Working paper prepared for JICA/IPD Africa Task Force Meeting
Yokohama, Japan, June 2-3, 2013

Introduction:

HOW INDUSTRIAL POLICY CAN HELP AFRICA MEET THE CHALLENGES OF THE 21ST CENTURY

April 2013

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It is a great pleasure for me to share with you my thoughts about strategies and challenges confronting African development at the fifth Tokyo International Conference on African Development (TICAD). I have had a long-standing engagement with TICAD, having attended the second conference in 1998 as World Bank's Chief Economist and having addressed the last two TICAD summits in 2003 and 2008. I have been impressed by the substantive and serious discussion of policy issues facing African policymakers at the level of heads of government.

This reflects the care that the organizers of TICAD take in developing a considered agenda and background work for the summit meeting.[1] The themes chosen for the conference, on boosting economic growth, ensuring human security—including the achievement of the MDGs and Consolidation of Peace—and addressing environmental issues and climate change are, and should be, at the center of concern for African policymakers. This is true both in light of where Africa is today, and the situation of the world economy that Africa is confronting in the wake of the crisis.

I believe that the lessons of East Asia, the remarkable success of this region of the world, have not been fully taken on board within the development agenda. A first step in doing so was of course the project that was sponsored by Japan at the beginning of the 1990s in which I participated. The results, published as a series of background papers for the report, *The East Asian Miracle*,[2] and the literature it spawned, have had enormous influence in rethinking

[1] This year included organizing a meeting with the Initiative for Policy Dialogue at Columbia University, New York in November 2012. Special thanks is extended to JICA for financial support, including support for the IPD task force that led to *Good Growth and Global Governance in Africa*, A. Noman, K. Botchwey, H. Stein, J.E. Stiglitz, eds., New York: Oxford University Press 2012, which discusses issues of industrial development in greater detail.

[2] *The East Asian Miracle: A World Bank Policy Research Report*, Washington, D.C.: The World Bank, 1993.

development strategies, including the eventual abandonment of the flawed structural adjustment policies that predominated in the 1980s.

The 21st century has witnessed an impressive revival of growth in Africa—over 5 percent per annum—in sharp contrast to the lost quarter century under the Washington Consensus reforms. Now is the time to address concerns about the quality of this growth to put Africa on a path of sustained, inclusive rapid growth—growth that is sustainable, not only economically, but politically, socially, and environmentally.

These concerns stem from the fact that in much of Africa, a large part of the accelerated growth has been based on booming commodity prices and extraction of minerals. The decline in the share of manufacturing sector in GDP within Africa that occurred during the lost quarter-century—a share that it is no higher now that it was at the end of the 1970s—is yet to be reversed. The same is true for the share of formal sector employment, which is where decent work (to use the terminology of the International Labor Organization) is to be found. Whilst foreign investment has risen substantially, it has been concentrated in non-renewable natural resources. This has been particularly disappointing, given the substantial improvements in "fundamentals" in so many African countries: they have demonstrated better macro-economic performance and better governance, but they have not been rewarded by foreign investors in the ways that one might have hoped.

I should emphasize, however, that while natural resources have been important in Africa's growth in recent years, growth has gone well beyond that. One of the best performing countries in the sub-continent, Ethiopia, had been growing at 11 percent a year in the 5 years prior to the death of Prime Minister Meles Zenawi, and around 9 percent over 2000-2010. Other examples of non-oil-rich African countries with good growth—around 6 percent or more during the decade—include Rwanda, Tanzania, Ghana and Uganda. By some estimates, only around a quarter to a third of the sub-continent's recent growth is directly attributable to natural resources

There is a second concern that the growth has not been as inclusive as one might have hoped. It is true that there has been a rise in the number of middle-income households (where "middle income" is given a loose interpretation), and the fraction of the population in poverty has declined. The proportion of Africans south of the Sahara who live on US$1.25 a day or less declined from 58 percent in 1990 to 51 percent in 2005, the last year for which the UN published comprehensive data. But the rate of poverty reduction, despite robust GDP growth in some countries, generally lags behind other developing regions: Across developing countries globally, the proportion of people living on less than $1.25 a day fell from 42 percent of the population in 1990 to 25 percent in 2005. But the absolute numbers in poverty have increased. The number of Africans south of the Sahara living on $1.25 a day or less increased from less than 300 million in 1990 to more nearly 400 million in 2005. And the number of working people living on $2 a day or less increased from 190 million in 1999 to 243 million in 2009.[3]

[3] All figures from UNDP MDG report.

Again, against these disappointing results, we need to note the successes: "Many Africans are joining the ranks of the world's consumers. In 2000, roughly 59 million households on the continent had $5,000 or more in income—above which they start spending roughly half of it on nonfood items. By 2014, the number of such households could reach 106 million. Africa already has more middle-class households (defined as those with incomes of $20,000 or above) than India. Africa's rising consumption will create more demand for local products, sparking a cycle of increasing domestic growth."[4]

With so many of the poor still living in the rural sector and dependent on agriculture (a situation that is likely to continue for several decades to come), inclusive growth will require increases in agriculture productivity. But results have been disappointing. While countries like India, China, and the United States increased their productivity by a factor of two, four, or more since the 1960s, African yields per hectare have hardly nudged upwards. This is not a surprise given the low levels of investment. The level of irrigation remains far below that of Asia: only 4 percent of arable and permanent cropland, compared with 39 percent in South Asia and 29 percent in East Asia. Fertilizer use of 13 kilograms per hectare in Africa contrasts with 90 kilograms in South Asia and 190 kilograms in East Asia.[5] Africa is still to benefit from a "green revolution."

But underinvestment in agriculture is not the only reason for the poor performance of the sector. Another reason is that the policy framework has been flawed: fertilizer subsidies, it is now recognized, may be an effective way of raising living standards. A third is that the agriculture subsidies of the North have a particularly adverse effect on Africa. A fourth is global warming, which again is having a particularly adverse effect on the region. A fifth is the population explosion. The combination of increasing population and declining land fertility has meant that Africa has gone from a land-abundant region to one in which substantial parts are becoming land-scarce. Systems of agriculture production and land tenure which may have worked well in the past, in a time of land abundance, won't work well in an era of land scarcity. But these systems have unfortunately not changed, or at least not changed as much as they should. Africa will have to learn to manage its land better. However, changing institutional arrangements is not easy. And such changes often take time. But there can be large costs associated with such delays.

There are a number of other challenges facing Africa today, which I briefly note. Some of these are two-sided. In the case of others, there are significant down-side risks.

a) *Demography:* The rapid growth of the population in the region, though slowing, still stands in sharp contrast to the low growth, or decline in other areas. Countries with a young population often exhibit more dynamism, more energy, than those marked by an aging population. But Africa will have to find jobs for these young people. This will

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[4] McKinsey Global Institute, *Lions on the Move: The Progress and Potential of African Economies*, 2010; see also footnote 4 for household income data.

[5] See J.E. Stiglitz and A. Noman, 2012, "Strategies for African Development," in *Good Growth and Governance in Africa: Rethinking Development Strategies,* A. Noman, K. Botchwey, H. Stein, and J.E. Stiglitz (eds.), p. 8.

require heavy investments. It will have to educate these young people. This too will place large demands on government budgets. If Africa fails in these tasks, there may be discontent and political, social, and economic turmoil. In some countries, the unemployment rate is unacceptably high. Markets have not been working in the way they should to ensure that everyone who would like work can get it. Young people who have done everything that they should—studied hard and succeeded—cannot get jobs, or at least jobs for which their education trained them. They feel the system has failed them.

b) There are similarly large challenges in ensuring that this burgeoning population receives adequate, or in many cases, just minimal health care. In some countries, the scourge of AIDS remains a threat.

c) Climate change/global warming is likely to have a more adverse effect on the countries of Africa than elsewhere in the world.

d) Africa, like everywhere else in the world, will suffer from the poor performance in so many of the advanced industrial countries: exports will be less than they otherwise would have been.

e) The global financial system has not worked well in recent years. Flows of funds have been erratic, and even if risk premia now seem to have declined, there is always the worry of a sudden reversal, a sudden increase in risk premia or a decline in the flow of funds.

f) Little has come of the *development round* of trade negotiations, initiated in Doha in November 2001. At the time negotiations were stalled, the agreement on the table arguably would have been of little benefit to Africa; many thought that it would make many African countries worse off. Meanwhile, bilateral ("partnership") agreements have proliferated, and many of these are even more unbalanced, and in particular, reduce access to life-saving medicines.

g) Inequality is a problem in most countries around the world, but the problem in some countries and regions is worse than in others.[6] Some of the African countries have among the highest levels of inequality in the world.

h) Throughout the region, there is a significant infrastructure deficit, and the absence of infrastructure is an impediment to trade and to regional integration.

i) Africa will be urbanizing rapidly in coming years—it has already been happening. But that too will require large investments in infrastructure. There needs, for instance, to be

[6] For a more extensive discussion of the causes and consequences of inequality, see J. E. Stiglitz, *The Price of Inequality*, New York: WW Norton, 2012.

good public transportation systems, water and sewage systems, housing, and public parks. It will be important that these investments be made early, and that there be more planning to the design and expansion of these cities. Without this, there is a risk that cities will evolve in ways that will lower standards of living and endanger the environment. We need to be sure to create livable cities.

THE GLOBAL ECONOMIC CRISIS AND THE RETHINKING OF POLICY FRAMEWORKS

The global financial crisis has led to a broad re-examination of the policy frameworks that had become conventional wisdom before the crisis. Indeed, it has even led to a re-examination of the role of the state. The state had, of course, to intervene intensively to moderate the impact of the financial crisis that broke out in 2008 and prevent a disaster on the scale of the Great Depression of the 1930s or worse.

That crisis reflected the poor "quality" of the growth experienced by rich countries in the financial and related booms. Growth was based on debt, and the growth was not inclusive. Those at the top took most of the gains. Those at the bottom, and even middle, saw their incomes stagnate or decline.

The immediate cause of the crisis was the breaking of the bubble.[7] The creation of the bubble (in the US, and in several European countries) was associated with uncontrolled financial liberalization. This is a familiar story—the East Asia crisis too was associated with capital and financial market liberalization. Yet, the world was slow to learn the lessons from these and other experiences.

Thus improving the quality and inclusiveness of growth is as much an imperative for the US and other rich countries as it is for Africa, though what that entails differs in important respects. But there are some lessons for all to learn: unbridled and under-regulated markets, especially in finance, are to be avoided.

There is a more general lesson: There are many different forms of capitalism and different forms of a market economy. The version sold to Africa under the Washington Consensus reforms—a version that retains a lingering influence in some quarters—is based on a particular interpretation of a particular form: the Anglo-Saxon one, particularly as purportedly practiced in the US. A closer look shows, however, that even in the United States, government plays a major role in the economy. This role has been pivotal in the creation of some of its most dynamic sectors, including the internet (hi-tech) and bio-tech.

The East Asia miracle showed that development was possible—growth, widely shared, that was beyond the level that had ever occurred before. And behind that development was the *development state*, a government committed to the development of its countries.

[7] For a fuller discussion of the crisis and what gave rise to it, see J. E. Stiglitz, *Freefall*, New York: WW Norton, 2010.

An important set of instruments for promoting development are those that fall under the rubric of industrial policies—a term that was not deemed worthy of mention in polite company when I arrived at the World Bank. Now the notion of industrial policy is much more widely accepted—even in developed countries as they try to deal with the great recession, dramatically and effectively practiced, for example in the rescue of the US automobile industry. Showing how industrial policies could facilitate the structural transformation of economies was one of the main concerns of the previous chief economist of the World Bank, Justin Lin. There is also growing concern with such transformation in Africa both amongst governments, such as those of Ethiopia and Rwanda, and civil society as reflected in the think-tank African Center for Economic Transformation (ACET), established some five years ago by K.Y. Amoako.

The increases in living standards that have marked the more advanced countries center around "learning," the increases in productivity associated with technological progress and a more educated labor force. My colleague Bruce Greenwald and I have just completed a book on *Creating a Learning Society: A New Paradigm for Development and Social Progress.*[8] It emphasizes the importance of learning, and the role of government in creating a learning society, and explains why Washington Consensus policies were counterproductive in creating a learning society—and thus in creating an economy with high quality sustained growth.

For Africa, industrial policies will need to have a broader focus than such policies have sometimes had in the past. They will have to focus, for instance, in ensuring the adoption of technologies that are environmentally sensitive. They need to address the other challenges facing the continent—promoting inclusive growth with high levels of employment, creating a learning society, creating livable cities, improving agricultural productivity, including reforming, and land tenure systems, where appropriate. In the West, innovations and investment have focused on saving labor. The growing problems of unemployment around the world, and the evident shortage of jobs, combined with the risks to our environment, imply that innovation and investment needs to be focused on protecting the environment and creating jobs.

Of course, unwittingly, every country—even those that have seemingly been critical of industrial policies—have practiced them. Every law, every public investment decision, indeed, almost every public decision, has some effect on the economy and its structure, some more than others. Building ports enables exports; not doing so "structures" the economy against trade. America's bankruptcy laws gave first priority to derivatives, thus encouraging this risky part of the financial sector.

Critics of the relevance of the development state and industrial policies for Africa sometimes argue that many of the countries in the region don't have the institutional capacity. But this misses two key points. When many of the Asian countries began their development trajectories, their states too were underdeveloped. They developed these capacities. The full-fledged development state does not arrive like manna from heaven overnight; it has to be

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[8] To be published by Columbia University Press.

constructed and along the way there is a continuum of "developmentalist" states with varying capacities.

Indeed, in most of these countries, market institutions too are underdeveloped. The two need to be developed together, in tandem. Each can help the other—and each can serve as a check against the abuses of the other.

To the extent that there are limits in market and state institutions, these limitations should affect the *manner* in which the developmentist state pursues its objectives. The policy framework that works well at one level of development might not work well at another. But it should be clear that the state has an important role to play in promoting growth at *every* level of development. And how to strengthen state capabilities should receive no less attention than how to make markets work better.

CONCLUDING COMMENTS

I want to conclude with six general remarks about changing perspectives on growth and on-going changes in the world. The first is perhaps obvious: instability is bad for sustained inclusive growth. But if that is so, it means that we need to focus on policies that lead to stability. Here, the IMF's recent decision to re-examine the role of capital controls is on target. Unfettered capital flows, especially of the short-term variety, can be, and often are destabilizing

The second is the link between instability and inequality. It is not only that instability leads to more inequality, but inequality leads to instability. This is one of the important points raised in my book the *Price of Inequality*. Our society, our economy, our democracies pay a high price for inequality. And one of the prices we pay is high instability. This is a result that has been again confirmed and emphasized by the IMF.

Thirdly, for more than a decade[9], we have been aware that what separates developed and less developed countries is not just a gap in resources, but a gap in knowledge. There are knowledge gaps not only between developed and less developed countries but amongst the developing countries. Conferences like this can do a great deal to close these knowledge gaps.

Fourthly, while knowledge gaps are important, so too are resource gaps. The developed countries as a whole have not lived up to the commitments on aid that they have repeatedly made. That is why I have been so enthusiastic about the recent announcement of the BRICS Development Bank, a South-South collaboration to enhance the funding available, especially for critically needed investment in the developing countries.

While the developed countries have not lived up to the commitments they made concerning aid, neither have they lived up to the commitments that they have made on trade: They have largely reneged on their agreements to restructure the global trade regime to make it more pro-development. On the contrary, much of what has happened subsequently has moved in the opposite direction, with bilateral and so-called partnership agreements reflecting the

[9] Especially since the World Bank's World Development Report of 1998, *Knowledge for Development.*

imbalances of economic and political power fragmenting the global trade regime. With further agreements currently being discussed, I hope that any such agreements will be pro-development, will focus on trade creation rather than trade diversion. The latter could mean that the poorest region of the world could become even poorer. There is a need for Western governments to move ahead with the Aid for Trade agenda, and to recognize the *right to development* within the global trade regime.[10]

Fifthly, the BRICS bank to which I alluded to earlier is but one reflection of fundamental changes that are occurring in the geo-political and geo-economic balance of power, especially after the global financial crisis. The income of the BRICS is now larger than that of the developed countries not long ago, at the time of the founding of the Bretton Woods Institutions. Rising incomes in Asia have helped fuel Africa's growth. But rising wages there will also mean marked changes in comparative advantages. This represents a unique opportunity for this continent. Much of manufacturing will be moving out of the countries in which it has been located. There is an open question about where it will move. This is where the industrial policies—focusing on learning—to which I referred earlier become critical.

Finally, we need to be aware of the deficiencies in GDP as a measure of success. As I emphasized in the beginning of these remarks, we want sustainable, equitable growth. I chaired an international Commission on the Measurement of Economic Performance and Social Progress.[11] The Commission was unanimous in its view that GDP was *not* a good measure of success, and relying on it could be highly misleading. This is especially true for countries with high levels of inequality, where there are high levels of foreign investment (so GNP, the income of the citizens of the country, could different markedly from GDP, the output produced within the country), and/or whether there are problems of resource depletion and environmental degradation. But one or more of these problems arise in most African countries.

The challenges facing Africa are daunting. But so are the opportunities. The successes of recent years cannot but make us optimistic. TICAD provides a wonderful opportunity for countries to learn from each other on how best to tackle these challenges, in ways which ensures sustainable and inclusive growth.

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[10] See Andrew Charlton and J. E. Stiglitz, 2006, "Aid for Trade," with Andrew Charlton, *International Journal of Development Issues*, 5(2), pp. 1-41 (reprint of paper prepared for Commonwealth Secretariat); and 2013, "The Right to Trade," with Andrew Charlton, a report for the Commonwealth Secretariat on Aid for Trade.

[11] The commission's report was released in 2009 and published as *Mismeasuring Our Lives: Why GDP Doesn't Add Up*, J.E. Stiglitz, A. Sen, and J.P Fitoussi (eds.), New York: The New Press, 2010.