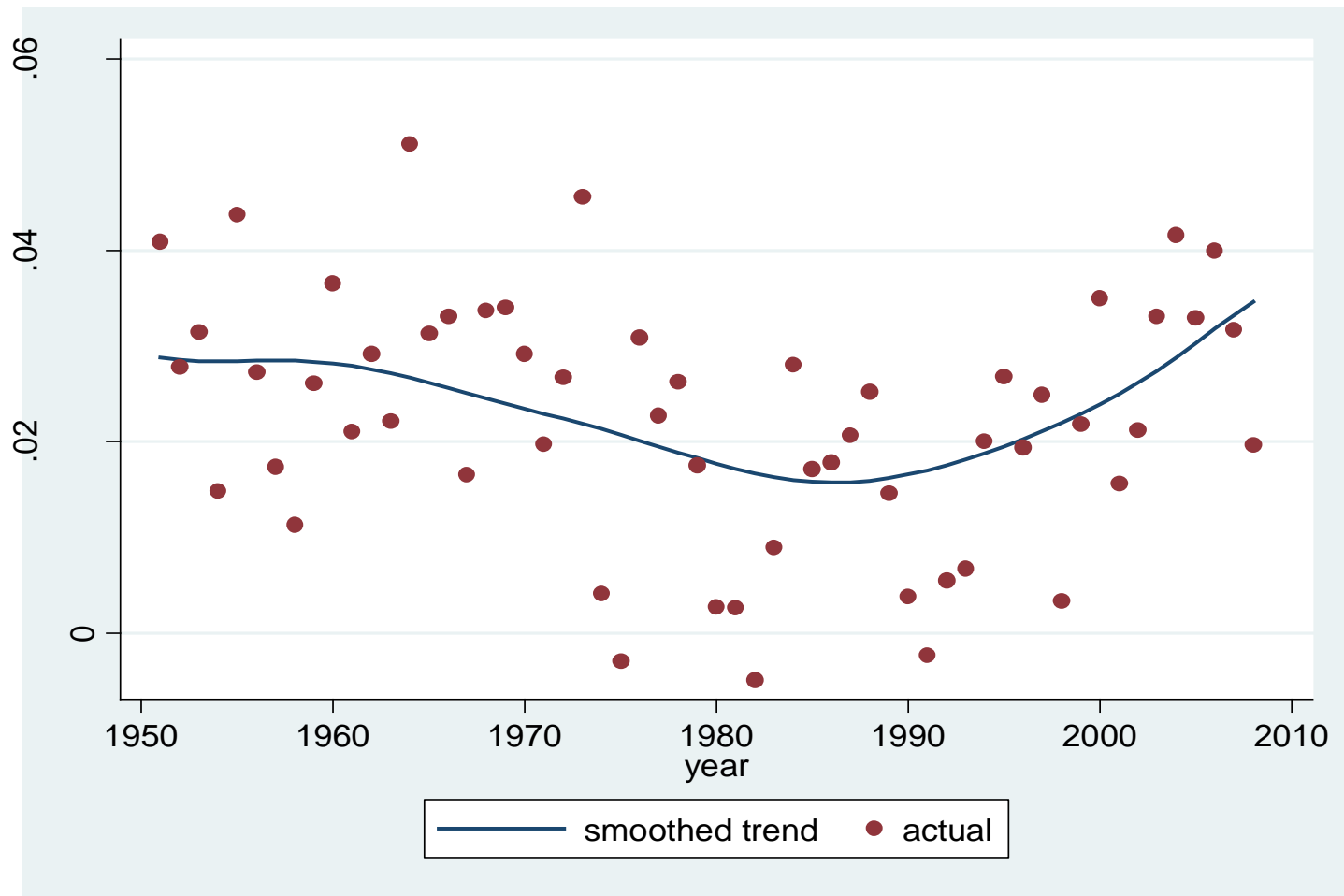# Good growth, bad growth, and manufacturing

Dani Rodrik
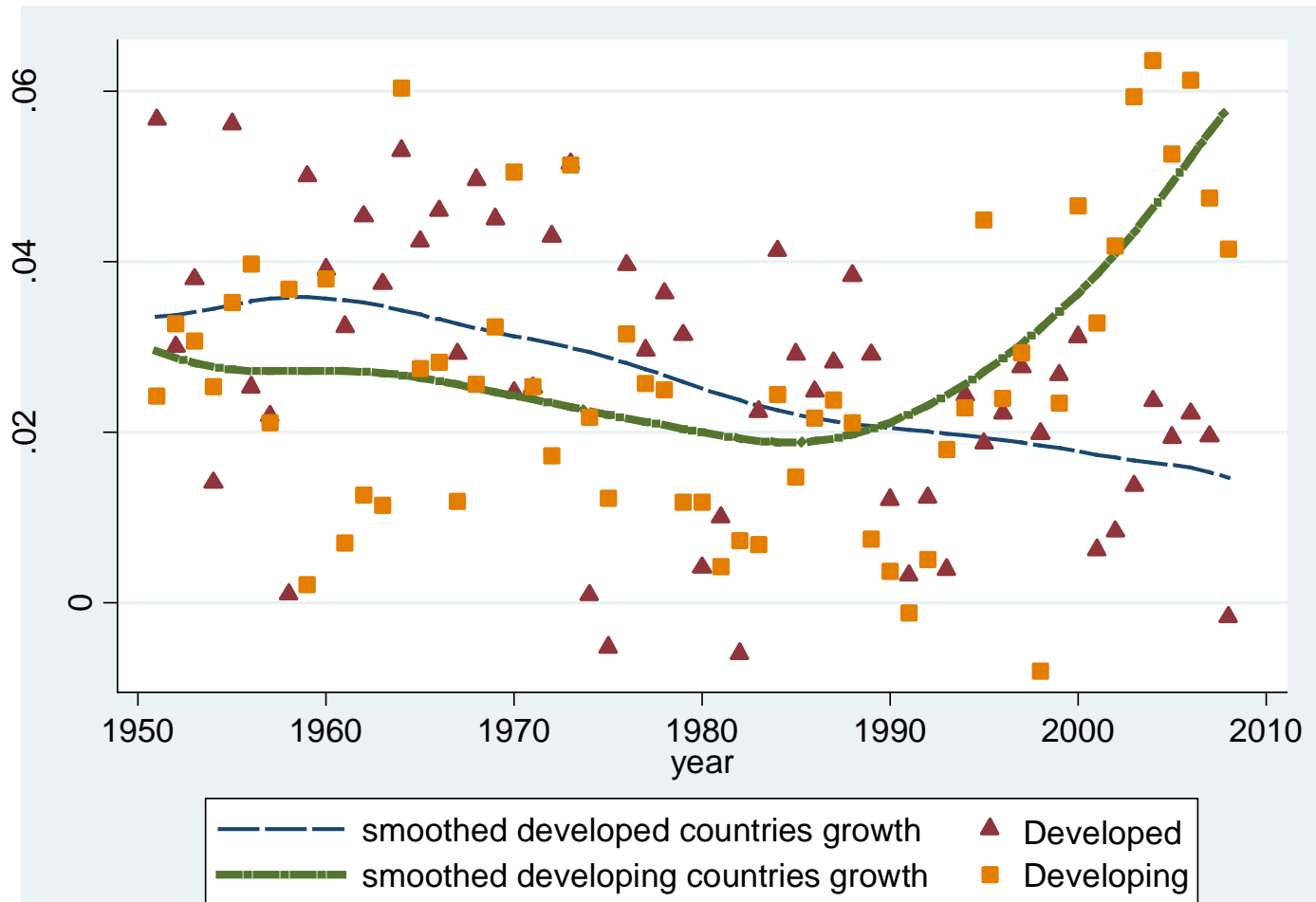
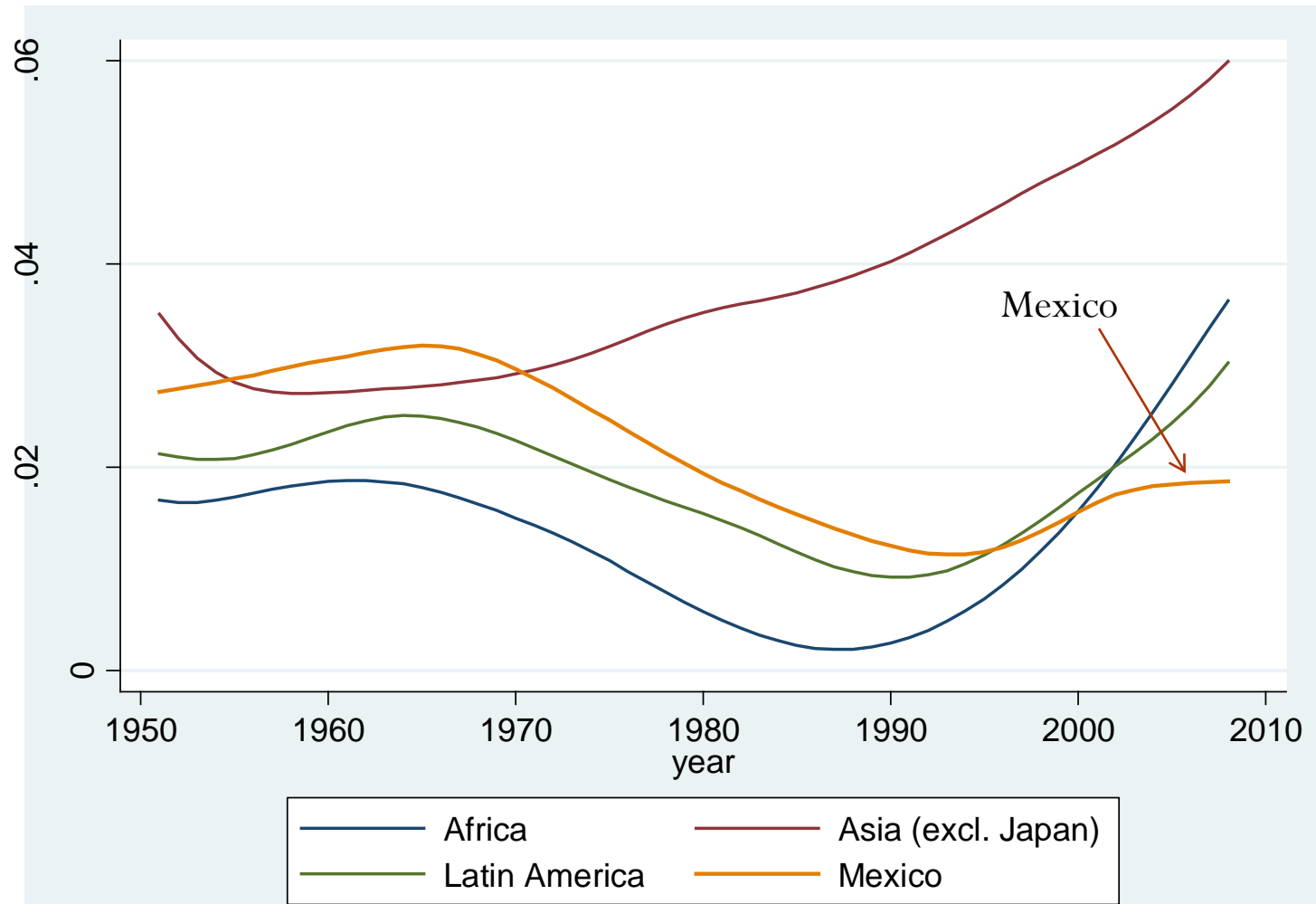September 2011

An extraordinary decade

Growth trends in world economy: GDP per capita growth rates, 1950-2008

...with sharply diverging performance

Growth trends in developed and developing countries, 1950-2008

Growth was widespread, for once

Developing country growth trend by region, 1950-2008 (smoothed)

But there are different kinds of growth, not all equally sustainable...

1. Foreign borrowing-led growth
   - Countries in the periphery of EU, LA in 1970s,
2. Commodity booms
   - 19th century, many LA and African countries in the last decade
3. Structural transformation-led growth
   - Every developing country is a mix of low- and high-productivity activities
   - The challenge is one of structural change: moving labor from the traditional to the modern parts of the economy
     - But the process of structural transformation is not automatic, and is impeded both by market failures and by government failures
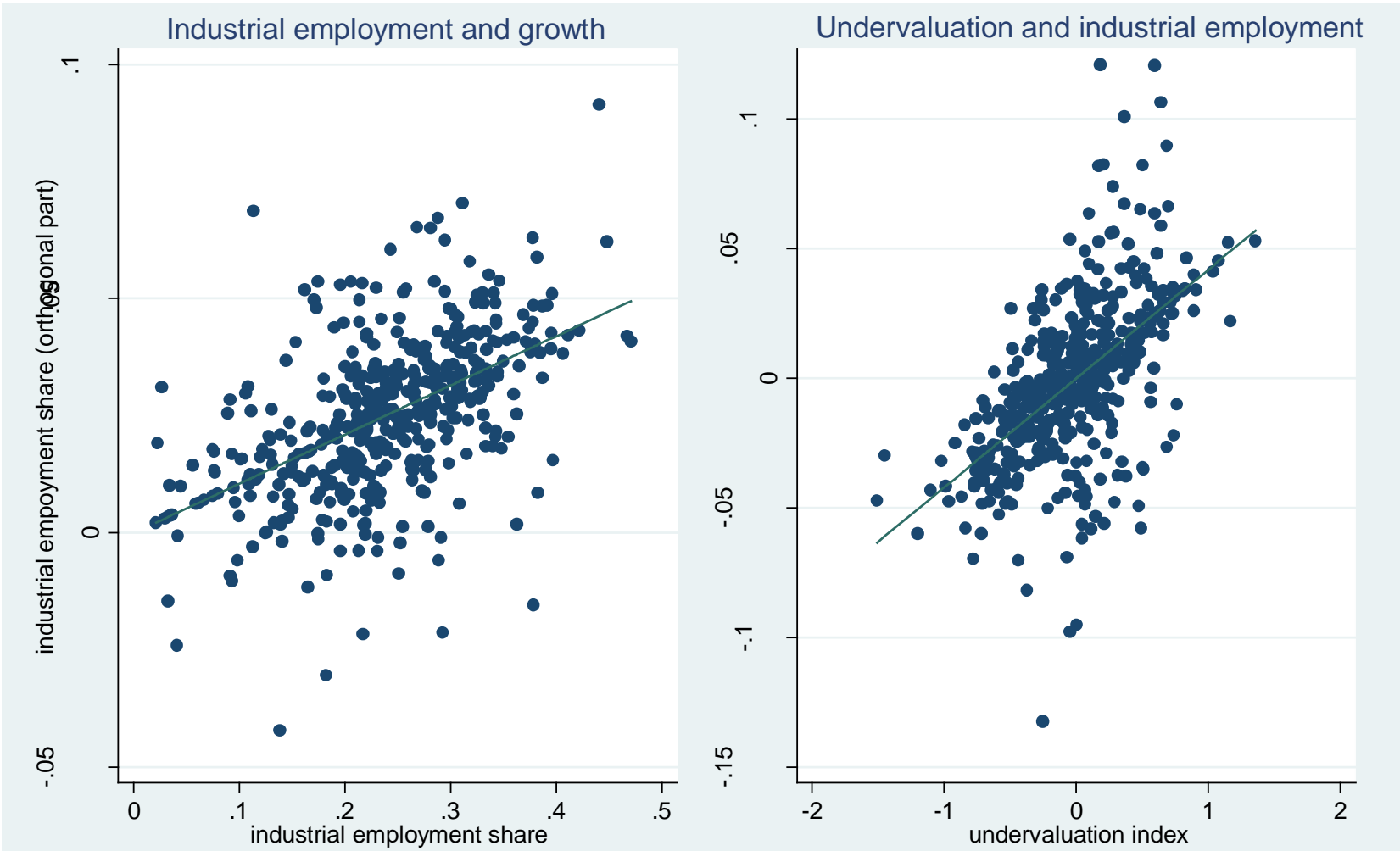
Only the last has been a sustained source of convergence (Japan, S. Korea, China, and other East and Southeast Asian countries)

Countries that rely *less* on external resources grow faster in the longer term
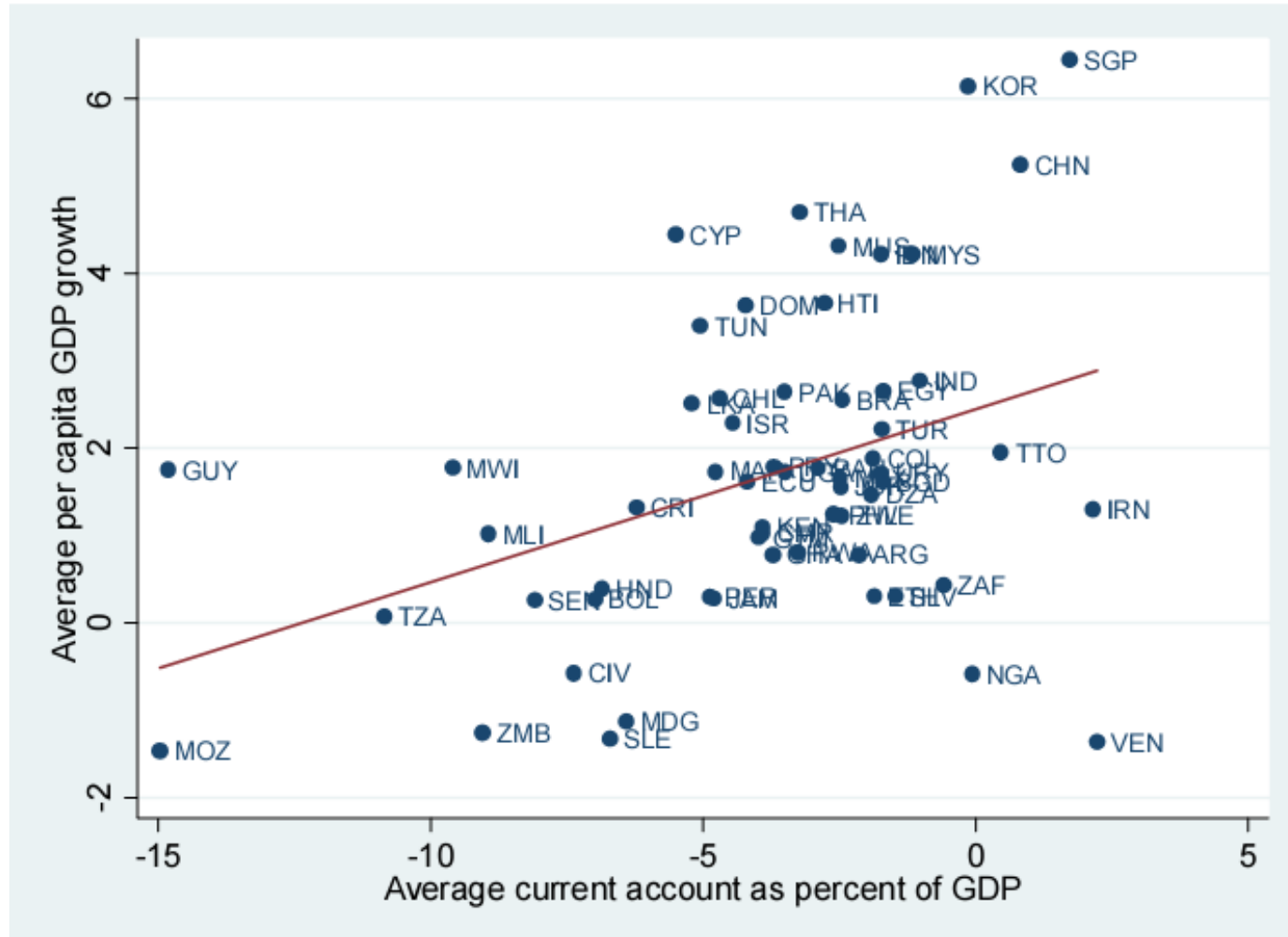
Source: Prasad, Rajan, and Subramanian (2006).

Industrialization is key to growth, which highlights the role of the real exchange rate

Each observation is a country over a 5-year period. Initial income and fixed effects for countries and time periods included.

Big difference between Asia and Latin America is the nature of structural change
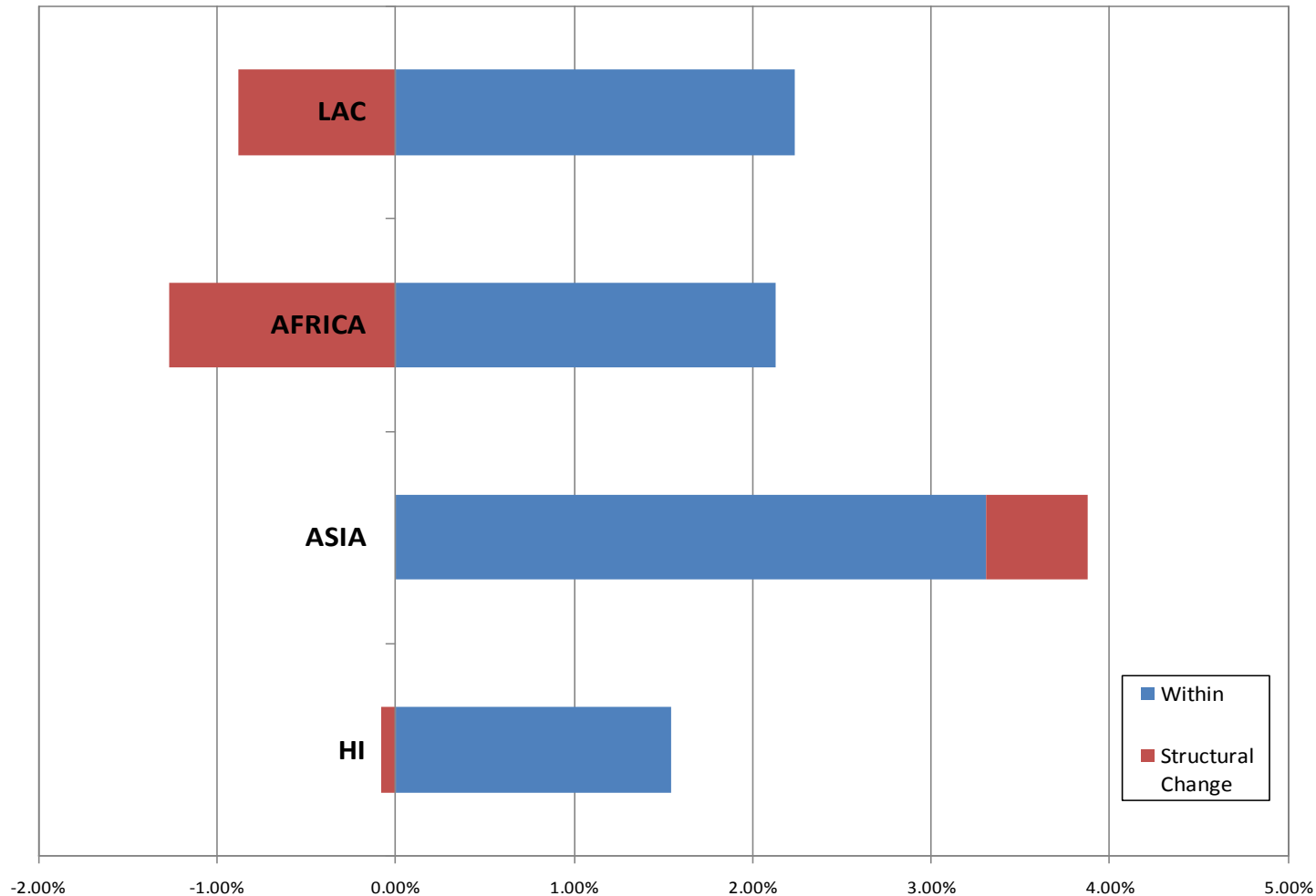
Contribution of structural change (red) and within-sector productivity (blue) to overall growth, 1990-2005

Growth-reducing structural change in Argentina

Correlation Between Sectoral Productivity and
Change in Employment Shares in Argentina (1990-2005)
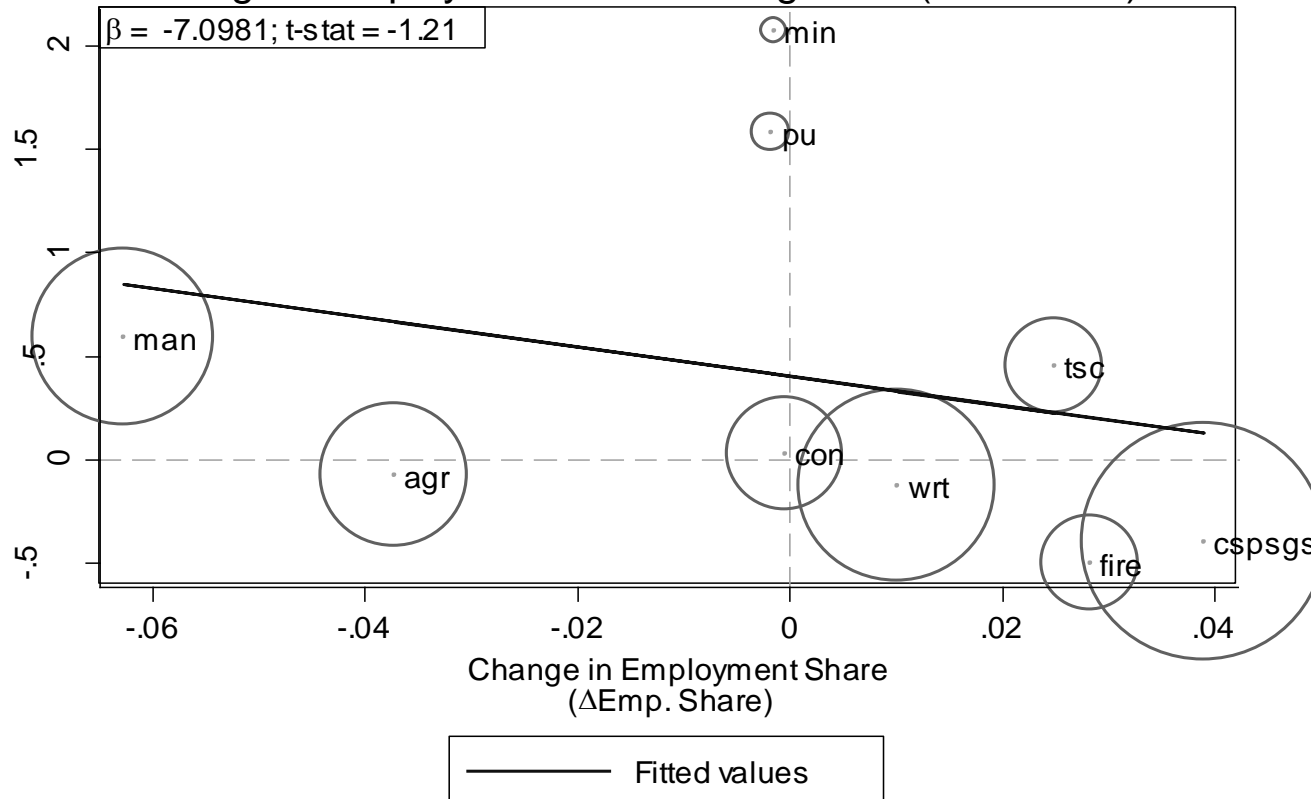
β = -7.0981; t-stat = -1.21

Fitted values

*Note: Size of circle represents employment share in 1990
**Note: β denotes coeff. of independent variable in regression equation:
ln(p/P) = α + βΔEmp. Share
Source: Authors' calculations with data from Timmer and de Vries (2009)

Change in Employment Share
(ΔEmp. Share)

Migration out of low-productivity agriculture Mexico's saving grace

Correlation Between Sectoral Productivity and
Change in Employment Shares in Mexico (1990-2005)

β = 4.9089; t-stat = 0.70
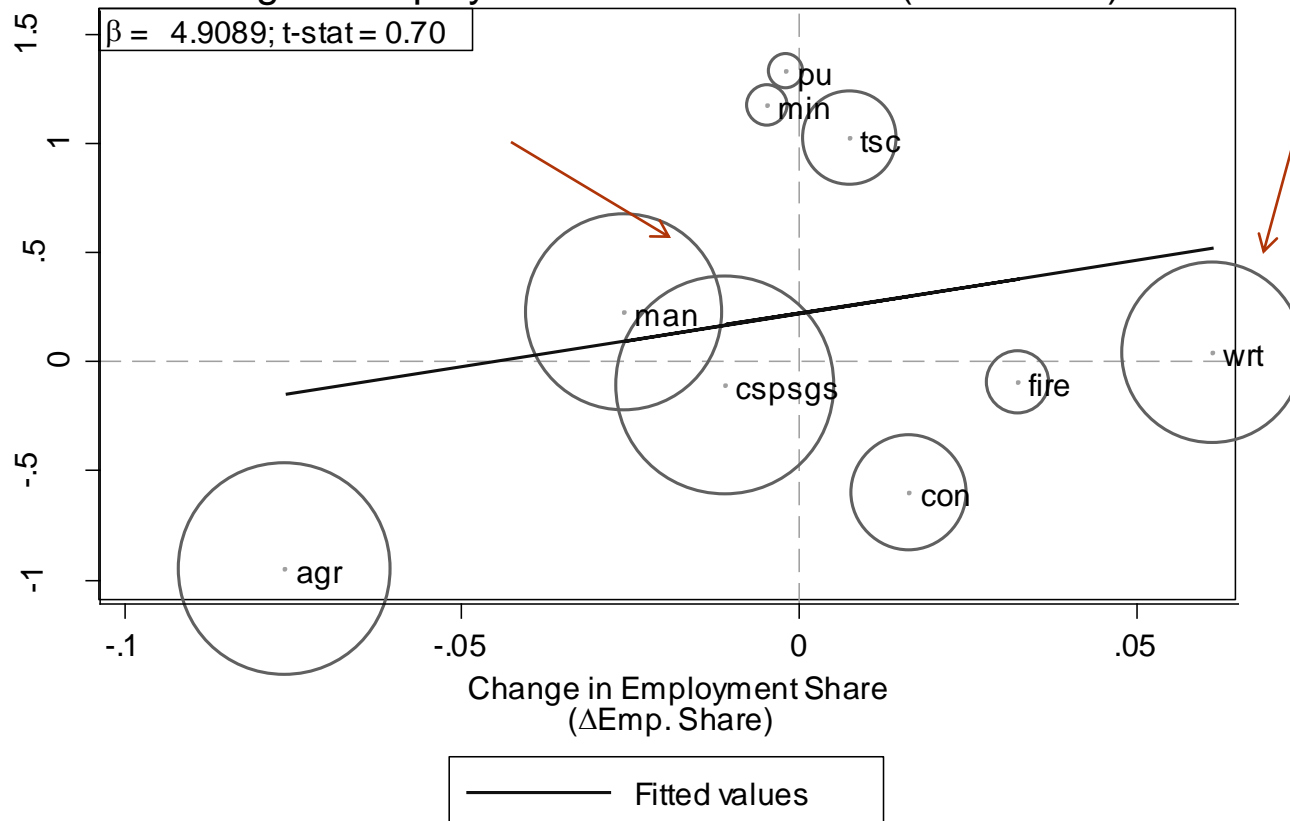
Fitted values

Change in Employment Share
(ΔEmp. Share)

*Note: Size of circle represents employment share in 1990
**Note: β denotes coeff. of independent variable in regression equation:
ln(p/P) = α + βΔEmp. Share
Source: Author's calculations with data from Timmer and de Vries (2009)

CANACERO 1er Congreso Mexicano de la Industria Siderúrgica

What has worked: "productivist" policies

- Sound "fundamentals"
  - Market-friendly policies
  - Macro stability
- But also:
  - Industrial policies in support of new economic activities
  - Undervalued currencies to promote tradables
    - The more a country relies on industrial policies, the less the need for currency undervaluation, and vice versa
  - A certain degree of repression of finance, to enable:
    - Development banking
    - Subsidized credit
    - Undervaluation

The practice of industrial policy must recognize that:

1. The requisite knowledge about the existence and location of the spillovers, market failures, and constraints that block structural change are diffused widely within society

2. Businesses have strong incentives to "game" the government

3. The intended beneficiary of IP is neither bureaucrats nor business, but society at large

Design features for IP institutions (1): Embeddedness

- <u>strategic collaboration and coordination</u> between the private sector and the government with the aim of uncovering where the most significant bottlenecks are
  - deliberation councils, supplier development forums, "search networks," investment advisory councils, sectoral round-tables, private-public venture funds...
- IP as a <u>process of discovery</u> rather than as a list of policy instruments
  - focusing on learning where the binding constraints lie, rather than on whether you should use tax breaks, R&D subsidies, credit incentives, and so on
  - eliciting information on private sector's willingness to invest subject to the removal of obstacles (or provision of incentives)

Design features for IP institutions (2): Carrots and sticks

- Success in IP is determined not by "picking winners" but by "letting losers go"
  - given uncertainty, optimal policy outcomes will necessarily lead to mistakes
  - A certain degree of experimentation is unavoidable
  - trick is not to avoid mistakes altogether, but to ensure that
    - mistakes are recognized as such
    - and entail phasing out of support
  - a much weaker requirement than "omniscience"
  - governments may not be able to pick winners, but they can recognize losers

Design features for IP institutions (3): Accountability

- If bureaucrats monitor businesses, who monitors the bureaucrats?
- Need for mechanisms of transparency and accountability
  - A high-level political principal and "champion" for IP activities
    - someone associated with IP activities and who can be held politically responsible
    - as with education policy or monetary policy
  - Mechanisms of transparency
    - publication of requests from business
    - publication of activities
    - accounting of expenditures
    - processes that are open to new entrants as well as incumbents
    - Periodic accounting of what was done and why (cf. inflation targeting)

Can Latin America return to rapid growth? Pluses

- Growth potential, as measured by "convergence gap" with advanced countries, larger than ever since the early 1970s

- Significant capacity to absorb (and generate) new technologies

- Much greater integration in international trade and production networks

- Better macroeconomic management

- Improved governance and institutions

Can Latin America return to rapid growth? Minuses

- Much greater integration in global finance
  - Sudden stops and financial whiplash
  - Currency overvaluation as soon as optimism sets in
- Much greater conflict between "productivist" and finance-centered policies
  - Should monetary policy target purely inflation or take into account competitiveness and employment too?
  - Should capital inflows be allowed to lead to currency appreciation or result in sterilization and capital controls?
  - Is there a role for industrial policies?