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Filling Africa's Policy Gaps — for Business and Development

Lunchtime keynote address

by

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It is, indeed, a great honour and pleasure to have been invited to address the Dow Jones Conference on African Business and Development. It is an honour because I see in front of me now so many of the most important leaders who are actively involved in shaping the continent's future. It is a pleasure because this is my first (and certainly not the last) visit for me in this fascinating city of Marrakech. The organizers and sponsors deserve our most effusive congratulations and appreciation.

I would especially like to express my gratitude to the Royal Palace of Morocco for the hospitality and beauty of the Mahgreb's "red pearl" and for the support that it has consistently given my organization, The United Nations Industrial Development Organization. Finally I would like to thank all of you from the private sector who by your presence indicate your interest in learning more about the region. I, myself, learned a great deal from my fellow panelists this morning.

I began to focus on Africa even before I was elected Director-General of UNIDO. UNIDO had to work for Africa and in Africa — or it did not deserve to work anywhere — I had concluded. As it turns out, UNIDO is also an ideal place for an intensive course on the relationship between business and development in the region. This is because we are mandated by our Business Plan to work intensively on Sub-Saharan Africa.

Today, therefore, I want to share with you my own thoughts on the region and also the thirty years of experience that UNIDO has accumulated working in it. The theme is complementary to what we heard this morning: *Filling Africa's Policy Gaps — for Business and Development.*

Let me begin by telling you where I am coming from.

In the late 1980s and early 1990s, I was fortunate to be part of a group of Latin American economists who worked on combining economic structural reform and trade liberalization policies to bring about economic stabilization and recovery.

I was part of the government team that implemented those changes in Argentina in the early 1990s. I therefore saw at first hand how a radical reform process unfolds. And, looking back, we can now be sure that those policies were the right ones, for the manufacturing industry in particular.

Today, those successful experiences in Latin America and in other developing regions in the last decade also allow us to declare the discussion closed: the debate on the need for economic restructuring and trade liberalization is over. We can

celebrate the fact that structural adjustment and trade liberalization really do work.

The statistics from the countries that advanced furthest and deepest show it. GDP, manufacturing value-added and manufacturing exports all grew more rapidly in response to structural adjustment and opening the economic borders. Even those who do not defend the approach acknowledge this.

I will argue first, therefore, that structural adjustment and trade liberalization are, and will remain, fundamental building blocks of sustained economic development in the future. In this, Africa will be no exception.

Nevertheless, their goal of macroeconomic stabilization is not sufficient by itself. Nor can we expect it to have the same success in all countries, especially not in Africa with very different resources and starting points.

I will argue therefore that we do not understand enough about why good macroeconomic performance does not guarantee positive and sustained change at the micro level — why, in particular, it does not always induce increases in manufacturing

productivity, export performance and technological and skill improvements.

I will suggest that both business and we (in the multilateral development agencies) should therefore focus much more on the differences in African countries' micro-level performances. It is in both our interests to gear our investments and activities to improving those performances. This would mean private companies taking the longer view of their profitability, investing in the community and, generally, behaving as good corporate citizens of Africa. It would mean the development community helping develop and support policy- (micro-level policy-) changes that will enable business to operate sustainably and effectively.

[Augment, not destroy, the on-going paradigm]

The first question I would ask you to consider, then, is the current direction that our international thinking on economic development is taking.

At one extreme, advocates of the neo-liberal consensus hold that macroeconomic reform and economic liberalization are <u>all</u> that is necessary. But <u>many</u> now recognize this is an incomplete recipe — there is a dynamic and a down side to this on-going paradigm. They do need responses. But let me be clear: I am <u>not</u>

calling into question the value of the current paradigm — only its claim to completeness as an economic and social remedy, particularly for Africa.

The typical dynamic is that the initial improvement following the introduction of structural adjustment programmes is not sustained. The surge of capital inflows in the form of aid and private capital, the improvements in growth GDP, MVA and export earnings proved temporary — later slipping back later towards previous levels, or even lower.

Ghana's experience illustrates this. Ghana, remember, is one of Africa's leaders in engaging low tariff-based protection and free trade. Massive depreciation, removal of quantity restrictions on imports, reductions in corporate taxes and capital gains taxes, removal of price controls, abolition of credit ceilings, privatization of state-owned companies, revision of the investment cost and granting of incentives to exporters and investors in infrastructure, combined to give Ghana a stable, open and liberal economy by the early 1990s.

What happened? Studies show that initially MVA did rise. This was because imported inputs were suddenly available to industries that previously suffered excess capacity. But as

liberalization spread to other imports, and excess capacity was used up, the exposure to world competition led to a steady deceleration of industrial growth. The sharp, then less rapid, decline that followed the initial rapid growth meant that Ghanaian manufacturing was not taking off in response to the economic and trade reforms. Ghana's employment in manufacturing also peaked before dropping back to a third of its peak level. Equally significant, foreign investment did not respond: Ghana saw no increase in annual FDI flows after the structural adjustment programmes. And what little there was went to mining and agriculture rather than manufacturing. Domestic investment did pick up slightly, but not enough to influence manufacturing growth.

[A similar story is told for Tanzania and Zimbabwe. Tanzania's expansion took the form of a two-year surge followed by a slowdown. Again growth was based on use of existing capacity. It did not engender significant industrial restructuring. It did not lead to improved technological capability, raised skill levels and greater competitiveness. And, as in Ghana, growth of import competition meant the gains could not be sustained.]

[Zimbabwe's response could be measured in studies of technological response at firm level.

(Note: *technological response* here means things like: equipmment upgrading involving computer-aided design; replacement investment; improvements in inventory control, maintenance, quality control; changes to products and introduction of new products; and adaptive process changes.)

An initially positive technological response of Zimbabwean firms to trade liberalization was followed by a negative one as firms suffered excess capacity, higher interest charges and growing uncertainty. Along with the removal of export incentives, these factors combined to reduce the firms' export activities. In other words the initial positive response to liberalization did <u>not</u> lead to sustained increases in competitiveness. Firms thus did not compensate for falling domestic demand by gaining markets abroad.)

On the plus side, in Ghana the number of small firms did rise in response to adjüstment. They were concentrated, however, in low-productivity activities aimed at local markets, sheltered from international competition. The industrial sector that actually suffered most was the modern, large-scale part. The reason: it depended on more complex technologies, and was therefore vulnerable to lack of in-house and in-sector technological capability needed to respond to increased competition. As one

study concluded: "the generally low level of technological capabilities in Ghana at the time of the adjustment meant that rapid liberalization which was unaccompanied by supply-side measures to develop skills, capabilities and technical support, led to significant and costly de-industrialization."

What Ghana's experience shows is that macroeconomic stabilization is not enough on its own. It needs to be prepared with complementary micro-economic policies and strategies. It needs to make use of grace periods for supply-side measures that, for example:

(1) Develop skills at specialized worker- and other training institutions, and through stimulation of in-plant investment in training;

(2) Support the technology infrastructure — quality assurance, metrology, R&D, technology information, and technology extension services — required especially by SMEs; and

(3) Provide adequate financial support for industrial restructuring and upgrading.

A second reason for reconsidering the neo-liberal consensus is that structural adjustment does not have the same influence on countries having objective differences. In Africa this is evident in

an inter-country comparison of the manufacturing-, manufactured exports- and technological response of firms exposed to trade liberalization in three economies: Kenya, Tanzania and Zimbabwe.

In terms of MVA, Kenya and Zimbabwe did worse in the five years after liberalization than in the period before it. (This was partly exacerbated, but not accounted for, by other factors. Tanzania did better.) Liberalization typically forced manufacturing firms to shut down or move to products not facing import competition. The latter were either resource-based or simple, low-productivity operations making goods for low-income consumers, i.e. they were a poor basis for long-term manufacturing and export development.

In terms of manufactured exports, all three countries did better. This was because structural adjustment and trade liberalization improved the export environment. Primary production was better, export incentives were stronger and access to imported inputs and equipment was easier. Nevertheless the evidence points to better use of existing export capabilities, existing skills and know-how — rather than on improved technology and higher skill levels.

The comparison also revealed significant technological response differences:

- between the countries (with Zimbabwe first, Tanzania last),
- between their sectors (engineering and clothing), and
- between firms.

Zimbabwe's firms are generally larger, more experienced, more export-oriented and more diverse than the other countries. They also proved far more responsive with their technological changes to the impact of trade liberalization. The same pattern is shown in the distribution of high-, medium- and low technological response within three countries.

The fundamental difference between Zimbabwe, Kenya and Tanzania has been called *technological dynamism*. Itself the outcome of a complex combination of firm size, firm age, training efforts, entrepreneurial education, firm-level skill development and cluster arrangements. Technological dynamism is but one factor determining the speed and effectiveness of structural adjustment and the impact on the policies that should follow stabilization. Others include the national physical resources, size of GDP, level of technology, education, managerial skills (in both the public and the private sector). Since each requires a policy response to complement macroeconomic stabilization policies, the

microeconomic policy mix will vary significantly from country to country.

With hindsight from such studies, even the most ardent defenders of structural adjustment now recognize the need to assess the capability of each economy to respond to structural adjustment programmes. The recognition is building that, for macroeconomic reforms to be successful over the long term they need to be buttressed by policies and actions that encourage and support adaptation at the firm- and the investment level.

I know this was the case in Argentina. Argentina's comprehensive structural economic reforms (balancing public accounts, market deregulation and privatization, labour reform and employment support programmes, tax reform and trade reforms) were consciously supplemented with a set of specific sectoral programmes. But micro-level programmes that, for example, promote technology innovation, retrain labour and develop suppliers also make considerable demands on the management capacity in the public sector to implement and develop them.

Thus, the most disturbing issue that now needs to puts on the agenda for business and economic debate is <u>why</u> macro-economic

reform does not guarantee changes in technological competence, improvements in individual and factory-wide skill levels, higher productivity, better manufactured export performance, greater value-added in exports and sustained growth rates.

Much more research and analysis is needed to understand the links between macroeconomic policy and microeconomic policy is the new priority — for the private sector as well as development planners and managers. We know that some country indicators in some countries respond positively to macroeconomic reform and trade liberalization. We know that the extent of the response varies, and that in many countries, especially in Africa, the response is not sustained. We can be certain that market failures as well as policy- and policy-implementation failures are a major part of the explanation. Areas we need to know much more about include:

- which interventions are most adequate to compensate the market failures,
- how best to incorporate them in new, implementable micro-level policies and programmes, and
- how to ensure the adequacy of the managers, experts and technicians needed to coordinate the programmes and provide training and assistance.

Some conclusions

That, briefly, ladies and gentlemen, is where we stand are today. Structural adjustment programmes have proved their usefulness, but by no means solve all the problems. Our diagnosis is that micro economic reforms are needed everywhere as a complement to the macroeconomic interventions. In order to frame them, however, we need to learn more about the interaction between macro- and the micro-level in each economy.

In Africa's context, there is work for all of us — the private sector, the public sector and multilateral institutions like my Organization, UNIDO. Let me, then, close with some suggestions for business, and for the multilateral system.

I would strongly suggest that investors take another look at Africa's potential in value-added manufacturing — for local and regional markets, and for export. Africa, I would remind you, consistently yields the highest return on investment compared to all other regions of the world. You get four times the return compared to developed countries, double the return on your investments in Asia, two thirds more than in Latin America.

Yes, the risks are greater too. But so is the potential. Africa has vast natural, mineral and human resources that can be tapped

with considerably less investment than other regions. Cocoa, coffee, tea, horticulture, tropical wood and other commodities can all be grown and processed at lower cost in Africa.

The broad message is that, after decades of misery and neglect, things are looking up. Africa is now enjoying a recovery. Increased per capita income throughout the region, is accompanied by strong growth in export earnings overall.

Africa is *already* being drawn into the gobalization process. More than a dozen countries grew faster than 5 per cent annually in recent years. South Africa is a prime example. Egypt is thriving, Mauritius and Tunisia are seen as economic miracles. Alongside are well-focussed , secure poles of development that combine political stability with the rule of law and a viable macroeconomic structure — such as Cote d'Ivoire, Uganda, Botswana. In industry, may countries are showing improved performance, especially in the north (Tunisia and here in Morocco), in the CFA countries and in Zambia and Zimbabwe in the south.

Key economic sectors are booming — electricity, telecommunications, computers, household appliances, tourism. Africa's media, Internet and English language communication are taking off.

A new generation of managers and entrepreneurs is making an impact. Its business demands on Africa's governments are exactly the same as those of foreign investors — good governance and effective institutional support.

Security is improving. Around 40 (of Africa's 53) are peaceful. Large regions of war-torn countries are also peaceful. Political renewal is evident in the huge impact of civil society, in the 42 properly elected or re-elected leaders, in the 16 new multi-party systems since 1990.

Progress on regional integration in the west, south and east, is supported by new partners (Japan and the U.S.) and better relations with former colonial rulers.

In this context, industrial investors naturally look particularly at countries that combine the human and physical resources with the market access they need. Asian investors, for example, were quick to capitalize on some of Africa's under-used preferential quotas under the Lomé Protocols. The future of the Lomé arrangement is, of course, still unclear. But it is not hard to imagine that especially here in north Africa there will be major benefits from special arrangements with the European Union

under the Euro-Mediterranean Partnership's free-trade area. (The parties have set 2010 as the target date for the gradual establishment of this area which will cover most areas of trade.)

But I am suggesting that, in addition to access to resources in markets, you look also at the progress those countries that are also undertaking the reforms necessary for stability and growth — the macroeconomic and trade reforms first, the microeconomic reforms required by the manufacturing sector second.

Look also, I would suggest, at what is happening in the sub-regional groupings the different African countries belong to. I can tell you that in the case of Latin America's reforms, the simultaneous creation of MERCOSUR for the southern cone countries was an essential complement to national reform efforts. MERCOSUR was the mechanism that exposed manufacturing firms to international competition on a <u>gradual</u> basis. It provided a limited but essential breathing space in which the public and private sector could, together, upgrade the institutions needed to develop and support export-oriented manufacturing.

In my view, African economies, with their small and fragmented markets, absolutely need the MERCOSUR equivalents. Regional integration is one of the key motors of

Africa's development. The present sub-regional groupings —from the Union du Maghreb Arabe here in the north, UDEAC and EECAS in the centre, ECOWAS and the UEMOA monetary union in the west to COMESA and SADC in the east and south —are important steps towards economic integration and common industrial development strategies.

What else can the foreign private sector do? Taking a longer-term view of the profitability of business operations in Africa enables companies to be fully-responsible corporate citizens in Africa. Three weeks ago, a sell-out business meeting in Houston on Attracting Capital to Africa was told that new ways were needed to grow commercial partnerships that would benefit both the people in Africa and the people in America. I concur.

Coca Cola's investments in education, Kodak's promotion of computer literacy represent one approach — both are philanthropic developments of Africa's capabilities. Du Pont's water filter that reduces guinea worm disease and Pfizer's work to eliminate *trachoma* is another — the transfer a highly relevant technology to Africa. I will offer a complementary idea — partnership between large, internationally-oriented industrial firms and private sector organizations representing small- and medium-scale industry in African countries.

The UNIDO Partnership Programme is an example. It addresses directly the issues implicit in what I presented earlier concerning Africa's poor technological response to structural adjustment and trade liberalization. It does so by creating active cooperation networks comprising at least one major corporation in a developed country, management consultants, and appropriate business NGOs — particularly manufacturers associations in the host developing country — and UNIDO.

An agreement signed last November illustrates the approach. It brought FIAT together India's with India's Automotive Component Manufacturers Association (ACMA) and the Automotive Research Association of India. Its purpose is to develop the performance of India's vehicle component manufacturers by structuring their industrial network towards global standards for quality, management and technological competence.

We are optimistic that through such programmes the small and medium scale enterprises that make up the bulk of developing country manufacturing industry will be linked into the subcontracting networks of multilateral corporations. And through that linkage, they will be able to understand and to participate in

the globalization of industry. I look forward to the day when I am party to such an agreement that establishes the first manufacturing network of that kind in Africa.

This was one practical example of how the multilateral system, of which UNIDO is part, can work directly with the private sector for the broad benefit of both sides. Another is to improve the links between manufacturers in Africa with manufacturers of all sizes in other regions. Work begins this week, for example on new Asia-Africa Investment and Technology Promotion Centre to be located in Malaysia's South Investment Business Exchange Link, Kuala Lumpur. Funded by the Government of Japan, the new Centre should be fully operational inside two years. Its mission comprises project portfolio development, investment meetings, provision of project completion services, and capacity building and training. Its initial focus will be industrial partnership development with Africa's agro-industry, with special attention to food processing and textiles.

Ladies and Gentlemen,

All the examples I have given involve business (African and foreign), African governments and the multilateral system working together. Such cooperation is crucial for Africa's progress. The fourth essential partner, which business can also influence, is the

international community of governments. Their aid funding remains crucial. Levels of aid have to be maintained or even increased. As you know, one of the unfortunate distinguishing features of the economies of many Sub-Saharan African countries is their aid dependence.

What we are proposing is, in effect, an *aid-investment nexus*. We are trying convince donor governments that a much better use for their bilateral and multilateral technical assistance would be to promote foreign investment and to prepare the grounds for FDI inflows into Africa. We will be much more convincing if business also argues the case for stronger relationships between official development cooperation and private investment. Technical assistance priority should be given to improving Africa's national infrastructures to attract more foreign investment. Africa's own private sector requires capacity building and skills upgrading in order to offer itself as an attractive partner for foreign manufacturers. A development-aid-investment nexus, in other words, would enable African countries to create an environment more suited to private sector-led industrial development, and to provide more effective entry points for foreign investment and industrial partnerships in Africa.

Another major initiative we are proposing is that instead of further *trade* concessions, let there be *investment* concessions. By investment concessions we mean arrangements whereby foreign industrial investment in Africa would be eligible for corporate tax reduction in the investors home country. The development component of such tax-compensated investment would be assured by granting such concession only to investments that create significant employment and enhance technology competence levels.

These and other ideas for new approaches to donor funding and private industrial investment will feature in a major Conference on Industrial Partnerships and Investment in Africa later this year in Dakar, Senegal. The Organization for African Unity, the African Development Bank Group, the Economic Commission for Africa and their Alliance for Africa's Industrialization are joining with UNIDO to bring together African Heads of State and Minister of Industry, leading African entrepreneurs, major foreign corporate executives, business association officials, and African private sector organizations, among others.

There will be a forum on *Forging Partnerships for Africa's Industrial Development.* Its main themes include new dimensions

of EU-African cooperation,, privatization and industrial partnerships, attracting capital for Africa's development, improving the investment environment, regional economic integration and investment promotion, private financing of infrastructure, and globalization and industrial investment in Africa.

Alongside there will be a donor's forum on *Resource Mobilization for Technical Cooperation Programmes.*

Ladies and Gentlemen,

The last great frontier for investment for the new century is Africa. I hope I have been able to convince you that it can be accomplished sooner rather than later:

- if we work together;
- if business works with the multilateral system and Africa's national governments to create a sustaining environment;
- if business uses its influence with its own governments to link aid to investment promotion and to help such investment with new financial mechanisms.

I thank you for your interest.