How to Jumpstart Industrialization and Structural Transformation in Africa

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• Poverty is not a destiny
• However, Africa countries are trapped in poverty
• All countries were poor and relied on agriculture and resources for living at the beginning

• The path for prosperity is diversification and industrialization.

• Africa has not diversified from agriculture and nature resources

Africa’s exports of primary commodities is more than 80 percent of its total export— the highest in the world.

• Primary commodity exports represents greater share of GDP of Africa compared to other regions. Especially, in almost all oil exporting countries, crude oil exports alone account for at least 50 percent of GDP and more than 70 percent of national budget
• Global commodity market is known for its frequent price shocks.

• An adverse price shock will result in a downward spiral of the continent’s export earnings and imposes severe pressure on national fiscal budget and current account balances.

• To stabilize the economy, African countries should
  – Have a good management of commodity export earnings

• To improve development performance, African countries should
  – Promote Industrialization and diversification

• But how to do it?
The Industrial Policy and A Facilitating State

• The industrial upgrading and diversification requires the government to play a facilitating role to overcome the inevitable externality and coordination issues.

• The industrial policy is an essential measure for a facilitating state.
  – Contents of coordination may be different, depending on industries.
  – The government’s resources and capacity are limited. The government needs to use them strategically.
Most industrial policies in the past fail. For an industrial policy to be successful, it should target sectors that confirm to the economy’s latent comparative advantage:

- The latent comparative advantage refers to an industry that the economy has low factor costs of production but the transaction costs are too high to be competitive in domestic and international markets.

- Firms will be viable and the sectors will be competitive once the government helps the firms overcome coordination and externality issues to reduce the risk and transaction costs.

But how can the government pick the sectors that are in line with the economy’s latent comparative advantages?
What Can Be Learned From History?

• Historical evidences show that successful countries in their catching-up stage all used industrial policies to facilitate their industrial upgrading and their industrial policies targeted industries existing in dynamically growing countries with a similar endowment structure and moderately higher per capita income:
  
  – Britain targeted the Netherlands’ wool textile industries in the 16\textsuperscript{th} and 17\textsuperscript{th} centuries; its per capita GDP was about 70% of the Netherlands’.
  
  – Germany, France, and the USA targeted Britain’s industries in the late 19\textsuperscript{th} century; their per capita incomes were about 60% to 75% of Britain’s.
  
  – In Meiji restoration, Japan targeted Prussia’s industries; its per capita GDP was about 40% of Prussia’s. In the 1960s, Japan targeted the USA’s industries; its per capita GDP was about 40% of the USA’s.
  
  – In the 1960s-80s, Korea, Taiwan, Hong Kong, and Singapore targeted Japan’s industries; their per capita incomes were about 30% of Japan’s.
  
  – In the 1970s, Mauritius targeted Hong Kong’s textile and garment industries; its per capita income was about 50% of Hong Kong’s.
  
  – In the 1980s, Ireland targeted information, electronic, chemical and pharmaceutical industries in the USA; its per capita income was about 45% of the USA’s.
  
  – In the 1990s, Costa Rica targeted the memory chip packaging and testing industry; its per capita GDP was about 40% of Taiwan’s, which was the main economy in this sector.

• Unsuccessful industrial policies, in general, targeted industries in countries where their per capita GDPs were less than 20% of the targeted countries
Why should successful industrial policies target industries in dynamically growing countries with a similar endowment structure and somewhat higher income?

• Countries that have a similar endowment structure should have similar comparative advantages.

• A dynamically-growing country’s industries should be consistent with the country’s comparative advantages. Some of its industries will lose comparative advantage as the country grows and its endowment structure upgrades. Those “sunset” industries will become the latent comparative advantage of the latecomers.

• For countries with a similar endowment structure, the forerunners’ successful and dynamic industrial development provides a blueprint for the latecomers’ industrial policies.
The existing tools and their drawbacks

• Business and Investment environment
  – The idea is based on Washington Consensus and its goal is to introduce a whole set of the first-best institutions
  – The issues are:
    • The government may not have the capacity to introduce all those changes
    • The first-best institutions may be different at different stage of development
    • No identification of industries with latent comparative advantages and no compensation for the first movers

• Growth Diagnostics
  – It focuses on binding constraints instead of the whole set of first best institutions
  – It relies on survey of existing firms. Many of them may be in industries where the country has no comparative advantages.
  – There may be no firms in the new industries that the countries have latent comparative advantages

• Product Space
  – The idea is based on the fact that firms in existing sectors own tacit knowledge that is helpful for successful upgrading/diversification to nearby sectors in the product space
  – The existing sectors may be wrong sectors due to the wrong interventions in the past.
  – Some sectors that the country has latent comparative advantage may be totally new to the country and the tacit knowledge can be brought in with FDIs
Growth Identification and facilitation: A New Structural Economics approach for industrial policy
**Growth Identification and Facilitation**

**Step 1**
Find fast growing countries with similar endowment structures and with about 100% higher per capita income, or 20 years ago had a similar per capita income. **Identify dynamically growing, tradable industries** that have performed well in those countries over the last 20 years. Alternatively identify major imports that are produced in countries with about 100%-200% of per capita income.

Avoid the government doing the wrong things or being captured by vested groups for rent seeking.

Incorporate the idea of tacit knowledge.

**Step 2**
See if some **private domestic firms** are already in those industries (existing or nascent). Identify constraints to quality upgrading or further firm entry. Take action to remove constraints.
Growth Identification and Facilitation

**Step 3**
In industries where no domestic firms are currently present, seek FDI from countries examined in step 1.

**Step 4**
In addition to the industries identified in step 1, the government should also pay attention to spontaneous self discovery by private enterprises and give support to scale up successful private innovations in new industries.
Step 5
In countries with poor infrastructure and bad business environments, **special economic zones or industrial parks** may be used to overcome barriers to firm entry, attract FDI, and encourage industrial clusters.

Step 6
The government may **compensate pioneer firms** identified above with:
- Tax incentives for a limited period
- Direct credits for investments
- Access to foreign exchange

Play the coordination function in a pragmatic way
Address the externality issue
Two additional points

• Agricultural development is also crucial for Africa:
  – For poverty reduction, and
  – For providing capital and a market for industrial products.
  – Agricultural development also requires structural change in technology and product composition

• A resource-abundant country’s resources will be a blessing if:
  – It has a good management of resources. (E.g., some of it must be saved for future generations, and enclave rent capture avoided.)
  – It uses (part of) the wealth generated from resources to facilitate structural transformation by investing in hard and soft infrastructure.
Concluding Remarks

• Poverty is not a destiny
• African countries can grow as dynamically as any successful countries in East Asia and other parts of the world, if they have an enabling government to facilitate private firms to capture the window of opportunity of industrialization from the pending relocation of light manufacturing due to rising wages in China and other emerging market economies

• A change in mindset is key for success: *Africa should look at what Africa can do well based on what Africa has now, instead of looking at what Africa does not have or cannot do well based on what the high-income countries have and can do well*