From Manufacturing Led Export Growth to a 21st Century Inclusive Growth Strategy:

Explaining the Demise of a Successful Growth Model and What to Do About It

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I. Export-led growth model behind 20th century growth miracles

- Unprecedented growth in East Asia—closing the gap in income per capita/standards of living with advanced countries
- That model won't be working in the future in the way and to the extent that it did in the past

End of old model

- Victim of own success: productivity exceeds rate of increase in demand (share of manufacturing in GDP declining everywhere as next slide shows)
  - Some vertical disintegration of service components of manufacturing gave appearance of more rapid disappearance of jobs
  - Vertical disintegration can have real consequences (e.g. for wages and flows of knowledge)
- Similar to what happened to agriculture in advanced countries almost a century ago

- Even with emerging markets taking larger share of manufacturing jobs, and with shift of jobs from China to Africa, new manufacturing jobs will only absorb a fraction of new entrants into labor force
  - Can still have impacts disproportionate to size
  - Countries may have a natural comparative advantage in some niches (or in some cases, even be able to create a comparative advantage)
  - But unlikely to have impacts that manufacturing export led growth had in China and East Asia
- Because of robotization, advantages of cheap labor will diminish

Manufacturing Share of GDP (%)

	2000	2015
World	19	15
E. Asia & Pacific	25	23
ECA	19	16
LAC	17	14
North America	16	12
South Asia	15	16
Sub-Saharan Africa	11	11
Tanzania	9.4	5.7
Low-Income	10	8
Lower Middle Income	17	16
Upper Middle Income	24	21
High Income	18	15

Source: WDI

II. New Thinking about development

- What separates developing countries from developed is not just a disparity in resources, but a disparity in knowledge and institutions
  - Development entails a structural transformation
  - There can be growth without structural transformation—especially common in resource dependent countries
    - But such growth won't be sustained
  - Markets on their own don't manage these transformations well
    - Critical impediments imposed by capital market imperfections, important externalities and coordination failures
    - Government needs to assume an important role

New understandings have led to new strategies

New understandings have led to movement from a focus on projects to policies and then to institutions

- Corresponding to the realization of the importance of not just physical capital, but human capital, social capital, and knowledge capital
  - And a change in norms and mindsets
    - Including the mindsets about change is possible—a movement away from traditional society towards modernization
  - In the West, associated with the Enlightenment

New understandings reflected in Stockholm Statement

1. GDP growth is not an end in itself
2. Development has to be inclusive
3. Environmental sustainability is a requirement, not an option
4. The need to balance market, state, and community
5. Providing macroeconomic stability

But this does not just mean balancing budgets or focusing exclusively on inflation

Stockholm Statement

6. Attending to the impact of global technology and inequality
    - Key issue is not developed vs. less developed countries, but appropriate treatment of labor, in both developed and developing countries
    - Requires investment in human capital
    - Creating new instruments of redistributions within and between countries
7. Social norms and mindsets matter
    - Bringing the insights of modern behavioral economics to bear in development economics
    - Effective ways of altering behavior (savings, fertility, etc.)

Stockholm Statement

8. Global policies and the responsibility of the international community
   - Recognizing the interdependence of countries
     - That the policies of the large rich countries have large externalities on the rest of the world, which they often don't take into account (including their monetary, regulatory, trade, and migration policies)
     - But tax havens affect all countries
   - International agreements cover only part of these arenas
     - Climate change agreements do not go far enough
     - Do not cover cost of adaptation by poor countries
   - Developed countries have not lived up to their commitments of .7% of GDP in aid

Marked change from the Washington Consensus

- With its narrow conception of the goals and instruments of development and participants in the development process

Broader goals to reflect challenges of the 21st century

- Inclusive growth
  - Trickle down economics doesn't work
  - Greater inclusivity can lead to more robust growth
    - There are policies that can simultaneously increase equality and growth
  - Employment generation is central to inclusive growth (especially where labor force is to grow rapidly as in Tanzania)
  - Seeing equality and growth as complements rather than substitutes is major change in development thinking
- Climate change and other environmental goals

- Good macro-economics is more than price stability

More instruments

- More instruments for monetary policy (now embraced even by advanced countries, e.g. in QE and macro-prudential regulation)
- More instruments for macro-stability (now embraced in new Institutional View of IMF, on capital controls)
- More instruments for developmental transformation—notably industrial policies, including for agriculture and services (so more appropriately labeled as learning, industrial and technology (LIT) policies)
- More instruments for maintaining full employment—active labor market policies

Clearer distinctions between means and goals

- Privatization, markets are not ends in themselves—they are only (possibly) *means* to the broader goals described earlier
- Other variables too need to be looked at through this lens
  - Inflation, budget deficits, current account deficits
- But not attending to some of these variables in a timely way may make it difficult to achieve our goals

Greater participation: a balance between markets, government, and society

- Not just markets, but government and civil society
  - Understanding limitations of markets
  - Systems of checks and balances critical
  - Media and civil society can play a pivotal role
- All successful development has entailed government playing an important role—**the development state**
- It has a multiplicity of roles
  - Providing enabling conditions for market to work
    - Including good physical and institutional infrastructure, an educated labor force
  - Regulating markets—preventing negative externalities (including exploitation and excessive volatility)
  - Promoting development more directly—learning, industrial and technology policies
  - Understanding the "big picture"—including the problems posed by excessively rapid population growth which requires attention to accelerating the demographic transition

III. Deconstructing success of export led manufacturing model

Open economy allowed one to avoid complexity of material balance equations—all one had to have was enough foreign exchange

- Export led growth generated necessary foreign exchange

- Didn't need to generate demand to absorb new supply
  - No need to worry about demand constraints
  - Flexible and correctly managed exchange rate, open economy, and "attentive" producers suffice to absorb supply

Deconstructing success

- Exports provided basis for **learning**
  - What separates developed and less developed countries is a gap in knowledge
    - Transfer of technology could be accomplished in numerous ways (buying technology, FDI)
  - Important spillovers to other industries
    - Institutional spillovers (e.g. education) even to other sectors
    - Demand for educated individuals—of benefit elsewhere in the economy
- Exports provided basis for **tax revenues**
  - Finance needed for government expenditures—infrastructure, education, technology
  - Hard to tax informal sector

Deconstructing success

- Generated **employment** in urban sector—key in supporting structural transformation and widely shared growth
  - Generated jobs for new entrants into the labor force and raised real wages

- Export-led manufacturing naturally combined structural transformation and urbanization, movement to a learning economy, openness that meant one could simply focus on foreign exchange constraint (ensuring that one had the foreign exchange one needed), and job creation for new entrants into the labor force to maintain reasonably high employment

Mechanisms for promoting exports

- Access to credit at near commercial rates—provided incentives for entrepreneurs
- Limited direct support
- Variety of industrial policy instruments

- **Natural system of accountability**
  - Successful firms proved profitable

IV. Similar outcomes will require a multifaceted growth strategy with different facets reflecting different aspects of manufacturing export-led growth

- Manufacturing
- Agricultural
- Resources
- Services

Africa suffered from pre-mature deindustrialization, neglect of agriculture and services, with natural resources not being used to promote development to the extent they should

- Government has to take an active role if there is to be successful structural transformation
    - Shadow prices for learning, learning spillovers, jobs, and foreign exchange may also entail deviations from market-only solutions

Premature deindustrialization as a result of structural adjustment programs

Deindustrialization in Sub-Saharan Africa

Value added by sectors (% of GDP)

	1981	1990	2000	2010	2016
Agriculture	23.7	23.4	19.6	17.8	17.9
Industry	35.4	33.7	36.5	27.4	23.7
Manufacturing	15.0	13.5	11.3	10.3	10.5
Services	42.1	41.8	43.9	54.8	58.3

Source: World Bank Development Indicator

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Manufacturing

- Limited ability to generate jobs—especially with advances in technology
- Limited ability to generate tax revenues with tax competition
  - Need international agreements to limit
- Appropriately designed policies can still play an important role
  - Industrial policies (to be described below)
  - But WTO circumscribes use of subsidies
- Needs to be more directed, where possible, taking advantage of natural advantage (mineral resources)

Agriculture

- Most important basis of employment
- Can be restructured in ways that are more dynamic, with more learning, learning to learn, a kind of transformation *in situ*
  - Modern agriculture can be very "advanced"
  - Focus on non-labor saving innovations—better crop mix, better fertilizers
  - Given the extremely low productivity of agriculture in SSA, there is enormous scope for modernizing agriculture
  - The transformation of farming from *traditional practices* to modern farming can be an exemplar of general societal transformation entailing modernization
- Can reduce need for foreign exchange for imported food; in some cases, large scope for agricultural exports
- Can reduce migration pressures

Role of agricultural in structural transformation

The African Center for Economic Transformation, in its second major report released in October, 2017 argued:

- *"Agriculture presents the easiest path to industrialization and economic transformation. Increasing productivity and output in a modern agricultural sector would, beyond improving food security and the balance of payments (through reduced food imports and increased exports) Sustain agro-processing, the manufacturing of agricultural inputs, and a host of services upstream and downstream from farms, creating employment and boosting incomes across the economy."*

Promoting agriculture

- Role of government provided extension services
- Importance of care in the design of IPR regime
- Role of government in certifying/providing quality seeds, fertilizer
- Role of government/NGO's in providing credit—preventing exploitation
- Role of government in providing marketing services

Natural resources

- Standard lessons of resource curse have not yet been learned by most countries
  - Need to maximize revenues from natural resources from well designed auctions and contracts
    - It may be necessary to auction off different parts of the production process, rather than to have a bid for a "manager"
  - Contracts need to be complemented by excess profit taxes
    - Countries need to be careful not to sign investment agreements that circumscribe ability to change taxes and regulations
    - Those that have signed such agreements should exit or renegotiate (e.g. South Africa)
    - Even with these agreements, it may be preferable to change contracts (e.g. Israel)
  - Sovereign wealth fund—both to manage cyclical variability and to prevent exchange rate appreciation
  - Manage exchange rate for competitiveness in other sectors

Natural resources

- The development of a country's resources should be, to the extent possible, part of the development strategy
  - More than just source of foreign exchange
  - Industrial policies can exploit a variety of forward, backward, and horizontal links
    - Possible losses in SR in return for long run learning
    - But careful appraisal of trade-offs required
    - Absence of current spillovers is not necessarily evidence that there aren't potentially long run profitable linkages.

Service sector

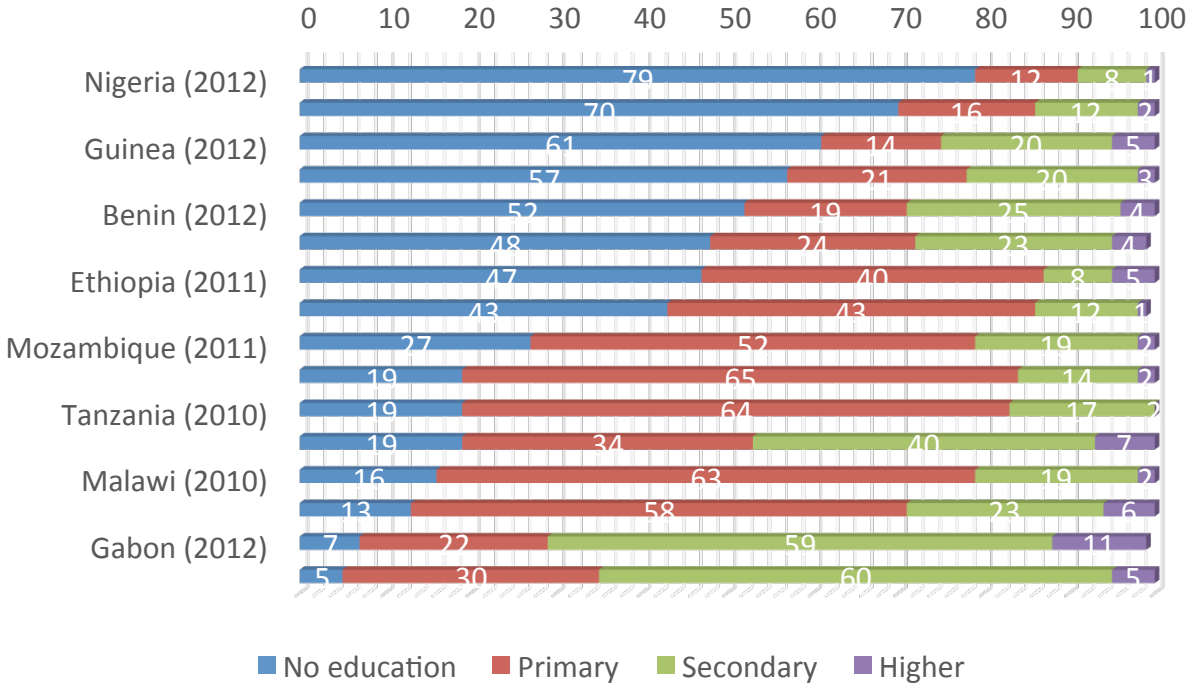
Move to service sector may have many implications

- Smaller production units
  - Part of explanation of seemingly **lower productivity growth**
    - Lower ability/incentives to engage in research
    - Some of observed lower productivity growth may be measurement problem
  - But not inevitable
    - More need for cooperative R & D, government R & D
  - Larger productivity differences across firms
    - Increased need for government to push "creating a learning society" to reduce productivity differences
- Many services can be more easily inserted into the global economy through internet
  - Especially if there can be quality certification, either through peer monitoring or certification services
  - Increasing need for skills training, including languages

Many different service sectors

- Housing services
  - Process of urbanization will require large investments
  - With large job creation potential
  - Government will need to take a more active role
    - Including in planning “livable cities”—important part of well-being
    - Extensive market failures in zoning, mortgage finance
- Government plays an important role in many key service sectors (though less than in some other regions)
  - Education
  - Health
  - Will need to expand that role
  - Especially important as both part of development strategies and end objectives
  - Low education levels also presents an increasing challenge to modernization, as the importance of learning grows

Distribution of active population according to education level



Note: Only countries with data after 2009 are included. Number are in percent.

Source: Demographic and Health Survey, reproduced from Chevallier and Le Goff 2014.

V. Industrial/LIT Policy

- Industrial policies were central to almost all countries that "caught-up" with the technological frontier and became developed
- Have played an important role even in advanced countries
  - *Entrepreneurial State*
  - SME lending
- All countries have industrial policies (whether they know it or not)
  - Decisions about infrastructure, education, research affect the direction of the economy
  - US had an industrial policy
    - Mostly in defense department
    - Hidden subsidies in tax structure
    - Even bankruptcy law was an implicit industrial policy: favored the financial sector (credits) vs borrowers; especially favorable treatment of derivatives and education loans

Industrial/LIT Policy

- Industrial policy: actions that aim to alter the allocation of resources (or the choice of technology) from what the market would bring about.
  - **Not confined to industry** but also to policies aimed at other sectors e.g. finance or IT and agriculture.
  - More accurate to call it **Learning, Industrial and Technology (LIT)** policy
- LIT policies take many different forms
  - African examples of LIT for IT provided by Rwanda and for agriculture by Ethiopia (earlier Kenyan tea).
  - Green revolution in South Asia
    - facilitated by policies of price support setting a floor on output prices as well as input subsidies, including notably for electricity, that enhanced the profitability of tube-well irrigation
  - The most famous examples are East Asian "**developmental states**"

LIT Policies

- LIT policies target the dynamic capacities of the economy.
  - Societal transformation depend on ***learning***, in all its forms—including *closing the knowledge gap that separates developing and developed countries, learning to learn,* and *closing the large gaps in knowledge within a country*
  - ***Creating a learning society*** is more than just a matter of education; it entails trade and investment policies, labor policies, competition policies, etc.
  - Targets sectors with more learning capabilities and learning spillovers
  - Possible conflict between policies that enhance static efficiency and those that contribute to learning
  - Striking the right balance is at the core of success
  - Neoliberal WC policies paid no attention to learning, seemingly unaware of the potential conflict, and thus failed to strike the right balance
    - Allocating a given amount of resources in a way that is consistent with *static* efficiency, as desirable as it may seem, may actually impede development and growth

Rethinking industrial policy

- General principles of industrial policies still apply in our multi-pronged strategies (including for agriculture)
  - Need to identify “learning” and “learning spillover” service sectors and agricultural activities
  - These can have much of the benefits of the learning provided by manufacturing
  - Industrial policies need to exploit linkages with natural resource —one of the country’s key comparative advantages

VI. Reassessing Comparative Advantage

Old theory based on static comparative advantage; new strategies must be based more on dynamic comparative advantage

- Where would Korea be if it had focused on static comparative advantage?
- Capital highly mobile
- Many aspects of technical knowledge (especially when embedded in machines) relatively mobile
- Skilled labor relatively mobile

Real source of comparative advantage

- Skills, health and discipline of work force
- Embedded Knowledge
- Institutions and norms
  - Institutional infrastructure
- Physical infrastructure
- Reputation ("branding")

All of these affect

- Ability to attract and retain talent
  - Young people care about the environment, about "meaning" in their work, and cooperation and challenge (including intellectual challenge) in the work place
- Ability to attract and retain capital

Hard—but essential—to change these in constructive way

Enhancing these should be central to development strategy

VII. How can developed countries help

Multiple instruments

- Fairer, pro-development global trade regime
- Pro-development IPR regime
- Pro-development investment agreements
- Pro-development/more stable financial markets/regulations
- Stymieing flow of corrupt money—shutting down secrecy havens
- Fairer multi-national tax regime

Global reserve system, to replace current dollar based system

With annual emissions awarded to developing countries

- Substantial amounts of transfers of purchasing power
- Would simultaneously increase global aggregate demand and global stability (addressing Triffin Paradox)
- More equitable than the current regime, where poor countries lend money to rich at low interest rates, and borrow back funds at much higher interest rates

VII. Concluding remarks: Reformulating development thinking

- Success in development over past 60 years was greater than anyone anticipated—contrast Myrdal's predictions for Asia with what happened
- There is an enormous gap in knowledge, as well as in resources, that has to be closed
- Most of the advanced countries are engaged in service sector—80% or more
  - So if there are disparities in standards of living, it relates to productivity in these service sectors
  - There are huge disparities in productivities within countries, even greater between countries

Reformulating development thinking

- The basis of the success of growth over past half century was export-led growth
  - We have deconstructed what enabled manufacturing to provide this growth spurt, this structural transformation
  - It won't be able to do so in the future to anything like that extent
  - There has to be another strategy—that performs some of the essential roles that manufacturing export-led development did

Reformulating development thinking

- Successful development policy will need to be explicitly more multi-pronged, addressing separate “challenges” that manufacturing sector addressed simultaneously
- We have shown how a coordinated {Agriculture, Manufacturing, Mining, Service Sector} strategy has the prospect of attaining the same success of the old manufacturing export-led strategy
- Government will need to play an important role in the new structural transformation towards a modern

Comprehensive Development Strategy

- In short, what is needed is a comprehensive development strategy
  - Leading to inclusive growth
  - With inclusive participation
    - Including a balance between markets, government, and society
- Based on these new understandings of what leads to successful economic and societal transformation
  - And creating new dynamic comparative advantages