CHAPTER 1
INTRODUCTION

THE POLITICAL COMMITMENT TO INDUSTRIALIZATION IN AFRICA

After gaining political independence, which occurred mainly in the 1960s, most African countries started to promote industrialization. The emphasis on industrialization was based on the political conviction by African leaders that it was necessary to ensure self-reliance and reduce dependence on advanced countries. Furthermore, there was the expectation that industrialization would hasten the transformation of African countries from agricultural to modern economies, create employment opportunities, raise incomes as well as living standards, and reduce vulnerability to terms of trade shocks resulting from dependence on primary commodity exports. But during the 1970s, with successive oil shocks and an emerging debt problem, it started to become clear that import substitution industrialization was not sustainable. With the introduction of structural adjustment programmes in the 1980s, African countries curtailed specific policy efforts to promote industrialization and focused on removing anti-export biases and furthering specialization according to comparative advantage. It was expected that competitive pressures would revitalize economic activity by leading to the survival of the fittest. But whilst these policies were certainly intended to have structural effects, the conventional view is that they did not boost industrialization in the region (Soludo, Ogbu and Chang 2004).

In recent years, African countries have demonstrated renewed commitment to industrialization as part of a broader agenda to diversify their economies, build resilience to shocks, and develop productive capacity for high and sustained economic growth, the creation of employment opportunities and substantial poverty reduction. For instance, in January 2007, the South African Government adopted the National Industrial Policy Framework (NIPF) aimed at diversifying the production and export structure, promoting labour-absorbing industrialization, moving towards a knowledge economy, and contributing to the industrial development of the region. It has also unveiled Industrial Policy Action Plans (IPAP) to implement the framework. The first IPAP was adopted by the National Cabinet in August 2007 and was for the period 2007/08 while the second IPAP was adopted in February 2009 and covers the period 2010/11 to 2012/13. Other countries in the region have also taken steps recently to build a modern, competitive, and dynamic industrial sector. For example, industrialization is a component of recent national development programmes unveiled by Egypt, Ethiopia, Kenya, Namibia, Nigeria and Uganda (Altenburg, 2011).

The commitment of African countries to industrialization is also evident at the regional level. The New Partnership for Africa's Development (NEPAD) adopted by African leaders in 2001 identified economic transformation through industrialization as a critical vehicle for growth and poverty reduction in the region. Furthermore, in February 2008, African Heads of State adopted a Plan of Action for the Accelerated Industrial Development of Africa (AIDA). Implementation strategies for the Plan were subsequently endorsed by African Ministers at the 2008 Conference of African Ministers of Industry (CAMI).[1] At the 2011 CAMI organized by the African Union, the United Nations Industrial Development Organization (UNIDO) and the Government of Algeria, participants deliberated on the effective implementation of AIDA and how to achieve sustainable industrial development in Africa. The new commitments build on past regional initiatives such as the Lagos Plan of Action (1980), the Abuja Treaty establishing the African Economic Community (adopted in 1991), and the Alliance for Africa's Industrialization (1996), which also stressed the need for diversification and economic transformation as a critical vehicle for achieving African self-reliance.

At the global level, there is also interest in drawing attention to issues and challenges of industrial development in Africa as evidenced by the fact that at the 85th plenary meeting of the United Nations General Assembly held in December 1989, the international community adopted Resolution 44/237 proclaiming 20 November as the Africa Industrialization Day (AID). The AID is an annual event coordinated by UNIDO and the first celebration was held in 1990. The AID is used to mobilize support and commitment of the international community to the industrialization of Africa. It is also an occasion for African countries to review progress made in industrial development and chart a way forward. The theme for the AID varies from year to year. In 2010 the event was held under the theme *Competitive Industries for the Development of Africa*.

THE RATIONALE FOR RENEWED COMMITMENT TO INDUSTRIALIZATION

The renewed commitment to promoting industrial development in Africa is timely. African countries have been buffeted by three very serious and interrelated external shocks, namely hikes in food prices, increases in energy prices and the global financial and economic crisis triggered by events in the United States housing market in the fall of 2007. The economic and social costs of the triple crises in Africa have been quite substantial. The growth rate of real output fell from an annual average of 5.2 per cent over the period 2000–2006 to 2.6 per cent in 2009. Similarly, the growth rate of real output per capita fell from 2.7 per cent to 0.3 per cent over the same period. The crises have also eroded recent gains made by African countries in poverty reduction and reduced prospects of achieving the Millennium Development Goals (MDG) by the target date (Osakwe 2010).

The triple crises have refocused attention on Africa's high vulnerability to external shocks and the need for policymakers to take urgent action to diversify their production and export structure to build resilience to shocks. The region is currently the least diversified in the world and, more importantly, has made relatively very slow progress in this area in the last two decades. The export diversification index for the region improved slightly from 0.61 in 1995 to 0.58 in 2009.[2] In developing countries in Asia, it fell from 0.32 to 0.26 and for developing America it fell from 0.36 to 0.33.

Recent research suggests that economic development requires structural change from low to high productivity activities and that the industrial sector is a key engine of growth in the development process (Lall, 2005; Rodrik, 2007; Hesse, 2008). Virtually all cases of high, rapid and sustained economic growth in modern economic development have been associated with industrialization, particularly growth in manufacturing production (Szirmai 2009). Commodity exports can lead to high but not sustained economic growth.

The necessity of structural change also arises from the fact that Africa needs high and sustained economic growth in order to make significant progress in reducing poverty. One of the major challenges which African countries currently face is to generate productive jobs and livelihoods for the 7–10 million young people entering the labour force each year. This is difficult to achieve simply through commodity exports but rather requires a complementary process of agricultural productivity growth and development of non-agricultural employment opportunities in both industry and services. If African countries are to achieve substantial poverty reduction and also the Millennium Development Goals (MDGs), they have to go through a process of structural transformation involving a decrease in the share of agriculture and an increase in the share of industry and modern services in output, with a shift between and within sectors from lower productivity to higher productivity activities.

THE STRATEGIC IMPORTANCE OF MANUFACTURING

The industrial sector is, in general, defined as being composed of manufacturing, mining and construction. However, there is a large literature that suggests that the manufacturing sector is the component of industry that presents greater opportunities for sustained growth, employment and poverty reduction in Africa.

The United Nations Department of Economic and Social Affairs (DESA) defines manufacturing as the physical or chemical transformation of materials, substances or components into new products. The materials, substances or components transformed are raw materials that are products of agriculture, forestry, fishing, mining or quarrying or products of other manufacturing activities. Substantial alteration, renovation or reconstruction of goods is generally considered to be manufacturing.

The strategic role of manufacturing in the development process can be ascribed to a variety of factors. The first is that technology and innovation are crucial for economic development and manufacturing has historically been the main source of innovation in modern economies (Lall, 2005; Gault and Zhang, 2010). The research and development activities of manufacturing firms have been the key source of technological advances in the world economy (Shen, Dunn and Shen, 2007). Furthermore, manufacturing is a major conduit for diffusion of new technologies to other sectors of the economy.

Another advantage of manufacturing relative to other sectors is that there are very strong linkage and spill-over effects associated with manufacturing activities. For example, it is well known that manufacturing is a critical source of demand for other sectors. In particular, manufacturing firms are important consumers of banking, transport, insurance and communication services. Furthermore, manufacturing provides demand stimulus for growth of the agricultural sector. Consequently, manufacturing has high forward and backward linkages, thereby contributing to domestic investment, employment and output in the development process.

Manufacturing is also attractive because, following Engel's law, the share of agriculture in total household expenditure falls as per capita income rises while the share of manufactures increases. This implies that manufactures offer significant opportunities for export market expansion and therefore is a key driver of growth in merchandise trade. Interestingly, countries that have derived significant benefits from the tremendous increase in merchandise trade over the past three decades are those that have been able to increase their exports of dynamic products, particularly manufactures, with high income elasticity of demand. Consequently, what a country produces and exports matters (Hausmann, Hwang and Rodrik 2007).

Manufacturing also has a higher potential for employment creation relative to agriculture and traditional services. In particular, the existence of diminishing returns to scale in agriculture (due to fixed factors such as land) implies that the opportunities for employment growth in the sector are limited. Consequently, as a country's population grows and urbanization takes place, there is the need for growth in manufacturing employment to absorb labour displaced from agriculture.

Despite the critical role of manufacturing in the development process, it is important that African policymakers do not seek to achieve industrial development at the expense of the agricultural sector because the latter can contribute to industrial development through, for example, the supply of wage goods that enhance the competitiveness of domestic firms in global export markets. Rattso and Torvik (2003) show that discrimination against the agriculture sector could lead to the contraction of industry, through trade linkages. De Janvry and Sadoulet (2010) stress the need for complementarity between agriculture and industry. They also argue that agricultural development can contribute to the creation of competitive advantage in industry. Furthermore, in the short-to-medium term, the agriculture sector will continue to be an important source of foreign exchange required to import intermediate inputs needed by domestic industries. It is also important to recognize that the provision of producer services also matters for the competitiveness of the manufacturing sector. In this context, the challenge for policymakers is how to create mutually supportive linkages between the industrial and non-industrial sectors of the economy.

THE NEW GLOBAL ENVIRONMENT

The global environment for African industrialization is also changing in several significant respects and efforts to promote industrialization in the twenty-first century must also take account of this new environment. First, multilateral trade rules as well as bilateral and regional trade agreements are shrinking the policy space available for promoting industrial development in African countries that are not classified as Least Developed Countries (LDCs). For example, the rules of the World Trade Organization (WTO) prohibit the use of industrial policy instruments such as quotas and local content requirements. The use of export subsidies have also been banned, except for the LDCs (Chang, 2009; Rodrik, 2004). Furthermore, as a result of the Economic Partnership Agreements (EPAs), African countries are under increasing pressure to abandon the use of tariffs as a measure of protection. Consequently, African industrialization is taking place in an environment in which the use of some industrial policy instruments applied by the developed and emerging economies are either banned or regulated.

Second, the global environment in which manufacturing production takes place has also changed in the sense that firms are increasingly facing stiff competition in global export markets due to the reduction in tariff and non-tariff barriers to trade in industrial products coupled with the significant decrease in transport costs and improvements in information and communication technology. For African countries, the new environment is challenging because of the rise and growing role of large developing countries such as China, India and Brazil in labour-intensive manufactures (Kaplinsky, 2007). These new competitive pressures imply that an effective response to competition is no longer just about selling products at lower cost. It is also about producing better products and getting them to consumers in a timely manner.

Third, increasing concerns over climate change are forcing firms to adopt or switch to new technologies and methods of production. In particular, manufacturers are under increasing pressure to adopt climate-friendly technologies and methods of production. Consequently, if African industrialization is to be sustainable it cannot rely on the old technologies and methods of production used by the developed countries when they were at a similar stage of development.

THE FOCUS AND ORGANIZATION OF THIS REPORT

Against this background, the 2011 *Economic Development in Africa Report* focuses on the topic *Fostering Industrial Development in Africa in the New Global Environment.* The Report provides an overview of the stages, performance and lessons learned from previous attempts at promoting industrial development in Africa (chapter 2). It then goes on to discuss key elements for a new industrial policy for Africa. This must begin with a careful diagnosis of the current situation and strategy design. A framework for this, as well as a typology of African countries, is set out in chapter 3. Chapter 4 goes on to discuss the why and the how of industrial policy, whilst chapter 5 indicates how the policy may be calibrated with the new global environment. The concluding chapter summarizes the major findings and policy messages of the Report.

The Report is the product of joint work, and is jointly published by UNCTAD and the United Nations Industrial Development Organization (UNIDO). It builds on the 2009 *Economic Development in Africa Report* on *Strengthening Regional Economic Integration for Africa's Development* and the 2010 Report on *South-South Cooperation: Africa and the New Forms of Development Partnerships*. It also builds on the 2009 UNIDO Industrial Development Report on *Breaking in and Moving up: New Industrial Challenges for the Bottom Billion and the Middle-income Countries*.