Light Manufacturing in Africa

GRIPS PRESENTATION
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The World Bank
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Outline

- Why industrialization
- Scope of study
- Approach
- Main findings
- The six major constraints
- Illustration with the Ethiopia study
- How East Asian countries have resolved the constraints
- Policy lessons
Why industrialization?

- Fastest way to raise per capita income
- No country in the world has become an advanced economy without going through industrialization, especially the production of light manufacturing
- Even the resource-based countries need light manufacturing to create jobs and prosperity
How is Africa’s performance in industrialization?

• Africa’s **GDP grew 5.2% per year** and **per capita income grew at 2% per year**

• Unsustainable growth arises mainly from commodity exports, manufacturing has **declined to <1%**

• Simple, labor-intensive manufacturing offers a **viable growth path**

• Timing is good because China’s climbing labor costs are pricing China out of low-end manufactured goods
Scope of Study

Case studies: Ethiopia, Tanzania, Zambia
China as a benchmark; Vietnam as a comparator

apparel  leather products  wood products
metal products  agribusiness
Approach

Methods:
- World Bank Enterprise Surveys
- Qualitative surveys
- Quantitative surveys
- Comparative value chain analysis
- Kaizen study

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Africa does have the potential to create millions of productive jobs:

- Growing labor cost advantage
- Natural resource advantage
- Privileged access to high-income markets for exports
- Growing domestic and regional markets

Current structure of light manufacturing in Ethiopia, Tanzania and Zambia:

- Few medium or large formal firms; vast number of small, low-productivity informal firms
- Need to improve productivity of both small and large firms
• **Vicious circle of pervasive poverty and low industrialization:**
  
  ➢ Big push model.
  
  ➢ Even under the most optimistic scenarios, most African countries could only meet the more modest targets in infrastructure needs after 20-30 years.
  
  ➢ Africa’s infrastructure deficit is huge because of poverty, but also because of the continent’s characteristics, including low population density, low rates of urbanization, the large number of landlocked countries, and the numerous small economies.

• **Need to break out of the vicious circle through a targeted approach**
The Six Major Challenges

At a broad level, six binding constraints to light manufacturing emerge:

- input cost & quality
- industrial land
- finance
- trade logistics
- entrepreneurial skills
- worker skills
The Constraints

Vary by country, by sector, and by firm size, so policies to address these constraints have to be specific

- Need to target policies to remove specific constraints in specific sectors
- Unlike previous studies, this study points to a small, specific, set of key constraints
- Narrowing analysis can make the reform agenda more manageable
## Constraints in Ethiopia
### By Size of Firm, Sector, and Importance

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<th>Land</th>
<th>Finance</th>
<th>Entrepreneurial skills</th>
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<th>Trade Logistics</th>
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*Note: Blank cells are not a priority.*
The Leather Industry in Ethiopia

- Employs 8,000 workers with $8 million in exports
- Second largest livestock population in Africa
- Suffers shortage of quality processed leather due to:
  - Poor disease control
  - Lack of quality processing of raw hides and skins
  - Trade policy on processed leather
- Among the solutions:
  - Treat ectoparasites
  - Technical assistance (Ramsay Shoes)
  - Allow the import and export of leather
Policy Implications

Because the binding constraints vary by country, by sector, and by firm size, **policymakers need to:**

- Identify, prioritize, and remove the **most serious constraints**
- Target policies **selectively**, in line with **comparative advantage and capabilities**
- Use a range of policies
- **Start small**
- Remember that **success breeds success**
How East Asian countries have resolved the binding constraints

• **General solutions**: industrial parks, industrial clusters, and trading companies

• **Specific solutions**: for inputs, through trade reforms; for land, through industrial parks; for finance, through networks and starting small
Policy lessons

- Creating a supportive environment for manufacturing
- Filling knowledge and financial gaps through foreign direct investment (FDI) and networks
- Using substitution policies and sequencing
- Starting small and building gradually
- Establishing islands of success by keeping targeted policies selective and within a country’s limited resources
Supportive environment

• Public endorsement of private sector initiatives
• Tailoring support to the business life cycle and backing winners: support the private sector
• Foster competition
• Maintain conducive macroeconomic and trade policies
• Neither the private sector nor the public sector can drive the process independently: success requires public-private cooperation
Filling knowledge and financial gaps through FDI and networks

• The role of FDI is key not only to supplement domestic savings, but to provide the expertise, technology, and ideas. Both FDI and networks play a fundamental role in providing this knowledge.

• In general, networks of family and friends allow start-ups to begin production without funding from the formal financial sector.
Using substitution policies and sequencing

- Industrial parks, industrial clusters, and trading companies are policy innovations that substitute for first best policies actually work. Bonded warehouses can offset the difficulties surrounding the availability of inputs and logistics.

- In most African countries, industrialization begins with the production of final goods in the light manufacturing sector because of the labor-intensity and low-skill requirements. Later, after firms have established themselves in the markets for final goods, the focus can shift from final goods to intermediate goods – which call for more capital and greater skills – linked to the production of the final goods, thus extending the supply chain.

- Sequencing of trade reforms is important, as the case of Zambia textiles showed.
Starting small and building gradually

• Starting small and simple works well in low-income environments. The development of China’s light manufacturing clusters illustrates the feasibility of a trajectory that begins with the assembly of simple final products in home workshops.

• Ethiopia’s cut flower industry began on 7 hectares in 2000. The business turned an immediate profit, and, within two years, the government was seeking to aid expansion. Access to additional land and finance, tax incentives, and duty-free imports led to the development of 800 hectares by 2007.
Establishing islands of success

- Production and exports of light manufacturing can expand without first resolving all the problems of a developing country.
- This approach allows governments to design concrete packages of specific, feasible, and inexpensive policies to jump-start industrialization.
- The World Bank’s Light Manufacturing in Africa Project has applied this targeted approach to Ethiopia, Tanzania, and Zambia.

THANK YOU

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