Building productive capacities and transforming economies to achieve sustained and inclusive development in Africa[1]

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Introduction

Achieving sustained and inclusive development requires strengthening efforts to build productive capacities to create decent employment and reduce poverty, particularly in Africa where the challenge of poverty eradication is daunting. But it also requires sharing prosperity through providing women, youths, and other marginalized or vulnerable groups with opportunities to participate and benefit from the growth process to ensure that no one is indeed left behind. Over the past few decades there has been a significant reduction in global poverty, as evidenced by the decline in the poverty headcount ratio (at $1.90 a day) from 35.9 percent in 1990 to 10 percent in 2015. While a decline in the poverty rate has been observed in all regions of the world, it is evident that the significant decline in global poverty recorded has been driven largely by progress made in the populous regions of East Asia and the Pacific, where the poverty ratio declined from 61.3 percent in 1990 to 2.3 percent in 2015, and South Asia where it fell from 47.3 percent to 24.6 percent over the same period (Table 1).

Table 1: Poverty headcount ratio at $1.90 a day (2011 PPP) (% of population)

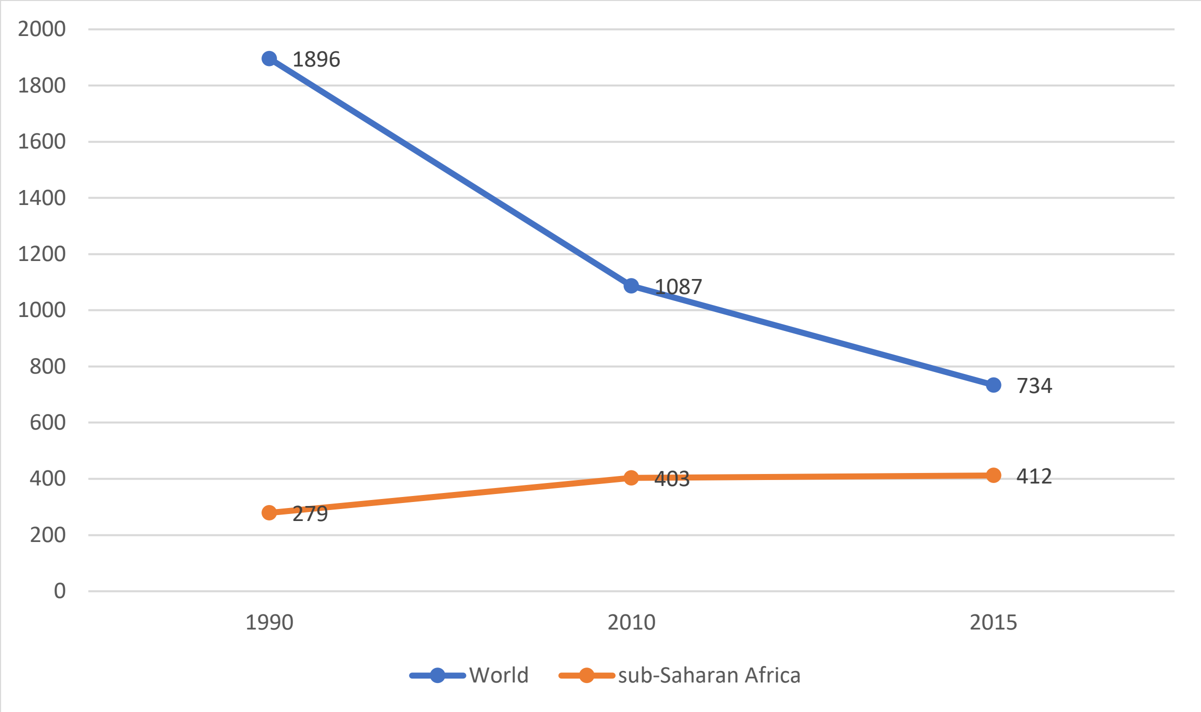
	1990	2010	2015
World	35.9	15.7	10
Sub-Saharan Africa	54.7	46.5	41.4
Middle East & North Africa	6.2	2	4.2
Latin America & Caribbean	14.8	6.2	3.9
Europe & Central Asia	..	2.4	1.5
East Asia & Pacific	61.3	11.2	2.3
South Asia	47.3	24.6	..

Source: World Development Indicators

Global extreme poverty is increasingly concentrated in Africa

There has also been a decline in the poverty rate in Sub-Saharan Africa (SSA) from 54.7 percent in 1990 to 41.4 percent in 2015. But the pace of decline has been far less than in other developing country regions despite the relatively rapid economic growth experienced by the region over the past two decades. The slower pace of poverty reduction in SSA has been ascribed to: challenges in translating growth into poverty reduction due largely to heavy reliance on natural resources; high inequality; lower economic growth; and prevalence of conflicts and weak institutions (World Bank 2018). Interestingly, in contrast to most developing regions, the decline in the poverty rate in SSA has gone hand in hand with an increase in the number of poor people on the continent. The number of poor people in SSA increased from 278.7 million in 1990 to 412.1 million in 2015. This increase in the number of poor people in SSA occurred while the number of poor people globally fell from 1896 million to 734.1 million between 1990 and 2015 (Figure 1). Consequently, there has been a significant increase in SSA's share of global poverty from 14.7 percent in 1990 to 37.1 percent in 2010 and 56.1 percent in 2015. Based on these trends, global poverty is increasingly an African phenomenon and the implication is that if we are to achieve the 3 percent poverty rate target enshrined in the Sustainable Development Goals (SDGs), international efforts have to focus on SSA because that is where the global battle on extreme poverty will either be won or lost.

Figure 1: Number of people who live below $1.90 a day (in millions and 2011 PPP)



Source: computed based on data from World Development Indicators

Effectively addressing the challenge of poverty reduction in Africa requires the development of productive capacities

It is widely understood and accepted in the development literature that effective efforts to address the poverty challenge in SSA must involve the creation of sustained and decent employment and this clearly requires the development of productive capacities, defined by the United Nations Conference on Trade and Development (UNCTAD) as the *"productive resources, entrepreneurial capabilities and production linkages which together determine the capacity of a country to produce goods and services and enable it to grow and develop"* (UNCTAD 2006). Weak productive capacities have been a binding constraint on achieving high and sustained growth as well as generating adequate employment to absorb the rapidly growing labor force in SSA. Many countries in SSA rely heavily on the extractive industries as a source of growth. While such industries have been key drivers of growth in these economies, they have made very modest contributions to employment creation because they are highly capital intensive and have less linkages to other sectors of the economy. Furthermore, the high uncertainty and volatility associated with commodity prices mean that countries that are reliant on commodity-driven growth are highly vulnerable to external shocks, which casts doubt on the sustainability of such growth. In this context, there is the need to broaden the sources of growth in SSA through developing productive capacities in the non-extractive sectors, particularly those that are labor intensive and have high income elasticities of demand.

The discourse on productive capacities in Africa must shift from the WHAT and WHY questions to the HOW question

The dialogue on developing productive capacities is often focused on its meaning or definition (the What Question) and on the rationale or case for developing productive capacities (the Why Question). While these are important issues, there is the need for more emphasis on how countries could effectively develop these capacities (the How question). There are two aspects to the HOW question: first, is the identification of feasible policy instruments that countries in SSA could adopt to build productive capacities, particularly in the manufacturing sector. The second is to develop methodologies and tools that countries could adopt to measure as well as monitor the development of productive capacities at the country level. Such a tool is necessary for evidence-based policy formulation and to provide policymakers with an understanding of the state of productive capacities development in their economy relative to where they want to be as expressed in their vision statements or national development plans. UNCTAD has taken on the second challenge through the development of a productive capacities index (PCI). The PCI is a weighted sum of eight components capturing key drivers and enablers of productive capacities development namely: human capital, natural capital, structural change, information and communication technology, institutions, energy, private sector development, and transport. The index ranges from 1 to 100, with higher values indicating higher levels of productive capacities. UNCTAD expects to complete and launch the index sometime in the second quarter of 2020.

African countries need a holistic approach to developing productive capacities

Productive capacity development takes place through sustained efforts to build new capacities as well as utilize and maintain existing capacities. However, in SSA, there is a tendency for governments to focus attention on the creation of new capacities, while existing capacities are neither maintained nor utilized. Surveys of manufacturing enterprises conducted by the World Bank indicate that firms in many countries in SSA have low manufacturing capacity utilization rates, even though enhancing productive capacities is a development priority in these countries. Table 2 shows that average manufacturing capacity utilization rates in SSA is about 70 percent compared to 78 in East Asia and the Pacific and 78 percent in South Asia. Within SSA, the average manufacturing capacity utilization rates are particularly low in Djibouti (53 percent), Eswatini (60 percent), Mauritania (57 percent), Sierra Leone (58 percent) and Zimbabwe (55 percent).

Some of the factors that have been identified as constraints to the utilization of existing manufacturing capacities in SSA include: difficulties experienced by firms in accessing key inputs at affordable prices; poor infrastructure, particularly costly and unreliable electricity services (Osakwe 2019); an unstable economic and political environment; and either inadequate domestic demand or difficulties in penetrating exports markets. There is the need to address these challenges facing manufacturing firms to increase capacity utilization rates and make better use of limited resources in SSA. The current approach to developing productive capacities, which does not reflect a good balance between creating new capacities and making more efficient use of existing ones, has clearly not yielded very good outcomes as evidenced by the fact that most countries on the continent still have very low productive capacities and account for very low shares of global manufacturing value added and exports.

Table 2: Comparison of average manufacturing capacity utilization rates across regions (2010-2020)

Economy	Capacity utilization (%)
All Countries	72.5
East Asia & Pacific	78
Europe & Central Asia	74.7
Latin America & Caribbean	70.5
Middle East & North Africa	67.1
South Asia	77.6
Sub-Saharan Africa	**70.4**
China (2012)	87
India (2014)	81.8

Source: https://www.enterprisesurveys.org/

Productive transformations are created and supported through smart and pragmatic industrial policies

The development experiences of both developed economies and industrialized developing economies provide ample evidence that productive transformations do not occur in isolation. They are created through determined efforts and support by governments in the form of industrial policies. But industrial policies must be applied in a smart and pragmatic manner for it to yield the desired outcomes. If it is applied in the traditional way it was implemented in SSA in the 1960s and 1970s, it is unlikely to result in meaningful productive transformation of economies of the region. In this regard, UNCTAD and UNIDO (2011) identified several lessons that African countries should learn from their development experiences regarding the use of industrial policies for economic transformation. **First**, structural constraints inhibiting firm development and growth must be addressed. Poor infrastructure, lack of skilled labor, high transactions costs, low entrepreneurial base, and the small size of domestic markets are some of the factors that have contributed to lack of productive capacities and transformation in African economies. An effective industrial policy must lift these binding constraints to unleash the potential and dynamism of firms for growth, employment creation, and poverty reduction. **Second**, firms provided support must be challenged to perform and policymakers should be able and willing to withdraw assistance when there is evidence of non-performance. One of the reasons the industrial policies pursued by African governments in the 1960s and 1970s did not yield the desired results was that the focus was on providing firms with incentives without putting in place effective mechanisms to hold them accountable for non-compliance. There was also a focus on the state building industries rather than assisting firms to be competitive, particularly in export markets. A smart and pragmatic industrial policy must address these limitations of traditional industrial policies implemented in Africa in order to be effective in inducing long-term productive transformation.

Third, promotion of manufacturing activities must not be done at the expense of agriculture. Although the agriculture sector employs more than half of the labor force in Africa, the traditional industrial policies implemented on the continent in the 1960s and 1970s promoted manufacturing activities at the expense of the agriculture sector, which was the main source of foreign exchange earnings in many economies. The result of this neglect of agriculture was severe shortage of foreign exchange to import the capital goods needed by domestic industries, which ultimately led to accumulation of large foreign debts and economic crises. In this context, there is the need for policymakers to exploit the linkages between agriculture and industry and treat both as complementary activities that must be promoted to maximize development impact. **Fourth**, technological capabilities of domestic firms must be developed. Technology and innovation are important drivers and enablers of productive capacity development and transformation. Domestic firms that have high technological capabilities are in a better position to produce sophisticated and dynamic products with high value addition. An effective industrial policy must prioritize the development of technological capabilities of domestic firms as an important component of an industrial development strategy. **Fifth**, due to the small size of African economies, exclusively inward-looking development strategies could have severe negative consequences for productive transformation. The small size of African economies means that they will require access to external markets in order to fully exploit the benefits of economies of scale in production. Industrial policies must take this market factor into consideration by striking a good balance between protecting domestic firms to induce economic transformation and promoting exports to generate foreign exchange. **Finally**, political stability is a necessary condition for success in productive transformation. Productive transformation does not take place in a vacuum. Entrepreneurs will invest in strategic sectors of the economy if they have an environment conducive to firm development and growth. In this context, there is the need for African governments to create a stable political environment and reduce the uncertainties associated with investment. They should also desist from promoting foreign investment through discriminating against domestic investors because the only effective way to attract sustained foreign direct investment is to have a vibrant and dynamic domestic private sector.

African consumers must play a positive role in productive transformation

African governments have the responsibility to formulate policies, create a good business climate, maintain political and macroeconomic stability, and promote entrepreneurship to develop productive capacities and foster economic transformation. To discharge this duty effectively they must have strong partnerships with the private sector to ensure that its needs and concerns are integrated into the design and implementation of policies. But government policies will also yield the desired outcomes if consumers play a positive role in productive transformation by buying goods produced by domestic firms thereby encouraging them to make further investments in the production sectors of the economy (Osakwe 2016). In the discourse on Africa's economic development, the focus has been on the roles of the government and the private sector as actors in the development of productive capacities. However, consumers also have an important role to play in this area because the kinds of goods they buy affect the incentives facing domestic entrepreneurs and their decision on whether to invest in production activities. A key reason why the beer industry was relatively unaffected by the deindustrialization experienced by most African countries in the 1980s and 1990s is that local demand for the output of the industry has been quite strong, thereby making it possible for domestic firms to thrive. In this context, African consumers should ensure that their consumption patterns and tastes support domestic productive transformation to create employment and foster sustained and inclusive development.

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