Africa Programme
Meeting Summary

Transformative Industrial Policy for Africa

Dr Carlos Lopes

Executive Secretary, United Nations Economic Commission for Africa

Professor Christopher Cramer

Professor of the Political Economy of Development, School of Oriental and African Studies

Chair: Clarisa De Franco

Portfolio Director, CDC

22 April 2016

10 St James's Square, London SW1Y 4LE T +44 (0)20 7957 5700 F +44 (0)20 7957 5710
www.chathamhouse.org

Introduction

This document provides a summary of a meeting held at Chatham House on 22 April 2016, at which the United Nations Economic Commission for Africa (UNECA) report, *Transformative Industrial Policy for Africa*, was launched.

As African economies have grown in recent years, sustaining such development has become a new priority. Recent market downturns have highlighted the need for upgrading commodity sectors through beneficiation and upstream development, and governments need to proactively encourage the growth of the manufacturing sector. At the same time, the rise of global value chains has made the implementation of smart and strategic economic policies with effective management ever more important.

The meeting was held on the record. The following summary is intended to serve as an aide-mémoire for those who took part and to provide a general summary of discussions for those who did not.

For more information – including recordings, transcripts, summaries and further resources on this and other related topics – please visit www.chathamhouse.org/research/africa.

Carlos Lopes

African countries have experienced a decade of improved economic growth, more political stability and a significant drop in the number of victims of conflict, but there remain significant problems with unemployment and a lack of diversification. To respond to these problems, UNECA undertook a major study led by the University of Cambridge's Ha-Joon Chang to understand how Africa can transform its economies.

The report concludes that a paradigm shift is required, beyond the confines of conventional industrial policy. African countries must begin to upgrade their existing commodity industries, crucially focusing on higher productivity sectors, particularly high-end services emboldened by technology, infrastructure, and human and financial resources. In a continent with a large youth cohort, manufacturing lends itself easily to employment, mechanization and chemical processing, and therefore has faster productivity growth than other sectors like agriculture. Furthermore, manufacturing enables productivity growth in other sectors, and has been the engine of economic growth in many economies around the world, from the UK to Malaysia and Uzbekistan, three countries assessed in the report.

In the early stages of development, the development of productive capabilities is a must. Critically, it depends on the promotion of infant industries through protectionist policies that shield them from destructive multinational corporate giants, allowing them to develop to the point at which they can successfully compete. However, industries that conform to the theory of comparative advantage must continue to be relied upon for export while infant industries are nurtured as part of a medium-to-long-term strategy. While the use of protectionist policies for fledgling industries is often seen as counter to current economic orthodoxy, UNECA's assessment of the experiences of industrial policy since the Second World War shows that, in fact, such policies have been present in a large majority of developed and emerging economies in the twentieth century.

International bodies like the World Trade Organization (WTO) place considerable restrictions on the industrial policy of developing countries. The largest restrictions are encompassed in bilateral trade agreements that have been voluntarily signed, and developing countries must renegotiate or revoke these agreements to gain a more favourable industrial policy environment.

A key dimension of the shrinking policy space is the rise of global value chains, but there are ways in which developing countries can challenge the growing share of value chains taken up by increasingly powerful corporations. South Korea, for example, successfully upgraded its production capacity in these industries through sustained investment, thereby gaining control of a larger share of the value chains in automobiles and electronics. The report recommends that, when attracting lead firms in global value chains, African countries need to choose the industries with the largest potential, given domestic constraints and global conditions. They must also induce the foreign firms that control these particular chains to create as many linkages and productive capabilities in the host economy as possible. This has been done successfully by several Asian countries.

Developing countries must pay attention to the possibility of upgrading not just manufacturing industries, but also the producer industries that support them, such as design and marketing. These have incredible value in maximizing the potential of these industries.

Economic theories alone are limited in representing the true complexity of the real world, but policymakers need to clearly understand these theories in order to overcome their frequent opposition to effective industrial policy. Thus, policymakers must also acquaint themselves with a range of industrial policy experiences to ensure they are not bound by theoretical demarcations that prohibit them from fully exercising their policy imagination. In the last few decades, policymakers in developing countries, particularly in Africa, have too readily adopted standard free-market and free-trade policies because they were not aware of alternatives, or not confident enough to adopt policies that ran counter to assumed orthodoxy. As shown by examples in South Korea and Taiwan, and more recently in Uzbekistan and Ethiopia, good industrial policy can be implemented in difficult circumstances if policymakers have decent knowledge of industrial-policy trends, theories and practices, and the confidence to implement them against conventional wisdom.

Christopher Cramer

The timing of the UNECA report is excellent, as the commodity price slump seriously undermines the 'Africa rising' narrative, which has been based on temporary market fluctuations rather than a serious long-term view of Africa's development potential. This report counters the popular argument that developing countries were once able to create industrial policies, but the power of the WTO and corporate interests within global supply chains have made this impossible in the modern era. These are genuine constraints, but there are still many avenues available to African countries with regard to industrial strategy.

The UNECA report does not stress enough that the reason for the failure of many African industrial policies is not the hindrance of powerful corporate interests or WTO rules, but because of policy failures with regard to coordination and investment. South Africa's policy on research-and-development investment for agricultural trade is one example, as the country's government has presided over a significant decline in agricultural output and productivity through poor policy.

Currently there is a softening in the views of economic theorists at both ends of the spectrum. Until recently, the mainstream view was that countries should produce and export in line with their existing comparative advantages. But there is now some acknowledgment that governments might be wise to make investments in anticipation of predicted future comparative advantage. Conversely, proponents of heavy state intervention and protectionism may have become more realistic about the real world constraints on industrial production and the current global economic landscape. UNECA's report briefly highlights this point when it notes that states can and should intervene, but that this should only happen in line with existing state capacity. On the other hand, there is an argument, which is currently playing out in the leather and floriculture sectors in countries such as Ethiopia, that only by pursuing new industrial projects can states build the expertise and capacity to develop. Ultimately, 'failure by doing' can lead to success and economic development. Countries that restrict themselves to their current comparative advantage are following a strategy that is woefully inadequate if Africa is to make serious development gains.

The UNECA report does not consider the difficulty for countries seeking to develop their financial sectors under the current global market rules and conditions. Likewise, it is impossible to overstate the importance of infrastructure yet this is largely missing from the report.

The report uses a good example from Chile to highlight that there is less distinction now between primary commodities and manufactured or industrial goods. This phenomenon could be termed the 'industrialization of freshness', to describe the impossibility of competing in the fresh food sector without appreciating the importance of industrial organization and infrastructure. Branding and IT support also add value. Industrial policy regarding agriculture blurs the distinction between primary and secondary commodities, and countries' abilities to trade these on the global market.

Summary of Question-and-Answer Session

Questions

What are your views on the crippling US sanctions on Sudanese banks, despite the lack of international consensus on the validity of this action?

What role should civil society play in Africa's industrialization?

To what extent will focus be placed on addressing linkages between the big service-sector industries that are largely import-dependent, like healthcare, and the ability of local markets to provide these goods? This is happening in Nigeria, but the example has not been learned from in other African countries.

Failure can be extremely damaging to a country's reputation and can hinder its ability to attract investment. Taking this into consideration, how can a 'learning through failure' industrial model succeed?

Carlos Lopes

On the issue of Sudan, the international financial system does not have clear ways of dealing with the problem described and unfortunately the might of more powerful countries can inevitably overcome much less powerful states. It is very difficult to impose methods to counter such measures through any particularly mechanism. Unfortunately it is unlikely that progress will be made on this in the near future.

The role of civil society can vary widely. On the issue of illicit financial flows we have seen specific interventions by civil-society organizations that have gained with renewed strength since the revelations in the Panama Papers, including highly public campaigns. In areas such as industrial policy this is more difficult, as topics are so complex and technical that they may not generate the same enthusiasm.

The opportunity for development driven by local and domestic African markets is often overlooked. African countries import 86 per cent of the processed food they consume, but there is little reason why the technically uncomplicated processes for producing these could not be conducted on African soil for

African markets. The potential for increased engagement with local markets is also often ignored in countries dependent on mono-exports such as Angola, where refining the country's own oil for supply to neighbouring markets would significantly reduce price volatility as products move up the supply chain. South Africa and the Democratic Republic of Congo (DRC) combined could consume all of Angola's refined oil output, considerably reducing the need to export unrefined oil to Angola's current largest markets, China and the US. Africans import 70 per cent of their refined oil because of an absence of industrial policy and a lack of attention to local markets. Due to better understanding of the supply chain, Nigerian tomato paste is increasingly processed domestically for the large domestic market, reducing reliance on imports.

Predictability is the best comparative advantage, as it creates conditions for investors and locals to take risks that otherwise would not be possible. Problematically, however, democracies are often less predictable than autocracies because of more complex politics and changing leadership, and ultimately a loss of predictability is a price worth paying for increasing democratization.

Christopher Cramer

The 'failing better' issue varies depending on the sector. Failure in some sectors is much more likely than in others, and in many there is potential for 'learning through failure' that does not mean starting from scratch. The broader policy environment is also crucial. Predictability is appreciated by foreign investors in policy environments that will allow experimentation.

Questions

Joblessness and the youth bulge can be the driver of industrial policy. Do you have any thoughts on making the link between industrial policy and jobs? What policies are necessary for involving youth in the industrialization process?

Africa does not suffer from a lack of policy, but a lack of commitment. The government of Ethiopia is committed to industrial policy because of its fear that demographic shifts and development issues must be tackled immediately, because otherwise they could lead to war. What are your thoughts on this?

Christopher Cramer

Generating good jobs is crucial, although what counts as a good job can be shocking. Flower workers or coffee pickers work in horrible working conditions for very little money, yet this is often still preferable to what they had before. The challenge is to enforce better labour laws, but this requires capacity building in ministries and department. As things currently stand, demand will have a larger effect than government policy on improving the situation for workers and young people at this stage.

Carlos Lopes

I would dispute that industrial policy is known by policymakers. Everyone espouses industrialization as a positive development that must be achieved, but this is different to actually mastering the techniques of successful industrial policy that can be translated into real change. Countries such as Kenya have an extremely fragmented approach, rather than a singular consistent industrial policy.

The 'race to the bottom' approach in which countries offer tax exemptions as a perceived shortcut to attracting investment is a concern, but multinationals still invest in countries with more complicated tax and regulatory frameworks because other factors are much more important in companies' assessments of what makes the best investment.

The need for peace must be taken into account. Issues of exclusion and inequality of social groups, not just individuals, are vital to understanding this. Governments must understand how to effectively manage diversity. UNECA believes in the need for a social contract based on demographics, including age. With aging populations in other parts of the world, there will need to be adjustments to global value chains and industrial production. All of this requires looking into opportunities that may exist in Africa.