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Irfan ul Haque

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Abbreviations

ADB	Asian Development Bank
FDI	foreign direct investment
GATT	General Agreement on Tariffs and Trade
ILCs	industrially lagging countries
IMF	International Monetary Fund
IT	information technology
NIEs	newly industrializing economies
R&D	research and development
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nation Industrial Development Organization
WTO	World Trade Organization
Y2k	the year 2000 problem; the millennium bug

RETHINKING INDUSTRIAL POLICY

Irfan ul Haque

(Independent Consultant and Member, New Rules for Global Finance Coalition)

Abstract

Despite the hold of the neoliberal orthodoxy on policy making in developing countries, industrial policy remains important for the promotion of industrial development. However, the context for the design of industrial policy has profoundly changed as a result of new rules governing international trade, the rise of global value chains and marketing networks, and other aspects of globalization. Traditionally, the case for industrial policy has been framed in terms of "market failures" but the paper argues that that is not a sufficient basis. After addressing the traditional points of criticism, an attempt is made to outline the "domains" of industrial policy in the current circumstances, especially for industrially lagging countries. As country contexts differ widely there are no satisfactory blueprints for policy making that countries can readily adopt. As in production decisions, considerable ingenuity and innovation is needed in designing policies. This is all the more necessary as the WTO rules have become increasingly stringent and the rise of international trading networks has created new barriers for young firms to enter the world market. These developments have changed the context but not the importance of policy in industrial development. The paper identifies areas where government intervention is needed and can still make a positive difference.

INTRODUCTION

The rapid flow of knowledge, large capital movements, new emerging patterns of international trade, WTO rules and disciplines, the rise of bilateral/regional trade agreements, all have created new opportunities as well as challenges for the developing world. It is evident that some developing countries are better able to take advantage of these developments than others. The question is what could be done – at national and international levels – to help the latter group of countries, which comprises the world's poorest countries, mostly in Africa. Promotion of industrialization in developing countries is at the centre of this discussion.

Contrary to a general perception – born out of the current sway of the neoliberal orthodoxy – industrial policy is alive and well. As Rodrik (2004:29) notes: "The reality is that industrial policies have run rampant during the last two decades – and nowhere more so than in those economies that have steadfastly adopted the agenda of orthodox reform". The use of industrial policy in East Asia, China, India, and Brazil is well known. Indeed, there are few examples of successful industrialization where government did not actively promote industry (Chang 2002).

Countries that otherwise subscribe to economic liberalism in fact do engage in industrial policy when they adopt measures targeted at promoting export activities or attracting foreign investment in specific sectors. It is also evident that the demand for selective protection of specific industries in the industrial countries remains on the political agenda, as imports of products of cheap labour are held responsible for unemployment and depressed wages.

There appears now to be taking place a rethinking on the issue of industrial policy. Rodrik's own paper (2004), which was written for UNIDO, breaks new ground in several respects. The Initiative for Policy Dialogue (Stiglitz's think tank) has set up an Industrial Policy Task Force (consisting of some famous economists) with the purpose of enhancing understanding and dialogue on policies to stimulate industrialization. Akyüz (2005) and Chang (2005) have reopened the discussion on the role of trade policy in industrialization and make a persuasive case for caution in the further lowering of industrial tariffs in developing countries under the Doha Round. The Asian Development Bank (ADB) continues to be actively engaged in the issue of international competitiveness in Asia and on the design of support policies (ADB 2003).

This paper aims to contribute to this discussion. It revisits the issue of industrial policy in the light of recent developments in the global economy, ranging from rules governing international trade to the rise of global value chains and marketing networks as drivers of trade flows. In Section 1, the rationale for industrial policy is discussed. This is followed by a discussion, in Section 2, of the key global developments that now provide the context in which industrial policy has to be designed. In Section 3, the domains of industrial policy are outlined. Main conclusions along with a broad indication of the future directions of industrial policy are given in Section 4.

1. Why industrial policy?

Productivity growth is the key determinant of a country's living standards and its ability to compete in the world market. Since the absolute level of productivity and its potential for growth vary across activities, a country's ability to catch up with the more advanced countries is largely dependent on what it produces and sells in the world market. Economic development implies structural transformation, typically from low productivity to high productivity activities, from agriculture and simple manufacturing activities to modern industry.

The agents steering economic and technological transformation are basically domestic enterprises, though foreign investors' involvement may be important in some activities. It is business firms that, in pursuit of profit, generate and manage technological improvements bringing to the market new products at diminishing costs. An economy that is dominated by technologically dynamic firms will tend also to grow faster. Thus, what makes firms to thrive, grow and compete in the world market is central to an understanding of the process of catch up of the poor with the rich countries.

A firm's performance depends primarily on the drive and entrepreneurship of its managers and owners whose investment decisions, worker training, marketing, R&D, etc., determine the pace of technological improvements. While there is no satisfactory explanation for the factors determining the supply of entrepreneurial talent, it is evident that some national environments – encompassing economic, political and social dimensions – are more congenial than others to the rise of dynamic firms. The search for profit is obviously the key motivation in a market economy, but what distinguishes, in the long term, the leadership of a successful firm is how that goal is pursued.

Existing productive capacity represents a certain level of productive efficiency but competing in the world market requires that this level be continually raised. Part of the process of structural transformation and technological improvement is autonomous and may be facilitated and promoted by the market as investors seek out profitable opportunities. But this may be too slow a process in relation to a country's own growth aspirations or in relation to technological improvements occurring elsewhere. Indeed, in an increasingly competitive and globalized world, technologically lagging firms

may not survive for long. Government intervention becomes necessary when competition alone does not propel business firms to innovate and undertake productivity enhancing investments, notwithstanding the numerous examples of misguided interventions that lulled enterprises into complacency and thwarted industrial development.

The traditional rationale for selective industrial policy (i.e. policies intended to promote specific industries as against general policies to promote industrialization) has been made in terms of "market failures" that arise when competitive markets either do not exist or are incomplete, in situations, for example, when there are information asymmetries, scale economies, or externalities. Markets also fail when investment decisions are interdependent and require coordination, i.e. investment A is contingent on investment B being made.

Typically, market forces alone do not provide clear enough indication of the profitability of resources that do not actually exist (e.g. new skills or technology), and resource allocations that have yet to materialize. The doctrine of comparative advantage – the cornerstone of mainstream trade theory – is of limited value in designing policy if economic development involves deliberate change in "factor ratios" through investment in physical and human capital as well as knowledge generation. In explaining the patterns of specialization at the specific industry level in the developing world, Rodrik (2004:27) notes: "Whatever it is that serves as the driving force of economic development, it cannot be the forces of comparative advantage as conventionally understood".

The focus on market failures has helped to target policy on certain critical weaknesses in developing economies, notably, provision of education, infrastructure and risk capital as well as public funding of R&D and programmes for skill improvements. It has also underscored the importance of making markets function more efficiently through, for example, the enforcement of contracts and property rights. However, the market failure approach has tended to restrict policy discussion to a narrow range of situations, and government's role in industrial promotion is cast more or less as a residual activity, to be undertaken reluctantly and cautiously. Certainly, the approach to policy making in East Asia – the example par excellence of successful industrialization through government intervention – was pragmatic and not bound by a narrow view of economic models. A broader approach to industrial policy is what is needed.

First, market failures are not always easy to locate except in the most obvious situations (namely, education, infrastructure, etc.) and, when they can be located, their seriousness may not be apparent. Thus, while the need for government action to promote, say, R&D may be recognized, there is little guidance as to how and to what extent government may intervene.

The reliance on market failures to rationalize government policy also seems to presuppose that the textbook model of competitive markets is essentially sound. But the fact is that that model suffers from serious flaws, not least on account of its absolute reliance on the profit maximization assumption. To what extent private corporations are driven by this motive and how they go about balancing conflicting objectives of improving share value versus profit distributions are keenly debated issues. It is also the case that there are market systems that encourage investors to take a short term view of profit possibilities compared to others.[1]

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[1] This is perhaps the single most significant difference between the so-called Anglo Saxon capitalist system and the traditional European socialist market economy as well as the Japanese or East Asian system (both of which have been under serious attack from the neoliberal orthodoxy).

In giving centre stage to the need for learning and technological adaptation in industrial advancement, Nelson and Pack (1998:25) note that "profit maximization is [not] something that managers actually are able to achieve, rather that something they strive for intelligently." Indeed, an unfettered pursuit of profits is liable to destroy market competition if firms are allowed to collude and form monopolies that strengthen their market position. It was to curb this tendency that the industrial countries enacted anti-trust or control of monopoly laws early in their industrialization. However, it is also the case that governments themselves at times promote cooperative or collaborative arrangements among firms in order to tap scale economies or promote generic research. In short, government policy is occasionally needed not because markets fail but because they work too well.

Secondly, the market failure approach makes public policy to focus basically on supplying lacking inputs: physical capital, skills, technology, etc. While this is an important policy area, developing countries also tend to suffer from a lack of demand for such inputs. High rates of unemployment of educated and skilled workers and the presence of industrial excess capacity are fairly common phenomena in the developing world. Brain drain from developing countries is not just a curious paradox but also a serious waste of a very scarce resource. These problems, which call for government intervention, are again not a manifestation of market failure, as conventionally understood.

Finally, there is what amounts to a "private sector failure", when a firm's goal of making profits (or raising share value) conflicts with national development. It may make good commercial sense for a private firm to pull out of one country and move to another that offers, say, more attractive tax treatment but this can have serious economic and social consequences for the country as a whole. Governments in industrial as well as developing countries are therefore called upon to prevent this from happening. Another example of private sector failure is what Hausmann and Rodrik (2003) have called the problem of "self-discovery", i.e. developing country investors are particularly hesitant to invest in new activities on grounds that they might bear the cost of failure but would end up sharing gains with later arrivals. Such situations, which are again not strictly speaking cases of market failure, justify government measures to restrict competition in new activities to overcome entrepreneurs' risk aversion.

2. The global context

The fact that promotional policies played a significant role in the development of both industrial and newly industrializing economies (NIEs) provides a solid rationale for the adoption of similar policies in the industrially lagging countries (ILCs). However, despite the earlier success, simple copying of past policies and practices is now neither feasible nor altogether desirable for countries striving to catch up with the more advanced countries. For one thing, the global context in which governments and firms operate today is rather different from the situation that prevailed barely two decades ago. For another, circumstances and conditions differ widely across countries. Policy therefore must be anchored in the local context. Just as considerable adaptation and innovation is required in taking advantage of borrowed technologies, deftness and creativity are the hallmarks of successful policy making.

Foremost among the developments that constrain government's room for manoeuvre ("policy space") is the fact that today's policy environment is one of market liberalism which has been more or less embraced by virtually all developing countries. Initially, neoliberalism spread through the imposition of policies by the IMF, World Bank and other financial institutions under the so-called Washington Consensus, but there has also been over time a fundamental shift in the perception of government's

role in economic management. There is now hardly a country that aspires to return to central planning, undertake large public sector industrial projects, or rely on high levels of protection. This does not, however, imply that there are no significant and important differences among the market systems. Indeed, the issue of what type of market system best suits a country remains a keenly contested territory. Nor indeed can it be said that countries have altogether foresworn the use of trade policy to further national interests. In key areas (notably agriculture, but also others), industrial countries continue to retain trade barriers and a robust case has been made for developing countries to resist pressures to further lower industrial tariffs (Akyüz 2005 and Chang 2005).

The role of industrial policy is also circumscribed by the WTO's increased intrusiveness (compared to GATT) into what were previously domains of domestic policy. Apart from the general lowering of trade barriers, the use of export subsidies and quantitative restrictions is now forbidden under the WTO rules (the least developed countries are excepted). The new rules governing trade now also cover trade related measures with respect to foreign investment (countries cannot apply domestic content or performance requirements) and intellectual property (laws governing intellectual property must meet certain specified minimum standards).

Somewhat perversely to the WTO's multilateral framework, the rise of bilateral or regional trade agreements has further eroded the policy space available to developing countries. In fact, on issues where they failed to get developing countries' consent in the WTO, the industrial countries have succeeded in these agreements to extract compliance. Rodrik (2004:33) notes: "Regional or bilateral agreements typically expand the range of disciplines beyond those that are found in the WTO. In particular, the U.S. has pushed for tighter restrictions in the areas of investment regulations, intellectual property protection, and capital account whenever it negotiates a free trade agreement with a developing country".

The fact, however, is that the general lowering of trade barriers has not brought the world much closer to the textbook notion of free trade. As the role of trade policy has generally weakened, international trade flows have come to be increasingly controlled and driven by goals and strategies of major corporations, located mostly in the industrial world.[2] A high proportion of world trade today is not conducted at arm's length in competitive markets, but rather consists of intra-firm trade or trade within commercial networks.[3] Apart from the use of transfer pricing by multinationals to minimize tax burden, this development has two implications.

One, it is no longer sufficient to be a low cost producer; it is now also necessary for the producer to become part of a trade network or a value chain. Getting picked up from this dance floor of many competitors worldwide is as much a question of luck as of productive efficiency. An Asian Development Bank report (2003:211) observes: "Explaining how and where a manufactured good is 'produced' is no longer an easy matter – design, production, distribution, and servicing are all divided into elements that are spread all over the world." The kind of "outward oriented" strategies – based as they were on the low labour cost advantage – pursued, for example, by the Republic of Korea or Taiwan Province of China in their early industrialization, would not generally be feasible or effective in today's environment. The situation is in the nature of the catch-22: a developing country producer

[2] Du Boff (2001:8) notes that large companies "have disproportionate clout on national legislation", "have become too large to fail", "exert massive pressure on America's international behavior", and have a "formidable grip on US trade policy".

[3] The precise size of this trade is not known. One OECD study estimates intra-firm trade for the United States at about 30 per cent. If trade within networks is included, the proportion could be double that figure.

needs to secure a major sales order to get started in business, while corporate buyers in industrial countries look for firms with proven track record.

Two, the relationship between the large international firms and small producers in developing countries is fundamentally unequal. It is the former that decide where to buy, invest, and locate industrial activity, and by and large determine the return a developing country producer receives. This is because in industries with high sales costs, advertisement expenditures, or R&D expenses, large firms enjoy a distinct competitive advantage over small producers. Large firms also tend to have disproportionate clout over economic and trade policy both at home and in host countries. It is also a fact that market concentration has increased in as diverse industries as food, garments, automobiles, pharmaceuticals, and computers. The increased vulnerability on account of all these factors is one reason why globalization is seen as a threat rather than as an opportunity in most developing countries. The question then arises whether these countries have something to learn from the more successful countries.

Finally, the increasing importance of South-South trade raises somewhat different set of issues for industrial policy. Manufactured exports from developing countries – mostly, the East Asian NIEs – now account for more than one-third of world trade in manufactures, compared to less than 20 per cent barely two decades ago. The main markets for these exports remain in the industrial countries, but they now constitute the bulk of manufactures imported into the developing world. Thus if the ILCs are to industrialize, they would need to protect themselves not so much from the industrial countries as from the NIEs, which continue to pursue active promotional programmes while maintaining higher levels of protection.

It remains to be seen whether the industrially more advanced countries would support industrial development of the lagging countries through progressive restructuring of their own industry and encouraging imports from the latter. This was more or less how industrialization spread within the East and South-East Asian region, a phenomenon that came to be called the "flying geese pattern" of industrial development. As noted by one observer: "All [East Asian] countries started with a focus on technologically simple labour-intensive goods – clothing, sports goods, toys, processed foods and so forth. Although the speed of graduation from these varied, moves into a range of more capital-intensive, technologically sophisticated items always followed with the four first tier NIEs vacating export markets, which were then filled by the second tier group" (Weiss 2005).

If the flying geese pattern is to be extended to other developing regions, it would be necessary for the industrially more advanced economies to open up their economies to imports of labour-intensive or resource-intensive products, while allowing the lagging countries to pursue promotional policies including higher protection on their nascent industries. A rough indication of how trade policy may evolve over time is provided by a stylized tariff profile of infant industry protection in Akyüz (2005). A distinction is made between resource-based/labour-intensive products, with which countries usually start their industrialization; and low, medium, or high technology-intensive products which start getting produced with industrial advancement. At each stage of this sequence of industrialization, countries require protection for a certain length of time; as industries mature and become internationally competitive, protection can be reduced or even eliminated. One important implication of this concept of sequencing of protection is that it would entail differentiated application of the "special and differential treatment" under the WTO.

3. The domains of industrial policy

Despite its widespread use, industrial policy remains controversial. There is better tolerance of policies that aim only to create a favourable environment for industrialization, such as macroeconomic stability, public provision of education, guaranteed property rights, and legal enforcement of contracts. But there is considerable resistance to policies designed to promote specific industries. The failure of industrialization in many developing countries is one reason why this viewpoint prevails. However, the main reason is that policies intended to promote particular industries go against the basic tenets of the prevailing economic orthodoxy. Interventions are held to distort market signals, governments are seen as incapable of successfully "picking winners", and the protected infants are believed never to grow up. Before discussing the considerations that may guide industrial policy in the current global economic environment, it is necessary to dispose of these points of criticism.

With respect to the first criticism, it is generally recognized that market prices fail to provide adequate incentives for developing skills and human capital or to guide investment decisions needed for structural transformation of developing economies. In such situations, policies are needed occasionally to reinforce, other times to counteract, the allocative effects of market signals, or what Alice Amsden has called "getting prices wrong". Prices are at any rate "distorted" even without state intervention when conditions for perfect markets do not prevail, which is usually the case.

The issue of "picking winners" arises when policies are targeted at specific industries. It is argued that governments have no sound, economically rational basis for promoting one industry against another. However, "picking winners" is a mischaracterization of industrial policy, for there is no such thing as a "winning" industry. In selecting an industry for promotion, policy makers must obviously take account of market conditions and the country's existing capabilities, but whether the industry is viable in the long term depends on a variety of factors, notably, perseverance in learning from experience, continual search for improvements in products and production methods, and agility in finding and securing new markets (Haque 1995). Government can and do help to *create* conditions that permit a country to become particularly good at producing certain things, whether it is aircraft manufacturing in Brazil, steel in the Republic of Korea, or cut flowers in Kenya.

Rodrik (2004:3) emphasizes that what matters is not so much the specification of the *outcome* as the *process* through which policy decisions are made. He notes: "The right model for industrial policy is not that of an autonomous government applying Pigovian taxes or subsidies [i.e. lump sum 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."

Finally, with respect to the assertion that "infants never grow up," two points may be made. One, a number of "infants" in developing countries actually did mature into competitive, world class industries; examples range from garments to sophisticated electronic equipment in different parts of the developing world. Two, there is really no specific moment when industrial development can be considered as successfully accomplished, for, in the competitive world, "success" is constantly under challenge. Established industries and firms frequently go through difficult periods, and governments take risks in supporting or not supporting them. Thus, it was under the Reagan administration – the foremost champion of neoliberalism – that Harley-Davidson Motor Company and Chrysler Corporation were saved from bankruptcy. Similarly, aircraft manufacturing in Brazil, pharmaceuticals

in India, and automobiles in South Africa – which are regarded today's success stories – also went through difficult and trying times that necessitated government rescue measures.

In short, there are circumstances when government promotion of specific industries is both necessary and worthwhile. It may take the form of ensuring that investments, not immediately profitable, actually take place or protecting nascent industry from foreign competition. Regardless of the type of support measures, however, a few generally accepted principles – largely drawn from the East Asian experience – provide useful guide for policy making in developing countries. These include laying down performance benchmarks, making the beneficiaries accountable for their performance, and specifying time limits for protection, etc. (These are discussed at length in Lall 2000, Rodrik 2004, and Weiss 2005.)

A choice in any case has to be made as to which industries government may promote – an inevitably difficult and uncertain process. But serious mistakes are more likely to be avoided if policy decisions are made in close collaboration and consultation with the private sector. The problems of "crony capitalism" aside, neither government bureaucrats cut off from the commercial world nor private investors seeking quick and easy returns are capable of choosing investments that support long term economic growth. Rodrik (2004:1) underscores the "need to embed private initiative in a framework of public action that encourages restructuring, diversification, and technological dynamism beyond what market forces on their own would generate."

While other countries' experience may hold useful lessons, there is no blueprint of "good policies" that countries could readily adopt. The fact is policy making is basically contextual. Similar policies may work well in one place but not in another. Thus, the choice of industrial specialization and policies that go with it is more or less unique to individual country circumstances. Even among the East and South Asian countries, there were significant differences in policies and patterns of industrial development. As Lall (2000:7) put it: "clearly there are not only 'many roads to heaven' but also many heavens." He goes on to point out that the "tools used in the successful countries were not that different from those used in less successful economies – the secret lay in the combination of those policies and the efficacy of their implementation." One might add that serendipity or chance can also be important. Embraer, the Brazilian aircraft manufacturer, was saved from financial collapse by an unexpected sales deal at an international air show; Bangladesh's thriving garment industry also owes something to chance; and India's rise in the IT industry was helped by the Y2k fears.

The previous section noted the increased influence and reach of the WTO rules, the rise of bilateral/regional trade agreements, the impact of corporate strategies and goals on the pattern of trade flows, and the increasing importance of the South-South trade. These developments, which are all rather recent, have fundamentally altered the domains of industrial policy compared to the past.

Although developing countries' room for manoeuvre in policy making is now greatly circumscribed, the existing tariffs on manufactures continue to provide developing countries with some degree of protection from outside competition. Demands for lowering them under the Doha Round therefore need to be resisted, as Akyüz (2005) and Chang (2005) have strongly argued. At the same time, countries can (and do) try to get existing rules changed or modified when they seriously undermine national interest. Thus, in the WTO, developing countries continue to seek modification or clarification of some of the provisions, including the clause covering "special and differential

treatment". Finally, what is actually permissible under the new rules governing international trade is still subject to "legal interpretation" (Hoekman 2004).[4]

At the same time, it is evident that there is a need to broaden the differentiation among developing countries so that NIEs can be distinguished from ILCs.[5] Given that some developing countries have now fairly advanced and internationally competitive industries while others remain dependent on commodities, trade policy as an instrument for promoting industrialization is likely to be more important for the latter group of countries. The relatively more advanced developing countries are also likely to have access to a broader array of policy instruments. Basically, what seems to be needed is to extend the "flying geese pattern" of industrial development to other developing regions, with countries progressively lowering trade barriers as their industries become mature and competitive to yield space to imports from other countries of the South.

The rise of value chains and supplier-buyer networks has profounder implications for policy making. In order to export, it is no longer sufficient for a developing country to produce goods efficiently and competitively. Developing country suppliers of labour intensive products must now not only overcome the traditional trade barriers – which remain high for certain developing country exports – but also must become part of some trade network in order actually to export. The rise of supply chains, as drivers of international trade, has resulted in what are basically monopsony situations, where foreign buyers more or less dictate the prices they pay to developing country producers.

In such trading networks, there is little commitment on the part of buyers to their suppliers, who can be easily replaced by others. If a developing country producer succeeds in joining a trade network, there is no assurance that such an arrangement would be durable, as new and more attractive sources of supplies are constantly coming up. Thanks to the universal appeal of the mantra of "export-led growth", simple labour intensive manufacturing has become fiercely competitive, with suppliers struggling to contain costs and remain attractive to foreign buyers. Activist policies in support of domestic firms in one country are either challenged promptly in the WTO or are quickly matched by similar actions in other countries. This results in "a race to the bottom", implying compressed wages, stagnant or falling living standards, and a neglect of environmental consequences.

To deal with these problems, Pack and Saggi (2005:44–45) propose the establishment of national trading companies as found in some East Asian countries. They note: "Governments could attempt to encourage the development of trading companies as there may be a market failure given the characteristic that setup costs for such a firm may be significant but marginal costs of adding firms to the network may be small. Such trading firms could operate across clusters of manufacturing firms." Countries might also re-examine the value of "export orientation", which is at the core of the value chain problem, and explore avenues for successful import substitution especially when their own markets are flooded by cheap imports from the industrially more advanced developing countries.

Finally, there is the issue of enterprise development. The rise of domestic industries depends critically on the ability of domestic firms to undertake needed investments, generate and manage technological change, and compete in domestic and foreign markets. Thus, the support to domestic industries ultimately involves measures that nurture and promote domestic firms. However, such measures are opposed by industrial countries, who argue that they discriminate against foreign firms and insist on foreign firms being given similar "national treatment". They brought this matter to the WTO under the

[4] UNCTAD 2003 discusses a range of possibilities within the existing WTO rules that developing countries may find useful.
[5] The sub-category of "least developed countries" is already accepted for differential treatment in the WTO.

rubric of “competition policy”. Although the developing countries succeeded in getting it excluded from the Doha Round of trade negotiations, the issue is by no means dead and can be expected to resurface at a later date.

As noted earlier, in the early stages of industrialization, competition may need to be restricted in order to allow a firm in a new industry to get established and survive in the market. The need for restricting competition also arises when foreign firms enjoy certain privileges or advantages on account of their size (e.g. access to finance, advertising, political influence) that the smaller local firms do not. Industrial countries, through their anti-monopoly policies, aim to ensure that competition remains fair and routinely protect their firms from foreign hostile takeovers when it is deemed to be in national interest. In contrast, developing country firms are much more vulnerable as they neither have the size to successfully withstand foreign competition nor do they generally have the protection offered by anti-monopoly laws. To avoid a “to race to the bottom”, developing countries need to cooperate and adopt a collective approach on this issue. In this connection, Ajit Singh proposes the establishment of an International Competition Authority, which would aim “to control the anti-competitive conduct of the world’s large multinational corporations … as well as to control their propensity to grow by takeovers and mergers” (Singh 2002:22). This proposal merits serious consideration.

4. Concluding observations

The rationale for industrial policy in the sense of selective promotion of industries remains robust despite recent developments. What has, however, changed over time is the context in which industrial policy is framed. Globalization, a general predilection for liberal economic policies and increased openness in trade, have not made industrial policy disappear but they have nevertheless brought about a fundamental shift in the general view on what governments can and should do to foster industrialization. Perhaps, the most significant change has occurred with respect to the role of trade policy, which was the principal instrument for industrial promotion in the past. While it remains relevant and useful as a policy tool, the general lowering of trade barriers and more stringent WTO rules have resulted in lessening its importance.

While traditional barriers to developing country exports remain significant, it is today rather difficult for developing country producers to sell labour intensive products in foreign markets without going through established supply chains or trade networks. Establishment of national trading companies, as proposed by Pack and Saggi (2001), could help to overcome these new obstacles to trade. But government policy also needs to pay greater attention to domestic enterprise development, for it is individual firms that innovate and harness technological change and compete in the world market. Successful industrialization depends on these firms.

The paper has argued that “competition policy” should be considered as an essential complement to industrial policy in developing countries. Apart from regulating competition among domestic firms at early stages of industrial development, ILCs need to protect their firms from unfair encroachment of foreign firms in their markets. However, it is generally difficult for governments in relatively small economies to act alone, as they risk losing foreign capital altogether. It is for this reason that developing countries should consider including in their trade and development agenda the establishment of an International Competition Authority, as proposed by Singh (2002).

The proliferation of bilateral trade agreements between industrial and developing countries also has important implications for the development and survival of industry, especially in the ILCs. Apart

from lowering trade barriers, these agreements usually contain provisions concerning rules relating to FDI, capital account liberalization, intellectual property protection as well as clauses on labour and environment standards. Developing countries have been remarkably accommodating of industrial country demands under bilateral agreements, even as they collectively opposed those measures in the WTO. This evidently contradictory position on the part of developing countries is likely to have done more harm to the fight for “policy space” than the tightening of WTO rules.

The rising prominence of the industrially more advanced developing countries in world trade offers new challenges for the ILCs. On the one hand, the first group of countries offers rapidly growing markets and a new source of FDI but, on the other, their exports are flooding the markets and stifling nascent industry in the latter group of countries. The issue here is whether the countries with more advanced industry would adapt their policies so that, as they move up the technological ladder, space is yielded to producers of simpler, labour intensive industries in the less advanced countries. This implies extending the so-called “flying-geese pattern” of industrial development observed in East Asia to other parts of the development world.

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