

WHY SERVICES NEED AN INDUSTRIAL POLICY

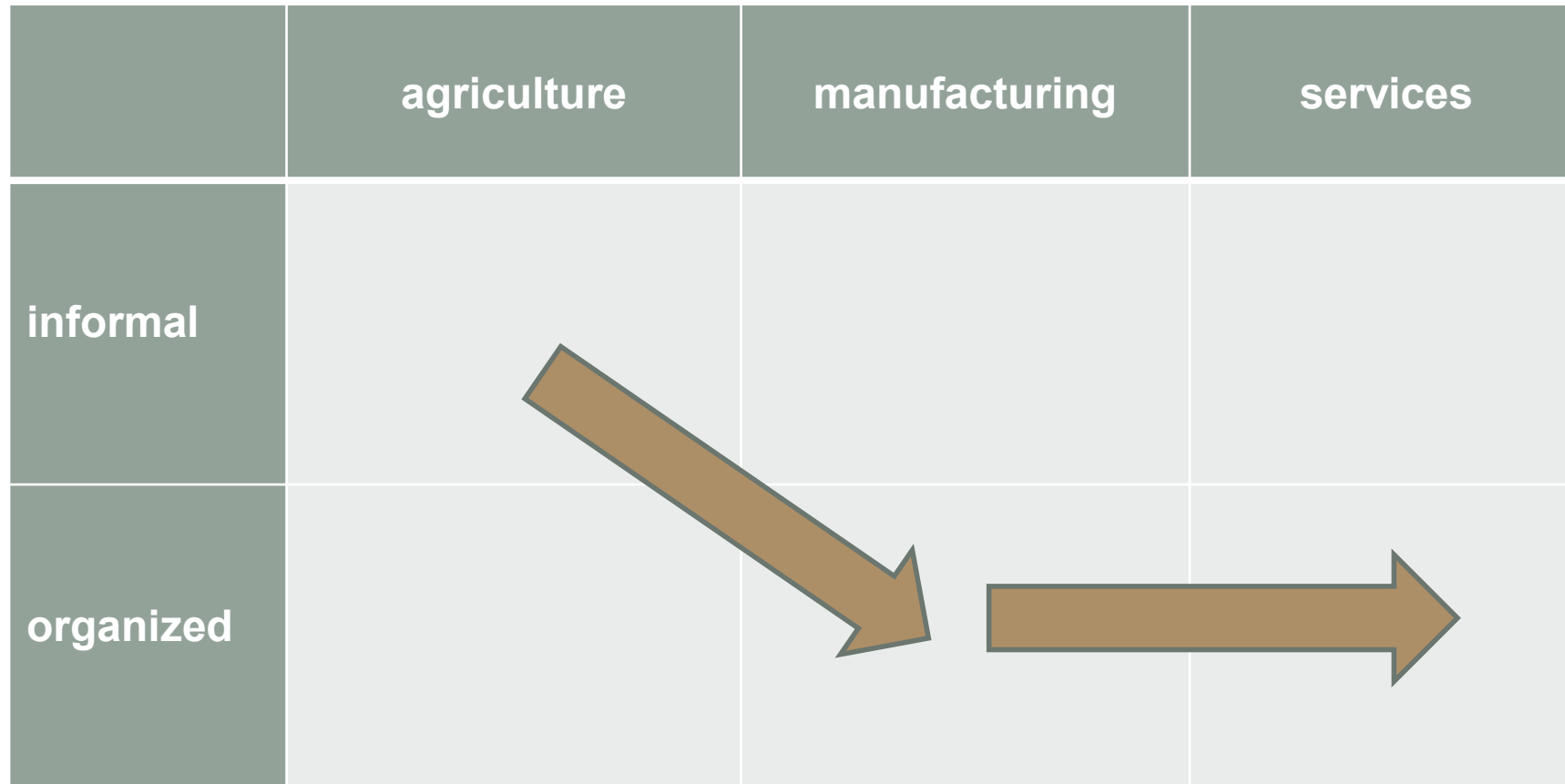
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February 2023

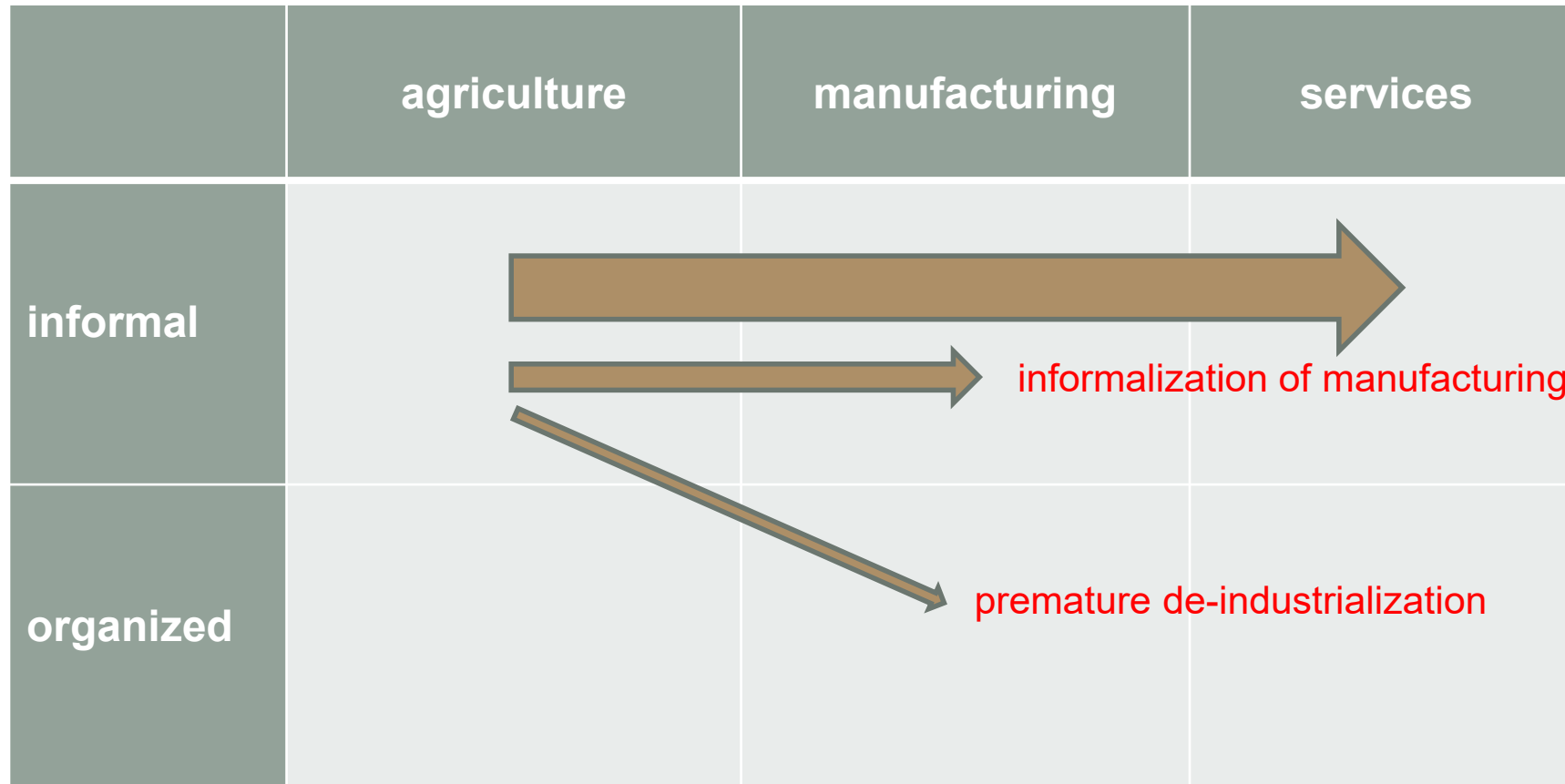
Outline

- Fundamental changes in patterns of structural change
- Lowering of the underlying growth potential
- A focus on services and “good jobs”
 - with a different type of “industrial” policy

Patterns of structural change: East Asia and advanced countries

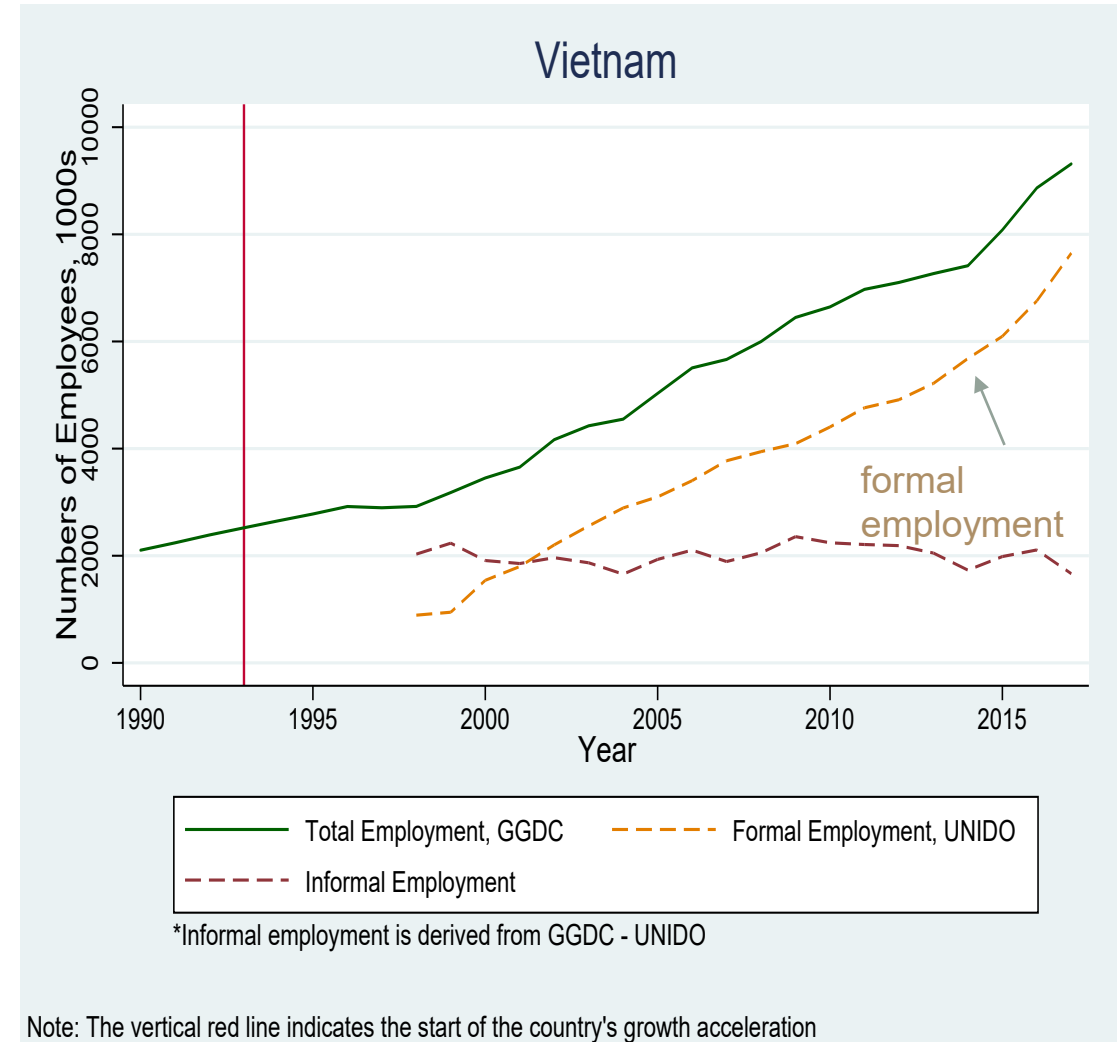
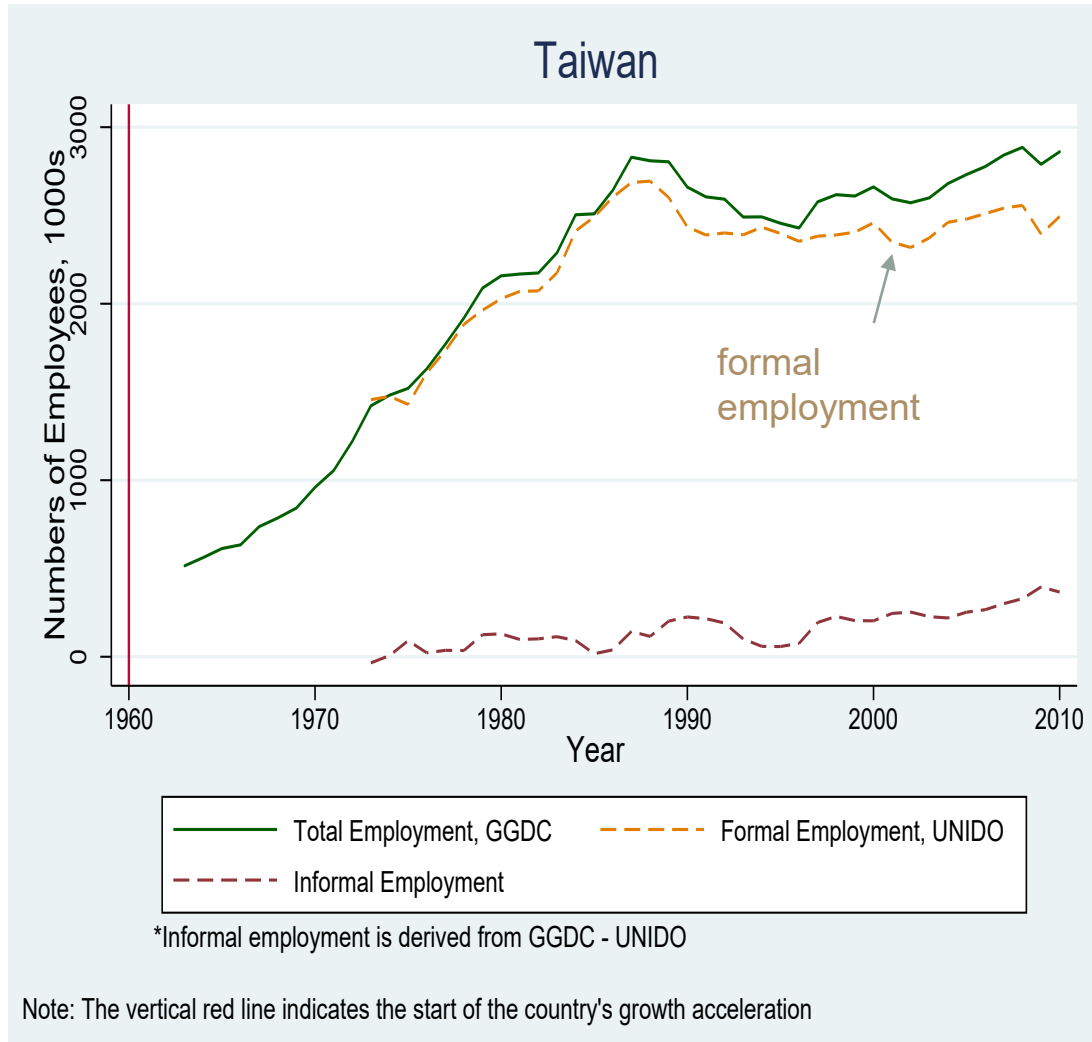


Patterns of structural change: low-income countries today



Traditional, manufacturing-led growth

Manufacturing employment

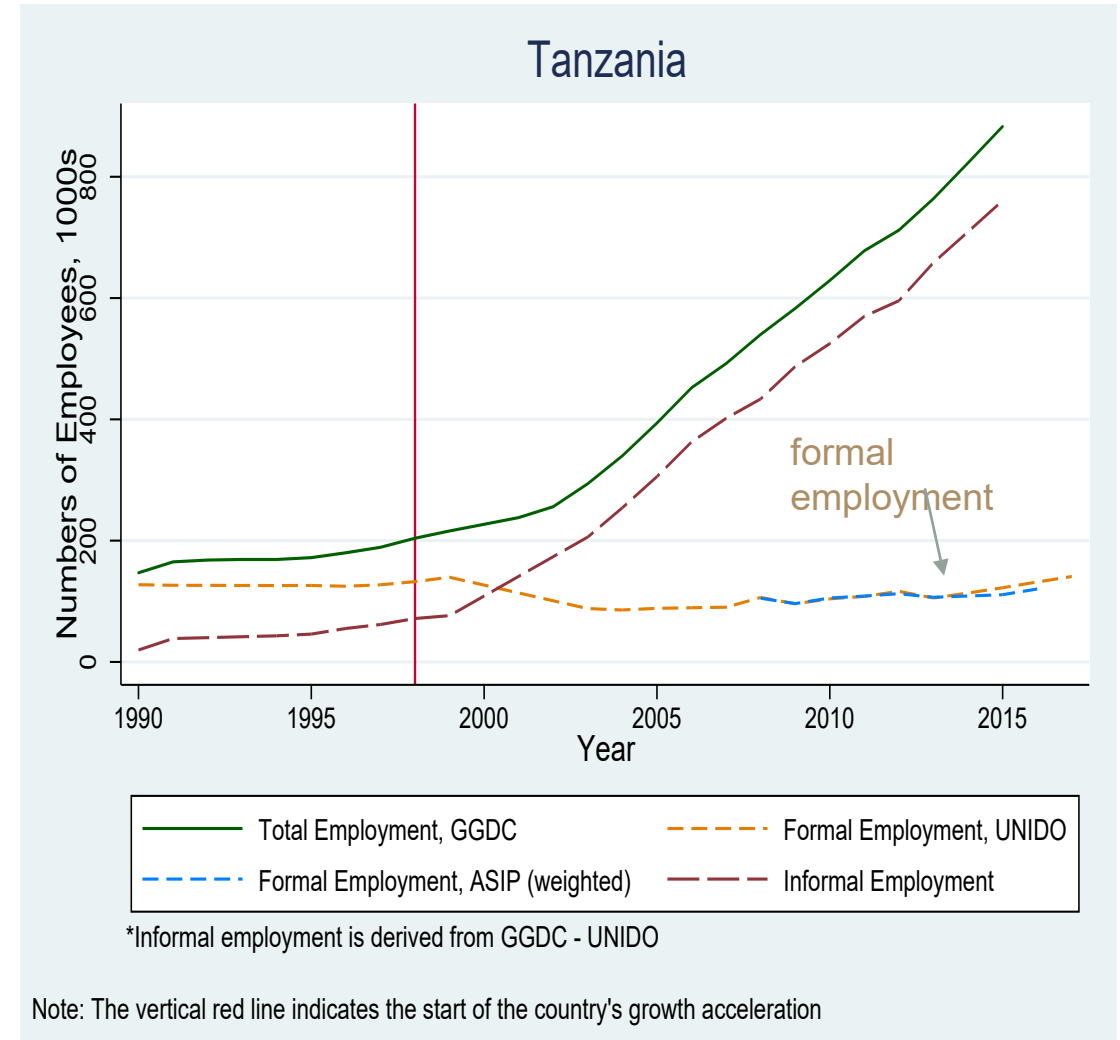
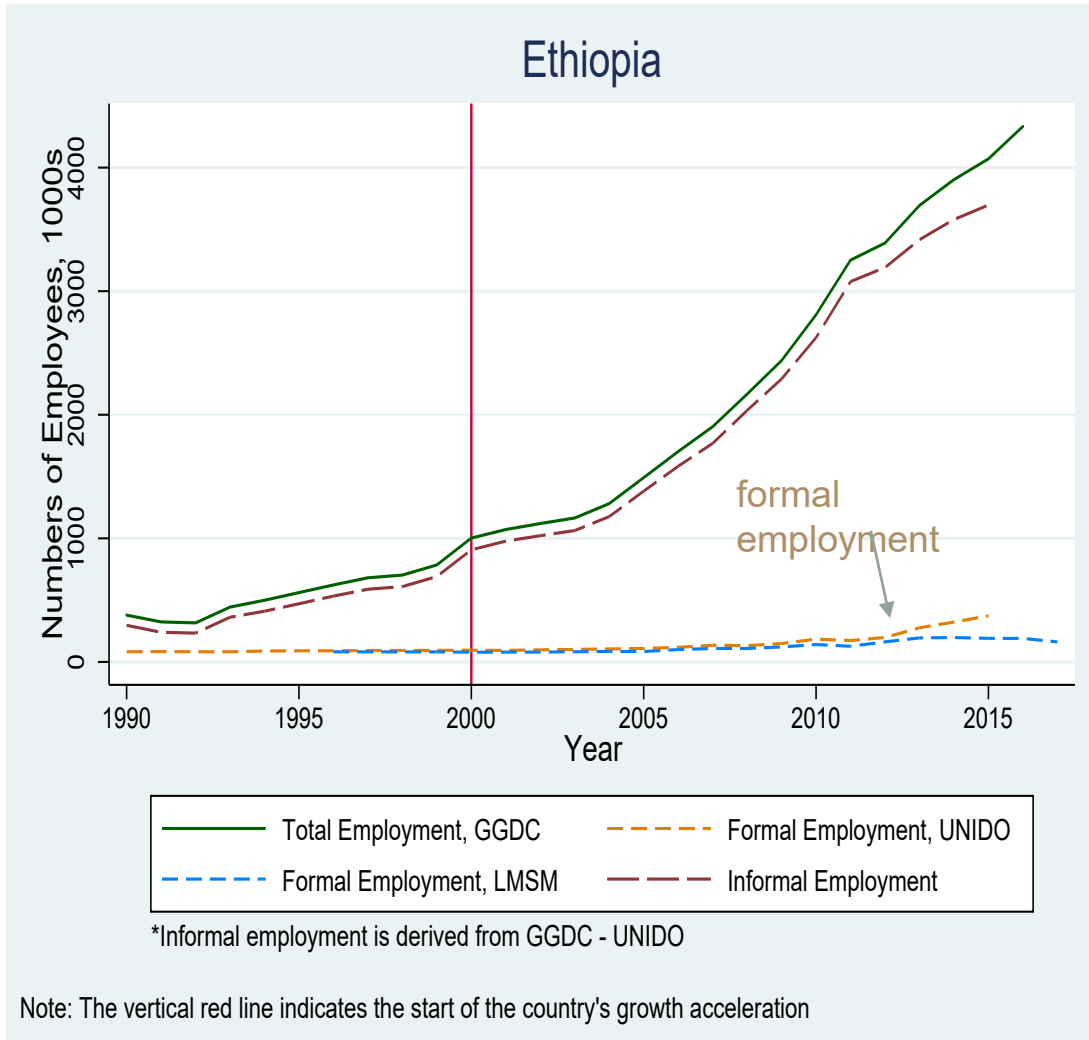


Note: The vertical red line indicates the start of the country's growth acceleration

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... versus African model

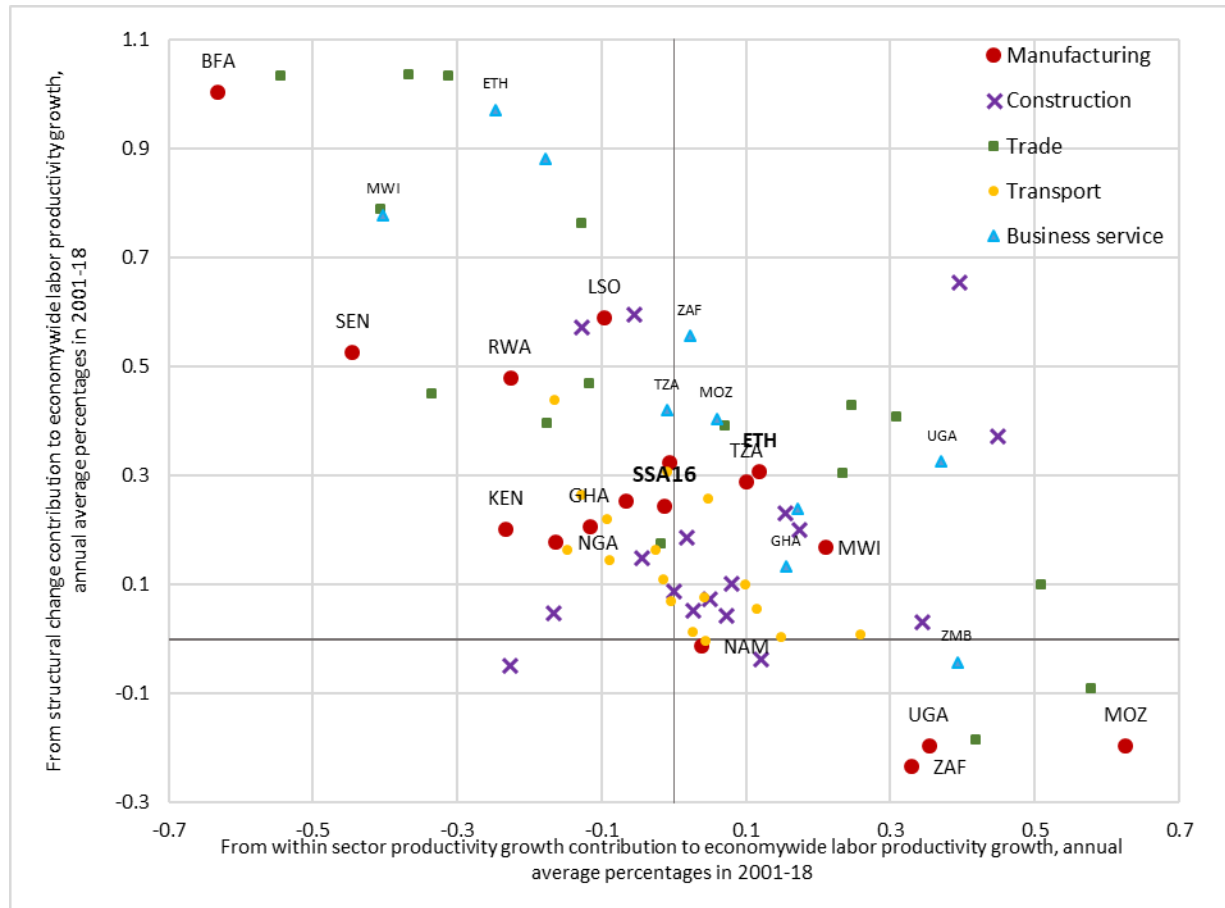
Manufacturing employment



The declining growth dynamic of structural change

- In high growth countries, labor used to move from low productivity to higher productivity, and productively dynamic sectors
 - formal manufacturing, traditionally
- Now the movement is to sectors that may have initially higher productivity (compared to traditional agriculture) but are productively not dynamic
 - mainly services, but also small-scale, informal manufacturing

Greater structural change => lower productivity growth in “modern” sectors in Africa

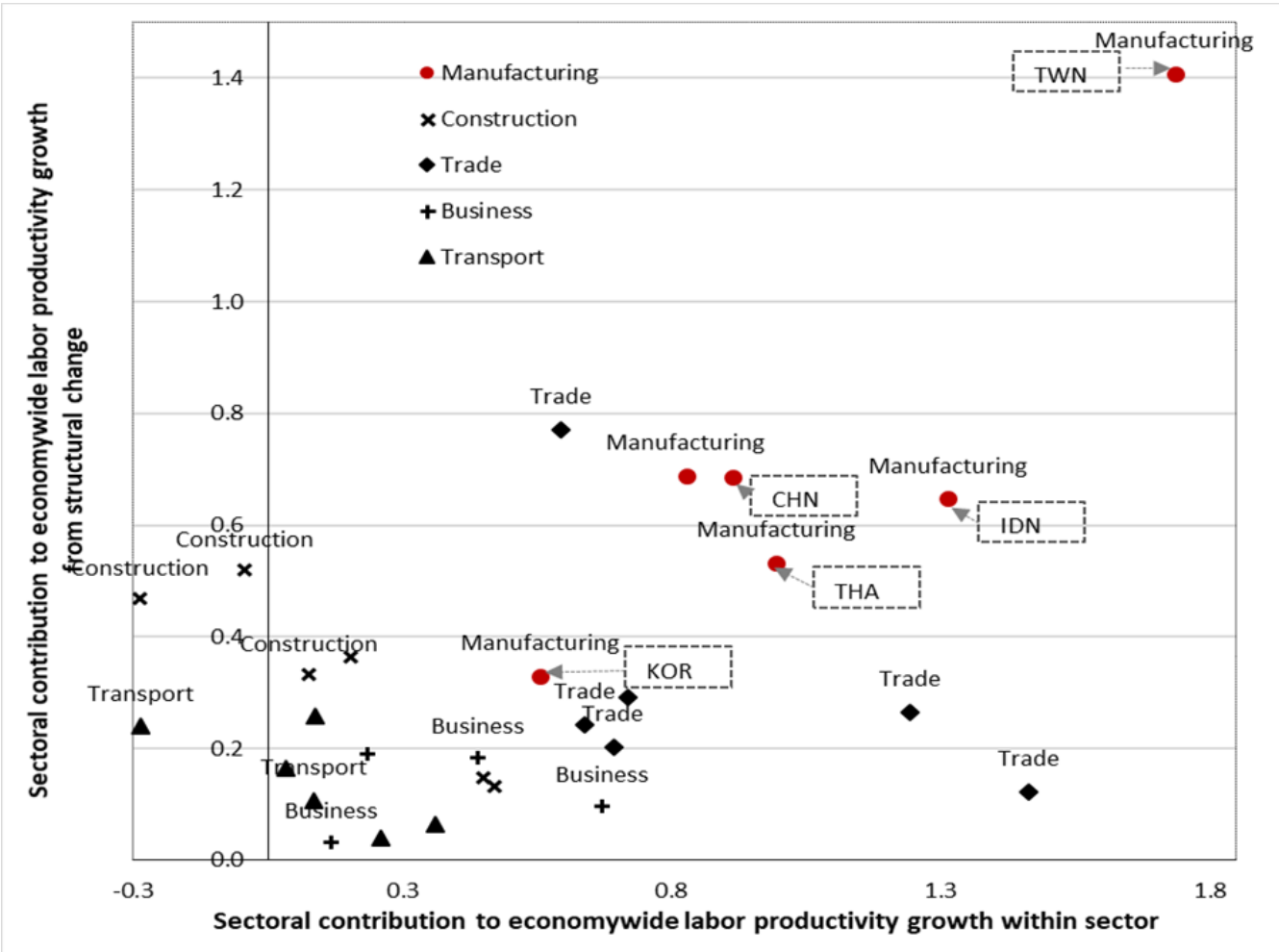


Negative correlation between contributions of structural change and within-modern sector productivity growth in recent growth

Source: Diao et al. (2022) based on the Economic Transformation Database, 2021.

Notes: There are 16 African countries in the figure, and they are Burkina Faso (BFA), Cameroon (CMR), Ethiopia (ETH), Ghana (GHA), Kenya (KEN), Lesotho (LSO), Mozambique (MOZ), Malawi (MWI), Namibia (NAM), Nigeria (NGA), Rwanda (RWA), Senegal (SEN), Tanzania (TZA), Uganda (UGA), South Africa (ZAF), and Zambia (ZMB).

... versus Asia



Positive correlation between contributions of structural change and within-modern sector productivity growth in recent growth

Source: Diao et al. (2022) based on the Economic Transformation Database, 2021.

Can services drive rapid growth?

- Need to understand why (formal) manufacturing was formidable growth engine:
 1. productivity dynamics
 - [unconditional convergence](#)
 2. labor absorption capacity
 - intensive in low-skill labor (traditionally)
 3. tradability
 - can expand without turning terms of trade against itself

What is different now?

- Changing nature of manufacturing technologies
 1. productivity dynamics
 - unconditional convergence
 - ~~2. labor absorption capacity~~
 - ~~• intensive in low-skill labor (traditionally)~~
 3. tradability
 - can expand without turning terms of trade against itself

The services conundrum

Two types of services

- high-productivity (tradable) segments of services cannot absorb as much labor
 - since they are typically skill-intensive
 - IT, FIRE, business services (IND, PHL)
- low productivity (non-tradable) services cannot act as growth poles
 - since they cannot expand without turning their terms of trade against themselves
 - continued expansion in one segment relies on expansion on others
 - limited gains from sectoral “winners”

Key question facing development strategy: where will the good jobs come from?

- Good jobs = productive jobs
 - mandates/standards (e.g. minimum wages) or employment subsidies at best partially effective
 - education/training works, but only in the long run
- Necessity of creating good jobs in (mostly domestic) services
 - and SMEs
- Good jobs require good firms
- Hence the need for a mixture of interventions on both supply- and demand-sides of labor market
 - education & training important but not adequate if good firms are not there
 - new kind of “industrial policy”: increase demand for less-educated, “lower-skill” workers by increasing productivity of such workers and the firms that employ them

New type of “industrial policies”

- Collaborative and iterative relationship with firms
 - instead of top-down, arms'-length, ex-ante rules
- Customized assistance to firms with soft conditionality on job creation
 - instead of subsidies and tax incentives
- Focused not smaller and mid-sized, mostly services firms
 - instead of export champions and most productive segments of the economy
- Based on quid-pro-quo:
 - firms need access to stable, skilled workforce, reliable horizontal and vertical networks (w/out holdup, informational problems), technology, contractual and property rights enforcement
 - governments need firms to internalize “good jobs” externalities in employment, training, investment, and technological choices
 - deep uncertainty precludes simple remedies (such as Pigovian employment subsidies)

	Traditional industrial policy	Approach proposed here
Externalities targeted	R&D, innovation, learning externalities; coordination failures in investment	Good-job externalities in local economic development and direction of innovation
Sectors	Manufacturing, tradable sectors	Largely services (in addition to manufacturing)
Firms	Large, globally competitive firms	SMEs
Assumptions about the government	Governments can identify market failures ex ante and is sufficiently insulated from capture	Knowledge about location and magnitude of market failures is widely dispersed; government faces substantial uncertainty; state capacity is endogenous
Types of incentives	Tax, credit subsidies	A portfolio of business services, including marketing, management & tech assistance, customized training, infrastructure, seed capital/loans for directed technologies
Application of incentives	Fixed schedule of incentives, except for incentive packages for large firms which may be negotiated	Customized to firms' needs and adapted to context
Selection criteria	Ex ante eligibility criteria	Voluntary buy-in and participation
Conditionality	Hard; rigid ex-ante criteria	Soft; provisional, open-ended and evolving
Relationship with recipients	Arms'-length	Collaborative, iterative; active project management

Reconsidering development policy

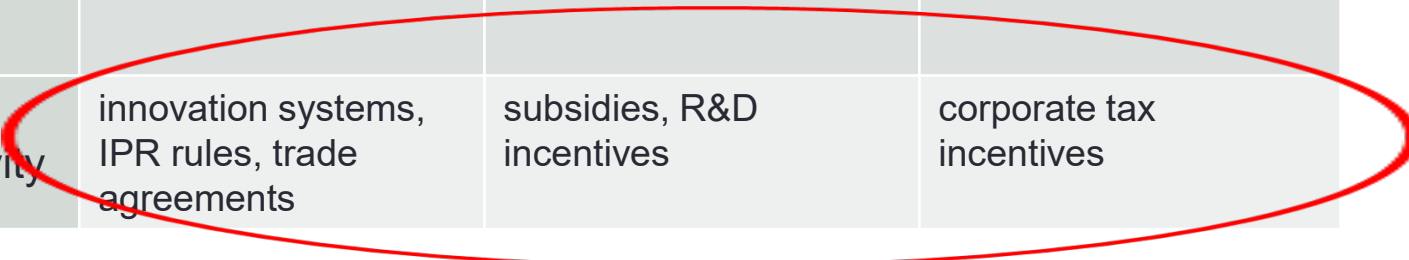
		At what stage of the economy does policy intervene?		
		pre-production	production	post-production
Which segment of the economy do we care about?	low productivity			
	middle productivity			
	high productivity			

Traditional poverty-reduction & social protection model

		At what stage of the economy does policy intervene?		
		pre-production	production	post-production
Which segment of the economy do we care about?	low productivity	investments in education and training		cash transfers; full-employment macro policies
	middle productivity			safety nets
	high productivity			

Traditional industrial & growth policies

		At what stage of the economy does policy intervene?		
		pre-production	production	post-production
Which segment of the economy do we care about?	low productivity			
	middle productivity			
	high productivity	innovation systems, IPR rules, trade agreements	subsidies, R&D incentives	corporate tax incentives



The good-jobs development model

		At what stage of the economy does policy intervene?		
		pre-production	production	post-production
Which segment of the economy do we care about?	low productivity			
	middle productivity		promotion of higher-quality jobs in SMEs through: employer-linked training policies; wage subsidies; customized business incentives & services	
	high productivity			

The convergence of social and growth policies

- Inclusion/equity possible only through creation of productive jobs in sectors that can absorb low-educated workers
- Growth possible only by expanding productivity (and employment) in labor-absorbing sectors