

MODERN INDUSTRIAL POLICY

An Introduction

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Industrial Development

- Historically, rapid growth is associated with the expansion of industrial activities -manufacturing (**Kaldor's first law**)
- There is a strong positive relationship between the growth of manufacturing production and the growth of manufacturing productivity (**Kaldor's second law**)
- The faster the rate at which labor moves from traditional agriculture and low-productivity informal activities to the modern sector, the more rapid the rate of economic growth (**Kaldor's third law**)

Questions

But how do countries industrialize?

Is it a process of factor accumulation as in the neoclassical growth model?

Is it the result of exploiting a country's comparative advantage?

Is there room for government intervention?

Stylized facts about development (cont...)

- Structural change is policy induced (comparative advantage is manufactured) and requires strategic thinking
- Some specialization patterns are more conducive than others in promoting industrial upgrading
- Countries have to make decisions...you are "doomed to choose"
- The key is to make these decisions with sound information
- Close private-public sector coordination is key to the development of strategic intervention

Industrial Policy: The Market vs. Planning

- Industrial Policies: Any type of **selective intervention** or government policy that attempts to alter the sectoral structure of production toward sectors that are expected to offer better prospects for economic growth than would occur in the absence of such intervention.
- Do they complement or distort market forces (rent seeking)?
- Chang: Historically, all major developed economies used some form of industrial policy and/or infant protection to develop their industrial sector
 - Why do many people recommend the opposite now to developing countries?

Industrial Policy: The Market vs. Planning

Standard Rationale for IP

Pervasive role of market failures that result in the under-provision of entrepreneurship in pursuit of structural change

There is room for government intervention either when markets are characterized by some distortions (e.g., externalities –benefits generated by some agents rendered free to others; market power) or because they are incomplete (e.g., futures markets do not exist)

In the presence of market failures a competitive market system does not yield a socially efficient outcome

Industrial Policy: The Market vs. Planning

Standard Rationale for IP

- The presence of technological externalities, knowledge spillovers and dynamic scale economies
- But there are two other key market failures:
 - Information externalities associated to the discovery of the cost structure of new activities –subsidize investments in new, non-traditional activities
 - Coordination externalities in the presence of scale economies –they do not require subsidization
 - Cluster approach
 - Private sector can achieve coordination

Industrial Policy: The Market vs. Planning

Private-Public Sector Collaboration

- Developing countries need to embed private initiative in a framework of public action that encourages restructuring, diversification and technological dynamism beyond what market forces on their own would generate
- The key is strategic collaboration between private sector and government with the aim of uncovering where the most significant obstacles to restructuring lie and what type of interventions are most likely to remove them
- NOT about “picking winners” !! This is irrelevant
- ST will not happen naturally as a result of comparative advantage

Basic principles of the New Industrial Policy

Elements of an Institutional Architecture

- Place political leadership at the top
- Set up coordination and deliberation councils
- Set up mechanisms of transparency and accountability

Basic principles of the New Industrial Policy

Design Principles for Industrial Policy

- Incentives provided only to “new” activities
- Clear benchmarks for success and failure
- Built-in sunset clause
- Public support must target activities, not sectors
- Subsidize activities with clear potential for spillovers and demonstration effects
- Implementation handled by agencies with demonstrated competence
- Monitoring by principal stakeholder who has political authority at the highest level

Basic principles of the New Industrial Policy (Rodrik 2004)

Design Principles for Industrial Policy (cont..)

- Close communication with the private sector
- Optimally, mistakes that result in “picking the losers” will occur
- Promotion activities need to have the capacity to renew themselves to ensure an on-going cycle of discovery

Industrial Policy: The Market vs. Planning

Dissenting opinions on IP

- Pack and Saggi: Public interventions have played a small role in recent industrial successes – Little empirical support for an activist government policy, even though market failures exist
- Easterly: Against planning; Planners should go to hell; No top-down central planner has enough information; Interpretation of the East Asian Miracle as a result of the workings of the market

What does WTO say about industrialization policies?

- WTO prohibits export subsidies
- But WTO is flexible and allows countries to promote their industries under the banner of promoting science and technology
- WTO offers opportunities for countries to promote their manufacturing sectors
- Developing countries should be aware of the “reciprocal control mechanisms” (i.e., monitorable performance standards and results-oriented performance standards) used by the successful industrializers

IP in Korea

- 5-year economic development plans started in 1962: (i) 5-year Economic Development Plans; (ii) Monthly Meetings (Presided by the President)
- Export success was the single criterion of performance
- Discussions focusing on changing IP started in 1978 (e.g., eliminating picking the winners)
- In 1986, the Industry Promotion Act was passed. It replaced 7 sector-specific promotion acts
- Collective consensus; trial and error; public-private partnership; coherence

Thank you