

# **AFTER THE CRISIS: INDUSTRIAL POLICY & DEVELOPMENTAL STATE**

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March 2010

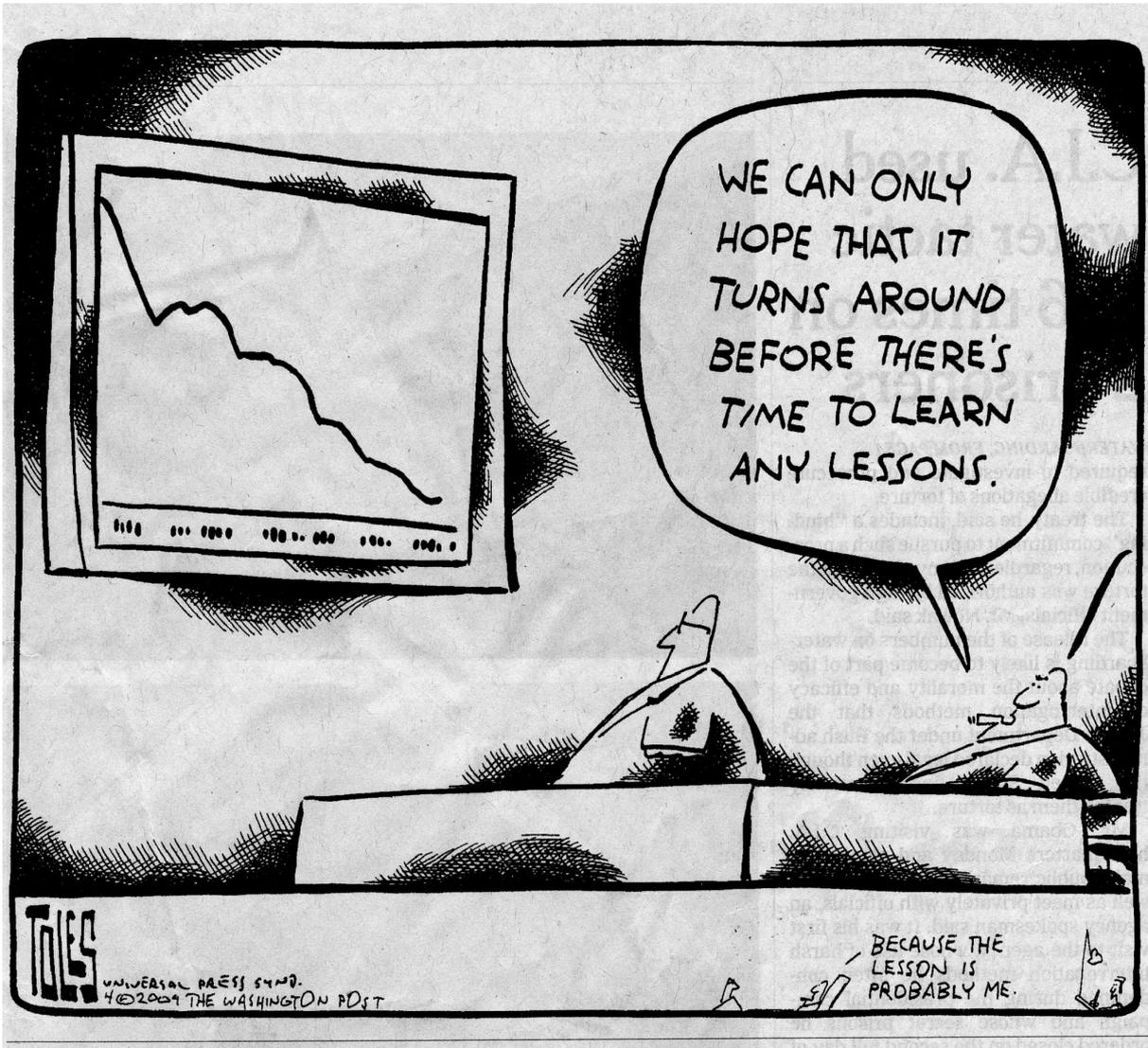
# Starting point

- Great Recession has induced some skepticism of western mainstream policy prescriptions for “more market and less state”, which have steered economic policy in western states and international organizations for past 30 years.
- The new skepticism, or new ambiguity, opens the way to reconsideration of role of state in development, including as steerer of industrial development (& not just as umpire).
- There are signs of some rethinking in World Bank & IMF.

“Stop! Wait! Government’s no longer the problem – it’s the solution!”



*“Stop! Wait! Government’s no longer the problem—it’s the solution!”*



BECAUSE THE LESSON IS PROBABLY ME.

TOLES

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# Outline

- (1) The content of mainstream principles & prescriptions
- (2) Challenges to the mainstream approach
- (3) New-old thinking about role of the state
- (4) Types of industrial policy
- (5) Functions & organization of a developmental state
- (6) New thinking in international organizations

# Content of mainstream principles

- “A nation that opens its economy and keeps government’s role to a minimum invariably experiences more rapid economic growth and rising incomes.”  
(consensus at World Economic Forum, 2002, *New York Times*, 9 Feb, 2002, p.1).
- ‘Adam Smith was right when he said that “Little else is required to carry a state to the highest degree of opulence from the lowest barbarism but peace, easy taxes and a tolerable administration of justice”’. (Gregory Mankiw, *Wall Street Journal*, 3 January 2006)

# Content of mainstream principles (contd)

- “[R]estrictions to market access for foreign investment should only apply to exceptional cases where national security is at stake”. (G8 communique, June 2007)
- “Free market theory, mathematical models and hostility to government regulation still reign in most economics departments at colleges and universities... The belief that people make rational decisions and the market automatically responds to them still prevails.... Graduate students who stray too far from the dominant theory and methods seriously reduce their chances of getting an academic job”. (Patricia Cohen, New York Times, 4 Mar 2009) [Also, a job in World Bank/IMF.]

# Role of state in mainstream view

- Ensure macroeconomic stability, esp. price stability.
- Liberalize trade
- Improve institutions: property rights; generic business environment.
- How to assess business envt? *WB Doing Business*, World Econ Forum competitiveness reports
- World Bank's Country Policy & Institutional Assessment formula (CPIA)

# Role of industrial policy in mainstream view

- Industrial policy = policies which affect industrial performance through *microeconomic* variables (eg relative prices)
- Mainstream view says states should not have vertical or sectoral IP; at most, horizontal or generic or sector-neutral IP (eg support for SMEs, R&D).
- **Default role of state:** no IP, only macrostabilization + trade liberalization + “institutions”.
- **Assumption:** Optimum industrial upgrading & changes in production structure will occur “automatically” if government gets prices & institutions right (= the default role).

# Empirical challenges to mainstream view

- Much evidence runs against the mainstream view, but contrary evidence has tended to be ignored over past 30 years
- Example: mainstream portrays world economy as “open system”, with ample opportunity for countries to move up income hierarchy.
- Evidence on country income mobility?

# STATE MOBILITY MATRIX

<b>1978-2000</b>					
Rich	<b>82</b>	12	6	0	100 (34)
Contenders	13	<b>6</b>	69	13	100 (16)
Third World	3	6	<b>28</b>	64	100 (36)
Fourth World	0	0	5	<b>95</b>	100 (44)

# Empirical challenges to mainstream

- “Contender” countries **fell** in number b/w 78-2000
- **Malaysia**, stuck in “middle-technology trap”. Malaysia’s “technological capabilities are relatively static (& may even be declining) and ... industrial competitiveness is marking time” (Yusuf & Nabeshima, World Bank, 2009)
- Lack of upward mobility of “contender” countries is bad news for low-income countries. They have no smooth path into higher value-added activities.

# New-old thinking about role of state

- Global financial crisis has shaken confidence in “free market” model
- Opens the way for other arguments to be considered
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# Key ideas of new-old approach

- (1) Successful cases of development in second half 20<sup>th</sup> century: govts focused on changing production structure & upgrading industry (not just ON “making mrkts work”).
- (2) Growth is a process full of uncertainty about what might work, therefore a process of self-discovery of cost structures & mkt opportunities, difficult to predict in advance, path-dependent.
- (3) Evolutionary economics, institutional economics better than neoclassical economics (Schumpeter, Nelson & Winter). But marginalized in universities.

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# Key ideas: industrial policy

- (4) IP shd be focused on creating a process of “search networks”, public-private forums to identify constraints & opportunities.
- (5) Focusing on improving “business envt” too generic. Ignores fact that constraints to growth of particular sectors may be very specific.
- Hence need **vertical or sectoral IP**.
- Cf *EU industrial policy* (2005): IP must be horizontal/generic, not sectoral, which wld be “a return to [bad] interventionist policies”; but also, “for IP to be effective, account needs to be taken of the specific context of individual sectors” (p3).

# Industrial policy in capitalist E. Asia

- SK, Taiwan, S'pore – active industrial & technology policies during fast-growth phase. Focused not mainly on “making markets work better” but on **production** diversification & upgrading.
- IPs were **both** horizontal and vertical.
- Price-distorting incentive policies, including managed trade, managed FDI, sectorally-specific incentives for exports. Taiwan – large public enterprise sector.
- See my *Governing the Market* (2004).

# Types of industrial policy

- (1) Horizontal or generic, vertical or sectoral.
- (2) “**Leading** the market”, and “**following** the market”
- Leading the market = “picking winners”. Example, POSCO
- A lot of EAsian industrial policy “followed” or “nudged” the market.
- Eg. Taiwan fiscal incentives for specific products.
- Eg. Protection, linked to performance conditions.
- Eg. FDI firms nudged to switch to local suppliers.
- Trade policy: combined import replacement with export promotion. Firms replacing imports not insulated from competition.
- Following the mkt is far from both “bureaucrats picking winners” and from World Bank’s Country Policy & Institutional Assessment (CPIA).

# Developmental state

- The term “developmental state” applied to Japan, SK, Taiwan, S’pore; France; Brazil (1960s).
- State coordinated & steered mkt agents; created “search networks” or coordination forums, with sustained public-private interactions.
- **Examples of coordinating forums:** Japan’s MITI, Taiwan’s Economic Planning Council & its Industrial Development Bureau, SK’s Economic Planning Board, S’pore’s Economic Development Board; France’s Commissariat General du Plan.
- Sub-national: Industry associations; regional developmental states (Italy).

# Developmental State

**Membership of forums:** those whose interests counted most in shaping content of “national interest”. “Insider system”.

Their sustained interaction encouraged them to **mute their oligopolistic struggles for advantage, to define convergent interests**, so that they served wider interests than their own specific ones.

Their interaction governed by **same informal, personalized rules** as in rest of society, but now disciplined by the logic of repeated interaction in the coordinating forums and the emerging sense of a common interest.

Public officials steered the interactions, but not in

# “Street-level” developmental state

- Taiwan’s Industrial Development Bureau
- Ad hoc task forces for specific projects (eg factory automation).
- Acted in “nudging” role, decade after decade; & brought info from micro to macro (national economic plan).

# Developmental state

- **Key conditions:** (1) State support must be given against performance conditions. If not, India's automobile industry prior to 1990s.
- (2) Insiders must support measures of “**inclusionary growth**”, to offset discontent of outsiders which could be mobilized by factions of insiders and destabilize the insider system. Eg rural development in E Asia.
- (3) Bifurcated economic & political administrative structures. Political patronage via political channels, without sacrificing economic efficiency.
- Eg SK's New Community Movement.
- (4) Industrial policy officials should have limited discretionary resources under direct control (eg for discretionary subsidies).

# Signs of new thinking in IOs

- World Bank and IMF have been hostile to any such role of the state.
- Eg. WB's *Economic Growth in the 1990s: Learning from a Decade of Reforms* (2005), says nothing about industrial or technology policy.
- Today: **World Bank**: (1) VP for Research, Justin Lin (Chinese), published "New structural economics: a framework for rethinking development" (February 2010), which takes favorable view of a limited form of industrial policy.
- (2) April 2009 WB announced changes to its "Employing Workers Indicator", key indicator of "business climate" in its *Doing Business* reports. Now gives favorable scores to countries with worker protection in line with ILO conventions.
- **IMF's current Standby Agreements (SBAs)** show more flexibility, less one-size-fits-all than earlier ones.
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- Governments of low-income countries should use the new ambiguity to experiment with policy, bearing in mind they face powerful gravitational forces against rise up income hierarchy.