# Executive Summary

## AFRICA'S IMPERATIVE TO INDUSTRIALIZE IN TODAY'S GLOBAL CONTEXT

The global economy has, since the turn of the century, seen vast shifts in production and trade patterns alongside the emergence of new growth poles in the South. The rapid rise of economic powers such as China, India and Brazil, the continuing financial and economic problems of industrialized countries, and ways of doing business revolutionized by advances in technology have taken the world into a new phase of globalization. This evolving order presents Africa with challenges as well as opportunities which, if met by effective policies, could lead to substantial socio-economic and political transformation, propelling the continent as a new pole of global growth.

Following two decades of near stagnation, Africa's growth performance has improved hugely since the start of the 21st century. Since 2000 the continent has seen a prolonged commodity boom and sustained growth trend. And although growth slowed from an average of 5.6 per cent in 2002–2008 to 2.2 per cent in 2009—hit by the global financial crisis and steep food and fuel price rises—Africa quickly recovered with growth of 4.6 per cent in 2010. The continent's growth slipped again in 2011 owing to political transition in North Africa, but rebounded strongly once more to 5.0 per cent in 2012, despite the global slowdown and uncertainty.

This remarkable performance—although largely commodity driven—is underpinned by a variety of factors, such as strengthening domestic demand associated with rising incomes and urbanization, increasing public spending (especially on infrastructure), bumper harvests in some regions (due to favourable weather), tightening trade and investment ties with emerging economies (linked to their investment in Africa's natural resource and extractive industries) and post-conflict economic recovery in several countries. Africa's medium-term growth prospects remain strong, too, at for example 4.8 per cent in 2013 and 5.1 per cent in 2014.

Yet this impressive growth story has not translated into economic diversification, commensurate jobs or faster social development: most African economies still depend heavily on commodity production and exports, with too little value addition and few forward and backward linkages to other sectors of the economy. Indeed, the pattern of social development in Africa has been mixed over recent years: changes for the better are still recorded in most areas (especially education, child and maternal mortality rates, and gender equality), but the pace is too slow for African countries to achieve their social development goals, especially some of the Millennium Development Goals by the end date of 2015.

The limited impact of commodity-driven growth on employment and social development has been aggravated by liberalizing reforms and globalization that, in the absence of serious government policies to promote economies' productive capacities and ability to compete in international markets, have left a legacy of inappropriate incentives and institutions that threaten economic and political stability as well as social cohesion. Major deficits in state and institutional capacities, in physical and policy infrastructure, as well as an inability to mitigate impacts of external shocks have contributed to the continent's "transformation challenge". African countries must therefore address the reasons why stronger growth and trade have not stimulated economic diversification, job creation and socio-economic development.

The key challenge for African countries today is how to design and implement effective policies to promote industrialization and economic transformation. Despite some gains in manufacturing over the last decade, the continent is yet to reverse the de-industrialization that has defined its structural change in recent decades: in 1980–2010, its share of manufacturing in aggregate output declined from more than12 per cent to around 11 per cent, but remained at more than 31 per cent in East Asia, where labour-intensive industries induced high and sustained growth and helped lift hundreds of millions of citizens out of poverty.

Africa has also lagged behind East Asia on other measures. That region has seen not only surging per capita income but also a soaring share of global exports and income over the last four decades (table 1). Industrial policies were particularly successful in East Asia because of committed and visionary political leadership and institutions that designed and enforced strict performance criteria for industries that received subsidies and trade protection, supported by a capable bureaucracy largely insulated from political capture.

## TABLE 1: AS AFRICA DE-INDUSTRIALIZED, EAST ASIA WAS FIRING ON ALL CYLINDERS

| | 1970 | 1980 | 1990 | 2000 | 2010 |
|---|---|---|---|---|---|
| ***Africa*** | | | | | |
| Nominal GDP per capita (US$) | 246 | 900 | 780 | 740 | 1,701 |
| Share in world output (%) | 2.75 | 3.65 | 2.22 | 1.85 | 2.73 |
| Share in global exports (%) | 4.99 | 5.99 | 3.02 | 2.31 | 3.33 |
| ***East Asia*** | | | | | |
| Nominal GDP per capita (US$) | 335 | 1,329 | 3,018 | 4,731 | 8,483 |
| Share in world output (%) | 9.83 | 12.94 | 18.14 | 21.53 | 20.69 |
| Share in global exports (%) | 2.25 | 3.74 | 8.06 | 12.02 | 17.8 |

Source: World Bank, World Development Indicators, 2012.

Africa's industrialization strategies have not, however, transformed its economies. The seeds of its woes were sown during the colonial period but the problem worsened after independence with the failure of often externally generated industrial policies.

The colonial legacy is the result of the extractive nature of African colonialism, which left behind structures, institutions, and infrastructure designed to benefit non-Africans. For instance, the roads and railways built in colonial times were primarily designed to transport minerals and other raw materials from the African interior to the continent's ports for shipping to Europe. They were not designed to join one part of the continent to another, and created a legacy that is still felt in the twenty-first century, with production and export of commodities geared towards the needs of the former colonial powers—not value addition.

Then comes the seesaw of policy failure after independence: first, import substitution policies under which African countries decided to industrialize, then structural adjustment programmes, which forced African countries to de-industrialize.

The continent's early state-led industrialization strategies that focused on import substitution were characterized by massive public investment and ownership of enterprises and financial institutions—and a range of policy measures including tariff and non-tariff barriers, credit controls and foreign exchange restrictions to protect infant industries. But most governments did not have the financial and managerial capacity to operate public enterprises and financial institutions, and the policies intended to direct investment towards industry distorted factor prices and rates of return. Thus, while import-substitution strategies succeeded elsewhere—especially in East Asia—they failed to ignite sustained industrialization in Africa, leading to mounting and unsustainable deficits, stagflation and debt crises in many countries by the end of the 1970s.

To help African countries deal with unfolding economic crises, the International Monetary Fund and the World Bank imposed structural adjustment programmes in the 1980s and 1990s. Their theoretical premise was that markets are efficient but government interventions are inefficient because they distort market signals. Hence, long-term development planning was abandoned and industrial policies neglected in most African countries. The market-led development model removed inefficient government interventions but did not create the conditions for development or address the numerous market failures in African economies, such as a severe shortage of technical skills and entrepreneurship and low rates of investment.

African governments focused on macroeconomic stability and institutional reforms to protect property rights and ensure contract enforcement—often on advice from donors and multilateral development institutions—but without coherent strategies to address market failures and externalities that constrained investment, growth and economic diversification.

Thus, Africa's growth plummeted during the "lost decades" of the 1980s and 1990s while unemployment soared, and production and export bases became more concentrated. And without industrial policies to address policy and market failures (especially of information and coordination), African countries have been unable, until now, to diversify and parlay recent high growth and increased trade into social and economic development.

More recently, the structure of the global system has made it practically impossible for Africa to benefit from globalization or move up the value chain, which requires Africa to influence the global agenda in its favour.

## TRIGGERING COMMODITY-BASED INDUSTRIALIZATION AS AN ENGINE OF GROWTH AND ECONOMIC TRANSFORMATION

Africa boasts significant human and natural resources that can be used to promote industrialization and structural economic transformation through value-addition strategies in all sectors (agriculture, industry and services), though not all African countries are rich in natural commodities—some are resource poor.As well as a growing, predominantly young and urbanizing population, the continent is endowed with many natural resources, including plentiful land and fertile soils, oil and minerals. Africa 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, and 60 per cent of arable land in addition to vast timber resources.

With such abundance and rising global demand for raw materials, African governments are forging new partnerships, boosting infrastructure investment and sharing skills and technology.

But Africa can do better. Primary commodity production and exports entail huge forgone income through lack of value addition, the export of jobs to countries that can add value, and exposure to high risks due to dependence on exhaustible commodities and fluctuations in commodity demand and prices. Instead of relying on exports of raw materials, the continent should add value to its commodities to promote sustained growth, jobs and economic transformation.

While African commodity-exporting economies have benefited greatly from recent sustained increases in the price of their primary commodity exports and an increase in resource rents, these rents cannot be relied on as an engine of growth and development. This is not only because commodities are exhaustible but also because adding value would help African countries to reduce exposure to the risk of commodity price fluctuation and at the same time move to higher-value and more diversified product- and end-markets where prices are more dependent on market fundamentals than speculation.

Indeed, the entry of financial agents on the spot and futures markets and the resulting financialization of commodity trading have frequently caused these markets to move from a price-taking environment to one of market power, partly because they are highly concentrated and often laced with information asymmetry. Financial agents have become key players in driving speculation and herd behaviour, and have distorted commodity markets including upward shifts in coffee and cocoa prices and all-time low prices for cotton.

This behaviour has left African countries more vulnerable to fluctuations in commodity markets, whereas artificially high prices for some commodities have reduced incentives for value addition. Promoting commodity-based industrialization could offer a powerful tool for African countries to tackle this "tyranny of financialization". Equally, production of many commodities is capital intensive, holding back employment and the distribution of their rents. A more sustainable, inclusive and equitable growth path in commodity-exporting economies lies in the possibilities of building backward and forward linkages for commodity production.

One upshot of the above factors is that, although Africa's growth exceeded the world average in the 2000s, it did not translate into commensurate poverty reduction at a time when poverty elsewhere fell heavily, skewing the global poverty reduction picture. Similarly, the global dispersion of production has led to unequal benefits, benefiting east and south-east Asian economies, especially China, the most.

So, how can Africa avoid marginalizing itself from the world economy and achieve inclusive economic growth? The 2013 edition of the Economic Report on Africa, themed "Making the most of Africa's commodities: Industrializing for growth, jobs and economic transformation", argues that one answer lies in effective industrial policies and commodity-based industrialization, strengthening industrial linkages to the commodity sector.

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The conventional wisdom in the "resource curse" literature argues differently—that commodities are an undesirable form of economic specialization undermining the viability of industrial activity—although global economic dynamics now suggest that this trade-off between commodities and industry no longer holds. The shift in global economic gravity from high-income Northern to low-income Southern economies suggests a reversal in the long-term declining trend in the commodities–manufactures terms of trade. More important, on top of offering short- to medium-term comparative advantages, commodity-based industrialization can, with the right industrial policies, serve as a launching pad for long-term diversification and competitiveness in new and non-commodity sectors in Africa's commodity-rich countries.

Moreover, the past decade has seen a major shift in the structure of global value chains (GVCs) in many sectors, as major firms seek to outsource non-core competences, and thus promote linkages. This suggests that we may be entering a new era in the relationship between the exploitation of commodities and the growth of industry—if African governments put in place policies to facilitate and accelerate such dynamics. As firms that control GVCs cannot be relied on to promote linkages beyond their own interests, African governments need to make strategic interventions to empower indigenous firms to insert themselves and compete in regional and global value chains.

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The desire by African governments to promote linkages from the commodity sector is not new and the continent offers many successful sector and country experiences. Mauritius provides a good example of a country that successfully developed visions and long-term strategies to move from a degree of high production and export concentration in 1980 to wide diversification three decades later. Changes in the nature of globalization in the current era have opened still-unrealized opportunities for increasing local industrialization linkages.

Against this backdrop, the report examines key constraints and opportunities for African countries to make the most of their commodities by adding value through linkage development. It then addresses how African countries can design and implement industrial and other development policies to promote value addition and economic transformation, and to reduce their dependence on producing and exporting unprocessed commodities.

The analysis uses desk research and country-specific background policy information, primary firm-level data and information from questionnaires and interviews to underpin evidence-based policy recommendations. The primary data were collected and country case studies prepared for nine African countries in the five subregions—Algeria, Cameroon, Egypt, Ethiopia, Ghana, Kenya, Nigeria, South Africa and Zambia.

As in previous years, the report begins by examining recent trends in Africa's economic and social development as well as selected issues, namely trade and financing for economic transformation and the question of how to translate growth into decent job creation, before focusing on "Making the most of Africa's commodities: Industrializing for growth, jobs and economic transformation"—a very brief synopsis of which is distilled into the following paragraphs.

## MAKING THE MOST OF AFRICA'S COMMODITIES: CONSTRAINTS AND OPPORTUNITIES

Some of the nine countries show evidence of making progress in developing local linkages (backward and forward) from the hard, energy and soft commodity sectors. But value addition is still limited and the depth of linkages varies among countries, mainly because of country- or industry-specific constraints that cannot be overcome by market forces and that call for strategic and systematic industrial policies. Even today, up to 90 per cent of the total income from coffee goes to rich consuming countries—underscoring the benefits African countries are currently forgoing.

The following are the key findings of the report on value chain linkages.

## THE BIG DIFFERENCES IN SOFT, HARD AND ENERGY COMMODITY SECTORS AFFECT HOW LINKAGES DEVELOP

Most soft commodities, as against 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.

## ESTABLISHING MARKETING LINKS AND STAYING IN GVCS IS ESSENTIAL, BUT REQUIRES SYSTEMATIC INVESTMENT AND SUPPORT

Searching for buyers is a costly exercise for any firm, but a firm must be inserted in regional and global value chains. Building these linkages requires appropriate domestic strategic government support 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.

## ALL LINKS IN THE VALUE CHAIN REQUIRE SUPPORT TO UPGRADE

Trade-offs between the links may, though, be needed. 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.

## REGIONAL MARKETS MAY OFFER MORE OPPORTUNITIES THAN TRADITIONAL MARKETS

Such opportunities are more apparent when a firm enters a GVC. Regional markets may be initially less demanding and allow local firms to build the necessary production capabilities required to graduate into more demanding 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 provide local competitive advantage.

## 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).

## MAKING THE MOST OF AFRICA'S COMMODITIES: A POLICY FRAMEWORK

The report identifies factors that influence linkage breadth and depth—technical features of the value chain, industry structure, lead-firm strategies for their critical success factors, location and infrastructure, a variety of constraints (trade restrictions, standards), and government industrial policy. The unevenness of development among countries is attributed to two primary sets of linkage drivers—structural and country-specific.

Structural drivers refer to the age of the commodity-exploiting sector and sectoral factors such as the requirement for just-in-time and flexible logistics, the characteristics of commodity deposits, and the sector's technological complexity. By their very nature, these drivers are difficult to influence through policy interventions. Country-specific drivers, on the other hand, are much easier to influence by government policy, and refer to factors dependent on national context, such as infrastructure and human resources.

There is no "one size fits all" policy approach for commodity-based industrialization in African countries, or anywhere for that matter, and government policy should be country specific and evidence based. It should also have clear priorities, designate institutional steps to ensure responsibility for implementation across ministries at central or local levels, and be backed by transparent budgets.

The key policy recommendations for adding value and industrializing in Africa follow.

## ADOPT AND IMPLEMENT A COHERENT INDUSTRIAL POLICY

If African governments want to speed up and deepen value addition of local production linkages to the commodity sector, and to embark on a commodity-based industrialization path, they must adopt a strategic approach and work closely with all stakeholders to formulate and implement industrial policy. The policy should start by identifying value addition or linkage opportunities as well as medium- and long-term interventions.

## CREATE APPROPRIATE INCLUSIVE AND TRANSPARENT INSTITUTIONAL INDUSTRIAL-POLICY MECHANISMS

It is critical for governments to develop prioritized country-specific, industrial-policy roadmaps for value addition, working closely with stakeholders including representatives of firms and of research and innovation institutions. They should set up a multi-stakeholder institutional council that focuses on developing linkages to the commodity sector, led by the most appropriate government department (usually the ministry of industry). This council should be charged with developing a joint, strategic vision for industrialization—gathering the most reliable information and elaborating an appropriate step-by-step linkage strategy. The strategy should outline support mechanisms including responsibilities, activities, outputs and milestones.

## 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. World Trade Organization rules provide some legal leeway to least-developed economies—and many countries anyway find real-world mechanisms to push through and sustain local content policies. Policies should focus on adding value locally (rather than satisfying special interest groups), removing red tape and streamlining regulations, as well as securing technical and financial assistance for developing linkages.

## ADOPT STRATEGIC INTERVENTIONS TO INSERT INDIGENOUS FIRMS IN SUPPLY CHAINS

Following the dynamics of national, regional and global value chains, it is in the interests of major commodity firms to outsource many of their supplies and services. Industrial policy should cover customized supply-chain development programmes that help indigenous firms to insert themselves in these value chains and to remain competitive. Such policy may focus on upscale niche markets and quality certification—environmental sustainability, speciality products or fair trade—as well as on special funding mechanisms to build firms' capabilities in backward and forward linkages.

## BOOSTING LOCAL SKILLS AND TECHNOLOGICAL CAPABILITIES

Skills shortages are often a binding constraint on developing industrial linkages in Africa.

They hamstring local suppliers in upgrading operational competitiveness, meeting technical requirements, innovating, adopting world-class manufacturing practices and running supply-chain and customer-management programmes. Backward linkage development to the hard commodity sector is particularly demanding of technological capabilities to compete with global suppliers. Building necessary skills requires coordinated support from other firms, the government and donors. Government support may include matching-grant programmes for skills development for local firms, creation of technical training institutions and staff hires.

## ADDRESS INFRASTRUCTURE CONSTRAINTS AND BOTTLENECKS

Infrastructure deficits affect not only cross-border infrastructure but also feeder roads linking agricultural producers to processing centres. Infrastructure development helps to ease these bottlenecks, and has spin-offs for jobs for unskilled and semi-skilled workers as well as for training for those with higher artisanal skills. Industrial and development policy in Africa should include strategic investment in infrastructure and avoid "enclave" infrastructure projects and programmes aimed only at satisfying the needs of commodity producers. Governments should use commodity access to secure favourable financing (of infrastructure in bilateral agreements), to leverage public–private partnerships (to facilitate infrastructure provision) and to restructure institutions that provide soft infrastructure (to simplify and make the regulatory framework effective, efficient and business friendly).

## IMPROVE POLICY IMPLEMENTATION THROUGH COORDINATION AMONG MINISTRIES

Value chains are cross-cutting, ministries are not. A commodity-based industrial strategy necessarily requires inter-departmental direction and implementation. Soft commodities tend to fall under the mandate of agriculture ministries and hard commodities under mining and oil ministries; industrial policy requires the involvement and direction of ministries of industry, besides the budgetary allocations for implementation. Effective policy implementation therefore requires coordination across ministries and departments in the context of broader national development plans and frameworks that ensure participation of the private sector and other stakeholders.

## 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. It is extremely difficult to export to high-income, industrialized-country markets as their critical success factors are often beyond the immediate reach of many domestic firms. Regional markets are often less demanding and provide learning opportunities for domestic firms to build their production capabilities step-by-step. They also allow them to build economies of scale, some degree of specialization between countries and functional upgrades through regional "country of origin" branding—hence greater returns. African countries should therefore fast-track implementation of the Continental Free Trade Area agreement and accelerate that of regional trade arrangements to reduce or eliminate non-tariff barriers, sanitary and phytosanitary measures, and technical barriers to trade. They should also improve regional infrastructure and harmonize customs procedures.

## MAKING THE MOST OF REGIONAL POLICY FRAMEWORKS

To be effective and improve coordination at regional and continental levels, national industrial development frameworks in Africa should, as far as possible, be closely aligned with the priorities of the Accelerated Industrial Development of Africa Action Plan, endorsed by African Ministers of Industry in 2007. This identifies priorities for action at national, regional, continental and international levels, including product and export diversification policy, natural resource management and value addition in natural resources, infrastructure, human capital and technology, institutional frameworks and resource mobilization.

To cater to domestic and export markets, this report recommends that national value-adding strategies should also be closely coordinated to boost efforts by African countries to promote strategic commodities such as rice, legumes, maize, cotton, palm oil, beef as well as dairy, poultry and fishery products at continental level, and cassava, sorghum and millet subregionally.

## ... AND FINALLY

The findings and recommendations of this report strongly complement those of previous years that emphasized the need for African countries to pursue effective policy actions to address the factors constraining economic transformation. For example, the 2012 report pursued the theme that, to address the failures of state-and market-led development experiences and to unleash Africa's potential as a pole of global growth, the continent required developmental states that design and implement innovative and bold long-term actions.

This report underscores the point that commodity-based industrialization in Africa should not—and cannot—be the only way for African countries to industrialize. Not all African countries are rich in natural resources and, in the long-term, even resource-rich countries have to venture into innovative non-resource-based activities to sustain their industries when resources are exhausted.

Africa's industrialization is likely to take place in a changing globalized economy full of uncertainties. African governments should therefore work together to develop a united vision on how to influence the global economic agenda and, in so doing, shape the outcomes of globalization itself. The time has come for Africa to stop being a bystander to its own destiny.