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Policy Brief
Growing Middle Class and Continental Import Substitution
Connecting the Dots to Unlock Made in Africa

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Table of Contents

1. Introduction

Africa has significant endogenous growth potential in many sectors, particularly due to an expanding middle class, which occurs simultaneously with an expanding but young and rapidly urbanizing population[1]. Moreover, Africa's GDP growth in recent years has been favorable[2]. Thus, an increasing number of people can now buy locally produced value-added goods and services. The growing demand for "Made in Africa" products offers a great opportunity to boost local production, create much-needed jobs and strengthen intra-African trade relations[3]. Manufactured goods already account for a large share of intra-African exports and increased demand from the middle class could further support value-added production and exports[4].

The establishment of the African Continental Free Trade Area (AFCFTA) creates an integrated African market for trade in goods and services. The creation of the single continental market, with a population of 1.3 billion and a combined GDP of approximately US$ 3.4 trillion, offers a particularly efficient way to deepen regional integration and promote import substitution[5]. Import substitution is understood to mean the productive transformation of African economies and expansion of intra-African trade such that the continent produces what it otherwise imports. Under AFCFTA, African countries can increase their manufacturing capabilities, produce more goods locally and export to other African countries. This will create jobs, reduce dependence on imported goods, and increase competitiveness in the global market. It will also lead to increased competition, potentially lower prices and poverty reduction[6]. However, to deliver its potential impact, the AFCFTA must benefit from the growing domestic demand fuelled by the continent's growing middle class and support the growth of the latter to promote inclusive economic growth and increase productivity and economic diversification.

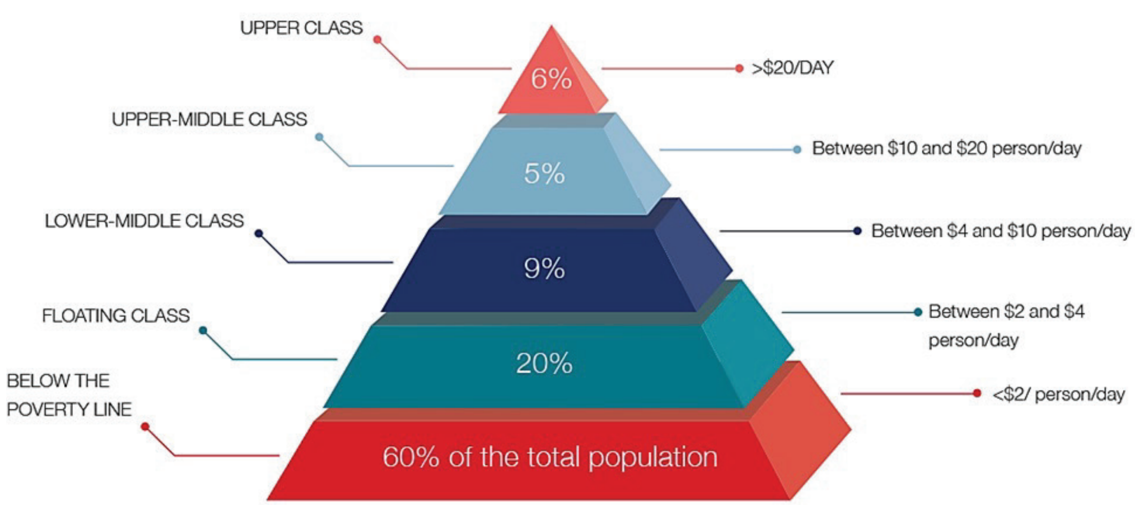
2. The state of Africa's middle class

The African Development Bank (AFDB) has defined the middle class as the share of the population that can afford to spend between $2 and $20 per day. In 2010, around 326 million people or 34.3% of Africa's population were in this group, a threefold increase from 1980[7]. Some estimates indicate that the middleclass population in Africa could increase to 1.1 billion (42% of the total population) by 2060[8]. This growth is being driven by several factors, including strong economic growth, population growth and increased access to education and health care[9].

However, the middle class is not a homogeneous group. By the AFDB definition, Africa's middle class encompasses three distinct categories: the floating class living on $2-$4 per day, the lower-middle class living on $4-$10 per day, and the upper-middle class on $10-$20 per day (Figure 1). In 2013, the lower- and upper-middle class populations, which are comparatively more robust and stable, were about 150 million people[10]. Clearly, the bulk of the middleclass population includes those whose position in the class is insecure and vulnerable to shocks. The AFDB has called them the "floating class" that can quickly return to poverty. Ignoring the floating class may cause growing inequality between rich and poor.

Unlocking the potential impact of the middle class on import substitution in Africa requires an understanding of the constraints faced by this segment of the population.

FIGURE 1: DISTRIBUTION OF AFRICA'S POPULATION BY WEALTH CLASS



Source: [African Lions: Who are Africa's rising middle class?] Hendrik van Klerk, 2018

3. Africa's middle class and successful import substitution: challenges and opportunities

Challenges for the growth of the middle class

The growth of Africa's middle class faces several constraints. One of them is inequality. According to the AFDB, the level of income inequality in Africa is higher than in all other regions in the world but on. In 2019, the top 10% of the population in sub-Saharan Africa earned on average 27 times more than the bottom 50%[11]. This means that a significant portion of the population is unable to climb up the social and economic ladder.

Another major problem is unemployment. In 2022, the unemployment rate for people aged at least 15 in Africa was 7.1% in 2022, significantly higher than the global average of 5.8%. The working poverty rate - that is, a situation where the total income of a household with at least one person in paid employment is insufficient to put it above the poverty line - was 31.1% compared to the global average of 6.4%[12]. This means that many people do not have a stable income or access to economic opportunities, and when they do, the opportunities often cannot help them move up the income ladder.

Inequality and unemployment are worsened by high adult illiteracy rates and low access to credit in Africa, which means that many people do not have the skills, knowledge and funding necessary to take advantage of economic opportunities that could help them move up the income ladder. In 2016, 27% of the world's adults who could not read or write lived in sub-Saharan Africa. This is higher than in any other region of the world except Southern Asia[13]. Moreover, although sub-Saharan Africa has the world's largest share of mobile money accounts, only 34% of adults in total have an account with a formal financial institution. The wide penetration of mobile money in Africa is, however, an opportunity that can be seized for financial inclusion[14].

The middle class as an opportunity for import substitution

The middle class as an opportunity for import substitution

The dynamic link between urbanisation and the rising middle class creates huge potential for sustainable and inclusive industrialisation in Africa, especially in the context of the AFCFTA. The continent currently presents opportunities for import substitution in several sectors, including:

- Automotive sector, with an export potential of US$10 billion by 2026, of which around 10% will be intra-African;
- Pharmaceutical products, with 65% of an unrealised US$ 1 billion potential;
- Cotton clothing, with an export potential of US$ 6.4 billion by 2026, of which about 15% would be intra-African); and

- Baby food, with an estimated intra-African demand of over US$1.2 billion by 2026.

Recent events show how vital self-sufficiency in some of these sectors is. For example, Africa imports US$11 billion worth of imported packaged medicines annually. Import dependence on these products is higher than other regions, for example, seven times higher than India. Most of the imports are mixed and unmixed medicines, consisting mainly of oral solids and creams that are likely to be branded generics, which have less complex procedures than patented medicines but are slightly more complex than plain generics. The main barriers to increased intra-African production and trade include lack of markets of scale, lack of competitiveness compared to other regions as well as lack of harmonization of rules and regulations across the continent are being eliminated with the implementation of AFCFTA and other African Union instruments.

The development of value chains in each of these sectors will link "at least five African countries from different regions and have the potential to add value, reduce imports, boost trade, diversify economies and open up opportunities for women and youth. The middle classes will play an important role in the development of these value chains and their indirect impact on imports[15].

Firstly, the middle class can provide a source of labour for manufacturing industries. This is because the middle class is more likely to have the skills and education required for manufacturing jobs.

Secondly, the middle class may constitute the main consumers of African manufactured goods and services. Purchasing power, but also the concomitant growth of urbanization and the rise of the middle class create new consumption patterns that are satisfied by industrial production. Here particular emphasis should be placed on urbanization, transforming "African cities ... major markets for traded goods, including manufactured goods and food. They are home to Africa's emerging middle classes, with income levels that allow for significant consumer spending," according to the AFDB.

The greater purchasing power of the urban middle classes creates a large and growing demand for value-added manufactured goods[16]. In sub-Saharan Africa alone (excluding South Africa), a 2018 estimate reported over 100 million middle -class people with a total purchasing power of over US$400 million per day[17]. The purchasing power of Africa's middle class is expected to grow significantly in the coming years: the continent's middle class is expected to spend US$2.1 trillion by 2025 and US$2.5 trillion by 2030[18], thus creating a further upward momentum in the demand for manufactured goods.

4. Linking Africa's growing middle class to successful import substitution within the framework of the AfCFTA

There is virtuous cycle between the size of the middle class and the growth of the private sector needed to promote "made in Africa" as the basis for an effective import substitution strategy. In the context of the AfCFTA, Africa's growing middle class and its increasing purchasing power can fuel domestic demand in African economies, thereby stimulating productive transformation. Moreover, the middle class is more likely to have the savings and investment required to initiate and increase investments in business. This is particularly beneficial for Africa's medium and long-term growth, considering the centrality of the private sector to economic productivity and employment in Africa[19]. However, successful import substitution requires action in several areas to strengthen the relationship between the middle class, national productive capacities and intra-African trade.

Structural transformation

Structural transformation involves moving resources from low productivity sectors to high productivity sectors. In Africa, this means shifting resources from agricultural production to manufacturing. The benefits of this shift are clear: manufacturing has the potential to create jobs, increase productivity and promote economic growth. In 2018, Africa's manufacturing sector created 1.5 million jobs. This is a step in the right direction, but more needs to be done to achieve sustainable industrialisation[20]. African countries need to build domestic manufacturing capacity and stop relying on commodity exports. For example, by transforming cocoa from raw beans to ground powder, the value of cocoa exports could increase by a factor of 2-3[21].

Physical infrastructure

Africa has a significant infrastructure deficit, which makes it difficult and expensive to produce and transport goods and services within and between countries. Africa's private sector loses up to 30% to 60% of its productivity to poor infrastructure[22]. The notion that Africa's infrastructure deficit reflects its relatively low-income levels does not hold because the infrastructure deficit exceeds those of other developing countries with similar levels of per capita income[23]. Overcoming the deficit requires annual investments between $130 and $170 billion[24]. Among others, there is an urgent need to develop requisite industrial infrastructure such as special economic zones and industrial parks to facilitate the implementation of industrial activities; attract investment; reduce transaction costs and increase the ease of doing business;

Soft infrastructure

In addition to physical infrastructure, industrialization requires soft infrastructure to create a more skilled workforce, an attractive investment climate and a more dynamic economy. An enabling business environment with good security, strong institutions, stables and supportive policies, rule of law and property rights is essential for a growing middle class and a thriving private sector. These are key to structural transformation and economic diversification. An enabling business environment with good security, strong institutions, stables and supportive policies, rule of law and property rights is essential for a growing middle class and a thriving private sector. These are key to structural transformation and economic diversification.

Access to energy

Energy is an important input in the industrialisation process. Efficient industrial production is difficult with poor access to energy. According to the International Energy Agency, 600 million people in sub-Saharan Africa do not have access to electricity. Poor access to energy also limits aggregate productivity because the private sector and households need energy to function optimally. Estimates suggest that African countries lose between 1% and 2% of GDP annually due to power cuts. Thus, continued efforts to increase access to electricity are crucial to Africa's productive transformation. The good news is that progress has been made in recent years. In 2018, renewable energy investment in Africa reached a record high of $7.4 billion: Sustained investments in renewable energy may also help to close the energy access gap.

Private sector development

The private sector is estimated to contribute about 80% of Africa's GDP and about 90% of all jobs. The private sector can invest in research and development to develop new technologies for manufacturing. They can also provide training and education to workers to develop the skills needed for manufacturing jobs. In addition, the private sector can work with governments to create an enabling business environment, making it easier for companies to operate and invest in Africa. Finally, the private sector can promote intra-African trade by investing in cross-border infrastructure and developing regional value chains. By leveraging the resources of the private sector, African countries can achieve their industrial goals faster.

Demographic dividend

Some 628 million Africans are under the age of 24, and by the year 2050, that figure is expected to jump by half to 945 million. It will represent almost twice the young population of South and Southeast Asia, East Asia and Oceania combined. Africa's youth population is expected to double by 2050, making it the youngest continent in the world. This demographic dividend presents a unique opportunity for the continent's industrial and Made in Africa agenda. According to the African Development Bank, the youth demographic could add up to $500 billion to Africa's economy over the next decade.

Digitization

Digital technologies contribute to the improvement of production processes, reduction of production and logistical costs and enhancement of overall economic efficiency. Through these effects, Africa's industrial output could increase by up to $500 billion by 2025. Most African countries already have significant opportunities for digitalization. For example, the increasing number of Africans who have access to the internet and mobile phones creates a foundation for the growth of e-commerce such that by 2025, e-commerce could account for up to $75 billion online sales per year, that is, about 10% of the entire retail sales in Africa's largest economies. By deploying digital technologies, countries can participate more efficiently in intra-African trade within the context of AfCFTA.

5. Conclusion

Strengthening the distributional impact of the AfCFTA is indispensable for the continuous growth of Africa's middle class. This will provide support for achieving the transformational outcomes envisaged in the implementation of AfCFTA. The specific challenges and opportunities highlighted above provide pointers to some key areas for policy intervention to preserve the growth of the middle class and take advantage of the middle class to facilitate import substitution.

As a starting point, it is very crucial to directly focus on creating an enabling economic environment across the continent. In this regard, AfCFTA has the potential key advantage of freer labour mobility, which offers the private sector in each African country access to a larger pool of skilled workers from other countries. However, policy makers within and across countries need to work together to actively promote innovative financing models for credit provision and for infrastructure development.

Cooperation between countries is also needed to promote the development of cross-border infrastructure projects that will increase productivity and regional integration. Insecurity may be addressed by increasing investment in security infrastructure, such as surveillance systems and border control measures, promoting regional security cooperation and integration efforts to address transnational security threats, and investing in social and economic development programs that address the root causes of insecurity, such as poverty and lack of economic opportunities.

It is also important to address the high levels of informality and unemployment in the labour force, which continue to constrain industrialization in Africa. Although micro, small, and medium enterprises create 70–80% of jobs and contribute 30–35% of GDP in Africa, at least 65% of them are informal. Thus, creating meaningful jobs in the formal sector will contribute to manufacturing and value addition on the continent. Moreover, reducing informality will significantly reduce working poverty, promote job security and reduce the use of precarious employment arrangements, which is a potential risk in the context of improved labour mobility due to the AfCFTA. But this will not be easy to achieve. It will require sustained effort over the medium to long term in order to achieve sustainable industrial development, poverty reduction, and growth of the middle class.

Relevant policy options to reduce the burden of informality, strengthen the private and promote sustainable employment across the continent include, inter alia:

- Promoting entrepreneurship and small business development as way to create new jobs across diverse sectors;
- Implementing on-the-job training programmes to provide workers with the skills necessary to succeed in high-demand and more formalized industries;
- Creating public-private partnerships, which if well -structured and managed, can attract foreign investment and create jobs in new industries.
- Deepening agglomeration policies such as the creation of special economic zones and the strengthening of existing ones to facilitate the growth of the private sector

especially in manufacturing and value-added production.

Finally, political coordination is essential. There are two sides to this point. On one hand, national trade and industrial policies can no longer be treated independently. Instead, African countries need to ensure linkages between their trade and industrial policies. This facilitates national competitiveness by ensuring that each country can effectively sell what it produces and can efficiently produce what it is able to sell. On the other hand, cross-country cooperation to coordinate industrial policies is necessary. Without such coordination, African countries may end up competing with each other over certain sectors or products while some sectors are neglected. Country-level competitiveness can be quickly eroded under such situation. The risk of this type of productive country competition is even higher in the context of AfCFTA. The existence of several continental programmes and frameworks will make it easy to achieve the required coordination. These programmes and frameworks include the AU Agenda 2063; Accelerated Industrial Development of Africa (AIDA); Plan of Action to Boost Intra-African Trade (BIAT); African Quality Policy; AU Trade Facilitation Strategy; Digital Transformation Strategy for Africa (DTSA); Pharmaceutical Manufacturing Plan for Africa (PMPA); Programme for Infrastructure Development in Africa (PIDA) and several others.

6. Notes

1 Presently, 60% of Africa's 1.25 billion people are less than 25 years old, the highest of any region in the world, and this is expected to gain 20% by 2030. Projections suggest that by 2030, 17 African cities will have over 5 million inhabitants and a further 90 cities will have at least one million. See Foresight Africa: Top Priorities for the Continent in 2019. Africa Growth Initiative, Brookings Institution, 2019.

2 Data from the IMF World Economic Outlook Database in April 2022 shows that between 2019 and 2022, Africa's GDP grew at an annual average of 3.12%, compared to the global average of 2.42%. While global average GDP declined by 3.04% in 2020 due to the COVID-19 pandemic, Africa's GDP showed more resilience, declining by only 1.62%.

3 https://www.worldbank.org/en/topic/trade/publication/free-trade-deal-boosts-africa-economic-development

4 African countries generally trade more in manufactures with themselves than they do with the rest of the world. In 2014, manufactured goods made up 41.9% of intra-African exports compared to 14.8% of exports to the rest of the world. See https://www.brookings.edu/research/intra-african-trade-a-path-to-economic-diversification-and-inclusion/ for a longer discussion.

5 As of February 2023, 47 African countries have ratified the agreement.

6 Recent estimates by the World Bank indicate that the full implementation of the AFCFTA could bring income gains on the continent between 7% ($450 billion) and 9% ($571 billion) by 2035 – above the baseline without the AFCFTA – and could lift 50 million people out of extreme poverty. It is also estimated that Africa's manufacturing sector could double in size under the AFCFTA, with annual output increasing from US$500 billion in 2015 to $1 trillion by 2025 and creating over 14 million stable, well-paid jobs. See Making the Most of the African Continental Free Trade Area: Leveraging Trade and Foreign Direct Investment to Boost Growth and Reduce Poverty, World Bank, 2022 and The potential of manufacturing and industrialization in Africa: trends, opportunities, and strategies, L. Signé, 2018.

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