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Sub Saharan Africa economy: Manufacturing an economic transition

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Abstract (summary)

Recent research suggests that the choice of production processes by African manufacturing firms is important, and that firms in some countries are using capital- and skilled-labour-intensive production processes that result in higher levels of value added per worker (a video summary of this research is available; Click here to open in a new window).

Full text

Sub Saharan Africa economy: Manufacturing an economic transition

Very few low-income countries have made the transition to upper-middle income status without developing a sizeable export-focused manufacturing sector, which has typically been at the heart of the process of industrialisation. While African economies have struggled on average to develop substantial manufacturing industries, there are differences between countries, and it is a mistake to characterise the continent's manufacturing firms as homogenous. Output per worker is typically three times higher in Kenya than in neighbouring Tanzania, for example, and five times higher in South Africa. Understanding the genesis of such differences is important if firm performance is to be raised.

Manufacturing has been a poorly performing sector in Africa in recent decades. Between 1996 and 2013 real manufacturing output grew by an average of 7.9% a year in Nigeria, 7.6% in Tanzania, 4.4% in Ghana, 2.5% in Kenya and just 2.4% in South Africa. Growth rates in manufacturing need to be sustained at well over 15% a year for a decade or more for African countries to make the transition to an industrialised economy: not only does GDP need to grow at rates in excess of 10% to raise average per capita income substantially, but the share of national output accounted for by agriculture needs to shrink markedly.

Learning by exporting

The continent has been hit particularly hard by the rise of China, with its efficient infrastructure and cheap workforce, as an export-manufacturing power. As wages in China have risen, labour-intensive export manufacturing has rippled through supply chains that have become primarily embedded in East Asia. In 1996-2013, real manufacturing output in Vietnam-one country that has benefited from an influx of labour-intensive

export-oriented activity-grew by an average of 10.2% a year.

Exporting is critical because most African economies are too small or too poor-or both-to provide the economies of scale needed to justify investment in sophisticated production processes, supply chains and the development of ancillary services such as logistics. In Nigeria, in particular, there will be a role for domestically focussed manufacturing firms providing the local market with low-cost consumer goods, notably for food. However, that will not be sufficient to power the entire manufacturing sector. It is also well established that exporting is linked to productivity; research by the IMF suggests that firms in Africa that export are 17% more productive than those that do not.

Sources of difference

The poor performance of manufacturing in Africa is the result of both proximate factors, such as changes in market share for particular firms, and ultimate factors, such as productivity. Understanding the drivers of cross-country differences in output per worker, both at the firm and macroeconomic level, has been an enduring topic of economic research, with the very low level of value added per worker in Africa (that is, the amount of income generated in the form of wages and profits) being a major motivating factor.

Low value added per worker can be the result of a number of factors: first, low levels of inputs, such as capital and raw materials, for workers to use; second, low productivity, perhaps resulting from poor management practices or deficiencies in infrastructure; third, the use of low value-added technology, perhaps because firms are unwilling to invest in capital-intensive processes; and fourth, low levels of education and skills among workers. All are likely to play a role.

The extent to which the growth of Asia's so-called tiger economies can be attributed either to investment or productivity has been hotly debated, and the question has not been fully resolved. The Economist Intelligence Unit believes that Sub-Saharan African economies will begin to grow at a faster rate than those in Asia from 2015, primarily due to slowing growth in China, and so these questions will be extremely pertinent to Africa over the coming decades (although our long-term forecasts for Africa are contingent upon a continued improvement in the business environment). We are also forecasting that manufacturing growth will accelerate in most African economies over the next five years, but the rate of expansion will remain well below that required to achieve a transformation of the economy.

Technology and productivity

Recent research suggests that the choice of production processes by African manufacturing firms is important, and that firms in some countries are using capital- and skilled-labour-intensive production processes that result in higher levels of value added per worker (a video summary of this research is available; Click here to open in a new window). Manufacturing firms in Tanzania tend to use more raw materials and other intermediate inputs than those in Ghana, Kenya or Nigeria, which in turn use more than similar firms in South Africa. Not only is there evidence of technological diversity, but the returns to education are higher with less material-intensive technology.

This is intuitive: firms using sophisticated machinery to produce garments will be able to make better use of skilled labour than those using scissors. The causation is likely to run both ways: a lack of skilled workers makes investment in sophisticated equipment unviable, but without these opportunities, workers have little incentive to acquire complex skills. An emerging trend of resource nationalism and making it more difficult to use expatriate workers will exacerbate these problems by reducing the supply of skills and inhibiting technology transfer. The enabling conditions for technological change and giving firms the right incentives to invest therefore appear to be an important pre-condition for industrialisation.

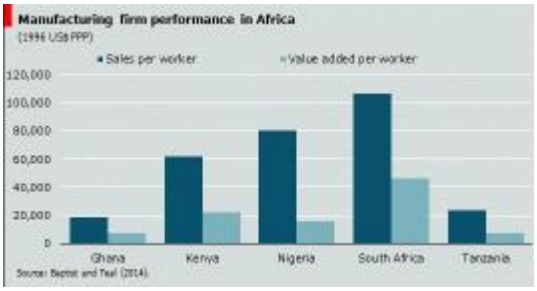
The important question that then arises is what leads firms in Tanzania, Ghana, Kenya and Nigeria to use production processes that are less effective at generating income than those in South Africa? One answer may be found in the business environment. The World Bank, among others, has argued that high indirect costs are reflective of the poor investment climate in Africa, and that ignoring intermediate inputs portrays too narrow a view

of firm performance in Africa.

For example, firms operating in South Africa may be more likely to purchase sophisticated intermediate components, while firms in Ghana may be more likely to purchase raw materials and manufacture intermediates in-house. The incentives for this could derive from differences in infrastructure and supplier reliability, the availability of maintenance services and the risk of macroeconomic shocks. This is one channel which may account for the more intensive use of raw materials by manufacturers in Ghana compared with those in South Africa.

A second factor that may lead African firms to adopt material-intensive technology is risk. Raw materials are more easily variable than other inputs and so may be preferred by firms that are operating in a risky environment or which are subject to credit constraints. If political unrest might cut a firm off from its markets, it is less costly to cease purchasing raw materials than to find an alternative use for specific machinery. The trade-off to this is that the lower ratio of capital in the input mix limits firms' scale and their ability to profit in periods when demand is high.

The manufacturing sector, which has been central to almost every successful development experience, cannot achieve sustained increases in output per worker without shifts in technology. It is these increases in output per worker that, in turn, lead to sustainable increases in the incomes of both workers and the owners of capital. African policymakers have some way to go before the conditions for such a sustained shift are in place.



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