

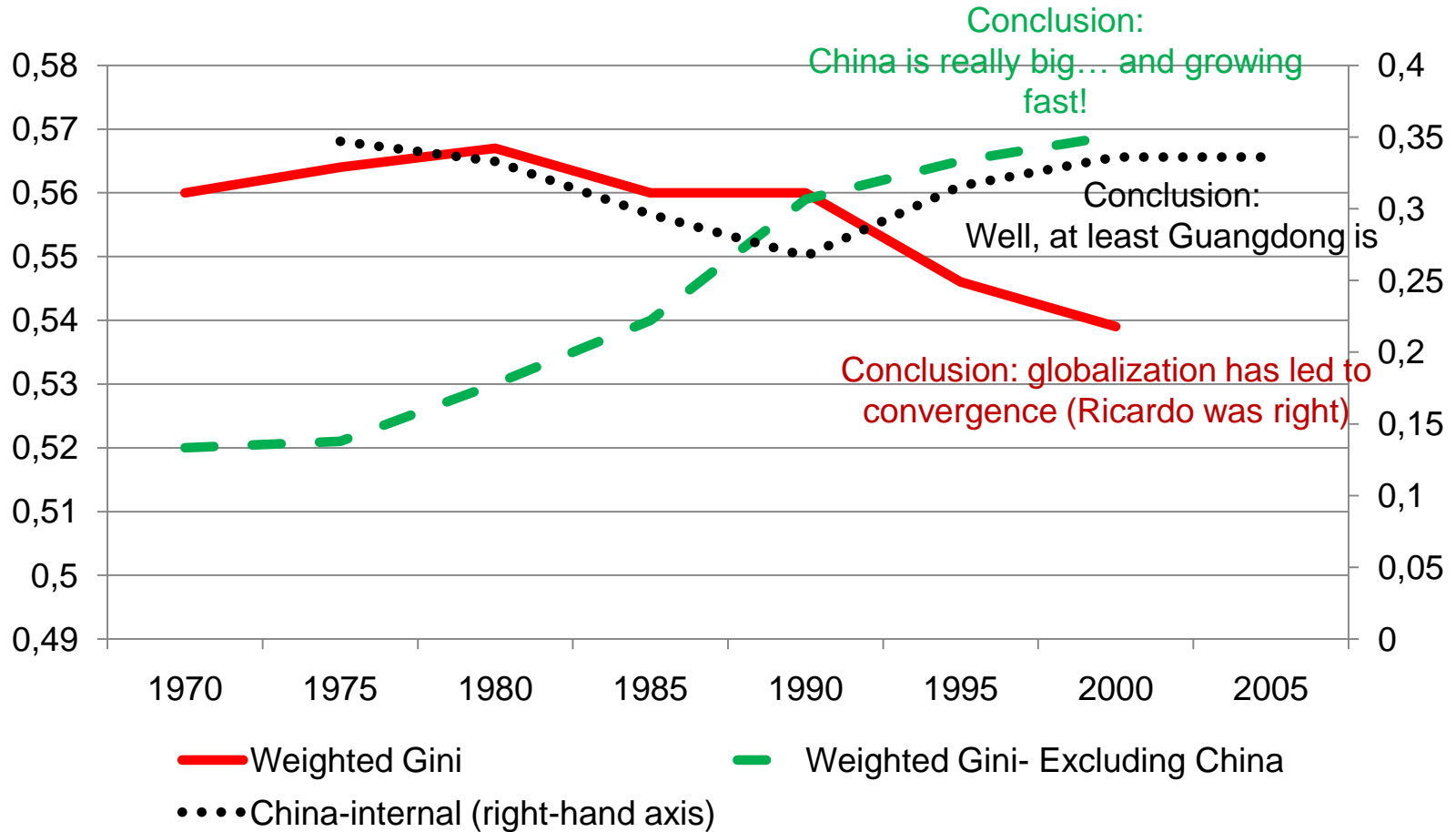
# Trade and Industrial Policy 2.0 – Facilitating firm-level competitiveness and economy-wide adjustment

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# A cautionary tale inspired by this week's *Economist*

## Trends in global income inequality (Gini coefficient)



# Outline

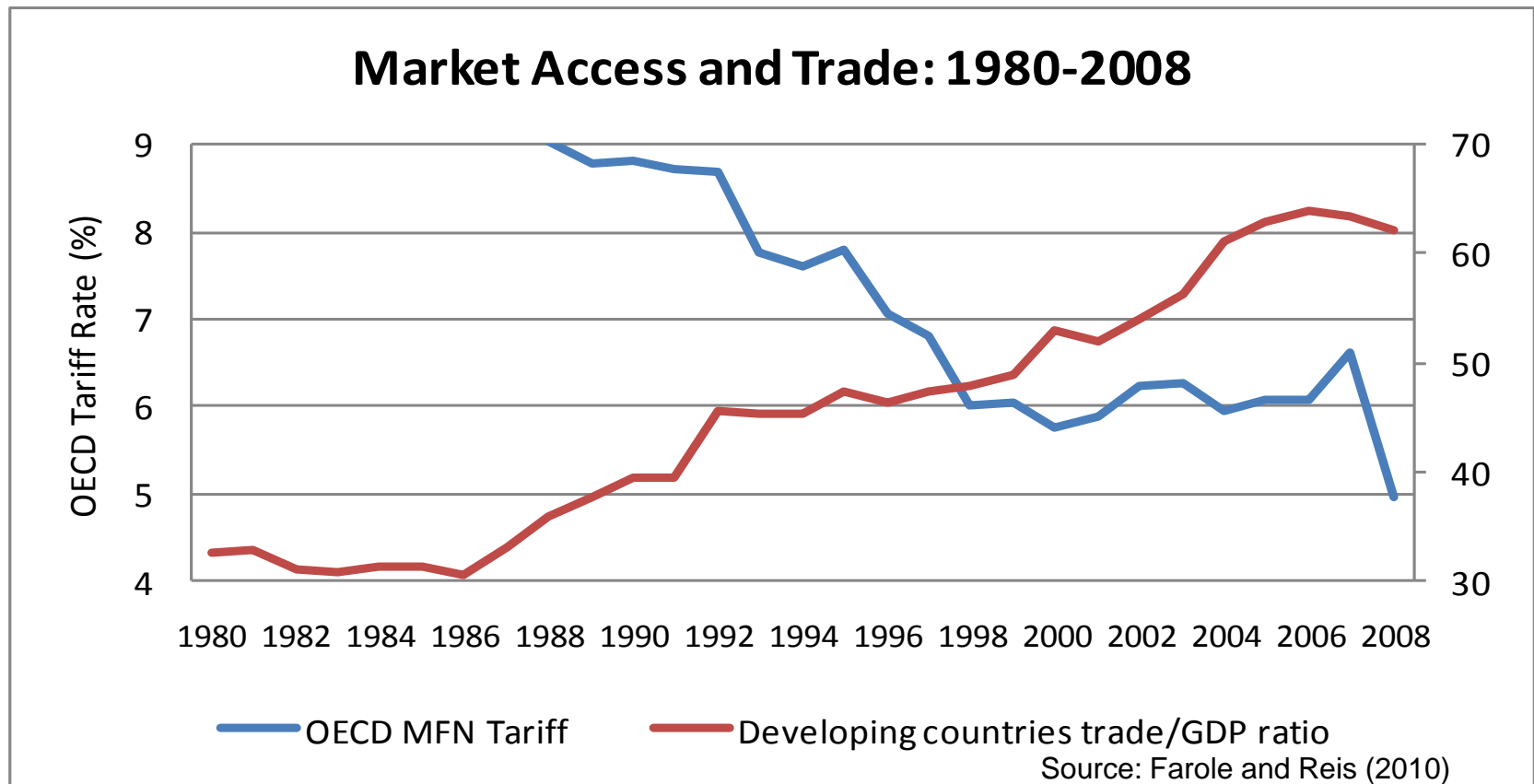
## 1. Context

2. Industrial policy and regional policy

3. Why governance is critical

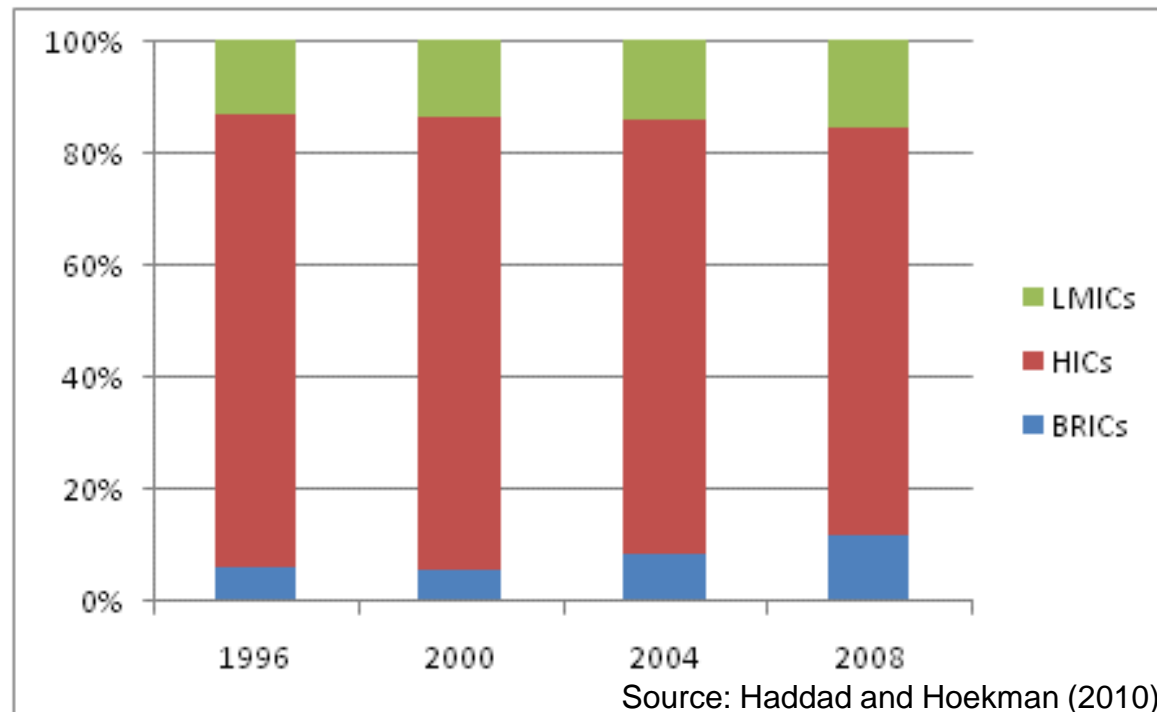
# Trade integration has been a key driver of growth in recent decades

- Trade has grown at twice the rate of GDP in recent decades (and FDI twice that still)
- Catalyzed by liberalization (first generation reforms) + technology



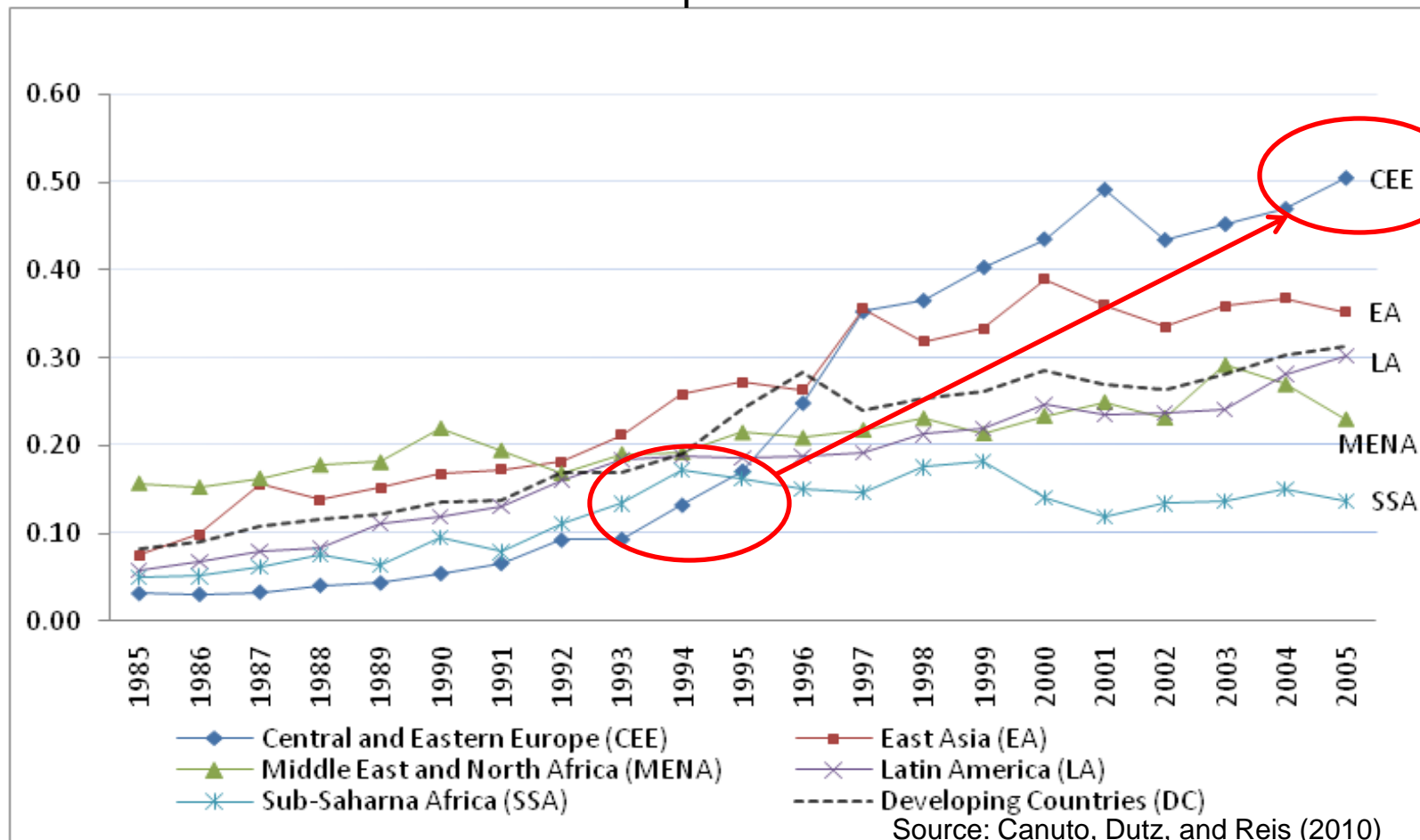
# Developing countries account for an increasing share of world trade

- Import share of BRICs doubled between 1996 and 2008; overall import share of HICs down from 81% to 72%
- “Rise of Asia” as dominant trade force – low and middle income Asia 5% of world trade in 1988 →15% in 2008; share of OECD manufacturing exports from low and middle income Asia rose from 3% to 14% in this time
- Exports for LMICs to BRICs (South-South) nearly doubled in this period

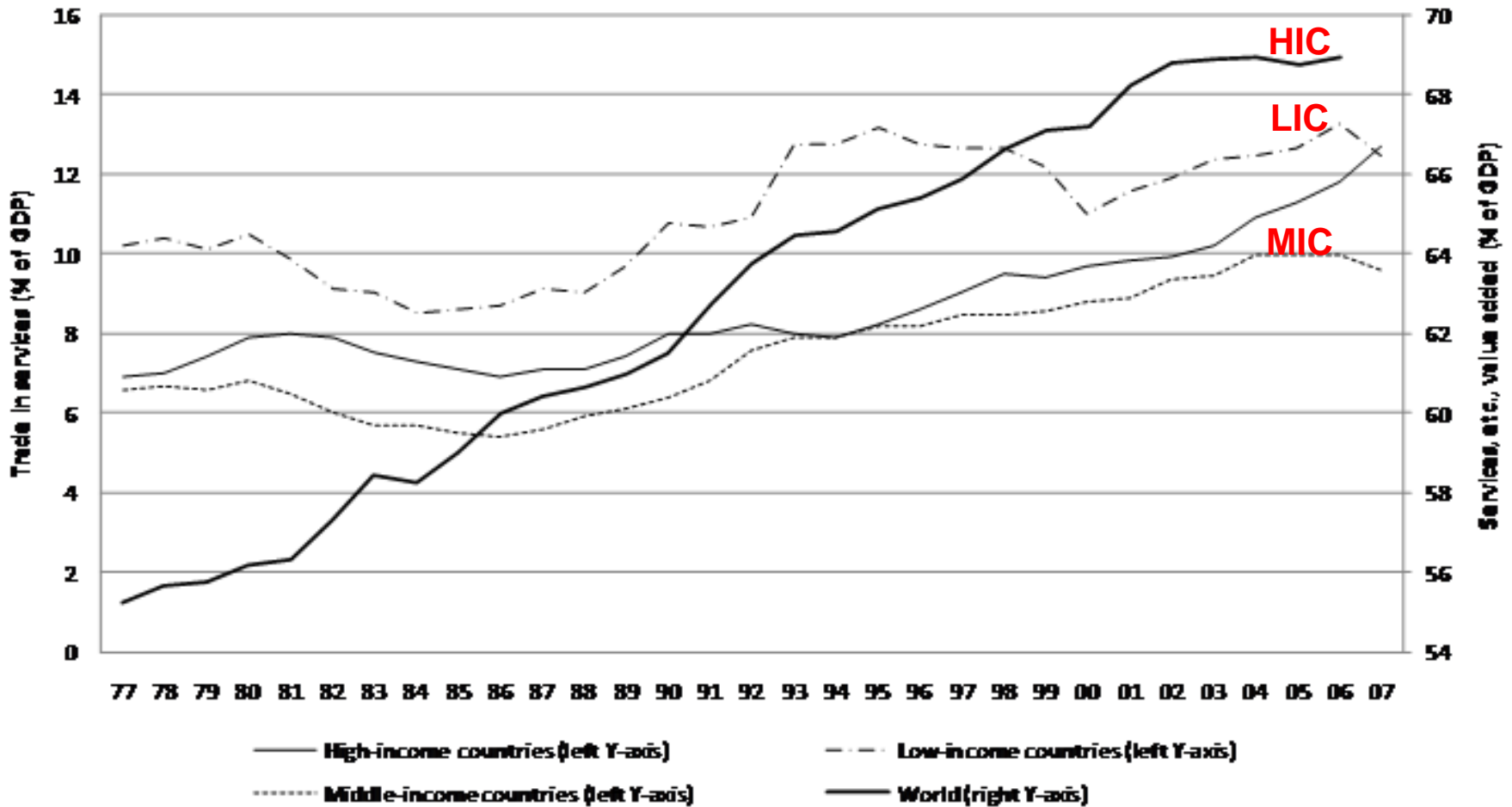


# “Unbundling” of production vertically leading to spatial fragmentation

Vertical trade in developing countries increased from 8 percent in 1985 to around 33 percent in 2005



# Rapid growth of services sector trade



# But then... the Great Trade Collapse

- 2008-09 crisis: trade ↓ 36% Q4 '07 to Q2 '09
- Called into question existing growth strategies – pressure for greater government “activism” to support growth. In practice many of the underlying pressures for “activism” were shaped by these trends that pre-dated the crisis

## Key post-crisis priorities for trade and industrial policy:

1. **Diversifying** markets and products (incl. into services)
2. Maintaining momentum in structural transformation processes – **e.g. avoiding the “middle income trap”**
3. Addressing **adjustment and inequality:**
  - Supply-side constraints prevent firms in many LICs and MICs from taking advantage of opportunities available from trade
  - Regional inequalities growing in many countries



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# Renewed government “activism” need not mean a return to the days of classical industrial policy

## The fraught territory of IP and regional policy

- “Picking winners...” or “Doomed to choose...”
- East Asian Miracle v. Latin American ISI disaster
- “Place-based” v “spatially blind”

## An emerging consensus?

- Market and government failures exist – can contribute to inefficiencies and underutilization of potential
- **Firm level competitiveness (productivity)** is in a large part determined by inputs that governments deliver or impact. **Both horizontal and vertical** interventions needed
- But structural transformation requires not just within-sector static productivity gains but **dynamic adjustment capacity** (sectoral and spatial) – promoting **entry and exit of firms and mobility of factors of production**

# Framework for competitiveness approach (trade context)

## Aligning incentives



## Reducing trade related costs



## Overcoming market and government failures

- Removing policy-induced biases and distortions in the economy and ensuring that resources are channeled into the most productive sectors and the most productive firms in those sectors:
  - Trade (access, barriers, incentives) and tax policies
  - Macro-economic policies (e.g. exchange rate)
  - Competition policy

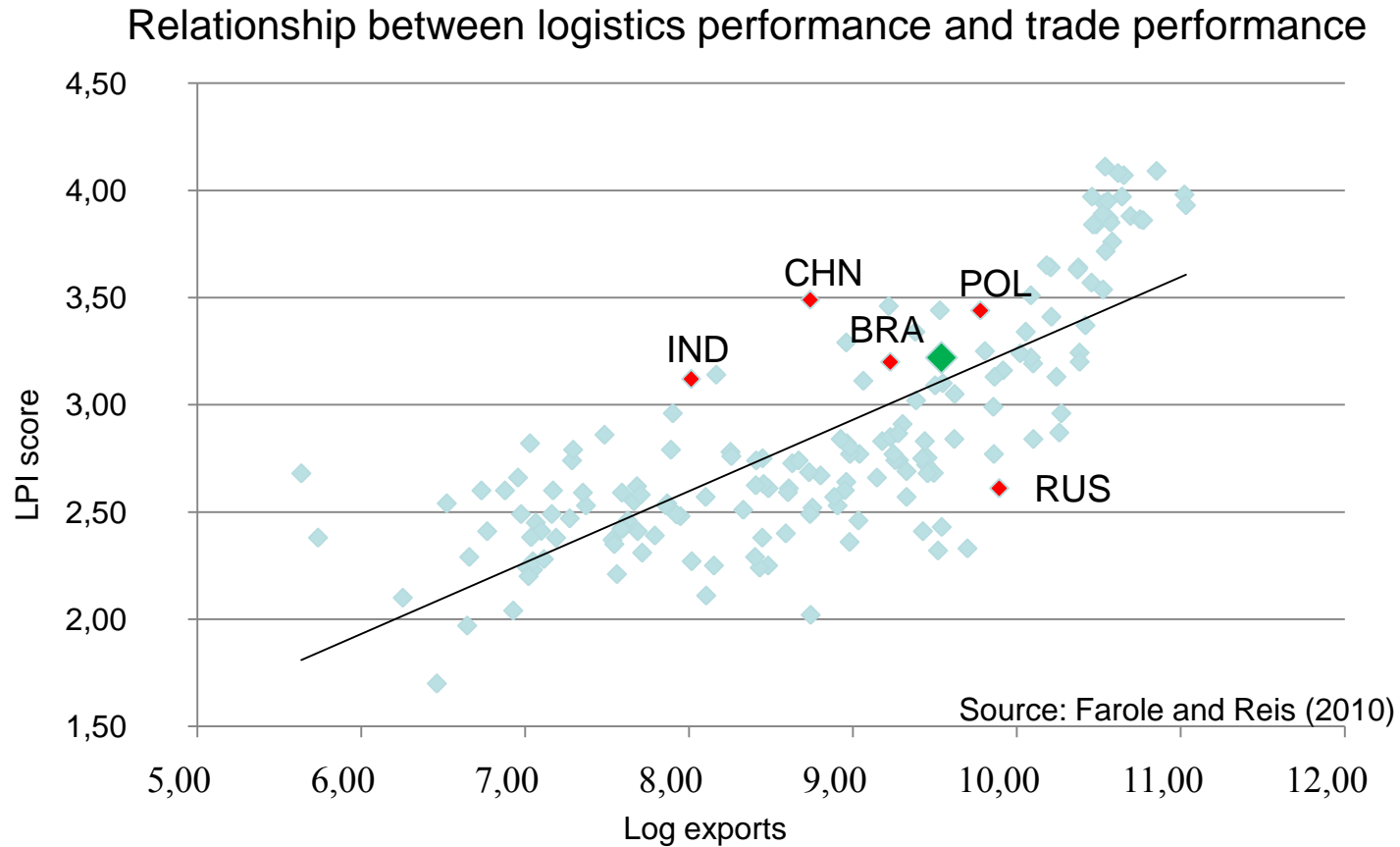
Promotes dynamic entry/exit

- Cost and quality of: energy, telecommunications, customs, transport and logistics, customs, finance, education & training

Will have vertical components

- Supply-side / “pro-active” policies:
  - Standards and certification
  - Export and investment promotion
  - Clusters and economic zones
  - Innovation

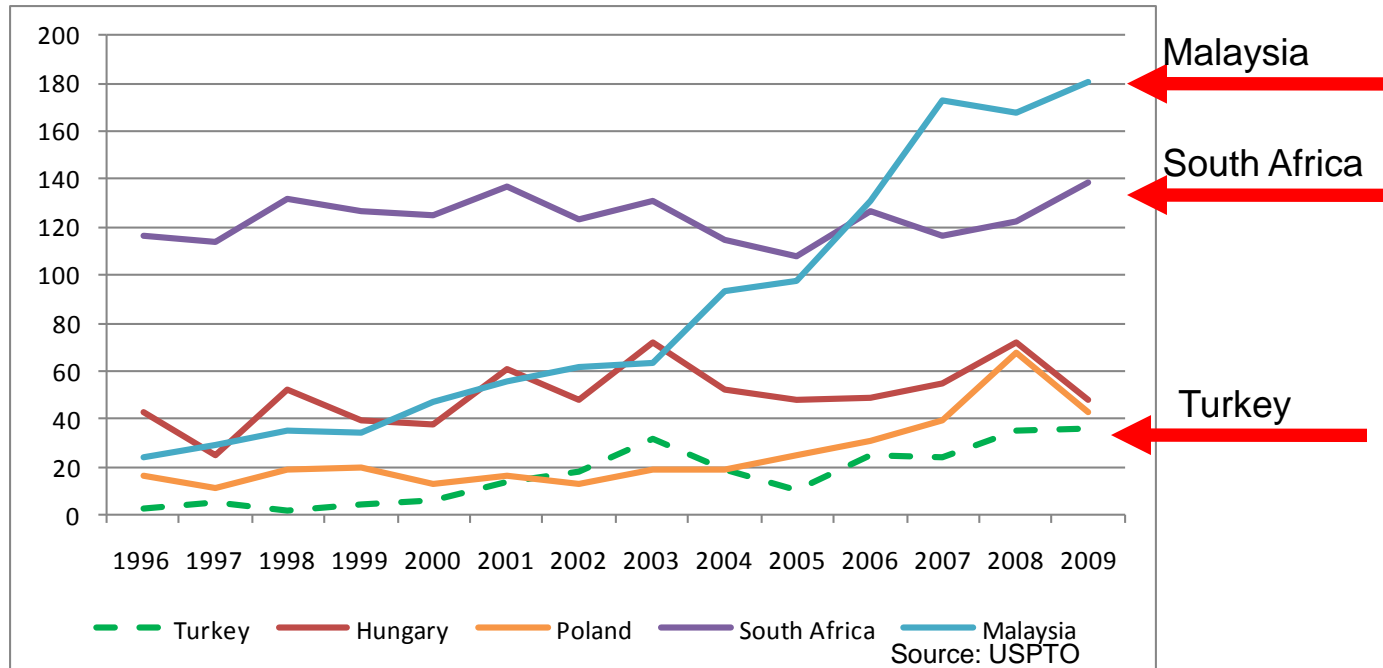
# Example 1: targeting trade facilitation



But international connectivity in the absence of efficient internal connectivity can contribute to widening disparities and prevent peripheral regions from benefitting from the gains to trade

# Example 2: innovation policy

Number of annual patents granted in the US (1996-2009)



- But it's not just about patents: appropriate growth policy (Aghion) may be **learning and adaptation** – catching up at the frontier
- Significant opportunity to bridge divide between industry vanguard and the mass of **formal and informal SMEs** whose main challenge is upgrading productivity – **diffusion and incremental adaptation**
- Role of **regional systems of innovation**

# Example 3: Using SEZs and clusters to facilitate external economies

- SEZs and clusters are usually not the answer in truly peripheral regions
- But where they can reinforce existing agglomerations or take geographical advantages they can be highly effective

- Many good SEZ examples

- Shenzhen
- Penang
- Mauritius

- Even more cluster examples

- Chile wine / salmon
- Peru horticulture
- Cambridge, Jutland, B-W
- Etc.

Here, one gets into targeting of clusters/sectors or of places ...

**Advertisement:**

**Two new World Bank studies in SEZs coming out soon – February and June**

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# Implementing the competitiveness agenda requires a different approach

**Governance of industrial policy**: the process by which industrial policy is translated into socio-economic impact and so depends on how IP is: 1) determined; 2) implemented; and 3) monitored

- Whether or not we are “picking winners” we are in any case making policy choices, so (democratic) governance matters
- IP (and regional policy) prone to vested interests and politics. It also tends to suffer from a lack of effective feedback loops
- Traditional top-down models of IP no longer appropriate – importance of PPD and coalition-building
- The importance of institutions:
  - Formal and informal (Storper)
  - Networks and “Institutional thickness” (Amin & Thrift)

**But don't mistake networks and coalition for an absence of power dynamics**



# Key elements of IP governance

## Principles of governance (Hausmann and Rodrik)

- Open architecture: no predetermined sectors
- Self-organization: no forced classification or communication channels
- Transparency: Public process and independent evaluation, with bias toward *socially* productive interventions

Such a model requires two key dimensions to be considered:

## Coordination

- Horizontal: coordinating across ministries / agencies and overcoming conflicting agendas; ensuring public-private dialogue; working with local coalitions
- Vertical: Avoiding top-down while ensuring there is an authority that can broker consensus and ensure IP remains priority

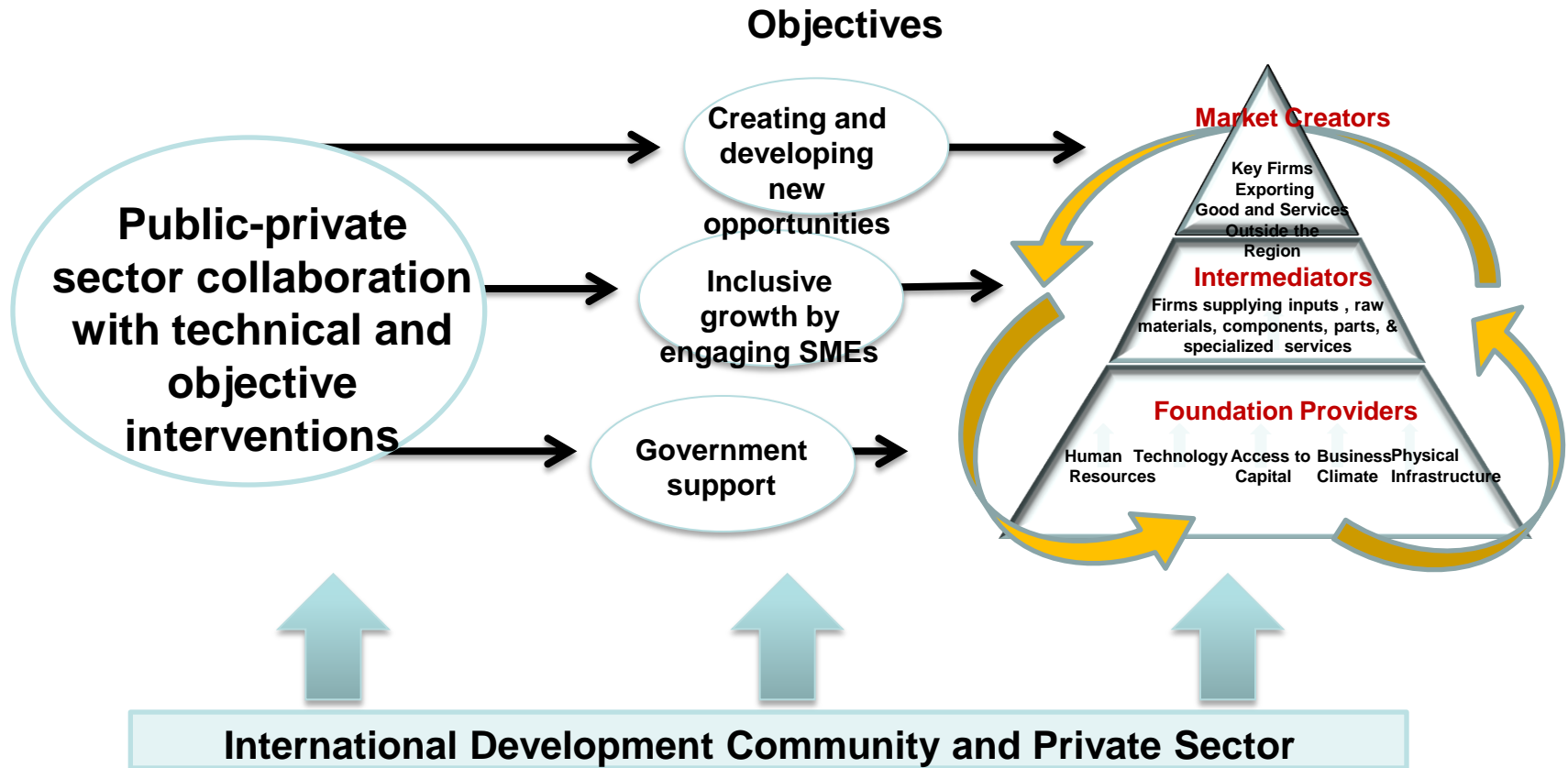
## Information

- Gathering and tracking information to inform the IP process
- Monitoring and evaluating impact

**Voice + accountability**

# New “Competitiveness Partnership Initiatives” at the World Bank – premised on public-private dialogue

## World Bank’s Competitiveness Partnership Initiatives



# EU regional policy reform proposals are following similar principles of governance

In implementing IP at the regional level, the normal risks are often compounded by entrenched local elites and variable capacity of local institutions

*Key elements of the proposals from the Barca report:*

- Multi-level governance
- Local coalitions and democracy
- Promoting experimentalism and mobilizing local actors... but combining this with greater accountability
- Performance monitoring – **indicators and M&E**

# To paraphrase Rodrik...

“The hard part is not picking winners but pulling the plug on losers..”

**THANK YOU!**