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STATES, MARKETS AND INDUSTRIAL DEVELOPMENT IN THE 21ST CENTURY

What options for developing countries?

Brendan Vickers

October 2007

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[F]orcing poor countries to liberalise through trade agreements is the wrong approach to achieving growth and poverty reduction in Africa, and elsewhere.

Commission for Africa Report (2005:285)

If liberalization was an unambiguously beneficial tool for economic development, would not countries be rushing ahead to liberalize, rather than fighting to maintain some independent trade policy?

Aileen Kwa (2007:6)

The declining policy autonomy of states as they cede control to markets may only be a temporary phase, until new forms of intervention are demanded and discovered.

Helen Milner and Robert Keohane (1996:249)

Introduction

Sustained industrial development and diversification have been key catalysts for economic growth and poverty reduction over the past half century, especially in East and South East Asia. This has heralded major structural changes to the world economy and its trading patterns, with developing countries now exporting a greater share of manufactured goods, including high- and medium-technology products. East Asia has historically led this pack of developing nations, followed by Latin America and the Caribbean. Between 1967 and 1993, the proportion of industrial exports rose from 3.7 per cent to 50.5 per cent of total exports in Indonesia, from 12.6 per cent to 65.5 per cent in Thailand, from 21 per cent to 78 per cent in Singapore, from 24.9 per cent to 68.4 per cent in Malaysia, from 67.3 per cent to 93.7 per cent in South Korea, and from 93.4 per cent to 96.8 per cent in Japan (ECA 2004: 58). By contrast, sub-Saharan Africa has experienced industrial decline,¹ as measured by manufacturing value-added (MVA) per capita. Even South Africa's share of the world manufacturing market has shrunk, as has its ratio of global and sub-Saharan African MVA.

Despite recent policy reforms, sub-Saharan Africa has yet to benefit from the significant growth of world trade² and foreign direct investment (FDI) over the past few decades. Africa's share of global exports dropped sharply from 4.1 per cent to 1.6 per cent between 1980 and 2000, and its share of imports fell from 3.2 per cent to 1.3 per cent over the same period. Even in raw materials, its share of world trade dropped from 8 per cent in 1980 to 4.4 per cent in 2000 (ECA 2004: 55), although the recent cyclical commodities upswing (driven largely by Chinese and Indian demand) has significantly improved growth prospects. By contrast, the continent continues to produce a paltry 1 per cent of the world's manufactured exports.

The historical challenge for sub-Saharan African countries is therefore diversification of their production structures, not static specialisation (see Box 1). This requires that African countries harmonise their trade policies (and reforms) with

their broader national development strategies. As the Economic Commission for Africa (ECA) argues: 'A lesson that Africa can draw from the Asian experience is that trade strategy can seek to apply a well-sequenced and optimal combination of openness and control within the context of overall development strategies, while avoiding the kinds of protectionist policies of the 1960s and 1970s that seriously constrained competitiveness' (ECA 2004: 55).

BOX 1: OPPORTUNITIES AND OPTIONS FOR GROWTH STRATEGIES IN AFRICA

Manufactured export-led growth: Some African economies can realistically hope to follow the main Asian model based on manufactured exports. This strategy has the advantages of generating broad-based benefits since it creates many jobs, and enables very rapid growth. Mauritius has already transformed itself from an impoverished sugar island to a middle-income, diversified modern economy through this strategy (see Box 3). Countries such as Ghana, Kenya, and Madagascar could also follow. The basic conditions for success include a good coastal location, a supportive investment climate, and reduction in the trade transaction costs in order to enhance competitiveness.

Natural resource-based equitable growth: Some African countries are sufficiently abundant in valuable natural resources, so their most likely route to prosperity is through the equitable exploitation of their resource base. Botswana has transformed itself from an impoverished desert country to middle-income status through this route. Resource-rich coastal countries (eg Nigeria, Democratic Republic of Congo, Republic of Congo, and Cameroon) could also use these rents judiciously to support diversification of their export bases, thereby reducing their dependence on volatile resource rents.

Natural resource-based export diversification: Some African countries may be able to follow the emerging Latin American model of modern agriculture. One possibility is to diversify within the primary sector itself (eg agribusiness in Chile, Costa Rica or Colombia) or move towards natural resource-based, export-oriented industrialisation (eg Indonesia or Malaysia). The latter case would entail value-addition through processing, or using rents and revenues from natural resources to finance export-oriented industrialisation. Landlocked countries pursuing this route could focus on high-value, low-weight products, since they can more effectively absorb the high trade transaction costs associated with their location disadvantages.

Labour export and high-value service sector: Some African countries may well be so disadvantaged that prosperity for their populations will depend upon employment opportunities in more fortunate neighbouring economies or, like India, by pursuing the high-value service sector (ie the office economy). Landlocked countries in the Sahel and Southern African countries have a long tradition of inter-country migration (eg Swaziland and Lesotho vis-à-vis South Africa, or Burkina Faso vis-à-vis Côte d'Ivoire) and it is likely to be a feature of a prosperous future. Investment in human capital would also be supportive of building such high-value service sectors.

Source: Ndulu et al (2007: 141-142)

This report reviews industrial policy theory in order to better situate recent industrial restructuring impulses within contemporary debates and emerging intellectual streams. The first section traces the competing normative claims of states and markets on industrial policy, and locates the continued importance of manufacturing (broadly defined), including assembling, value-addition and processing, as the modern engine of growth and development within these debates. It then contrasts the principal assumptions of the two conventional schools of thought – ie the neoclassical and interventionist approaches – before turning to more recent treatments of this debate. The latter includes the roles of the United Nations Conference on Trade and Development (UNCTAD) and other prestige UN panels that are today at the forefront of a shifting global policy mood in favour of more policy space for developing countries. It concludes by constructing two heuristic state models, the neoliberal competition state and the interventionist developmental state, that may assist a better understanding of future industrial trajectories.

1. Conceptualising and contesting industrial policy

1.1 Industrial policy and the state-market conundrum

Although the concept of ‘industrial policy’ may be relatively new to the literature (see Chang 1994), its broad practices and principles are centuries old, dating back as far as Renaissance Italy. Historically, it is then not uncommon that:

Governments start industries (such as the English woolen textile industry, the Japanese auto industry); they assist industries on their way up (semiconductors), on their way to a more favorable location (autos), and on their way down (steel). Governments engineer the reconstruction of industries (textiles) (O’Hara 2005: 503).

In broad terms, industrial policy – or public support measures – refers to the role of the state in the domestic accumulation regime, specifically in shaping the organisation of production, its involvement in the investment function, and the allocation of resources among or within industrial sectors. This implies interventionist impulses on at least three fronts: to address market dominance through competition policy; to *proactively* direct and steer industrial development in a new structural direction (through investment, privatisation, trade facilitation, public-private partnerships, labour markets, etc); and to *reactively* respond to problems of global structural economic change (Mottershead 1994).

1.1.1 The industrial policy debate: a hung jury?

It is hardly surprising then that the conceptual contours and practical deployment of an industrial policy conventionally conjures up trenchant debates about the relative importance and normative desirability of either the regulatory state or the unfettered market. In these debates, it is usually an orthodox faith in the ‘rationality’ of economics that triumphs over the ‘irrationality’ of politics. Put otherwise, classical economic orthodoxy jettisons any proactive role for the state in shaping economic development and diversification.

But classical economic theory is often devoid of any power or gendered³ analysis (hence its premium on perfect markets, information, technology transfer, etc). While government intervention is viewed negatively, corporate influence on the market is seen as ‘neutral’, even positive. Such biases have meant that global trade rules, the political conditionalities attached by the international financial institutions, and bilateral trade agreements tend to restrain government action (the main economic actors in low-income developing countries), but not corporate action (the driving forces of developed country economies) (Kwa 2007: 15).

This sparring between state and market perspectives has been pronounced around the competing interpretations of the rapid rise of the East Asian newly industrialised countries (NICs) during the 1960s-70s, with a second tier of near-NICs poised to repeat their success. The latter include Indonesia, Malaysia, Thailand, and the Philippines (O’Brien and Williams 2004). Over the past 25 years, economists have found a fertile ground for research in the East Asian economies. The annual output of articles in scholarly journals about these economies grew much faster than all articles in economics. There were approximately 4 200 scholarly articles written about the East Asian economies that were indexed by the *Journal of Economic Literature* from 1986 to 2001 (Davis & Gonzalez 2002). But this also extends to Western Europe: a debate rages between those who characterise the Irish state in the post-Celtic Tiger era as either a ‘developmental state’ or a ‘competition state’, and those who argue that it is difficult to characterise it as either, since it contains elements of both (Kirby 2007). In South Africa there is also a debate on whether the country can truly evolve into a democratic developmental state, or rather epitomises a ‘class-compromise non-developmental state’ (Leftwich 2002). These entrenched and often misrepresented state-market ideological positions do not, however, help the cause of development in many poorer nations: ‘In short,’ suggests Kriekhaus (2004: 47), ‘neoliberals and statistes have arrived at a “tie” in the industrial policy debate, where both sides can point to the plausibility of their claims but cannot determine which claim is *most* plausible.’

For this reason, more recent theoretical currents rather emphasise the need to institutionally strengthen the *process* of industrial policy co-ordination, governance, and vision, rather than focusing on its panoply of possible *outcomes* (which does not, however, renege the case for policy space and regulatory flexibilities). From this perspective, writes the Harvard economist Dani Rodrik, industrial policy is better understood as a

strategic partnership between the state and the private sector to identify and address the key obstacles to economic restructuring. It is only from this strategic collaboration that the state and entrepreneurs may be able to craft the appropriate macro- and microinterventions to unlock full domestic economic potential (Rodrik 2004).

While strategic collaboration between the state and capital is necessary, it does not, however, constitute a sufficient basis for crafting an optimal restructuring policy. Rather, the role of labour and labour market regulation, bargaining, wage and price controls ought to be factored in too, since this is a key element of whichever policy approach or mix determines the industrial strategy.

The corporatist model of the European welfare state is often referred to as an exemplary example of the requisite social contract and institutional fabric for consensual restructuring. But labour – the most powerful social force of the previous two centuries (see Cox 1987) – has been considerably weakened worldwide by the circuits of economic globalisation (ie downsizing, rightsizing, flexibilisation, post-Fordist-type assembly, and decentralised divisions of labour, etc) and is generally on the defensive. The problem and challenge is therefore how to theorise the nature of capitalist states in an era of globalisation, where there is now even greater imperative to provide *social policies* for social protection, welfare and security and *labour policies* that are flexible, yet accommodating of labour rights. Given the variety of vested interests at play, this process will invariably become the site of competing value claims, such as international competitiveness, employment, and socioeconomic equity and distribution.

1.1.2 Industrialisation, institutions and history

Industrialisation ultimately requires a complex medley of state and market forces to transform an economy from *concentrated* assets based on primary products, to a *diverse* set of assets based on knowledge. Kumar and Gallagher (2007) argue that this historical process involves investing in human, physical, and natural capital in manufacturing and services, and divesting in rent-seeking, commerce, and unsustainable agriculture. If countries simply follow the Ricardian injunction to specialise in their static comparative advantage, they risk being locked into the prevailing global division of labour:

Evidence strongly suggests that rich natural resources, even when combined with a well-developed human resource base, do not automatically lead to processing and diversification. Without active policies designed to promote and support such activities, being rich in natural resources can be detrimental to diversification away from unprocessed commodities (Akyüz 2005: 17).

For instance, it would be foolhardy to expect Mozambique to simply rely – or bet the livelihoods of future generations – on its natural comparative advantage: the sale of raw cashew nuts (see Box 2). Manufacturing (including value-addition and

BOX 2: ASSESSING ECONOMIC OPENNESS: THE MOZAMBIKAN CASHEW NUT SECTOR

Mozambique liberalised its cashew sector and banned restrictions on exports of raw cashews in the early 1990s. In 1980, Mozambique had 14 processing factories and was the first African country to process cashews on a large scale. The ban on exporting raw cashews was lifted in 1991/92, and replaced with an export quota and export tax. The quota was subsequently removed, and the export tax on raw nuts came down from 60 per cent in 1991/92 to 14 per cent in 1998/99. Following these measures, farm-gate prices rose, raw cashew exports increased, and resources were pulled out of cashew processing. However, even under the most favourable assumptions, the magnitude of the benefits generated by these effects was quite small – both in economic terms and in relation to the amount of time and energy that Mozambique's government spent on this issue over the years. The standard gains from the liberalisation have to be set against the efficiency losses that have resulted from the idling of processing plants.

In theory, the workers employed in these plants should have found alternative sources of employment after a reasonable time, perhaps suffering some wage losses in the process. In reality, a large number seem to have remained unemployed. One account claims that 90 per cent of the sector's 11 000 workers were unemployed in 2001. Even if one takes a fraction of this number, the loss in real output is roughly equivalent to the direct efficiency gains generated by the liberalisation. Disappointing outcomes were also partly due to complications arising from imperfect market structures in the cashew sector. This means that increases in export prices are not passed on one-for-one to farmers. In other words, traders rather than the poor captured much of the benefits of the liberalisation. Externally, the world market for raw cashews is significantly less competitive than that for processed cashews. In effect, India is the dominant buyer of raw cashews from Mozambique. Mozambique's transformation from an exporter of processed cashews to an exporter of raw cashews can be expected therefore to produce a terms-of-trade loss for the country, which limits any gains from liberalisation.

Source: Economic Commission for Africa (2004: 62)

processing) certainly offers better growth-pulling prospects for developing countries: it allows for more rapid productivity growth and expansion of production, and avoids the declining terms of trade that have frustrated the growth prospects of many commodity-dependent economies. Imbs and Wacziarg (2003) indeed confirm that as countries become richer – particularly those with a mean income of more than \$15 000 – sectoral production and employment shift from relatively high concentration to diversity.

Recent comparative experiences suggest that there are divergent paths to industrial development (and thus the need for policy space). Mauritius successfully diversified its economy from sugar exports to the production and export of clothing and textiles, complemented by tourism. Its industrial policy included the establishment of an export processing zone, which allowed duty-free import of inputs for export production (see Box 3). In Chile, the development of agro-industrial clusters – such

as salmon farming, wine and fresh fruit – demonstrates that natural resource-based growth can be sustainable if it is focused on high value products (supported by public-private partnerships to extend research and technology services into new activities). Malaysia, once reliant upon commodities, has diversified to become a leading producer and exporter of manufactured goods (eg electrical and electronic equipment). At the same time, it remains a major world supplier of agro-industrial products based on palm oil and rubber. South Korea's outward orientation during the 1960s was achieved not through import liberalisation (of which there was little), but through export subsidisation (of which there was a lot) (Rodrik 2002). Finally, China's economic boom is historically based on the production and export of manufactured products, with significant investments by technologically advanced foreign firms in the mainland. Beijing's two-track reform strategy in agriculture, industry, and trade has maintained non-market institutional forms while aligning incentives correctly at the margin (Rodrik 2002). For this reason, the next section explores the manufacturing sector and its economy-wide multipliers as the primary objective of industrial policy, while not discounting the importance of services and its many sub-sectors.⁴

BOX 3: INDUSTRIAL DEVELOPMENT: THE RECIPE FOR SUCCESS IN MAURITIUS

Successful institutional reforms typically combine imported blueprints with local flavour. A good example of this in the area of trade comes from Mauritius, where superior economic performance has been built on a peculiar mix of orthodox and heterodox strategies. This economy's success derives in large part from an export processing zone (EPZ), which operates under free trade principles. The EPZ has enabled a boom in exports of garments to European markets and an accompanying investment boom at home. Yet the island's economy has combined the EPZ with a domestic sector that was highly protected until the mid-1980s. The origins of this essentially dual-track strategy (not unlike that followed in China) lay in the social and political make-up of the island and in the decision by policymakers not to disrupt a fragile ethnic situation through an across the board liberalisation that could have disadvantaged established import-substituting groups. The creation of the EPZ generated new opportunities in trade and employment without removing protection from the import-substituting groups or from the male workers who dominated the established industries. The segmentation of labour markets early on between male and female workers, with women predominantly employed in the EPZ, was crucial, as it prevented the expansion of the EPZ from driving wages up in the rest of the economy and hurting import-substituting industries. New profit opportunities were created at the margin while leaving old opportunities undisturbed.

Source: Rodrik (2002)

1.2 Manufacturing: the engine of growth and development

From the above discussion, it is apparent that industrial policy is a pragmatic necessity, particularly for developing countries in a rapidly evolving world economy characterised by ‘first-mover advantage’ and catalysed by globalisation and its motive force: technical change. As Rodrik (2006: 1) notes: ‘Economic globalization has greatly increased the premium on manufacturing, particularly of the exportable kind’, since world markets provide near-limitless demand for these goods. However, Rodrik fails to adequately treat the potential pitfalls of ‘immiserising growth’.⁵ Nonetheless, he correctly argues that in the current economic orthodoxy: ‘Economic policies promoting manufacturing, or some manufacturing sub-sectors over others, are still frowned upon’ (Rodrik 2006: 2).

Contrary to earlier predictions, the manufacturing sector continues to dominate the trade terrain. It is today acknowledged that a dynamic industrial sector is central to a modern economy and an engine of economic growth, particularly since trade in services since the 1990s has not grown as spectacularly for many developing countries (Kwa 2007: 8).⁶ The importance of manufacturing has a strong theoretical genesis, harking back at least to Alexander Hamilton’s infant industry thesis, which later influenced the work of Friedrich List (1841), the father of economic nationalism. A second salient theoretical contribution is associated with the structural or Marxist school of development economics of the 1950s-60s. Its intellectual progenitors – including Kaldor, Rosenstein-Rodan, Hirschmann, Prebisch and Chenery – all nursed a strong faith in the elixir of manufacturing. During the 1980s, when the rise of Japan provoked a managed trade response from the West,⁷ some American scholars defended their industrial heartlands and factories as a source of national wealth, power, and competitiveness. They ultimately assailed the ‘myth’ of a ‘post-industrial economy’ (Cohen and Zysman 1987).⁸ In the following decade, Reich’s (1991) principles of benevolent economic nationalism similarly revolved around an acute concern with American competitiveness and the ailing welfare state.

This long historical pedigree is today complemented by a growing corpus of robust empirical studies that place industrial development (specifically non-traditional manufactures) in the driving seat of economic growth and development. A number of lessons for late-industrialisers are emerging: economic development requires productive diversification across a wider range of products and even services (not specialisation based on comparative advantage),⁹ rapidly growing countries are those with large manufacturing sectors, growth accelerations are associated with structural changes towards manufacturing, and countries that promote industrial upgrading and exports of more sophisticated or dynamic goods grow faster (see Rodrik 2006; UNCTAD 2006).

A diversified manufacturing sector is particularly important for commodity-dependent Africa, and would surely help the continent to escape the trap of underdevelopment and cyclical terms-of-trade losses. A recently released IMF working paper

agrees, noting that a stronger and more dynamic manufacturing export sector would assist in sustaining the continent's growth (Johnson et al 2007). However, its authors caution that a development strategy based on expanding manufactured exports should avoid real exchange rate overvaluation and the state should develop microlevel institutions to reduce the direct regulatory costs for exporters. In summary, then, there is a healthy nexus between manufacturing and dynamic, diversified development.

These arguments are best captured by UNCTAD, which today displays a far greater appreciation for comparative economic history than do the Washington-based multilaterals: 'The development of a strong manufacturing sector has been at the core of all successful catch-up experiences over the past 250 years, which suggests that achieving a lasting productivity-based increase in manufacturing is indispensable for a sustained rise in income levels and, ultimately, the eradication of poverty' (UNCTAD 2006: 150). Seen from this perspective, industrial policy should be deployed for three ends:

- Long-term economic diversification, upgrading technological capabilities and building more dynamic activities generally (agriculture, manufacturing, and services).
- Resolving information and co-ordination failures in the economy.
- Enhancing new or existing firm-level productivity, efficiency, and competitiveness.

1.3 The conceptual contours of industrial policy

While the objectives of industrial policy may appear clear, much conceptual obfuscation still attends this construct. This leads Chang (1994) to propose a threefold typology for understanding industrial policy. His first definition is broad, aggregating all government policies that affect industrial performance (such as macroeconomic, infrastructural, education, and so forth). However, the parameters of this definition are so wide that it ultimately becomes analytically vacuous. In contrast, the second definition is narrower and equates industrial policy with sector-specific targeting exercises. This definition resonates considerably with the proactive and reactive intervention-types of industrial policy:

Industrial policy is a policy aimed at *particular industries* (and firms as their components) to achieve the outcomes that are *perceived by the state* to be *efficient* for the *economy as a whole* (Chang 1994: 60).

The final definition is more mixed, midway between these two nominal poles: although the core of industrial policy is targeting – or sectoral industrial policy – this does not exclude other non-sector-specific, general or functional industrial policies, such as generalised support for industrial training or research and development (R&D).

Having provided some conceptual clarity about what exactly is meant by industrial policy, the following section investigates the salient theoretical debates about the appropriate balance of power between states and markets when promoting industry.

BOX 4: INDUSTRIAL POLICY: SELECTIVE, HORIZONTAL AND FUNCTIONAL INTERVENTIONS

Lall and Teubal (1998) craft an alternative framework for understanding the role of public support policies in leveraging industrial development and diversification. Their model draws a hierarchical distinction between the source, aims, objectives, and impact of three industrial policies, as illustrated below:

- Selective policies target and promote particular sectors or firms (the ‘picking winners’ narrative) – for example, sector-specific subsidies or promoting ‘national champions’.
- Horizontal policies straddle sectors and provide generalised support that stimulates activities for which markets are missing, underdeveloped or difficult to craft – for example, generalised incentives to promote technology, R&D, and training.
- Functional policies improve market operations, notably factor markets – for example, competition or trade policies designed to stimulate and enhance competitive pressures.

2. Schools of thought on industrial policy

2.1 The neoclassical or government failure approach

This orthodox approach to economic policymaking places little faith in the abilities of governments to mount effective interventions to direct and steer economic development, diversification, and technological upgrading. Economies are perceived to be spontaneous and self-regulating organic entities, and not susceptible to interventionist policy tinkering. Discretionary state measures to control prices, production, and consumption are deemed extremely costly to the overall functioning of the market and, ultimately, detrimental to the international security structure:

Governments are chronically unable to intervene efficiently in the market process, and government intervention in property rights and resource allocation usually ends up by exacerbating market failure. . . To this day, government intervention in the domestic sphere ultimately leads to international economic conflict (Sally 1998: 29,193).

The emphasis here is on getting prices, institutions, and infrastructure ‘right’ as the basis for an outward-oriented growth strategy. This approach optimally relies on the disciplining effects of global competition to restructure inefficient enterprises, reduce

labour costs, and raise living standards and welfare through lower consumer prices.

It was under the rubric of the 'Washington Consensus' – premised on the privatisation, deregulation and liberalisation of production, consumption and prices – that this reform agenda reached its apogee during the 1980s and 1990s. These policies attained considerable notoriety in the developing world, where they were enforced as Structural Adjustment Programmes (SAPs) in response to the debilitating debt crisis.

This one-size-fits-all economic approach is today discredited. Its final death blow came in 2006 when two studies – one by American University Professor Robin Broad and the other by Princeton University Professor Angus Deaton and former IMF chief economist Ken Rogoff – detailed how the World Bank's research unit had been systematically manipulating data to show that neoliberal market reforms were promoting growth and reducing poverty in developing countries. In its wake are an inventory of complementary policy and institutional reforms that the World Bank and other advocates of 'post-Washington Consensus' economics (galvanised by the Nobel Laureate Joseph Stiglitz) argue are necessary to fully harness the cargo cult of liberalisation (see Box 5).

The World Bank now admits that the policy advice it so readily doled out to its developing country clients during and after the epoch of structural adjustment did not do enough to boost exports, stimulate growth, and reduce poverty. In the most comprehensive evaluation ever conducted of the World Bank's work in trade, in April 2006 the Bank's Independent Evaluation Group (IEG) found that the Bank did not fully understand the implications of its narrow focus on trade liberalisation or do enough to strengthen trade capacity on the ground.¹⁰ In particular, the Bank was least effective in assisting countries to manage external shocks and adjustment costs related to liberalisation. Even more damaging for the Bank's reputation was the veiled assertion that its overzealous liberalisation had led to deindustrialisation: 'The speed of import liberalisation increased competitive pressures in countries that were unable to generate dynamic and sustained manufacturing growth' (Bretton Woods Project, 2006).

Trade liberalisation is certainly essential when an industry reaches a particular level of maturity, provided these reforms are undertaken selectively and sequenced as part of a national development strategy. By contrast, the manner in which it is recommended under the Washington Consensus is more likely to lead to the destruction of existing industries, particularly those that are at their early stages of infancy (without necessarily leading to the emergence of new ones). Furthermore, any new industry that emerges would reinforce and reflect static – rather than dynamic – comparative advantage. Put otherwise: 'The low income countries, in particular, will be locked in production and exports of primary commodities, simple processing and at best assembly operation or other labour intensive ones with little prospect for upgrading' (Shafaeddin 2005: 1).

Other scholars are more sceptical about this complementary checklist: they hold that this augmented paradigm is better understood as the *outcome* of successful economic development, rather than a universal template (Rodrik 2001). In addition,

BOX 5: THE WASHINGTON CONSENSUS AND ITS AUGMENTED FORM**Original Washington Consensus**

Fiscal discipline
 Reorientation of public expenditures
 Tax reform
 Financial liberalisation
 Unified and competitive exchange rates
 Trade liberalisation
 Openness to FDI
 Privatisation
 Deregulation
 Secure property rights

Augmented Washington Consensus*The original list plus:*

Legal/political reform
 Regulatory institutions
 Anti-corruption
 Labour market flexibility
 World Trade Organisation (WTO) agreements
 Financial codes and standards
 Prudent capital account opening
 Non-intermediate exchange rate regimes
 Social safety nets
 Targeted poverty reduction

Source: Rodrik (2001)

a new school of thinking based at the Center for International Development (CID) at Harvard University urges less reliance on simple formulas or best practices à la Washington Consensus, but deeper economic analysis to diagnose, identify, and target a country's unique binding constraints on growth. In the words of its intellectual progenitors, the 'Harvard Boys':¹¹

The principle to be followed is simple: go for the reforms that alleviate the most binding constraints and, hence, produce the biggest bang for the reform buck. Rather than use a spray-gun approach in the hope that we will somehow hit the target, focus on the bottlenecks directly (Hausmann et al 2006).

In sum, the latter perspectives all emphasise the importance of policy heterogeneity – or policy space – over the beguiling claims of the standard reform agenda: 'There is no single model of a successful transition to a high-growth path' (Rodrik 2001: 21).

Grudgingly, the international financial institutions and conservative policy think-tanks do now mandate the state with key regulatory (rather than directive) functions: crafting a sociopolitical environment conducive to development (World Bank 1997), building institutions for markets to function more effectively (World Bank 2004), and reforming the investment climate to foster productive private investment, which it is argued is the engine for economic growth and poverty reduction (World Bank 2005).

Today's orthodoxy is quintessentially premised on the problem-solving assumption that increased free trade, growing FDI and accelerated economic growth are all positively correlated (see Box 6). This translates into an orthodox triangle of reforms:

trade liberalisation, investment climate reform, and a generalised supply-supporting regime. This approach, here styled as a 'trade paradigm', is now briefly examined to better understand its inherent state-market dynamics.

2.1.1 Trade liberalisation

Trade liberalisation is located within the laissez-faire or free trade paradigm, with its rich political, economic and moral tomes advocating an open and unfettered system of free imports and exports (Irwin 1996, Bhagwati 2002). In this school of thought, global welfare is maximised when countries specialise in the export of goods in which they are factor-abundant and import goods in which they are factor-deficient (rather than diversify). According to this logic, developing countries with abundant unskilled and semi-skilled labour (ie most of sub-Saharan Africa, including South Africa) should aim to specialise in labour-intensive activities, while industrial countries should focus on skill- and technology-intensive activities. This implies that under the WTO's non-agricultural market access (NAMA) negotiations:

BOX 6 : ECONOMIC OPENNESS AND GROWTH: NEW CONTROVERSIES

Dollar (1992) assesses the degree of openness of economies using indices of real exchange rate distortion and exchange rate variability. The first captures the extent of openness to intermediate goods resulting in real exchange rates favourable to exporters, and the second captures uncertainties in investment decisions. Using cross-country regressions, Dollar finds that high levels of distortion in exchange rate variability are correlated with low per capita income growth, a result that leads to the conclusion that openness has a positive effect on growth and development.

Rodriguez and Rodrik (2001) argue that Dollar's distortion index does not accurately capture the extent of trade restrictions: in many cases such distortions are the result of monetary or exchange rate policies. Finally, Dollar's regression results are not satisfactory under alternative specifications.

Sachs and Warner (1995) measure openness using an index constructed from average tariff levels, non-tariff barriers, the nature of the economic system, the existence of a state monopoly over key exports, and the presence of a black market in foreign currency. This openness index is found to be positively correlated with the per capita income growth rate.

Rodriguez and Rodrik (2001) find that just two components of the index drive the econometric results: these are the existence of a state monopoly over exports and the presence of a black market in foreign currency. Neither of these accurately captures trade restrictions. Black markets in foreign currencies are caused by various political and economic factors, not just by lack of external openness. Export monopolies were found only in the 29 African countries that had embarked upon SAPs between the late 1980s and early 1990s, and cannot therefore be generalised to conclude a relationship between openness and growth.

Source: Economic Commission for Africa (2004: 61)

... developing countries would be expected to exit partly or wholly from skill- and technology-intensive and *potentially* high-value added sectors maintained behind tariff and non-tariff barriers. The same goes for industrial countries for labour-intensive products (Akyüz 2005: 35).

The economic rationale for a liberal international economic order – premised on the twinned static and dynamic gains from trade reform¹² – converges with an ethical belief that the freedom to engage in international transactions is integral to the broader economic freedom to produce and consume goods and services, guaranteed by the legal protection of persons and property (Sally 1998).

Sally (1998) usefully distinguishes between two paths to domestic and international liberalisation, ultimately favouring the latter: ‘liberalism from above’ and ‘liberalism from below’. The first approach, rooted in neoliberal institutionalism, is premised on the complex, protracted, and politicised process of intergovernmental negotiated co-operation. From this perspective, governments seek to balance their multilateral commitments with the policy space for domestic intervention in a mixed economy. This approach, based on the reciprocal exchange of concessions, is best exemplified by the old General Agreement on Tariffs and Trade (GATT) and its liberal governance successor, the WTO.

Compared to this multilateral focus, the second approach looks inward to emphasise the domestic preconditions for a liberal international economic order. It therefore accords pride of place to unilateral policy action at the national level. This perspective effectively translates into two policy vectors: first, unilateral trade liberalisation; second, institutional rivalry among governments to adapt to changing global conditions (eg the specific needs of mobile international capital, although this may spawn a ‘race to the bottom’). In summary, then:

Whereas neoliberal institutionalism instinctively conceives an appropriate institutional framework for a liberal international economic order in terms of intergovernmental negotiated cooperation ‘from above’, classical liberalism focuses its sights on the domestic preconditions of international order: the appropriate institutional framework is sought, first and foremost, ‘from below’ at the level of *national* law and policy (Sally 1998: 192).

2.1.2 Investment climate reform

A country’s investment climate is broadly defined as the location-specific factors that shape the opportunities and incentives for domestic firms and transnational corporations to invest productively, create jobs, and expand their activities (World Bank 2005: 2). In the ‘global beauty contest’ for international capital, countries are prescribed a slimming diet: liberalising and deregulating the national policy regime, as recorded annually by UNCTAD;¹³ fostering economic, social and political stability;

and crafting horizontal and functional public support measures that facilitate trade and ‘crowd in’ private investment.

Governments have little scope for alternative strategies beyond these parameters. The ubiquitous threat by disaffected investors to withdraw their capital from the economy indeed inhibits national policy space for more flexibility. In other words, the state’s role as a catalyst and facilitator is juxtaposed against the injunction that: ‘Private firms are at the heart of the development process’ (World Bank 2005: 1).

2.1.3 General industrial supply-side regime

The third pillar is a non-discriminatory industrial regime that provides horizontal and functional public support – particularly to develop and upgrade economic, social and human infrastructure – but eschews the selective targeting of sectors or types of ownership. The received wisdom of the World Bank (2005: 13) holds: ‘Overall, experience with government efforts to “pick winners” is discouraging.’

Opposition to selective industrial policies stems from at least two major disquiets. First, critics hold that industrial interventions are prone to political capture, rent-seeking, and corruption. For instance, trade theory predicts that import-competing fractions of domestic capital would logically pursue downstream and upstream directly unproductive profit-seeking (DUP). Downstream DUP refers to lobbying for rents from import quotas and tariff revenues, whereas upstream activities involve lobbying for protection in the formulation of policy (Bhagwati 2002: 36). Endogenous tariff theory similarly explains the prevalence of protectionist policies by suggesting that the political process is broadly inclined to favour well-organised producer groups that claim protection against imports, over general welfare:

Minority producer interests win out at the expense of majority consumer interests, outsider groups bereft of political voice and the overall public good. The political market becomes a vast and opaque machine of frenetic redistribution, turning activity away from the production of goods and services, and retarding innovation, adaptiveness and growth (Sally 1998: 179).

The above risks are hardly fanciful and examples of failure do exist (eg Brazil’s micro-computer and ship-building industries, or Malaysia’s automotive sector). However, these arguments too often simply rely on ideological hyperbole or elide cases of successful sector interventions elsewhere (eg South Korea’s steel industry, or Brazil’s aeronautical, mining, steel, and automotive sectors). The second major objection holds that the necessary bureaucratic skills, competence and co-ordination capacities for successful targeting exercises are simply lacking in many developing countries, so they should not venture in that direction (see World Bank 1993).

There is certainly merit to these arguments, but they hardly catapult economic orthodoxy on to the moral high ground. They are moreover rooted in old industrial

policy thinking, rather than more recent treatments of institutional processes and strategic partnerships. For example, in many developed and developing countries, privatisation – a pillar of the Washington Consensus – also turned out to be a boon for insiders or government cronies. In addition, it may be argued that the bureaucratic resources and skills required to modernise a country's institutions in line with the augmented post-Washington Consensus are far more daunting than sector targeting (Rodrik 2004). The planning paragons of the East Asian NICs, such as Japan's Ministry of International Trade and Industry (MITI) and the region's other super-bureaucracies, did not simply fall from the sky. They were developed incrementally by investing in human capacity, skills and institutional learning. The lesson for other late-industrialisers is apparent. Having considered the case against industrial policy narrowly defined, the next section considers the arguments in favour of greater intervention by the state to support industry.

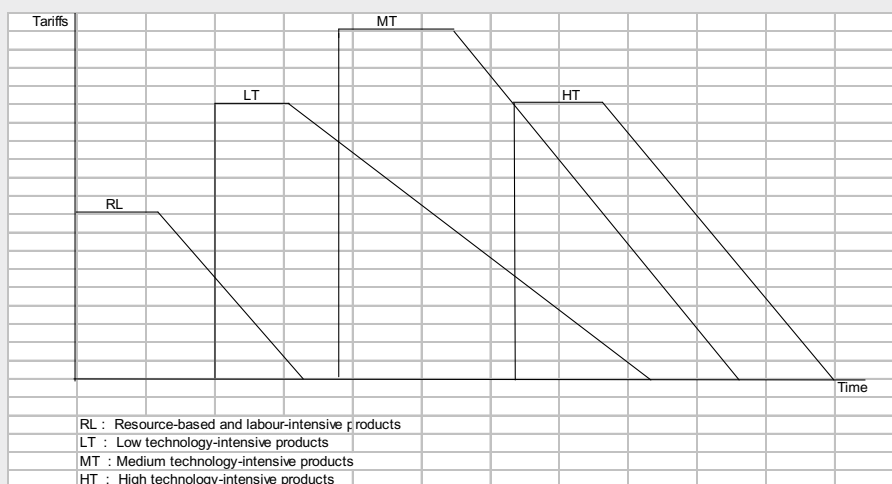
2.2 The interventionist or market failure approach

In the wake of the widespread social disruptions and economic dislocations precipitated by structural adjustment and marketisation during the last two decades, a growing number of developing countries are today returning to the comfort of neo-Keynesian principles. This includes a more proactive role for the state in directing economic and industrial development. This school of thought argues against global market forces as the principal drivers of industrial progress, technological upgrading, and economic growth. Its advocates place greater faith in the ability of governments to mount effective interventions and to play a more decisive, directing role within a market economy, often in favour of domestic firms and their long-term competitiveness (Lall 2004). Its proponents recognise that the private sectors of developing countries confront at least four market failures that are common in today's 'first-mover' global economy, which require remedial action from the state:

- *Information externalities*, where the private sector lacks the information about opportunities to make productive (and profitable) investments;
- *Co-ordination externalities*, where profitable new industries will not develop unless upstream and downstream industries are developed simultaneously;
- *Imperfect competition*, where highly concentrated sectors make entry into the industry and technological change extremely difficult; and
- *Environmental externalities*, where the environmental costs of production and consumption are not reflected in prices and lead to the under- or overproduction of certain goods and services (Gallagher 2007: 1).

This perspective is inherently *pro-business*, rather than *pro-market*. To pre-empt the critics, it must be stressed that this approach is not synonymous with an atavistic model of ISI, which once dominated development debates alongside *dependencia*

BOX 7: TARIFF PROFILE OF SEQUENCED INDUSTRIES FOR INFANT INDUSTRY PROTECTION



In an early phase, a country would be wise to maintain high tariffs on consumer goods it wishes to produce, while applying low or zero tariffs on necessary inputs and machinery. In a second phase, it can lower the tariffs on consumer products as it gets more efficient, while raising tariffs on inputs that it may now want to produce. In a third phase, it may increase the tariff on machinery so as to produce capital goods, while reducing tariffs on consumer goods and inputs. In an advanced phase, it can afford to levy low tariffs on the various categories of goods. A developing country is thus ill advised to bind tariffs at low or zero levels on products it does not presently produce; policy flexibility for modulating applied and bound rates for future diversification reforms is called for.

Source: Akyüz (2005; see UNCTAD 2006)

thinking and the Prebisch-Singer thesis relating to the secular decline in commodity prices over the medium to long term.¹⁴ For today's 'smart' economies, the perpetual protection of old industries is passé. Industrial policy is better recast as a long-term competitiveness strategy, with only temporary protection for industries that demonstrate reasonable competitive potential (it is not welfare enhancing to continue to bear the costs of protection when that industry becomes competitive). This is ultimately based on strategic integration into the sinews of the global economy (eg China since the late 1970s, Mauritius, and Vietnam). On its own, undisciplined protection can be harmful to the economy and even ineffective, since:

- Protection cannot succeed indefinitely if it is not offset by competitive pressures on firms to invest in the capability-building process,
- The demands of product markets must be effectively co-ordinated with the supply dynamics of factor markets, and
- There are natural limits to protected, fragmented, and small domestic markets as the basis for industrialisation policies.

In summary, this epistemic school of thinking today accepts the need for greater openness to world prices and more exports of goods and services into the world market. But this is qualified by the caveat that greater reliance on the market does not preclude – nor proscribe – a proactive role for the state in supporting the development of technologically advanced and dynamic industries (eg Lall 2004, Rodrik 2004). ‘In the final analysis,’ writes Akyüz (2005: 45), ‘it is successful industrialization in the developing world that should be expected to lead them to free trade, not the other way round.’

Tariff policy is a case in point. While not the most effective or first-best option, in the absence of other proscribed policy tools, a modulated regime of high and low tariffs designed to protect learning in dynamic sectors – rather than deep-seated inefficiencies or vested interests in sunset industries – may be a key instrument for restructuring (see Akyüz 2005, Gallagher 2005, UNCTAD 2006). Box 7 illustrates the evolution of optimum tariffs that would be necessary for infant industry protection in late-industrialising countries in order to overcome their technology and skill gaps with the more advanced economies at each stage of industrial development.

However, this is easier said than done. Chang (2002) argues that mature developed countries, by their insistence on ‘good’ policies and institutions today, have metaphorically ‘kicked away the ladder’ that they once used to industrialise. The latter historically included infant industry tariffs and export subsidies, which are today disciplined by the WTO. With a production – rather than a trade – paradigm as their point of departure, proponents of industrial policy deploy at least four arguments to support their position. These are briefly sketched below.

2.2.1 Comparative historical development

The first argument is principally an historical one: protectionism was the rule and free trade the exception during the industrialisation of today’s mature economies. Even the United States, an ardent advocate of free trade today, was once upon a time ‘the mother country and bastion of modern protectionism’ (Bairoch, cited in Akyüz 2005: 8). The United States maintained average applied industrial tariffs of 40–50 per cent from 1820 to 1931 (Chang 2002). In addition, high tariffs were then augmented by higher transportation and information costs than today, which provided natural protection from imports, particularly for the European offshoots (Akyüz 2005: 11, Page 2007). Indeed, argues Wade (2003), there is no example of modern industrialisation based on the laissez-faire approach peddled by economic orthodoxy and its disciplinary agents today:

Almost all now-developed countries went through stages of industrial assistance policy before capacities of their firms reached the point where policy of (more or less) free trade was declared to be in the national interest. Britain was protectionist when it was trying to catch up with Holland. Germany was pro-

tectionist when trying to catch up with Britain. The United States was protectionist when trying to catch up with Britain and Germany, right up to the end of the World War II [sic]. Japan was protectionist for most of the twentieth century up to the 1970s, Korea and Taiwan to the 1990s (Wade 2003: xv).

Historically, the world's three waves of industrialisation have been associated with high tariffs, which facilitated economic convergence and 'catch-up' among several countries at that historical conjuncture.¹⁵ Few countries have pursued strictly free trade policies, opting rather for a more strategic and flexible approach to global integration and adroitly adapting their policies to changing conditions (Chang 2002, Lall 2004). Strategic trade theory – the academic vanguard of the New Protectionism of the 1970s-80s – indeed posits that public policy interventions can foster the competitiveness of domestic firms in global markets through economies of scale and increasing returns, and learning-by-doing effects (Stegemann 1989).

Related to this appreciative role of public policies is the revisionist interpretation of the East Asian 'miracle', led by the western Development Studies doyens Johnson (1983), Amsden (1989), and Wade (2003). Their work has effectively challenged neo-classical development orthodoxy by arguing that the economic successes in Japan (1959-73), South Korea (1955-90) and Taiwan (1955-90) were the products of activist 'developmental states' that sought to 'govern the market' and 'create winners', rather than simply 'picking them' (eg South Korea's steel industry¹⁶ or Singapore's SingTel¹⁷). From this perspective, industrial interventions were *growth-enhancing*, and far more salient than unfettered markets.¹⁸ The World Bank was quick on the defensive, releasing its response in 1993. While the Bank (1993) recognised that industrial policy measures and other forms of intervention – notably in the financial markets¹⁹ – may have supported the process of economic development, the underlying catalyst for the East Asian success lay with the adoption of market-conforming and export-oriented policies. The four Tiger economies had indeed tried to alter their industrial structures to achieve more rapid productivity growth, but with the exception of Singapore, these industrial structures had evolved largely in a manner consistent with market forces and factor-intensity-based comparative advantage (see World Bank 1993).

This debate assumed renewed proportions following the 1997 Asian financial crisis, which the World Bank and its agents soon blamed on East Asia's distinctive 'crony' capitalism. Within this triumphalist mood, post-crisis studies today tend to focus on the degree of institutional convergence – Japan is a case in point – and whether the Asian model of capitalism is today being trumped by the liberal-regulatory logic of contemporary orthodoxy. Thus Woo-Cummings notes (1999: ix): 'After the Asian crisis, however, it is back to the drawing board'. Nonetheless, it is noteworthy that various studies over the last decade have diagnosed statist development among the late-industrialising 'rest', even outside of Asia (see Amsden 2001). This indeed intimates a 'general theory of state-led growth' (Krieckhaus 2004: 48). For instance, the Latin American *desarrollista* state, epitomised by Brazil and Mexico, resonated obvi-

BOX 8: POLICY HETEROGENEITY TO INCREASE BENEFITS FROM INWARD FOREIGN INVESTMENT: STRATEGIES FOLLOWED IN EAST AND SOUTH EAST ASIAN COUNTRIES

- Hong Kong and China: Passive open-door policies to FDI and trade with no intervention to promote industrial development selectively.
- Malaysia and Thailand: Active industrial policies and promotion of local enterprises in certain activities, but effective open-door, non-interventionist policies in most export-oriented industries.
- Singapore: Active intervention in promoting strong participation by transnational corporations in manufacturing, no discrimination in favour of local industry, but pervasive and selective guidance and inducement of foreign investors to upgrade their capabilities, including increasing local technological activity.
- Korea, Taiwan, Japan: Restriction of FDI and maximising their reliance on 'external' forms of technology transfer in the context of a comprehensive set of industrial policies to develop the indigenous manufacturing sector, promote local linkages, and increase local innovative capacities.

Source: UN Conference on Trade and Development (1999)

ous developmental credentials (Schneider 1999). Africa has also had post-colonial states that were once developmental, at least in their aspirations and measurable economic performance. Botswana, Uganda, and Mauritius are still touted as cases today (see Mkandawire 2001, Mbabazi & Taylor 2005).

2.2.2 Domestic growth strategies and policy heterogeneity

The second argument in support of greater state activism and policy heterogeneity understands development as a complex process of domestic institutional innovation – and not simply raising trade volumes in world export markets. From this perspective, development is catalysed by a domestic growth strategy tailored to local conditions, institutions, and investors. An historical panorama of the latter includes import-substitution regimes based on temporary protection; outward-oriented industrialisation strategies; and a dual track approach that appropriates both state and market forces, which Ramo (2004) has adventurously called the 'Beijing Consensus'. These domestic policy measures initiate a period of economic growth, subsequently generating a cumulative cycle of institutional development and further growth. Trade is at best a complementary strategy, at least from this school of thought (Rodrik 2001: 14-16).

If countries are to develop and diversify their economies, they need the policy space to creatively craft domestic institutions that often depart from the objective claims of prevailing orthodoxies. But this policy space is increasingly circumscribed by the WTO; in addition, its mercantilist bargaining represents a Faustian deal for poorer nations in the world economy:

Access to the markets of the industrial countries matters for development. But so does the autonomy to experiment with institutional innovations that diverge from orthodoxy. The exchange of reduced policy autonomy in the South for improved market access in the North is a bad bargain where development is concerned (Rodrik 2001: 27).

Progressive scholars, NGOs, and broad social movements and activist networks in the North and the South thus argue that the world trading regime must shift from a market access perspective to a development perspective (see Kwa 2007). This requires two things. First, developing countries should articulate their needs not in terms of more market access and trade volumes, but in terms of the policy autonomy that will allow them to exercise institutional innovations that depart from prevailing orthodoxies. Second, the WTO should not aim to harmonise and reduce national institutional differences, but rather manage the interface between different heterogeneous systems. Rodrik pointedly adds:

When countries use the trade system to impose their institutional preferences on others, the result is erosion of the system's legitimacy and efficacy. Trade rules should seek peaceful co-existence among national practices, not harmonization (Rodrik 2001: 29).

2.2.3 The fallacy of liberalisation and economic growth

There is an impressive canon of evidence crafted by the World Bank and other like-minded agencies to support the principal premise of the trade paradigm: economies that are more open (ie low or zero tariffs) grow faster. However, these claims lack sound empirical and theoretical rigour (see Box 6). Moreover, as Rodriguez and Rodrik (2001) have argued, there is little evidence that trade liberalisation is correlated with economic growth, poverty reduction or economic development. They problematise this unidirectional hypothesis that greater openness stimulates faster economic growth and development.

The empirical evidence instead suggests that countries tend to dismantle their trade restrictions as they become richer (see Box 9). So, for instance, the United States applied a 44 per cent tariff in 1913 when its per capita income (at 1990 prices) was US\$ 5 301. This tariff was pared down to 14 per cent in 1950 when the country's per capita income had almost *doubled* to US\$ 9 561 (Akyüz 2005: 14). The corollary to this thesis is that no country has ever developed by jettisoning international trade, investment and exports. These observations provide a solid case for more selective, strategic, and regulatory integration into the global economy, as best epitomised by China since the late 1970s and, more recently, Vietnam. The latter only joined the WTO as its 150th member in 2007.

BOX 9: TARIFFS ON MANUFACTURED PRODUCTS AND PER CAPITA INCOME IN SELECTED DEVELOPED COUNTRIES, 1820-1980

	1820 ^a	1875 ^b	1913	1950	1980
Country	Tariffs, weighted average (per cent)				
United States	35-45	40-50	44.0	14.0	7.0
United Kingdom	45-55	0	0.0	23.0	8.3
Germany	8-12 ^c	4-6	13.0	26.0	8.3
France	.. ^d	12-15	20.0	18.0	8.3
	Per capita income (1990 international dollars)				
United States	1 257	2 445	5 301	9 561	18 577
United Kingdom	1 707	3 191	4 921	6 907	12 928
Germany	1 058	1 821	3 648	3 881	14 113
France	1 230	1 876	3 485	5 270	15 103

a Very approximate rates. Range of averages, not extremes.

b Per capita income data for 1870

c Prussia

d Numerous and large restrictions on imports of manufactured products render calculations of average tariff rates insignificant

Source: UN Conference on Trade and Development (2006:176)

2.2.4 Picking the losers rather than the winners

The ECA (2004: 61) is correct that: 'In East Asia not all interventions were positive, while some were aimed at emulating a free trade regime. But in Africa most State interventions were applied haphazardly to economic sectors without any attempt at targeting or sequencing. This tended to generate speculative and rent-seeking behaviour rather than sustained structural transformation and growth.'

With industrial policy redefined as strategic collaboration with business, there is some scope to selectively target, support, and discipline key industrial sectors – although public choice theory warns that such exercises are always susceptible to corruptibility. An alternative approach to this problem therefore holds that: 'The aim is not to pick winners, but to identify and discipline under-performing firms' (UNCTAD 2006: xi). The sociologist and theoretician of 'embedded autonomy', Peter Evans concurs: 'In short, the failures of traditional industrial policy flow not primarily from the predictive inability to pick winners, but from the political inability to jettison losers' (Evans 2005b: 204). This remains a salient political challenge for developing countries

today. The next section explores recent intellectual treatments of industrial policy for the twenty-first century.

3. Industrial policy for the 21st century

As was argued earlier, public support measures to restructure domestic industries appear to be back in vogue, galvanised theoretically by the revival of arguments supporting the creative functions of markets and the creation of new areas of comparative advantage (see UNCTAD 2006). Industrial policy has recently been theoretically refurbished by at least two respectable academics, the late Sanjaya Lall of Oxford University and Dani Rodrik of Harvard. In addition, UNCTAD and other prestige UN panels have recently been at the forefront of a shifting global policy mood in favour of more policy space for developing countries. These arguments in favour of greater state activism and better industrial governance are discussed below.

3.1 Sanjaya Lall and technological capabilities

Lall (2004) argues that in the contemporary global order, technical change – itself a motive force of globalisation – is rapidly shifting industrial and trade structures towards more complex, technology-based activities. If developing countries and their firms are to benefit from globalisation and become competitive hubs for global production or value chains, they must logically develop new industrial-technological capabilities:

Cheap unskilled labour or raw natural resources are no longer sufficient to sustain industrial growth: it is strong local capabilities that determine competitive success. Even ‘simple’ entry-level industrial activities like clothing, footwear or food processing require sophisticated capabilities if they are to face global competition (Lall 2004: 4).

But developing country enterprises often confront various market failures in building initial capacity and in subsequent deepening. For instance, markets may not give optimal signals for investment in new technologies when there are high, unpredictable learning costs and widespread externalities. Contrary to the neoclassical treatment of technology,²⁰ historical experience suggests that industrial capabilities develop slowly, in a cumulative and path-dependent manner, and subject to agglomeration economies (which entrenches first-mover advantage).

For this reason, Lall argues that public support policies are necessary to build and deepen the requisite capabilities for industrial development. This panoply of measures

should include *direct* interventions – notably infant industry support to provide ‘space’ for enterprises to master new technologies and skills without incurring enormous and unpredictable costs – and *indirect* measures to ensure that skill, capital, technology, and infrastructure markets meet their needs. In addition, there is a need to better coordinate learning across enterprises and activities and to harness greater access to world technology markets.

Lall correctly concludes that the industrial policies required in the current international setting are different from the traditional forms of inward-looking industrialisation that characterised the early post-World War 2 epoch. But supporting measures remain important, even under globalisation. The prevalence of path dependence, cumulativeness, and agglomeration economies in technological capability-building raises the demand for proactive industrial interventions. Without these measures, technological development in the developing world is likely to be slow and truncated, with further ‘digital divides’ between countries arising.

3.2 Dani Rodrik and strategic collaboration

Although Rodrik (2004) employs the concept ‘industrial policy’, his principal focus is on those restructuring policies that favour more dynamic activities generally, regardless of whether they are located within industry or manufacturing per se. The main purpose of public support policies is to diversify the economy and generate new areas of comparative advantage, notably new products and production processes. However, with his distinctive affinity for strengthening domestic institutions and governance, Rodrik is far more enamoured with correcting the policy *process* than with its policy *outcomes*:

The right model for industrial policy is not that of an autonomous government applying Pigovian taxes or subsidies, but of strategic collaboration between the private sector and the government with the aim of uncovering where the most significant obstacles to restructuring lie and what type of interventions are most likely to remove them (Rodrik 2004: 3).

By redefining industrial policy as a process of strategically engaging with business, Rodrik argues that the orthodox offensive against industrial policy – with such claims as governments’ inability to pick winners – loses much of its currency. Rather, good industrial policy ironically involves the obverse: ‘The trick for government is not to pick winners, but to know when it has a loser’ (Rodrik 2004: 12).

From this perspective, diversification of the production structure requires entrepreneurial experimentation and innovative investment to ‘discover’ the cost function of producing new goods or the feasibility of new modes of production. However, diversifying into non-traditional opportunities is never easy, since this process is

fraught with information and co-ordination externalities. Since diversification generates pecuniary costs for the private entrepreneur, but broad social gains for the economy as a whole (that can be easily emulated by competitors), there is little incentive to engage in risky cost discovery. In addition, profitable new industries could fail to develop in the absence of requisite upstream and downstream investments. These market failures imply that developing countries seldom catch up with their industrialised peers, and, as noted earlier, ‘first-mover’ advantages in some industries remain insurmountable. In effect, productive diversification demands public support measures or public-private partnerships (eg the salmon industry in Chile).

These industrial support measures should be temporary, outline clear benchmarks for success and failure, and include a built-in sunset clause when support will be phased out; be targeted to new activities only; and be politically supervised by competent authorities. They could take various forms: subsidising the costs of self-discovery, developing mechanisms for higher risk finance, internalising co-ordination externalities, public R&D, subsidising general technical training, and leveraging the role of nationals abroad. Most importantly, a development-friendly world trading regime would respect institutional diversity and the right of countries to ‘protect’ their domestic arrangements (Rodrik 2001).

3.3 UNCTAD, UN panels and policy space

It would be fair to say that in recent years, UNCTAD – conventionally wary of upsetting the Washington-based multilaterals, the IMF, and World Bank – has led a frontal critique of economic orthodoxy. Its outputs now routinely emphasise economic development and often invoke as exemplary the types of industrial and technological policies pursued by the East Asian countries. However, as was earlier noted, the scope to strategically deploy similar policies today has been relatively circumscribed by the multilateral disciplines and rule-making of the WTO as well as by other non-trade factors.

This erosion of policy space and the decline of *existing* domestic autonomy over economic policy is hardly a new phenomenon. As Chang (2006) highlights, it has a long historical pedigree, stretching back to the age of imperialism, when colonies were subject to unequal treaties. This was amplified by later historical conjunctures: the negotiation of the GATT in 1947, the onset of the debt crisis and structural adjustment in the 1980s, and the institutionalisation of a post-GATT trade regime under the WTO in 1995. Thus, given the tightened contours for economic development today, many scholars in the development academy agree that the current rules-based international environment, with its current and proposed prohibitive strictures, reflects little concern for needed development priorities (see Gallagher 2005).

Contrary to claims that governments can still circumvent the WTO to promote development, Dicaprio and Gallagher (2006) find that not only do many of the rules

negotiated in the Uruguay Round (1986-1994) constrict the ability of countries to put in place aggressive development policies, but these rules have been strictly enforced by WTO dispute panels. Indeed, more than 25 per cent of all WTO cases between 1995 and 2005 dealt with dismantling policy space in developing countries. Moreover, in the ongoing Doha Round of the WTO, there are constant demands from the majors to further 'negotiate away' or discipline extant policy space for future industrial development and diversification (see Box 10).

BOX 10: POLICY SPACE FOR DEVELOPMENT AND THE WTO

Policy instrument	Permitted	Agreement
<i>Goods trade</i>		
Tariff sequencing	*	GATT
Tax drawbacks	§	
<i>Intellectual property</i>		
Selective permission for patents	X	TRIPS
Short patent timelines with exceptions	X	TRIPS
Compulsory licences	§	
<i>Subsidies</i>		
Export	X	SCM
R&D	*	SCM
Distribution	*	SCM
Environment	*	SCM
Cost of capital	§	
<i>FDI</i>		
Local content	X	GATT, TRIMS
Trade balancing	X	TRIMS
Joint ventures	§	
Technology transfer	§	
R&D	§	
Employment of local personnel	§	
Tax concessions	§	
<i>Other</i>		
Human capital	§	
Administrative guidance	§	
Movement of people	*	GATS
Provision of infrastructure	§	

Key: X = GATT/WTO rules prohibit the measure; * = the measure is being considered for elimination in the Doha Round; § = measures still permitted; TRIPS = Agreement on Trade-related Intellectual Property Rights; SCM = Agreement on Subsidies and Countervailing Measures; TRIMS = Agreement on Trade-related Investment Measures; GATS = General Agreement on Trade in Services.

Source: Gallagher (2007)

A Doha Round ‘grand bargain’ may therefore involve a Faustian deal: developing countries exchange their policy autonomy (eg industrial tariffs for future diversification into more dynamic industries) for improved traditional access to Northern markets, a non-binding aid-for-trade package, with some static and dynamic gains from liberalisation. However, the latter gains have been sharply revised downwards. Prior to the Hong Kong ministerial conference in December 2005, the World Bank heavily massaged down its estimates of the global gains from the Doha Development Agenda: from a pre-Cancún high of US\$ 832 billion in 2003, to US\$ 287 billion, to a modest US\$ 96 billion for a ‘likely Doha’ scenario. Of this total, US\$ 16 billion will disproportionately go to developing countries, with the bulk of these gains to China, Argentina, Brazil, and India. Significantly, many others – including most of sub-Saharan Africa – would be worse off under this Doha deal.

It is not surprising that UNCTAD is today at the forefront of global debates on leveraging more policy space for developing countries to optimally combine the best mix of industrial, trade, technological, and social policies. The São Paulo Consensus that emerged from UNCTAD XI officially endorsed and defined policy space as:

The scope for domestic policies, especially in the areas of trade, investment and industrial development [which might be] framed by international disciplines, commitments and global market considerations. It is for each Government to evaluate the trade-off between the benefits of accepting international rules and commitments posed by the loss of policy space.

Policy space – or, alternatively, ‘open nationalism’ – is essentially a fusion of three key principles that are firmly established in international law and enshrined by the UN. These are the *principle of the sovereign equality of states*, the *right to development*, and the *principle of special treatment for developing countries*.²¹ When applied practically to the global trading regime, policy space implies that developing countries should not be required to adhere to all (or some) international disciplines that they may not be ready to implement, or which may be inappropriate for them at their current levels of economic development (see South Centre 2005).

Following decades of far-reaching market-oriented reforms in most developing countries, the failure of the orthodox reform agenda to catalyse global convergence and reduce poverty has led to renewed faith in public support policies. Since it first introduced the term ‘policy space’ into the trade lexicon in 2002, UNCTAD has played a pivotal role in shaping the contours of this debate. In 2006, amid the rancorous negotiations of the Doha Round, it crafted one of the boldest political statements yet on the importance of maintaining policy space for national development. Outlined in its headline Trade and Development Report of that year, UNCTAD argues for public support policies to strengthen the creative forces of markets and to stimulate diversification and technological upgrading:

Experience with reforms over the past 15 years, as well as recent developments in economic theory concerning the creation of new areas of comparative advantage, provide a strong rationale for the adoption of proactive trade and industrial policies (UNCTAD 2006: 193).

UNCTAD adds that:

The unsatisfactory outcome of the market-oriented reforms pursued in a majority of developing countries since the early 1980s may largely be due to the reduced number of policy instruments available to policymakers under the development paradigm of the past 25 years (UNCTAD 2006: ix).

UNCTAD's position is premised on strategic trade integration. This entails a more measured approach to liberalisation, combined with proactive industrial policies and an outward orientation designed to achieve international competitiveness in increasingly more sophisticated (or dynamic) products. In doing so, it also seeks to balance the welfare advantages of low uniform tariffs and the industrial policy tool of flexible and differentiated tariffs. From this perspective, it is favourably inclined towards temporary tariff protection for dynamic products or processes, accompanied by disciplined public support for investment and technological upgrading.

Other UN panels have similarly highlighted the need for more policy flexibilities for late-industrialisers. For instance, the Zedillo Commission, set up by the former UN Secretary-General Kofi Annan to explore additional financing for development, argued in favour of infant industry protection:

However misguided the old model of blanket protection intended to nurture import substitute industries, it would be a mistake to go to the other extreme and deny developing countries the opportunity of actively nurturing the development of an industrial sector (Zedillo Commission 2001: 9-10).

Having reviewed these recent treatments of the industrial policy debate, the final section of this report crafts two heuristic models: the neoliberal competition state and the interventionist developmental state. Both of these models emphasise competitive production structures as the main vectors for achieving more rapid economic growth and welfare. However, as becomes clear, they pursue antithetical strategies based on the degree of public interventionism within a broad market-based economy.

4. Industrial state models: the competition state and the developmental state

The construction of these two theoretical models reflects an appreciation that the state is not in terminal decline, heralding an incipient post-international relations or post-geography world. Rather, states and markets are engaged dialectically: their respective roles and relations are shaped, reshaped, and reconstituted through their mutual encounters. Political globalisation, involving state and institutional adaptation, is thus a response to and symptom of economic globalisation (see Cerny 1990, 2000). From this perspective then: 'A developmental state is not an initial endowment but an outcome of an act of construction' (Sindzingre 2004: 6).

From an International Relations perspective, this constructivist logic also applies to the competition state, whose regulatory ambit is amplified by the further reach of the global market into the domestic sphere: 'The challenge of the competition state is one of getting the state to do both *more* and *less* at the same time' (Cerny 2000: 126). These dynamics are explored below.

4.1 The rolled-back neoliberal competition state

This first model draws upon the work of Cerny (1990), Cox (1987), and other hyper-globalist theses on the internationalisation of the state within the disciplinary imperatives of global competitiveness, the constraints of financial soundness, and the demands of highly mobile global capital (Milner & Keohane 1996). From this perspective, the state no longer acts as a buffer between external economic forces and domestic economies, but increasingly plays the role of an agency or transmission belt for external capital, driving the domestic economy to adapt to the exigencies of the global economy and its commodifying norms (see Cox 1987). The state is itself transformed into a market actor:

Rather than attempt to take certain economic activities *out* of the market, to 'decommodify' them as the welfare state in particular was organized to do, the competition state has pursued *increased* marketization in order to make economic activities located within the national territory, or which otherwise contribute to national wealth, more competitive in international and transnational terms (Cerny 2000: 259).

This process has included attempts to reduce government spending in order to minimise the 'crowding out' of private investment by state consumption, coupled with the privatisation and deregulation of economic activities, notably the financial markets.

This, says Cerny, has resulted in the rise of a new discourse and practice of 'embedded financial orthodoxy'. The imperatives of competitiveness now constitute a 'new' structural realism, effectively setting the parameters for realistic and acceptable economic policies today. Put otherwise, the structural and relational power of the market appears to be homogenising, leading to the growing uniformity, regularity, and convergence of economic and social policies worldwide:

States are constrained to behave in similar ways for structural reasons, but the pertinent structure in this case shifts from the anarchy/power features singled out by Waltz to the competition/neo-liberalism of the post-embedded-liberal global economy (Clark 1999: 94).

Thus, not unlike the policy constraints imposed by Friedman's (1999) 'Golden Strait-jacket', or as Jessica Mathews writes:

Markets are setting de facto rules enforced by their own power. States can flout them, but the penalties are severe – loss of vital foreign capital, foreign technology, and domestic jobs (Mathews, 1997:57).

Some states have adopted distinct 'niche' strategies to better integrate into the global and regional economies, relying on export processing zones, regional free trade areas, offshore financial centres or simply by suppressing wages (Van der Westhuizen 2006). But these strategies are not exclusive; many developmental states have pursued strategic integration in similar fashion. In summary, Cerny (2000) identifies the following principal features of contemporary competition states:

- A shift from macroeconomic to microeconomic interventionism, as reflected in trade and competition policies, deregulation, and privatisation.
- Public support measures support flexible responses to competitive conditions in dynamic international markets, rather than maintaining strategic or basic activities for self-sufficiency.
- Emphasis is placed on controlling inflation and maintaining a strict monetary policy regime to support non-inflationary growth.
- Political discourse emphasises a pragmatic politics of enterprise promotion, innovation, and profitability in the public and private sectors, rather than welfare distribution within the nation (eg full employment, redistributive transfer payments, and social service provision).

4.2 The interventionist developmental state

The developmental state debate has received fresh intellectual infusion from various scholarly studies (eg Leftwich 1995, Woo-Cummings 1999, Mkandawire 2001, Gallagher 2005, Mbabazi & Taylor 2005) as well as new study groups and research programmes established for that purpose.²² This reflects an understanding that today's more complex global environment – blighted by growing digital divides, worldwide inequalities, and human insecurities – necessitates a critical rethink of the nature, meaning and contours of a developmental state paradigm suited to the realities of the 21st century.

In contrast to the minimalist market contours of the competition state project, the developmental state articulates explicit developmental objectives and seeks to directly or indirectly reorient the private sector towards servicing those ends. This brand of 'entrepreneurial' state activism thus aims to broaden the chances of future growth patterns being more redistributive and job creating. There was, however, no quixotic East Asian developmental state; but scholars have extrapolated broad lessons from their historic rise in the world economy. Leftwich (1995: 405), for instance, has distilled six indicators of a *typical* developmental state, but these are often very *atypical* of Africa's political economy:

- They are driven by determined developmental elites;
- The state is relatively autonomous in its ability to establish the rules of the game vis-à-vis organised interests within society, what Evans (1995a) calls 'embedded autonomy';
- They establish economic bureaucracies at the heart of the polity that were fundamental in shaping development policies;
- Civil society is initially weak or subordinated or penetrated by the state, and human rights protection is poor;
- Non-state economic affairs are effectively managed; and
- State policies achieve legitimacy through strong, redistributive economic performance.

In terms of their broad industrial policy orientation, Chang (1999) argues that successful developmental states have asserted their role in the economy by co-ordinating investment plans; crafting a national developmental vision, with the state identified as an entrepreneurial agent; building institutions that promote growth and development; and mediating conflicts that arise between the winners and losers of this dirigiste trajectory. The critical differences between traditional ISI – which the developmental state is not about – and the distinct outward approach deployed by the East Asian Tigers are illustrated in Box 11.

This present phase of the developmental state debate has spawned a number of peculiar problems and perspectives, as briefly examined below. First, given this unparalleled degree of economic interventionism in the past and its propitious Cold

BOX 11: OUTWARD-ORIENTED INDUSTRIAL STRATEGIES DEPLOYED BY THE ASIAN TIGERS

- Selectivity – or picking a few activities at a time – was the basis for industrial policy in East Asia, rather than promoting all industrial activities indiscriminately and in an open-ended way. Only those activities and functions that offered significant technological benefits and linkages were targeted.
- Forcing the early entry of entrepreneurs into world markets, using exports to discipline and monitor both bureaucrat and enterprises (or ‘reciprocal control mechanisms’ on subsidies, says Amsden (1989)).
- Awarding a lead role in productive activity to private enterprises, but public enterprises filled the gaps and entered risky markets.
- Massive investments in skill creation, infrastructure and support institutions (co-ordinated with interventions in product markets).
- Selectivity in FDI to help build local capabilities or to tap into dynamic, high technology value chains.
- Centralising strategic decision-making in competent authorities that could take an economy-wide view and enforce policies.
- Improving the quality of bureaucracy and governance, collecting information and learning lessons from technological leaders.
- Ensuring policy flexibility and learning, so that mistakes could be corrected en route, and involvement of the private sector in strategy formulation and implementation.

Source: Lall (2004)

War context, questions have arisen about the possibility of replicating similar developmental models in the current hegemonic world order, disciplined by the WTO. The multilateral regulation of trade is today organised around a highly complex constellation of negotiated, binding, and enforceable rules and commitments. As UNCTAD (2006: 167) notes pessimistically of this system: ‘The rules and commitments of the international trading regime restrict the *de jure* ability of developing nations to adopt national development policy.’

But as UNCTAD (2007), Chang (2006), and Page (2007) highlight, the WTO is not the only source of these injunctions. National policy space is similarly eroded by the conditionalities that are often attached to credit and aid, so-called WTO-plus commitments penned into bilateral and regional trade and investment agreements, and the new non-trade international obligations (such as Kyoto, etc). This is not to downplay the policy space that is *still* permitted by the GATT/WTO, but the pressures for global rules are inexorable (see Amsden 2000).

For instance, tariffs are to be reduced, not abolished, and there is potential scope for infant industry protection (up to eight years), there are tariff safeguards for a sud-

den surge in sectoral imports or overall balance of payments problems, and ‘smart’ industrial policies that focus on national systems of innovation are allowed. This leads Evans (1995b: 203) to charge that: ‘Neoliberalism is not just constraining industrial policy, it is redirecting it.’ But the incessant demands of the industrialised countries for more harmonised global rules – apparent at the WTO’s Cancún and Hong Kong ministerial meetings, respectively in 2003 and 2005 – has simply been unpalatable for the South. This has precipitated a backlash from developing nations that now demand more policy flexibilities to further industrialise, diversify, and develop.

Second, democracy, good governance and respect for human rights are today cast as preconditions for successful development. Democratic developmental states – whether an oxymoron or indeed a possibility – are thus distinguished from their East Asian authoritarian avatars by their emphasis on trilateral partnerships with civil society and private companies (Shaw et al 2000), and by measuring their policy initiatives against the benchmarks of long-term sustainable human development and social equity. This alternative conceptualisation of the developmental state resonates best with the progressive thinking of the Nobel Laureate, Amartya Sen (1999). He has defined ‘development’ as the process of expanding and enhancing human freedoms. Democratic developmental states thus have the emancipatory task of eradicating predatory *unfreedoms*: ‘... poverty as well as tyranny, poor economic opportunities as

BOX 12: CHARACTERISTICS OF IDEAL INDUSTRIAL STATE MODELS

	Competition state	Developmental state
Policy orientation	Pro-market	Pro-business
Paradigm	Trade	Production
Theoretical approach	Hyper-globalist, hegemonic, and problem-solving theory	Transformative, counter-hegemonic, and critical theory
Industrial policy	Functional and horizontal	Functional, horizontal, and selective sector targeting
Global economic integration	<i>Trade policy</i> based on unilateral liberalisation (big bang or gradual) with complementary institutional reforms	(i) <i>Trade negotiations</i> based on modulated liberalisation of tariff averages, with flexible policy space; or (ii) <i>Strategic and sequenced liberalisation</i> based on overall development strategy.
State capacity	Regulatory	Directive and planning
Objectives	Structural adjustment, competitiveness, and marketisation	Industrial competitiveness, diversification, and technological upgrading
Chief proponents	World Bank, IMF	UNCTAD

well as social deprivation, neglect of public facilities as well as intolerance or over-activity of repressive states' (Sen 1999: 3).

Finally, democratic developmental states have been widely touted as a panacea for the manifold developmental challenges confronting the African continent, particularly the 'predatory' proclivities of the post-colonial African state. This will be a complex task; sub-Saharan African nations are still a far cry from the premises of the developmental state. They first confront the challenge of reconstructing the state after various failures:

Obviously, the leap from neo-patrimonial regimes to a developmental state is one fraught with difficulty and one that is likely to be a slow process. But it is not impossible. What people now say about and observe in Africa is broadly what was said about a number of Latin American countries fifty or a hundred years ago (Taylor 2005: 52).

On the sanguine side, there is a new political and economic zeitgeist pervading the continent, heralded by the adoption in 2001 of the New Partnership for Africa's Development (NEPAD) and its underlying normative-neoliberal narrative of an incipient 'African renaissance'. NEPAD is indeed premised on improved governance and stronger institutions, both hallmarks of this developmental state approach. For Mkandawire (2001), the essence of an African developmental state is not simply its objective economic performance, but the presence of an overarching, hegemonic developmental ideology, coupled with the deployment of sufficient political and administrative resources to the task of economic development (measured by such proxies as fiscal allocations, etc). Viewed from this perspective, Africa has historically had many states that were, and still are, developmental.

5. Conclusion : towards an emerging 'Southern Consensus'

This study reviewed industrial policy theory, particularly its more recent intellectual treatments and currents. In a world economy characterised by first-mover advantage, it is no longer a question of whether governments should intervene to support industry, but how. In the end it argues that effective industrial policy, premised on strategic collaboration with business, should therefore be oriented towards profitable productive forces, and not simply deregulating the market (Rodrik 2004). This approach resonates with the normative contours of what could be termed an emerging 'Southern Consensus' on development (see Gore 2000).

First, economic growth is best achieved through trade reform that promotes *strategic integration* with the global economy, based on a selective tariff policy (designed to protect learning in dynamic sectors and new infant industries), export support,

and gradual capital account liberalisation (rather than blanket unilateral liberalisation). This form of support should be temporary, with a built-in sunset clause and clear performance benchmarks, since it is not welfare-enhancing to continue to bear the costs of protection when that industry becomes competitive.

Second, national economic strategy should combine a growth-oriented macro-economic policy designed to reduce both inflation and fiscal deficits and a supply-oriented 'productive development policy' embracing, inter alia, technology policy, human resource development, physical infrastructure development, and industrial organisation. Importantly, these policies should all be framed and evaluated in terms of their impact on the environment and ecology.

Third, successful industrial policy requires government-business co-operation within the framework of a pragmatic 'developmental' state whereby a capable economic bureaucracy advances a common set of societal objectives and succeeds in stimulating and regulating private sector investment. This requires enhancing the state's organisational and strategic capacity.

Fourth, the distributional dimension of this growth trajectory must be managed in order to ensure legitimacy, and should be pursued mainly by means such as wide asset ownership and widespread employment.

Fifth, strengthened regional co-operation and even integration among developing countries can help to accelerate industrialisation and structural change, and ease integration into the global economy. But as UNCTAD (2007) argues, trade liberalisation (and hence market integration) is not enough. Active regional co-operation should extend to areas of policy that strengthen the potential for economic growth and structural change, including monetary and financial arrangements, large infrastructure and knowledge-generation projects, and industrial policies. Notwithstanding the agglomeration caveats of the 'New Economic Geography', UNCTAD (2007) supports enhanced South-South regional co-operation, but advises developing countries to proceed carefully with regard to North-South bilateral or regional preferential trade agreements. The latter agreements may offer gains in terms of market access and higher FDI inflows, but they can also limit national policy space, which can play an important role in the medium- and long-term growth of competitive industries. Regional economic advance also requires a favourable democratic environment, supportive public institutions, and common regional norms and values (so-called 'soft infrastructure').

Finally, industrial policy needs to recognise the growth potential of the services sector and the informal economy as an integral part of the overall growth trajectory, and integrate the industrial and manufacturing needs of informal enterprises into a comprehensive industrial strategy.

Endnotes

- 1 This can be traced to the structural adjustment of the 1990s, which led to the closure of large numbers of manufacturing firms and the virtual collapse of important production and supply sectors in Cameroon, Kenya, Malawi, Mozambique, Tanzania, Zambia and Zimbabwe, to name a few. However, this is not simply a Southern pathology: Hungary suffered a similar fate under post-1989 structural adjustment.
- 2 International trade has grown rapidly at an average rate of 5.8 per cent a year. This means that between 1950 and 2000, world trade increased seventeen-fold (Ndulu et al 2007: 139).
- 3 As Ruiters (2007: 3) argues: 'Neo-liberal trade policies are not objective or neutral frameworks. There are underlying assumptions that hide the heteromascularity of the market and deny that women and men experience the market differently.'
- 4 There is a symbiotic relationship between manufacturing and services: manufacturing makes extensive use of services inputs, and so the price and quality of these inputs will directly or indirectly affect the competitiveness of a country's manufacturing sector.
- 5 As developing countries aim to diversify their exports, a rapid increase in exports of labour-intensive manufactured products may involve a potential risk that the terms of trade will decline to such an extent that the benefits of any increased volume of exports may be more than offset by losses resulting from lower export prices.
- 6 For developing countries, their share in services exports was 22 per cent in 2003, while their share in imports was 24 per cent. According to UNCTAD, developing countries generally remained net importers of commercial services, and their services trade has been below global averages (Kwa 2007: 8).
- 7 This coincided with the rise to prominence of regime theory in the American Political Science academy, and strategic trade theory in the study of International Political Economy.
- 8 According to Cohen and Zysman (1987: xiii): 'We are experiencing a transition not from an industrial economy to a service economy, but from one kind of industrial economy to another.'
- 9 Sustainable economic development requires increasing MVA.
- 10 In the period studied, 1987 to 2004, about 8 per cent of total World Bank lending, or \$38 billion, went to 117 countries for trade-related activities.
- 11 This juxtaposition with the 'Chicago Boys' is not simply cavalier: whereas the latter, led by the Nobel Laureates George Stigler and Milton Friedman, once supervised the withdrawal of the state from the economy, today the 'Harvard Boys' see greater scope for more proactive agency. Chicago thinking is based on neoclassical price theory and free market libertarianism; the refutation and rejection of Keynesianism in favour of monetarism (until the 1980s, when it turned to rational expectations); and its advocates reject the regulation of business in favour of laissez-faire.
- 12 The literature on trade liberalisation draws a distinction between the static and dynamic gains from trade policy reform. While the economic arguments around static gains are theoretically compelling and beguilingly simple, it is also recognised that the magnitude of these gains – a rise in income and wealth – are fairly low. Static once-off gains arise as the misallocation of resources under protection and import-substitution industrialisation (ISI) is corrected and resources shift from inefficient to efficient sectors, activities and firms that possess some comparative advantage. In contrast, dynamic gains are the long-term bonuses that ensue from trade liberalisation and its correction of the anti-competition and anti-export bias of protectionism. These include new technology and skills transfers, enhanced competitiveness and larger economies of scale that feed into productivity gains, a rise in real incomes, and economic growth. Classical liberals principally

- base their case for external liberalisation on these dynamic grounds which arise from the mutual reinforcement of external openness and domestic institutional upgrading.
- 13 UNCTAD, through its annual World Investment Reports, has become the authoritative register of these national policy changes affecting the investment and regulatory environments.
 - 14 According to the World Bank, real agricultural commodity prices (1980-2002) declined by 47 per cent, and real prices for metal and minerals decreased by 35 per cent. Within agricultural commodities, tropical beverages, oil-crops, cereals, sugar, and raw materials have experienced the steepest declines, while for horticultural products, meat, and dairy the fall has been less severe (cited in Kwa 2007: 12). However, since 2006 commodity prices have been on the rise due to a number of factors: first, increasing demand from China and India; second, production declines from certain countries; and third, the demand for bio-fuels (Kwa 2007: 12).
 - 15 According to Amsden (2000), these were: the first industrial revolution in the United Kingdom from about 1770-1830, the second industrial revolution in the North Atlantic from about 1873-1914, and 'late industrialisation' from about 1950-1995. In broad terms, tariffs fluctuated in a downward direction from 1830 to 1873, and then went up again between 1873 and 1914, and still further up during the inter-war years. After World War 2, tariffs were again high and then gradually diminished, first in the North Atlantic and then in latecomer countries.
 - 16 Ten years after it was set up as an infant industry in defiance of World Bank advice, the Korean steel industry was the tenth most efficient producer and is currently the fifth largest steel producer in the world (Kwa 2007: 36).
 - 17 SingTel is South East Asia's biggest phone company. Although it operates as a private corporation, it is a subsidiary of Temasek Holdings, the investment arm of the Singaporean government that is 100 per cent owned by the Ministry of Finance (Kwa 2007: 36-37).
 - 18 This finding is based on a loose association, rather than rigorous methodology.
 - 19 Financial sector policies were designed to facilitate two crucial functions: first, they encouraged savings; second, they channelled savings into activities with high social returns.
 - 20 As Lall and Teubal (1998: 1371) note: 'In a neoclassical world, technological development takes place under highly simplified assumptions: small, homogenous firms operating in perfectly competitive markets, where all technological options are known (i.e. "well-behaved" production functions), choices are made costlessly to optimise allocation on the basis of capital/labor costs, and technology is absorbed and used without further effort and cost.'
 - 21 In 1965, part IV (on trade and development) was added to the GATT, establishing new guidelines for trade policies of and towards developing countries. A Committee on Trade and Development (CTD) was created to monitor implementation (Hoekman 2002: 46). Special and differential treatment (SDT) was formally introduced into the multilateral trading system during the Tokyo Round, with the adoption of the 'Enabling Clause'. Its 145 provisions peppered throughout the GATT/WTO regime is an explicit concession to the fact that the historical evolution of the multilateral trading system and its global trading rules are heavily skewed in favour of the developed countries (see Wilkinson 2006).
 - 22 A good example is the programme convened by the Overseas Development Institute (ODI) in London.

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