

## **Development Policy**

### **Lecture 13**

# **Current Issues and Debates**

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## **Industrialization Strategy circa 1960**

### **Major themes of the Import-Substitution Strategy**

1. Leading role for the state
2. The “Big Push” / “Balanced Growth” strategy need
3. Unbalanced growth strategy also proposed
4. Big push of foreign aid needed for take off
5. Export pessimism

## Trade and Industrialization Strategy circa 1990

### Major themes:

- Export promotion strategy replaces ISI as the orthodox view
- Total Factor Productivity Growth replaces capital accumulation
- “Getting prices right” becomes the slogan of the day
- SOEs must be privatized
- FDI is good, foreign indirect investment is dangerous (Latin Debt Crisis)
- Foreign aid should be used to promote reform, not build infrastructure
- Washington consensus is born

## Trade and Industrialization Strategy circa 2012

### Major Themes

- There are no big ideas, but many paths to development (Rodrik)
- Foreign capital is still dangerous (Mexico 1994; Asia 1997, Argentina 2002)
- Globalization has a downside (Great Recession of 2009-10)
- The Washington consensus is a dirty word
- It's not getting prices right, it's getting institutions right (Acemoglu/Robinson)
- It's not macro, it's micro that matters (Banerjee/Duflo)
- It's all about the global value chain
- EOI leads to a middle income trap
- Government must push countries up the global supply chain

### Hausmann/Rodrik (2003) “Economic Development as Self-Discovery”

The orthodox view currently: Economic growth requires foreign technology (openness) and good institutions (property rights)” H/R argue against this view:

- In the 1990s, Latin America followed the orthodox prescription, but failed (per capita income relative to the US declined from 18% to 23%. Between 1985 and 2000).
- East Asian Tigers did not follow the prescription (had high levels of protection and many institutional weakness,) but grew very rapidly

Successful industrialization requires that potential investors learn (discover) what they are good at producing. But the investor will capture only a small part of social value of discovery, since others will emulate such discoveries. As a result:

- There will be too little investment in discovery in the first period
- And, there will be too much production diversification in the second period

Rents generated by industrial policy stimulate discovery, but for this to be effective measures have to be taken to rationalize industries and discipline high-cost firms. According to H/R this happened in East Asia, but not in Latin America

### Rodrik (2006) “Industrial Policy for the 21<sup>st</sup> Century”

The case for industrial policy rests on two market failures:

#### Information externalities:

“Market prices cannot reveal the profitability of resources allocations that do not yet exist.” Rodrik recommends a “carrot and stick” policy.

The carrot: trade restrictions or subsidies.

The stick: performance requirements & monitoring

#### Coordination externalities

“Many projects require simultaneous investments to be profitable”

“Coordination failure place premium on the ability to coordinate investment and production decisions of different entrepreneurs”

Bottom line: “Continued rapid growth in the developing world will require pro-active policies that foster structural transformation and spawn new industries and push countries up the ladder of comparative advantage?”

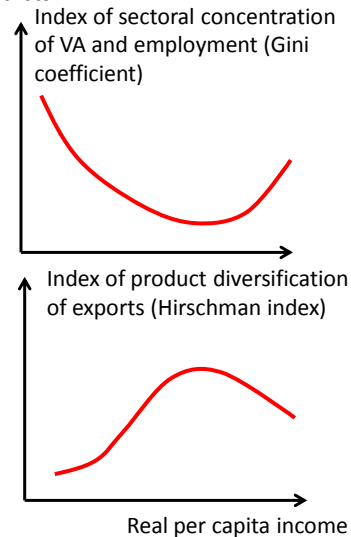
## Rodrik (2006) "Industrial Policy for the 21<sup>st</sup> Century"

Externalities are difficult to identify empirically, so **Rodrik's** argument is based on evidence (Imbs and Wacziarg, 2003 and Bailey and Lederman, 2006) that comparative advantage does not work as theory predicts.

**Imbs and Wacziarg** show that value-added and employment become more diversified (not more specialized) across sectors as per capita rises (contrary to the theory of comparative advantage)

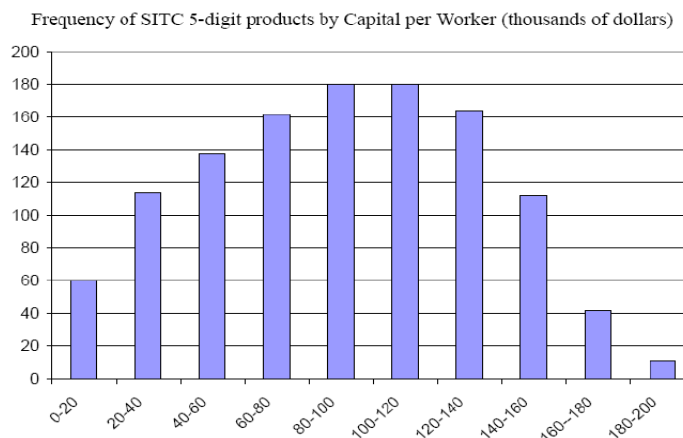
**Bailey and Lederman** show that exports also become diversified across products as per capita income rises, diversification arising mainly from exporting new products

From these findings, **Rodrick** asserts that "Whatever it is that serves as the driving force of economic development, it cannot be the forces of comparative advantage as conventionally understood."



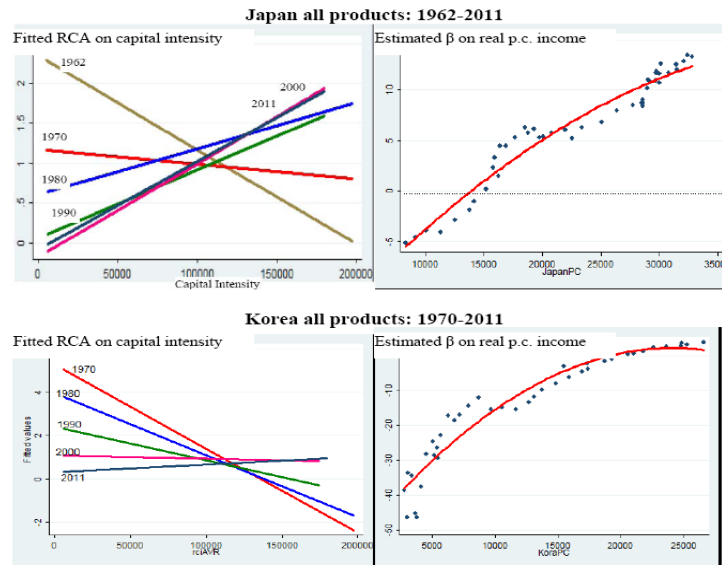
## Output, employment and export diversification on the road to economic development: An alternative explanation

The number of products classified by capital intensity rises, peaks and then falls as per capita income rises. As per capita income rises the zone of comparative advantage widens.

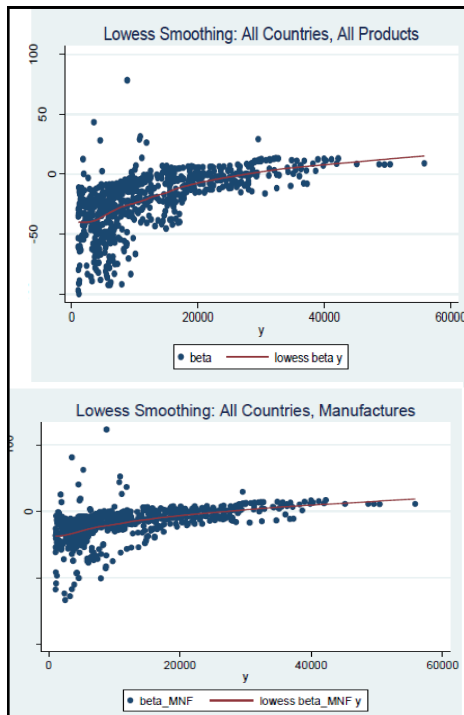


Pham and Riedel (2013) "An Assessment of the Dynamics of Comparative Advantage"

## The dynamics of comparative advantage



Pham and Riedel (2013) "An Assessment of the Dynamics of Comparative Advantage"

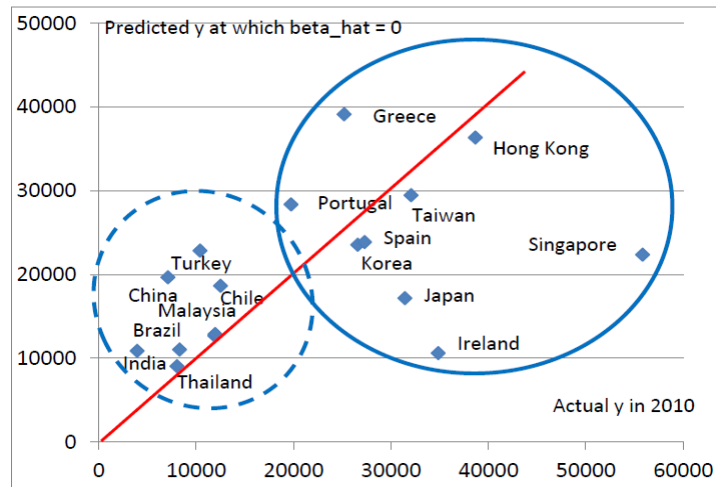


Dependent Variable: $\hat{\beta}$	All Products	Manufactures
$\ln(y)$	16.98	18.49
(t-statistic)	(37.82)	(34.27)
Constant	-154.65	-174.72
(t-statistic)	(48.00)	(-39.48)
R-squared	0.90	0.89
Root MSE	3.94	4.19
Number of obs	726	726
F-statistic	454	473
DF test for co-integration	-9.30***	-7.60***
y at which $\hat{\beta}=0$	\$9,025	\$12,700

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## The dynamics of comparative advantage

Countries below the red line have made the transition from relatively labor-intensive to relatively capital intensive exports



Pham and Riedel (2013) "An Assessment of the Dynamics of Comparative Advantage"

## Industrialization Strategy in the Era of the Global Supply Chain

**Baldwin (2012)** "Global supply chains have transformed the world. They revolutionized development options facing poor nations – now they can join supply chains rather than having to invest decades in building their own."

"Offshoring of labor-intensive manufacturing stages and the attendant international mobility of technology launched era-defining growth in emerging markets – a change that fosters and is fostered by domestic policy reform."

"Historic income gaps are narrowing as the North de-industrializes and the South industrializes -- a reversal-of-fortunes that constitutes perhaps the most momentous global economic change in the last 100 years."

"Global supply chains, however, are themselves rapidly evolving. The change is in part due to their own impact (income and wage convergence) and in part due to rapid technological innovations in communication technology, computer integrated manufacturing, 3D printing, etc."

*Richard Baldwin (2012), "Global Supply Chains: Why They Emerged and Why They Matter..."*

## Industrialization Strategy Pre Global Supply Chain

### The First Stage of Globalization : Steam made it possible, scale economies made it profitable

In the pre-globalisation world, each village made most of what it consumed. Production and consumption were linked by poor transportation technology.

The steam revolution, especially railroads and steamships, made it feasible to spatially separate production and consumption, starting from the 1830s and accelerating in the 1870s.

Once technologically feasible, scale economies and comparative advantage made globalization profitable.

### The First Stage of Globalization : Some facts

1. The steam engine reduced trade costs and made it profitable to produce at large scale and generated a self-sustaining cycle of production, innovation and rising income...

*Richard Baldwin (2012), "Global Supply Chains: Why They Emerged and Why They Matter..."*

## Industrialization Strategy Pre Global Supply Chain

### The First Stage of Globalization : Some facts

2. North industrialization and South de-industrialization

#### Per capita industrialization levels, 1760-1913 (UK in 1900 = 100)

	1750	1800	1830	1860	1880	1900	1913
France	9	9	12	20	28	39	59
Germany	8	8	9	15	25	52	85
Italy	8	8	8	10	12	17	26
Russia	6	6	7	8	10	15	20
UK	10	16	25	64	87	100	115
Canada		5	6	7	10	24	46
US A	4	9	14	21	38	69	126
Japan	7	7	8	7	9	12	20
China	8	6	6	4	4	3	3
India-Pakistan	7	6	6	3	2	1	2
Brazil				4	4	5	7
Mexico				5	4	5	7

Source: Table 9, Bairoch (1982); UK in 1900 = 100

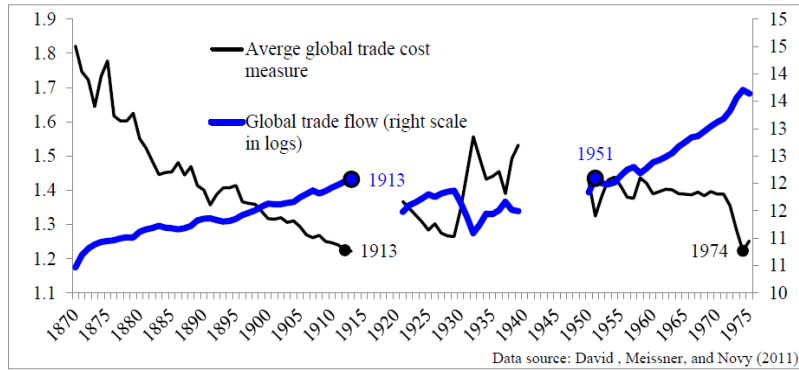
3. North – South income divergence

*Richard Baldwin (2012), "Global Supply Chains: Why They Emerged and Why They Matter..."*

## Industrialization Strategy Pre Global Supply Chain

### The First Stage of Globalization : Some facts

#### 4. Boom in trade and labor migration

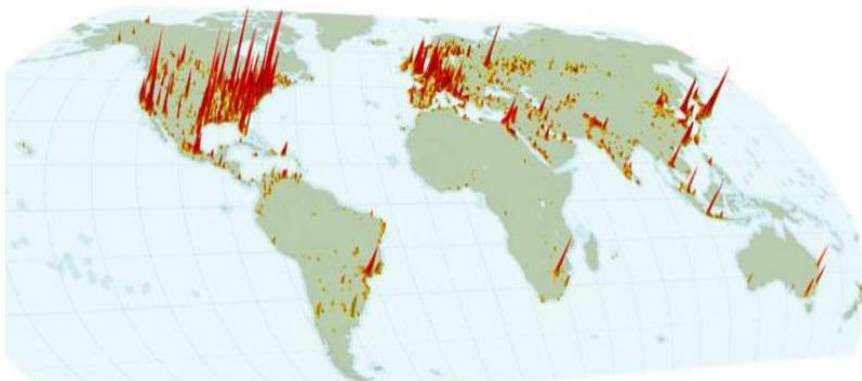


Richard Baldwin (2012), "Global Supply Chains: Why They Emerged and Why They Matter..."

## Industrialization Strategy Pre Global Supply Chain

### The First Stage of Globalization : Some facts

#### 5. Production clustered locally as it dispersed globally



**The world is not flat (Thomas Friedman), it is spikey (Florida)**

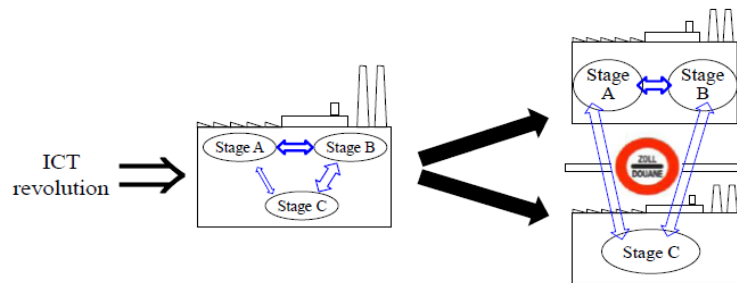
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## Industrialization Strategy in the Era of the Global Supply Chain

### The second stage of Globalization: ITC made it possible , wage differences made it profitable

- Coordinating production (inputs, technology, people, inputs, information) in a single factor used to be less costly and less risky
- The ITC revolution made it possible to coordinate at a distance and wage differences across countries made it profitable.



Richard Baldwin (2012), "Global Supply Chains: Why They Emerged and Why They Matter..."

## Industrialization Strategy in the Era of the Global Supply Chain

### The second stage of Globalization: The rise of the Global Supply Chain

- The GSC has led to a massive increase of intra-regional trade in a narrow range of products

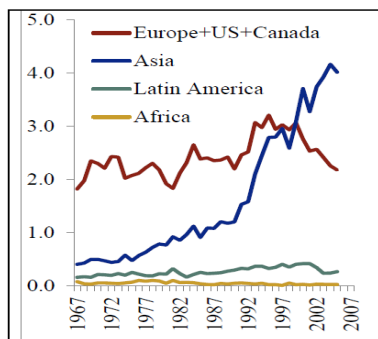


Figure 4: Regional measures of 21<sup>st</sup> century trade, 1967-2004

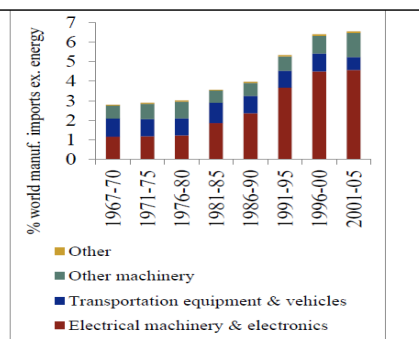


Figure 5: Sector measures of 21<sup>st</sup> century trade, 1967-2004

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## Industrialization Strategy in the Era of the Global Supply Chain

### How the rise of the Global Supply Chain has changed the world

1. Reversal of income divergence
2. South industrialization and North de-industrialization

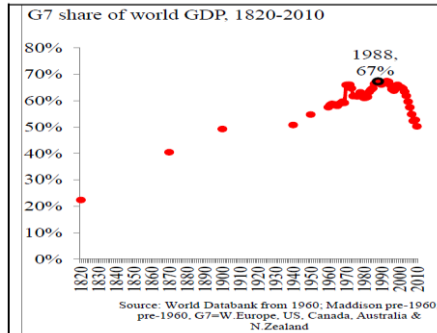


Figure 7: Reversal of the big divergence

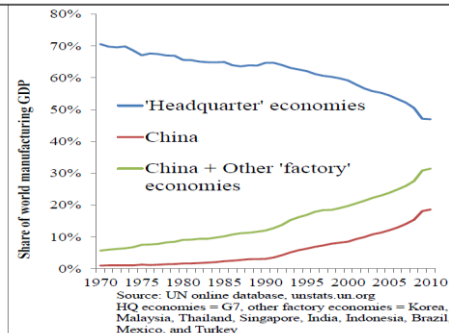


Figure 8: Reversal of industrialisation/de-industrialisation trend

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## Industrialization Strategy in the Era of the Global Supply Chain

### How the rise of the Global Supply Chain has changed the world

3. New Political Economy of liberalization—to get in the GSC countries have to lower trade barrier and join trade agreement

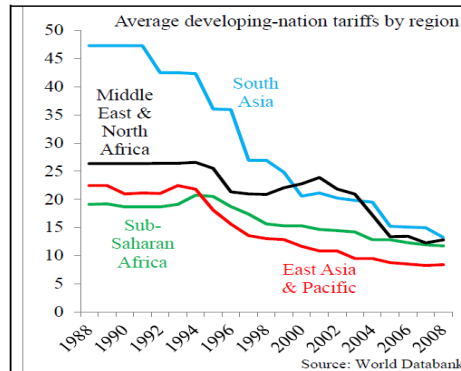


Figure 9: Unilateral tariff cutting by developing nations, 1988-2009

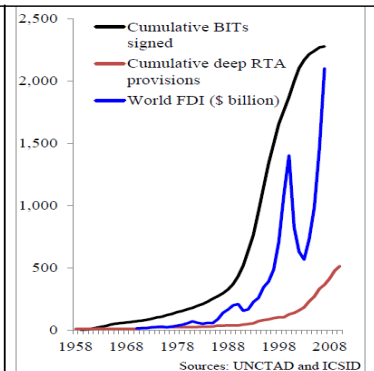
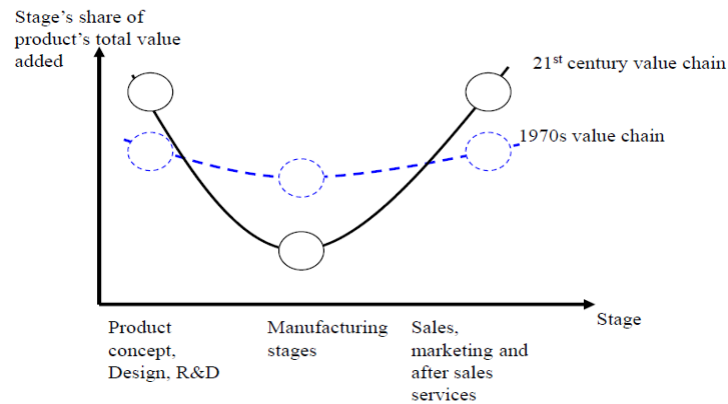


Figure 10: Indicators of FDI & 21<sup>st</sup> century trade disciplines, 1958-2009

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## Industrialization Strategy in the Era of the Global Supply Chain

The smile curve: Good and bad stages in the value chain



What are the implications of the “smile curve” for growth and industrialization strategy in Vietnam?

*Richard Baldwin (2012), “Global Supply Chains: Why They Emerged and Why They Matter...”*