

# Industrial policy finally legitimate?

The IMF and the World Bank may be about to acknowledge the role of industrial policy and government investment among others in accelerated development as two of their own staff have proven it, writes **\*Jomo Kwame Sundaram**.



Women at work in a clothes factory

For decades, the two Bretton Woods institutions have rejected the contribution of industrial policy (IP), or government investment and technology promotion efforts, in accelerating and sustaining growth, industrialization and structural transformation.

Finally, two International Monetary Fund (IMF) staff members, Reda Cherif and Fuad Hasanov, have broken the taboo. They embrace industrial policy, arguing against the current conventional wisdom that East Asian industrial policies cannot be successfully emulated by other developing countries.

## Miracle economies not miraculous

They argue that IP has been key to East Asian 'miracles', offering valuable lessons for sustaining 'catch-up' growth. For them, appropriate IP interventions have been key to successful entry into more sophisticated industrial activities, early strong export orientation, and fierce competition with strict accountability. For over half a century, especially following Asian and African decolonization after World War Two, developing countries have gone their separate ways with very mixed results, with all too many falling behind. Meanwhile, very few economies

have caught up with some of the most advanced economies and firms.

Between 1960 and 2014, 16 out of the 182 economies they study achieved high-income status, underscoring the difficulties for middle-income countries reaching high-income status within two generations. They distinguish three types of countries which have 'succeeded', namely the East Asian miracles, those discovering considerable oil and gas, and those that benefited from joining the European Union.

Cherif and Hasanov insist on the key role of industrial policy in the Asian

miracles, and for the US after the Civil War, Germany under Bismarck, and Japan after the Meiji Restoration. They argue that East Asian industrial policies have much in common despite their many differences.

The conventional growth formula — of improving macroeconomic stability (typically through anti-inflationary policies), strengthening property rights, and providing physical and social infrastructure and basic services to address government failures — was not enough.

Drawing useful lessons from varied country experiences is fraught with difficulty, especially considering the exogenous and conjunctural factors affecting growth, including luck. In contrast with the conventional empirical approach emphasizing averages, their analysis of long-term cross-country growth experiences underscores the value of studying the ‘tails’ or exceptions instead.

### Technology and innovation policy

Contrary to earlier formulations of industrial policy as primarily involving investment and technology, Cherif and Hasanov propose three key principles constituting ‘true industrial policy’, summarized as technology and innovation policy (TIP), namely:

- State interventions to overcome constraints to the early emergence of national producers in more sophisticated industries, beyond conventional notions of ‘comparative advantage’.
- Export orientation, not import substituting industrialization (ISI); this contrasts with providing effective protection in the national or regional market on condition of early export promotion to achieve export competitiveness.
- Ensuring both national and international competitiveness with strict accountability.

### Hyundai vs Proton

Cherif and Hasanov also contrast the cases of Malaysia’s Proton with South Korea’s Hyundai in support of their three principles. They argue that Proton did not export enough, reflecting failure to

build sufficient managerial and engineering skills as well as an innovative automotive cluster.

Hyundai, by contrast, has successfully created a global brand. Cherif and Hasanov insist that allowing several South Korean industrial conglomerates or chaebols to develop rival auto industries and the push to export were key to its success.

Governments have directed capital and labour into industrial ventures that firms probably would not have undertaken without appropriate incentives, but market competition, market signals, and private sector accountability are also recognized as important.

Without conclusive evidence, Cherif and Hasanov claim that due to the government’s push to export, Korean automakers ‘moved first, then learnt and adjusted’. In exchange for very low real interest rate loans, Korean chaebols had to quickly secure foreign market shares, while accountability was enforced by firing senior managers who failed to reach export targets.

Pressure to compete and export forced Hyundai to increase its R&D effort and technology upgrading, producing its own engine in 1991, and later, its first electric car. Korean encouragement of several chaebols in the automotive industry later forced them to restructure, with few surviving.

But would fostering more than one automotive firm have ensured Proton’s success in light of Malaysia’s smaller domestic market and more modest industrial capabilities? And what were the economic costs of Korea’s arguably wasteful automotive industry competition?

### Three development policy options

Cherif and Hasanov emphasize the importance of government ambition, accountability and adaptability. Government ambition is seen in terms of a feasible or pragmatic level of sophistication of new sectors and domestic ownership of industrial technology.

Government policy implementation must be subject to accountability, not only for firms, but also policymakers and senior managers responsible. As

conditions change and new knowledge becomes available, policy interventions must adapt to continue to be effective and feasible.

**Low gear:** The conventional approach to growth — of improving the investment environment, key institutions, infrastructure, macroeconomic stability, investments in education, and minimizing other government interventions — is likely to result in relatively slow ‘snail’s pace’ growth.

Such policy interventions typically address government failures, but not necessarily market failures, especially to develop more technologically sophisticated sectors beyond conventional understandings of comparative advantage.

**Middle gear:** This approach mainly relies on attracting FDI into more technologically sophisticated industries to participate increasingly in global value chains, or by improving the technological level of existing industries. This may accelerate growth for middle-income countries, but is unlikely to lead to sustainable development or ‘high-income status within two generations’ owing to limited national capacities and capabilities.

**High gear:** The East Asian miracle economies are said to be using a ‘moonshot approach’ for governments to create competitive national firms in frontier technologies, and more sophisticated industries with homegrown technologies, creating conditions for high, sustained long-term growth.

The speed and extent of the leaps to more sophisticated industries and technologies created by national firms are crucial for sustaining long-term development. Countries that manage this process well have better chances of soon becoming relatively advanced economies.

*\* Jomo Kwame Sundaram, a former economics professor, was United Nations Assistant Secretary-General for Economic Development, and received the Wassily Leontief Prize for Advancing the Frontiers of Economic Thought.*



A poor neighbourhood

## New data illuminates inequalities among the poor worldwide

Results show that children suffer poverty more intensely than adults and are more likely to be deprived of essentials such as clean water, sanitation, adequate nutrition or primary education, reports **\*Caroline Mwanga**.

A new report released at the UN High-Level Political Forum challenges the traditional concept of poverty and sheds light on the number of people experiencing poverty at regional, national and subnational levels, and reveals inequalities across countries and among the poor themselves.

Findings from the 2019 global Multidimensional Poverty Index (MPI) and

the publication “Illuminating Inequalities” – jointly developed by the United Nations Development Programme (UNDP) and the Oxford Poverty and Human Development Initiative (OPHI), and released on July 11, 2019 – offers data for 101 countries, covering 76% of the world population.

Of the 1.3 billion people who are described as “multidimensionally poor”,

more than two-thirds — 886 million — live in middle-income countries. A further 440 million live in low-income countries. In both groups, data show, simple national averages can hide enormous inequality in patterns of poverty within countries.

The MPI provides a comprehensive and in-depth picture of global poverty – in all its dimensions – and monitors