

New industrial policy (IP): the entrepreneurial state

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LSE, November 2013

Devt strategy of Adam Smith (1755)

- “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, all the rest being brought about by the natural course of things” (1755)

Standard devt strategy since 1980s

- Core idea: the market is preferred mechanism (rather than state) for achieving human ends.
- Goal of devt strategy: allocative efficiency + price stability
- Role of govt: “get the prices right”
- X-led growth + deregulation + free trade + suppression of labor costs

Doubts about standard devt strategy

- (1) How many *non-western* countries have become developed over past 200 years?
- Answer: < 10.
- (2) Have the catch-up countries stuck closely to neoliberal recipe?
- (3) What characteristics do catch-up c'ies have in common?

More doubts: export-led growth strategies reaching limits

- X-led strategies encourage firms & govts to keep wages low. Low wages limit domestic demand growth, esp when many c'ies follow same strategy.
- Demand in HICs likely remain low for some years

Devt of firm & societal “capabilities”

- Standard devt strategy says little about devt of firm & societal (production & marketing) capabilities.
- Yet production transformation is at core of devt process

Stages of catch-up industrialization

- I simple manufacturing, with FDI & foreign guidance for domestic firms
- II development of supporting industry, with technology from licensing, FDI spillovers, etc
- III domestic firms are fully capable of producing high quality goods
- IV domestic firms innovate in processes & products

Middle-income trap (1)

- The devt escalator is not smooth!
- Some analysts identify “glass ceiling” b/w stages II & III: importance of “quality”
- Others say it is around GDPPC of \$17,000 in constant 2005 prices, corresponding to move from III to IV (innovation-intensive production)
- This is an “endogenous” trap

Middle-income trap (2)

- There is also global political economy trap: Mid-income c'ies in competitive squeeze: cannot compete with low wage c'ies producing standard goods; have not dev'ed capabilities to compete in exports of skill- and knowledge-intensive goods & services.
- China struggling to avoid this trap.
- But also, rise of China can hurt (as well as help) the growth of capabilities in other mid-income c'ies

What is IP?

- IP = the state gives selective assistance to some sectors
- Distinct from:
 - (a) macroeconomic & ER,
 - (b) microeconomic deregulation agenda,
 - (c) “horizontal” policies,
 - (d) social policy
- Mainstream economics warns against IP

Warnings against IP

- Gary Becker, 1985: “The best IP is none at all”
- The Economist, 2010: “A smart innovation agenda...wld be about freeing markets”
- Lawrence Summers, 2011: Government “is a crappy VC”
Quoted in Joe Nocera, “Solar economics”, *International Herald Tribune*, 5 October 2011.
- John Williamson, 2012: “Little in the record of industrial policy suggests that the state is very good at ‘picking winners’”
“Is the ‘Beijing Consensus’ now dominant?”, *Asia Policy*, 13, January 2012, 1-16, at 10.
- The Economist 2011: “The government has a terrible record of picking winners”
(The Economist, “Angst in the United States: what’s wrong with America’s economy?”, 28 Apr 2011)

Pro IP argument:

- **Mkt prices** give signals for **incremental** change; but can block larger economic diversification & innovation
- What an economy produces today determines the skill & comparative advantage of tomorrow – an effect which is “external” to private decision-making
- Govt can help steer resource allocn to shape **compv advantage of tomorrow**.
- Therefore, CA in mfg (& high value-added services) substantially **man-made**

IP history:

- **Pre-WW2:** US & German catch-up led by state: high trade protection + infrastructure + public education + R&D esp in agriculture
- **Post-WW2:** East Asia (Jpn, SK, Taiwan, Spore): state had explicit strategy to build firm & societal capabilities, including protection + targeted subsidies + FDI + forced marriages b/w FDI & domestic firms

East Asian IP

- E. Asian trade protection was often high for assisted industries, but not unconditional. Domestic firms buffered from international competition, but not isolated
- Eg Taiwan: (1) firms in assisted sectors told that if their price/quality not at international levels within period of X years, protection lifted. (2) state orchestrated forced marriages b/w FDI & domestics: case of Philips & glass

Compare Chile, DR, Jordan, Malaysia

- These are small, open economies, where state has done much less than in E Asia to build up domestic firm capabilities, except in narrow sectors (within little spillover).
- S. Yusuf & K. Nabeshima, 2009, *Tiger Economies Under Threat*. Argues that Malaysia caught in middle-income trap, b/c state has done little to advance technological capabilities of domestic firms

US IP

- Generally believed that US has no IP, or ineffectual IP.
- In fact, US has long practiced “under the radar IP”. Takes form of federal or state agencies commissioning R&D from public labs or private labs & private firms, & building networks b/w labs, firms, VCs to induce them to share knowledge.
- Not centralized, not advertised.

US IP (ctd)

- Key sources: M. Mazzucato, 2013, *The Entrepreneurial State*. F. Block & M. Keller (eds), 2011, *State of Innovation*
- US federal/state agencies do not just give subsidies, tax cuts, set technical standards in hands-off way.
- They have taken leading entrepreneurial role in breakthrough technologies: ICTs, nanotech, biotech, etc., & not waited for private sector to initiate

US IP (ctd)

- Agencies have targeted product areas with (a) high capital intensity, (b) high tech risk. Private VCs tend to steer clear of these, & concentrate on product areas with lower capital intensity & lower tech risk.
- In Internet, biotech, nanotech private VC arrived 15+ yrs after public sector funds made the key investments.
- **Flaw in US IP:** state has not earned a **return** on the breakthroughs it hands to private sector. Hence public R&D underfunded.

IP since Crisis of 2008: pattern of increase

- Global Trade Alert (GTA) data set:
- Since 2008 US, EU c'ies, China, India, Brazil, Argentina, & others have moved further away from “level playing field” & intensified **policy selectivity** by sector, location, & ownership.
- Much of the IP directed at “green”
- WTO rules have affected choice of modes of selectivity.

WTO rules, by degree of constraint

- (1) **High**: tariffs, QRs, LCRs.
- (2) **Medium**: govt procurement, intellectual property, export subsidies in agriculture.
- (3) **Low**: devaluations, investment incentives, trade finance, export taxes

IP since Crisis: composition

- Govts have avoided tariffs & QRs.
- They have employed modes subject to “medium” or “low” WTO restraint: public procurement, discriminatory subsidies & bailouts (“murky protection”).
- **Conclusion:** (1) Since 2008 quantum of IP has gone up, especially for “green”; (2) WTO rules have affected **composition** of IP more than quantum.

IP governance problem in middle-income countries

- Public agencies in mid-income countries commonly used as sources of patronage & sinecures, & allocate gds & services personalistically (eg jobs, public contracts)
- Staff commonly left to own devices while heads busy themselves with personal business & pol networking
- Therefore, all governance – including IP governance -- operates in environment “hostile” for state effectiveness

Islands of excellence, pockets of effectiveness

- There are also examples of public agencies which operate like “islands of excellence” or “pockets of effectiveness” (PoE)
- They are substantially more effective than the country average in providing goods/services in line with mandate, & across the country
- **Question for IP governance:** how to create & sustain IP agencies which are PoEs?

Studies of agencies with PoE characteristics:

- Several studies of PoE: eg by Mirilee Grindle, David Leonard, Michael Roll, et al.
- Examples of PoE: (1) National Bank for Econ Devt of Brazil (BNDES); (2) EMBRAPA (agriculture research, Brazil); (3) National Agency for Food & Drug Administration & Control (Nigeria); (4) State Oil Company of Surinam; (5) S Korea's Economic Planning Board (1950s-70s); (6) Taiwan's Industrial Devt Bureau

Necessary conditions for PoE: (1)

- **Strong head of govt (or small coherent elite), which has strong interest in particular tasks being done effectively.**
- Why strong interest? Diverse motives: nationalist devt objectives; defence against external enemies; international prestige of head of govt.
- Pressure fr IFIs influential but not decisive.

Necessary conditions (2)

- **Head of govt breaks with normal – patronage -- appointment criteria**, against a lot of opposition. Instead, criteria for appointment to top positions emphasise technical qualification, proven leadership, proven incorruptibility.
- Director (CEO) comes fr outside the inner elite, connected to it through “weak ties”. Hence less vulnerable to “insider’s dilemma”.
- But, director **not** selected by formal bureaucratic procedures. Because must have “strong tie” to head of govt, not “weak tie”.

Necessary conditions (3)

- Director must be free to appoint members to the management teams, & select staff committed to mission (“**principled agents**”). Some will be from outside political elite networks (eg from private companies or overseas)
- Salaries/benefits probably higher than regular civil service.
- But performance not depend mainly on formal incentives. Staff work hard b/c see job as meaningful; **intrinsic motivation > extrinsic incentives**. Intrinsic motivation helps effectiveness b/c reduces director’s (Principal’s) costs of controlling staff (Agents).
- This puts added responsibility on director to foster organizational identity, & staff’s personal responsibility for mission

Necessary conditions (4)

- Crucial to change internal & external expectations of agency's modus operandi.
- Keys are: (1) **standardization** of procedures (eg project appraisals, project decisions); (2) regular evaluations of agency performance
- (1) & (2) enable agency to by-pass the parallel system of informal patronage
- **Internally**, standardization enables “uncertainty absorption” (March & Simon). It raises staff confidence in information they receive fr colleagues, do not have to check for themselves.
- **Externally**, standardization enhances predictability for clients, reduces incentives for bribes

Necessary conditions (5)

- **Bureaucratic autonomy** necessary, b/c agency will conflict with politicians, firms with contrary interests
- **Autonomy Paradox:** autonomy is not fixed, legal. Depends on political connections; it is inherently **relational**
- Managers must manipulate their external environment, use political connections

Necessary conditions (6)

- IP assistance must be made conditional on performance of firms – movement towards international competitiveness; so that it buffers them from international competitive pressure at early stage but does not remove that pressure.
- Eg sunset clauses; comparisons to price & quality of imports; performance standards for fiscal investment incentives; etc.

THE END

- Virtually all the most successful cases of economic development have involved a state being more proactive than Washington Consensus/standard devt strategy allows – beyond “fixing market failures”
- Since 2008 IP has intensified in most ACs & EMEs, especially under banner of “green”
- But state intervention can also destroy markets & impede development
- Key question in mid-income c’ies: how to create effective IP agencies