

Industrial policies and economic development

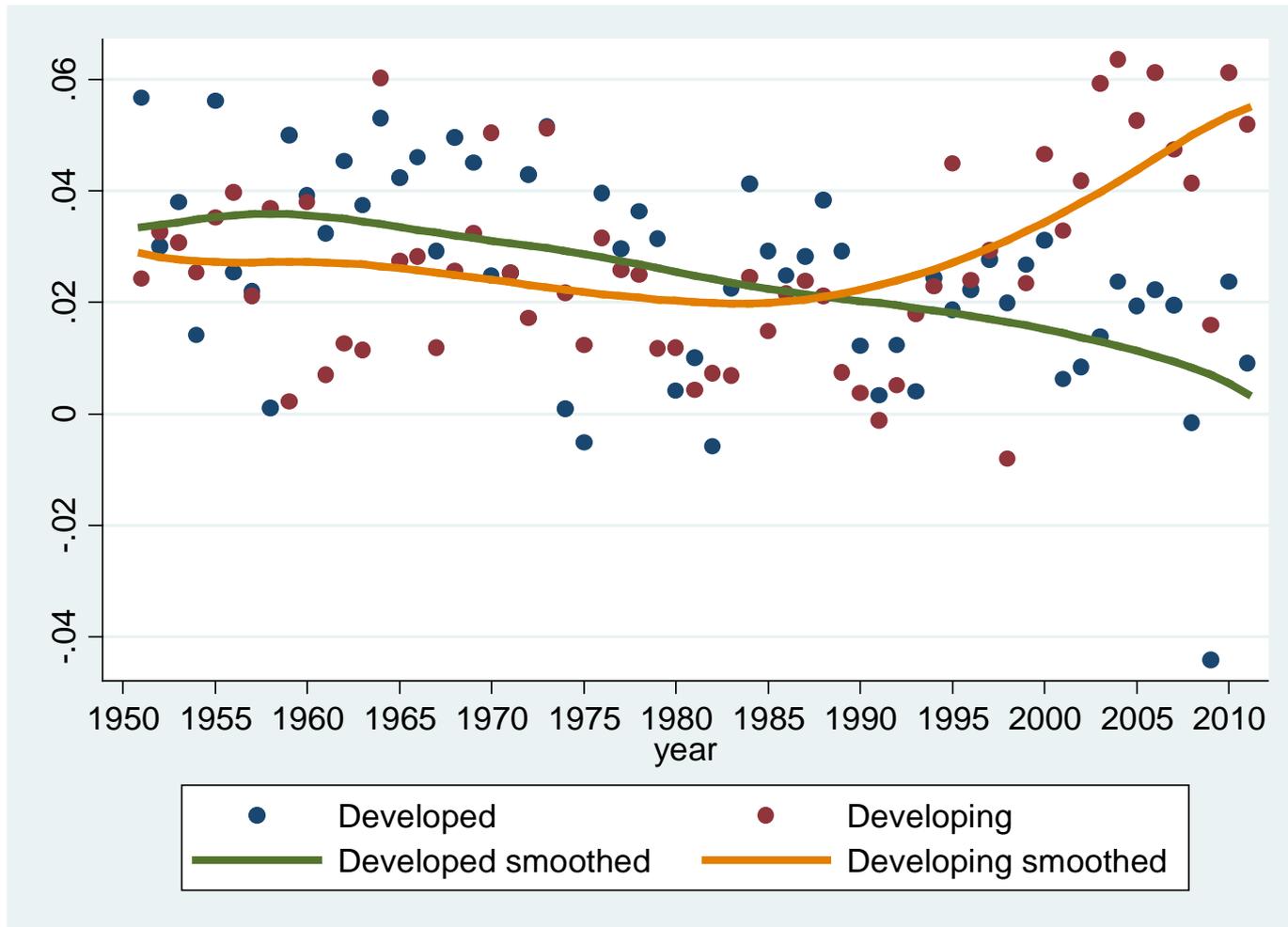
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A roadmap

- Recent experience with growth
- An interpretation: structural change
- The “new” industrial policy
- What industrial policy cannot do

A remarkable reversal in fortunes since 1990s



Growth trends in developed and developing countries, 1950-2011

Two interpretations

- Orthodox view: economic growth is conditional on “good fundamentals”
 - defined in practice in terms of policies such as openness, deregulation, privatization, protection of property rights, contract enforcement, low inflation and budget deficits, ...
- Structuralist view: economic growth is conditional on rapid structural change
 - which requires policies that stimulate employment in modern industries (manufacturing and tradable services), including industrial policies and competitive currencies

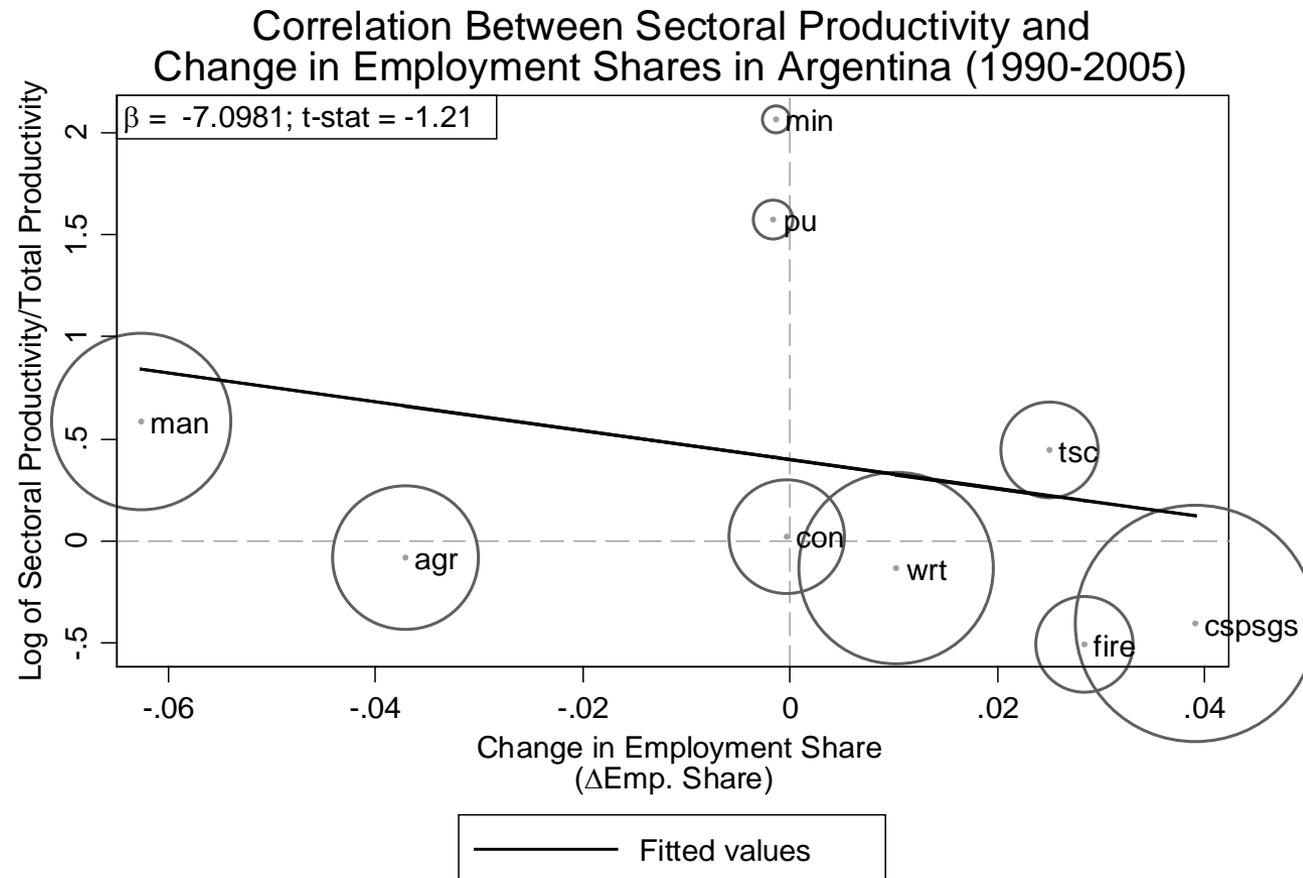
While there is overlap between the two sets of policies, there are also tensions and differing priorities.

How structural change contributes (or not) to economic growth

Three examples

- Argentina
- Thailand
- Hong Kong

Growth-reducing structural change: Argentina

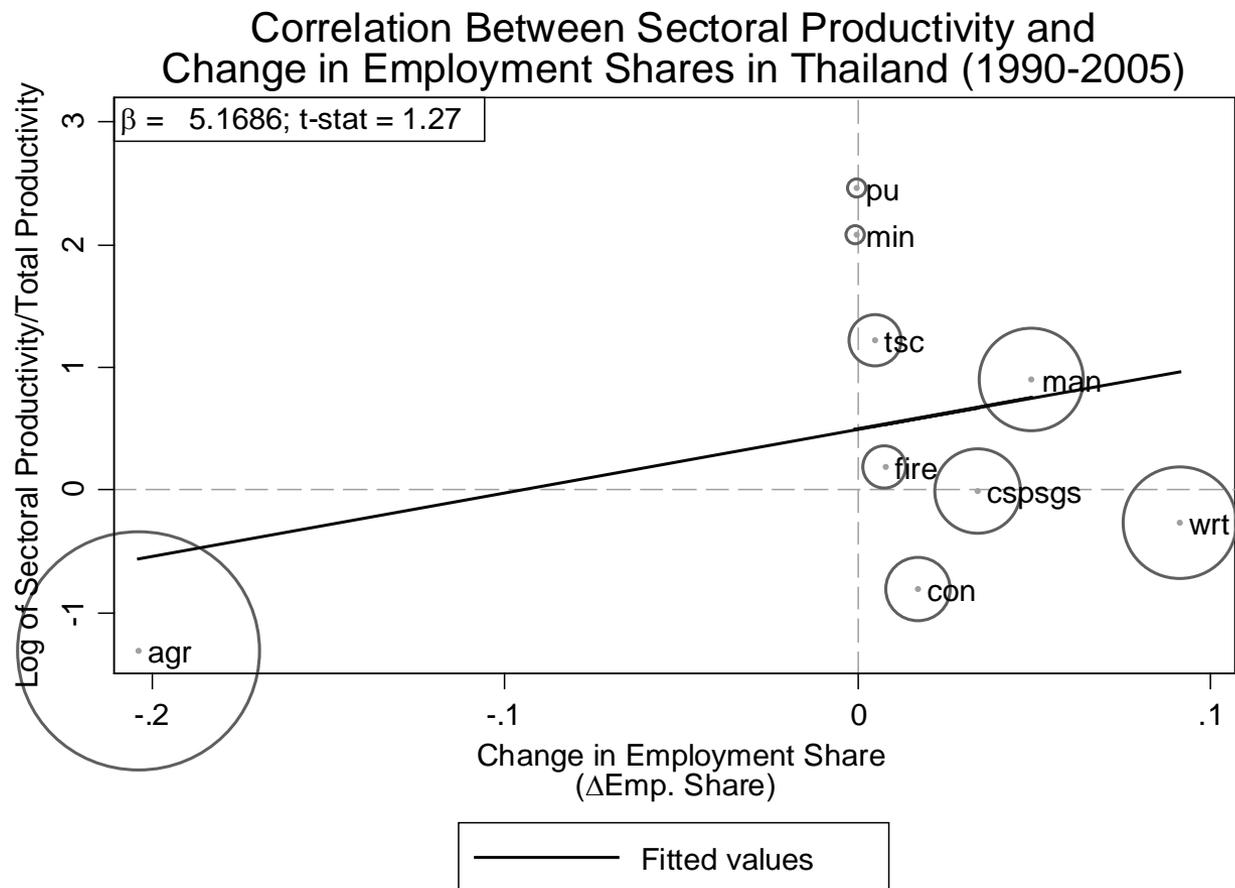


*Note: Size of circle represents employment share in 1990

**Note: β denotes coeff. of independent variable in regression equation:
 $\ln(p/P) = \alpha + \beta \Delta$ Emp. Share

Source: Authors' calculations with data from Timmer and de Vries (2009)

Growth-increasing structural change: Thailand



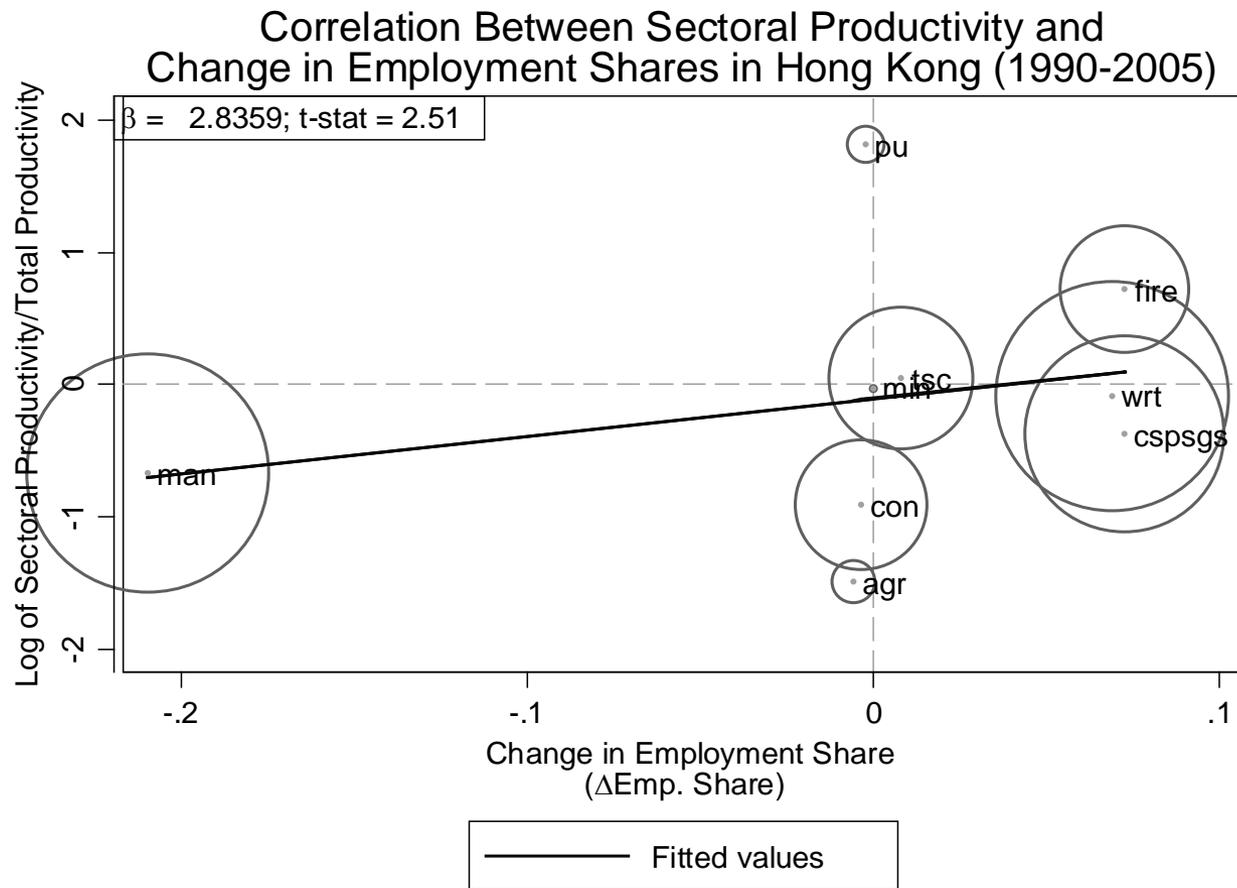
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Growth-increasing structural change: Hong Kong



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Structural transformation is impeded by both market failures and government failures

- Government failures

- generic

- poor labor laws, inadequate property rights, lack of contract enforcement, red tape, corruption, macro instability, high taxes, ...

- sectoral/micro

- specific regulations and taxes; lack of specific public inputs

- Market failures

- Demonstration effects and learning spillovers from introduction of new products or new technologies (“cost discovery”)
 - Coordination and agglomeration externalities (e.g., clusters...)

“Orthodox” development policy

- Government failures

- generic

- poor labor laws, inadequate property rights, lack of contract enforcement, red tape, corruption, macro instability, high taxes, ...

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... poor outcomes in Latin America since 1990

The new industrial policy

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... is about removing bottlenecks to new economic activities, whether due to market or government failures

The ambiguous case for IP (in practice)

Insurmountable obstacles to the practice of IP?

- Lack of information
 - can governments identify the relevant firms, sectors, markets subject to those market imperfections or the needed need public inputs?
- Political capture
 - can governments withstand lobbying and rent-seeking to prevent IP from becoming an instrument of rent transfer to incumbents?

Empirical evidence mixed and hard to interpret

- Successful examples plenty from East Asia to Brazil to Chile
- But also plenty of white elephants

The debate on IP revolves not around its theoretical merits, but around sharply conflicting views regarding the relative importance and pervasiveness of these obstacles

- “Look at how difficult it all is...”
- “But look at countries in East Asia who have done it ...”

Where does this leave us?

- It is recognized that policy can be exploited by powerful insiders and overwhelmed by informational asymmetries in all areas of government action
- But policy discussions typically focus not on *whether* the government should do it, but on *how*
 - debate on what works and under what conditions
- We need to approach IP in the same manner
 - look at it as an important government function, that can be carried out better or worse

Institutional design for industrial policy

Must be built on three ideas, each of which leads to a different “design principle”:

1. The requisite knowledge about the existence and location of the spillovers, market failures, and constraints that block structural change are diffused widely within society
=> “embeddedness”
2. Businesses have strong incentives to “game” the government
=> carrots and sticks, discipline
3. The intended beneficiary of IP is neither bureaucrats nor business, but society at large
=> accountability

A pragmatic approach to IP

- High-degree of engagement by a political principal
 - Plus, an environment that empowers underlings
- Willingness to experiment, try heterodox solutions
 - Problem-driven, rather than “best-practice” driven
 - Rents can be useful incentive device (carrot)
- Feedback loops
 - Technical: monitoring, evaluation, discipline (stick)
 - Political-bureaucratic: accountability
- Thinking of IP as a process of collaboration with private sector
 - rather than set of incentives and priority sectors

What industrial policy cannot do

- Substitute for the lack of basic “fundamentals”
 - human capital
 - proper institutions
- Compensate for macro imbalances
 - fiscal unsustainability
 - large external deficits
 - across-the-board uncompetitiveness due to high prices/overvalued currency