



# *Industrial Policy in the 21<sup>st</sup> Century: Are There Lessons from East Asia?*

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# Why Industrial Policy?

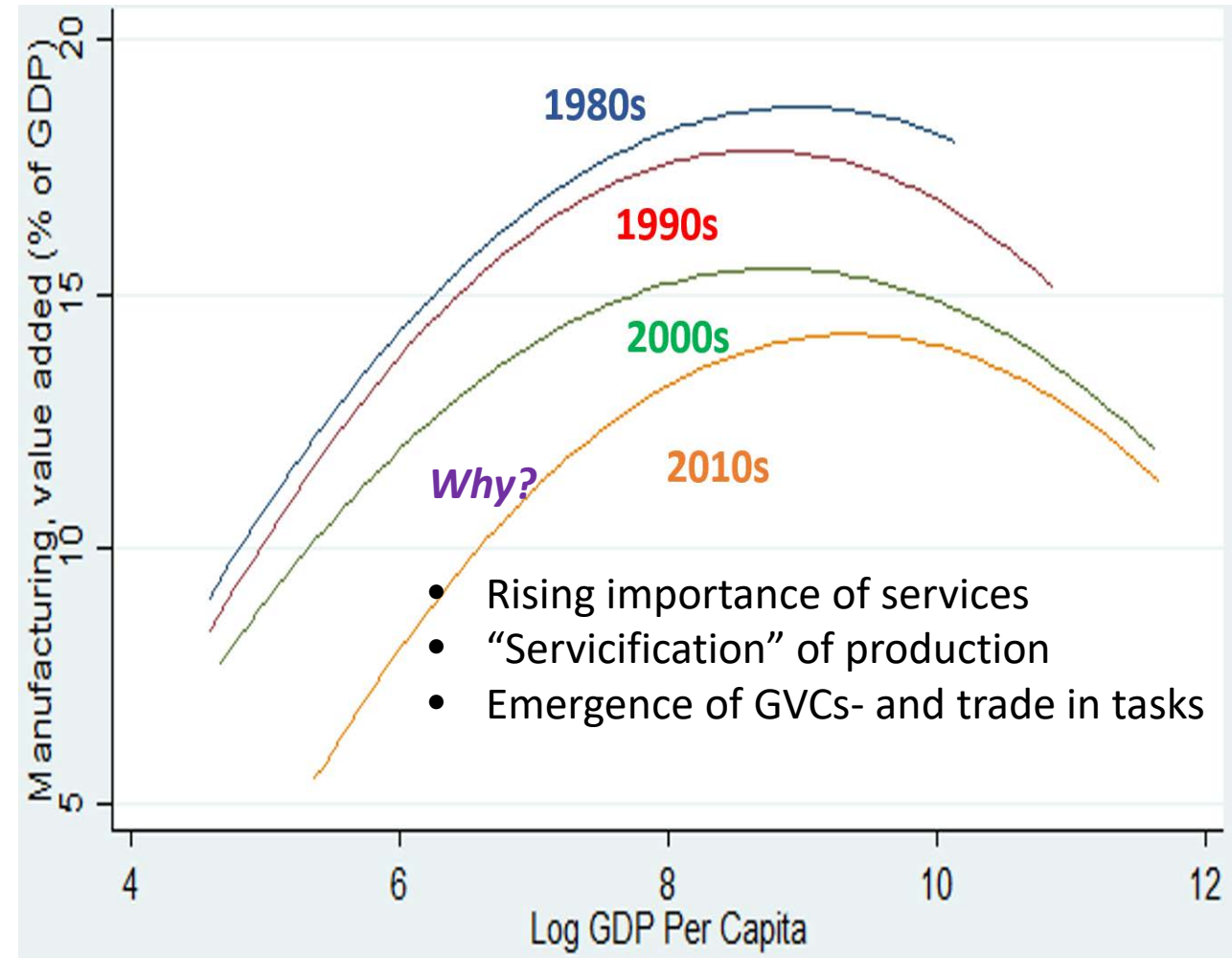
## The Market Place May Not Be Magical

- Market imperfections largely define what it means to be underdeveloped
  - Incomplete or imperfect markets (finance)
  - Incomplete information (labor markets)
  - Coordination failures (agglomerations)
  - Externalities (learning)
- Structural change is characterized by many of the market shortcomings listed above.
- Industrial policies are designed to stimulate specific economic activities and promote structural change (Lin; Rodrik; Stiglitz)

# A Changing Global Economy is Changing Our View of Industry

- Manufacturing as share of GDP is falling *at all levels of per capita income*
- Technology and falling transport costs have created many new activities that share characteristics of traditional manufacturing...
- For example...
  - Horticulture and agro-processing
  - Tourism
  - Tradable services, such as Information and communication activities
  - Transit trade and transportation

Manufacturing as share of GDP on average declines over four decades



# Structural Change: It's Not Just Manufacturing Anymore

- Patterns of structural change in contemporary low income countries may differ substantially from historical experience.
- Global changes and Africa's resource endowments suggest that many globally competitive activities will be "industries without smokestacks."
- The 21<sup>st</sup> Century challenge for policy makers is to promote the growth of high productivity sectors capable of absorbing large numbers of moderately skilled workers, wherever they appear in the economic statistics.

# Industrial Policy in the 21<sup>st</sup> Century

- Because “industries without smokestacks” share many firm characteristics with smokestack industries, they also respond to broadly similar policies
- Market imperfections mean that the social returns in growth-promoting investments exceed private returns
  - A (neo)classic case for public action
- Externalities and coordination failures call for a coherent strategy of public action
  - Put differently, a strategy for structural change
- Some elements of East Asia’s industrial transformation can guide such a strategy

# Four Drivers of Productivity and Location

- The “basics” (AKA: the “Investment Climate”)
    - Infrastructure and skills
    - Institutions and regulation
  - Exports
    - Firms in low income countries increase their productivity by exporting
  - Firm capabilities
    - The tacit knowledge and working practices that affect both productivity and quality
  - Agglomerations
    - Industrial clusters confer significant productivity gains
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- The East Asian experience shows that these four elements are interdependent and mutually reinforcing

# New Directions for Industrial Policy: Lessons from East Asia

## Mounting an “Export Push”

- High social returns but high private costs of entry
- Entering global markets needs an “East Asian style” export push
  - Broad ownership and effective institutions (leadership from the top)
  - Trade related infrastructure and trade logistics
- Support for regional institutions and infrastructure in Africa
- Sustaining an open trading system and rationalizing preferences

# New Directions for Industrial Policy: Lessons from East Asia

## Building Firm Capabilities

- An export push is a major source of capabilities
  - Demanding buyers; repeated relationships
- FDI is another
  - Build effective FDI agencies
- Strengthen domestic value chain relationships
- New approaches to management training



# New Directions for Industrial Policy: Lessons from East Asia

## Creating Clusters

- Agglomeration economies create a collective action problem
- SEZs are a means of creating clusters
  - Bring Africa's SEZs up to world class
- Strengthen the links between firms in the SEZ and domestic suppliers/purchasers
  - "Open architecture" in SEZs and better integration with urban planning

# The Practice of Industrial Policy

- Knowledge about the existence and location of the spillovers, market failures, and constraints that block structural change is diffused widely within society.
  - To make effective industrial policy governments must engage the private sector
- Implementing industrial policy needs “close coordination” with the private sector to identify constraints, shape policies and monitor results
- Businesses have strong incentives to “game” the government
  - This can result in capture.

# Coordination through an East Asian Lens

- Balancing between engagement and capture is the central challenge of the practice of industrial policy
- Coordination mechanisms used by the high performing Asian economies (from Japan to Vietnam) provide some guidance.
- Four elements of success:
  - A high level of commitment of senior government officials to the coordination agenda
  - Sharply focusing policy decisions and actions on specific constraints to firm performance
  - A striking willingness to experiment (public policy as pharmacology)
  - Careful attention to feedback

# Accountability is Essential

- Good policy requires accepting a certain failure rate
  - East Asian countries were well known for relying on both incentives and discipline (carrots and sticks)
- But who judges success and how do you build the capacity to let the losers go?
  - East Asia has been less successful in enforcing accountability
- Conditionality, sunset clauses, built-in program reviews, monitoring, benchmarking, and periodic evaluation should be features of all incentive programs.

# Concluding thoughts

- The global economy and changing technology offer new possibilities for structural change.
- Industrial policy in the 21<sup>st</sup> Century must adapt to these changing opportunities by taking a wider view of industry.
- The practice of industrial policy depends fundamentally on engaging the private sector.

