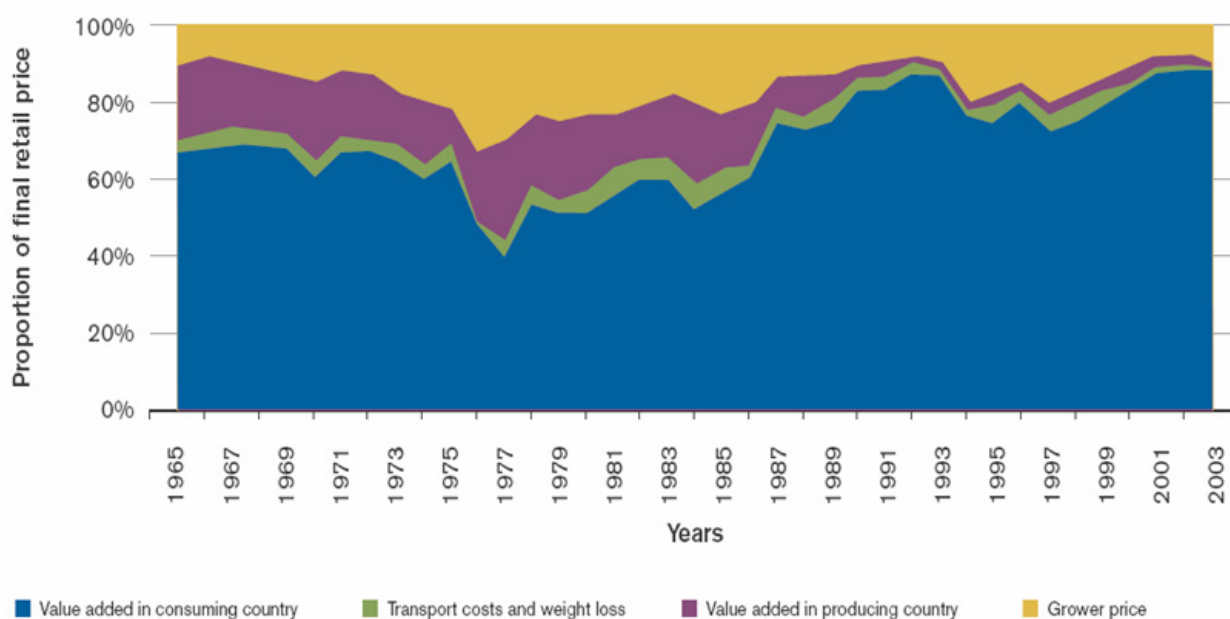
the forward and backward links within the various global value chains in cocoa, coffee, tea and agro-products. The industrial commodity sectors covered textile and clothing, leather, oil, copper and mining supplies.

The nine country case studies (Algeria, Cameroon, Egypt, Ethiopia, Ghana, Kenya, Nigeria, South Africa and Zambia) undertaken by the report found evidence that countries were making progress in developing local linkages in the hard, soft and energy commodity sectors. However, value addition is still limited and the depth of linkages (the accretion of local value added) varies more by country than the breadth (the share of local spending). This variation is the result of country or industry specific constraints that cannot be overcome by market forces and call for strategic and systematic industrial policies.

The study documented five key findings. Firstly, the big differences in soft, hard and energy commodity sectors affect how linkages develop. Most soft commodities, as opposed to hard commodities, have low technological content, lend themselves to small-scale production, are labour intensive, require a heterogeneous and diffused infrastructure and rarely stay fresh in their natural state, requiring early processing. Hard commodities generally embody more complex technologies and require intensive use of large infrastructure (such as roads, railways and ports) that can be used for developing other sectors. Energy commodities are mainly very technology, scale and capital intensive, requiring infrastructure of less use to other sectors.

Secondly, establishing marketing links and staying in global value chains is essential, but requires systematic investment and support. For many African countries, searching for buyers is a costly exercise for firms that must be inserted in regional and global value chains. Building those linkages requires appropriate Government support

**Figure 1: Intercountry distribution of income (percentage share of final retail price of coffee)**



Source: Kaplinsky (2004) based on Talbot (1997).

for firms to be globally competitive in “critical success factors” such as price, quality, lead times, dynamic capabilities and compliance with technical, private, health and environmental standards. Linkage development is thus a progressive and cumulative process and requires continuous investment in technologies, research and development and skills, among other elements.

Thirdly, all links in the value chain require support to upgrade. However, this may result in trade-offs between the links. For example, because output from the food commodity sector can vary enormously in quality, price and technical specifications, adding value in agro-processing normally requires support at different stages, including production, marketing, storage and transport. To avoid unintended negative impacts on producers in other links, strategies that target processing industries must be integrated with interventions at the commodity-producing and primary-processing stages.

Fourthly, regional markets may offer more opportunities than traditional markets. Such opportunities are more apparent when a firm enters a global value chain. Regional markets may be initially less demanding and allow local firms to build the necessary production capabilities required to graduate into more competitive global chains, a point particularly important for countries without large domestic markets. The regional approach opens up space for ensuring that regional integration within Africa is fast-tracked and streamlined to help local firms build competitiveness.

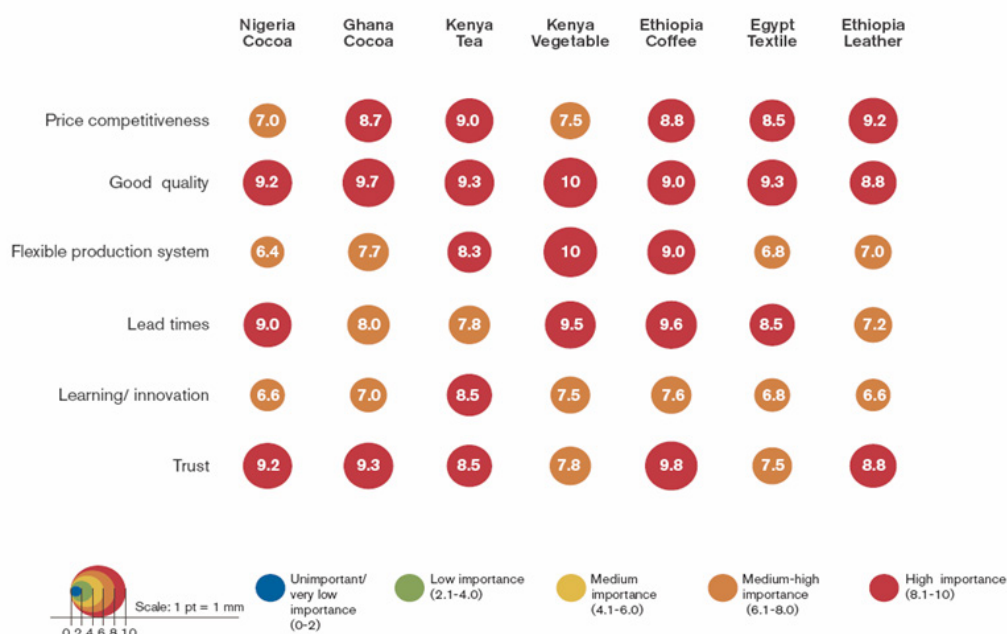
Finally, trade agreements with traditional industrialized countries and emerging partners are important for entering new markets. African countries need to improve market access for their value-added products through

agreements with traditional and emerging partners. Their strategies, based on a united framework for negotiation, should aim to maximize the development impact of partnerships and, specifically, to reduce high tariffs (on cocoa to India, for example) and remove tariff escalation (in the European Union, for instance).

## What influences linkage development?

The study identifies two primary sets of linkage drivers – structural and country specific – and the distinction between them has major implications for policy development. Structural linkage drivers refer to the age of the commodity-exploiting sector and several sectoral factors, such as the requirement for “just-in-time” and flexible logistics, the type of individual commodity deposits and the technological complexity of the sector. Country-specific drivers refer to contingent factors that are dependent on the national context, making them easier to influence by policy than the structural drivers. Examples of those drivers include ownership and infrastructure, skills and capabilities and linkage strategies. This means that policy-makers cannot make simple generic solutions for critical success factors, which differ widely by country, sector and value chain (Figure 2). They must analyse how multiple factors influence the economic terrain of each country. Each country’s industrialization strategy to facilitate local production linkages would depend on the sector, commodity characteristics, characteristics of particular value chains, critical success factors in different value chains,

Figure 2: Variation of critical success factors by sector and value chain



Source: ECA and AUC (2013).

firms' capabilities, stakeholders and state capacity to make the necessary institutional arrangements.

## A policy framework for linkage development

Having noted the factors that influence linkage breadth and depth, the Economic Report on Africa 2013 presents the following nine point policy framework to help African Governments develop policies and implementation mechanisms to drive their own commodity based industrialization:

- 1. Adopt and implement a coherent industrial policy:** to speed up and deepen the process of value addition and linkage development, African Governments need to make strategic responses, working closely with all stakeholders to formulate and implement industrial policy;
- 2. Create appropriate inclusive and transparent institutional industrial-policy mechanisms:** Governments do not have all the answers, and have to learn. Hence their "leadership" entails not directing participants but brokering meetings and ensuring that sectional interests are directed to the collective good;
- 3. Develop an appropriately directed local content policy:** local content policies have probably been the single most important policy driver of linkages from the commodity sector. It is crucial for such policies to be evidence based and well informed rather than ideologically driven;
- 4. Raise lead-firm procurement, sourcing and processing:** major commodity firms have the potential to deliver a major impact on local (backward and forward) production linkages. Governments can play a persuasive and regulatory role in ensuring that lead firms facilitate local sourcing;
- 5. Adopt strategic interventions to insert indigenous firms in supply chains:** industrial policy should cover customized supply-chain development programmes that help indigenous firms to insert themselves in those value chains and to remain competitive. Such policy may focus on upscale niche markets and quality certification, as well as on special funding mechanisms to build firms' capabilities in backward and forward linkages;
- 6. Boost local skills and technological capabilities:** deepening local linkages requires measures to target skills development, technological capabilities, access to capital and so forth. Furthermore, buyer-supplier cooperation is critical, as is providing incentives or export taxes to processing industries;
- 7. Address infrastructure constraints and bottlenecks:** the inadequacy of infrastructure in Africa is a major constraint on industrial development. Addressing this issue is often the most important factor in aiding the development of both the commodity sector

itself and its linkages. Governments should use commodity access to secure favourable financing, to leverage public-private partnerships and to restructure institutions that provide soft infrastructure;

- 8. Improve policy implementation through coordination among ministries:** value chains are cross-cutting, ministries are not. A commodity-based industrial strategy necessarily requires interdepartmental direction and implementation. Effective policy implementation therefore requires coordination across ministries and departments in the context of broader national development plans that ensure participation of all stakeholders;
- 9. Negotiate regional trade arrangements and foster intra-African trade:** regional markets can be important in facilitating local production linkages both within and between African countries. They can provide learning opportunities that allow domestic firms to build production capabilities in a step-by-step process. To be effective and improve coordination at the regional and continental levels, national industrial development frameworks in Africa should, as far as possible, be closely aligned with the priorities of the Action Plan for the Accelerated Industrial Development of Africa, endorsed by African ministers of industry in 2007.

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