

# **INDUSTRIAL POLICY FOR THE TWENTY-FIRST CENTURY**

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# **(1) Information externalities**

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- Diversification of the productive structure requires **“discovery”** of an economy’s cost structure—i.e., discovery of which new activities can be produced at low enough cost to be profitable.
- If the entrepreneur **fails in his venture**, he bears the full cost of his failure.
- If he is **successful**, he has to share the value of his discovery with other producers who can follow his example and flock into the new activity.
- In the limit, with free entry, entrepreneurship of this kind produces private costs and social gains.
- It is no great surprise that **low-income countries** are not teeming with entrepreneurs engaged in self-discovery.

## (1) Information externalities (Cont'd)

- The **first-best policy** response to the informational externalities that restrict self-discovery is to subsidize investments in new, non-traditional industries.
- As a practical matter, it is **difficult** to implement such a subsidy.

## **(2) Elements of an institutional architecture**

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- (i) Political leadership at the top.
- (ii) Coordination and deliberation council(s).
- (iii) Mechanisms of transparency and accountability.

## **(3) Ten design principles for industrial policy**

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1. Incentives should be provided only to “**new**” activities.
2. There should be clear **benchmarks/criteria** for success and failure.
3. There must be a **built-in sunset clause**.
4. Public support must **target activities**, not sectors.
5. Activities that are subsidized must have **the clear potential** of providing spillovers and demonstration effects.
6. The authority for carrying out industrial policies must **be vested in agencies** with demonstrated competence.

### (3) Ten design principles for industrial policy (Cont'd)

7. The implementing agencies must be **monitored closely by a principal** with a clear stake in the outcomes and who has political authority at the highest level.
8. The agencies carrying out promotion must **maintain channels of communication** with the private sector.
9. Optimally, mistakes that result in **“picking the losers”** will occur.
10. Promotion activities need to have **the capacity to renew themselves**, so that the cycle of discovery becomes an ongoing one.

**(4) An illustrative range of incentive programs**

## (4) An illustrative range of incentive programs

1. Subsidizing costs of **“self-discovery”**
2. Developing mechanisms for **higher risk finance**
3. Internalizing **coordination externalities**
4. **Public R&D**
5. Subsidizing general **technical training**
6. Taking advantage of **nationals abroad**

## **(5) Concluding Remarks**

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- Markets can **malfunction** both when governments **interfere too much** and when they **interfere too little**.
- Development policies of the last two decades have been obsessed with the first category of **policy mistakes— governments' errors of commission**. Hence there have been efforts to **reduce or eliminate regulations**, trade **restrictions**, financial repression, and **public ownership**.
- Recently governments around the world have begun to seek a **more balanced strategy**, as **liberalization and privatization** have **failed** to deliver the **expected performance**.
- **Properly formulated industrial policies** have an **important role to play** in such strategies.

## (5) Concluding Remarks (Cont'd)

- **Governments cannot pick winners** because developing countries **lack the competent bureaucracies** to render it effective.
- **Industrial interventions** are prone to political capture and **corruption**.
- There is **little evidence** that **industrial policies work**.
- What is needed is **not industrial policy**, but **across-the-board support for R&D** and **intellectual protection**.
- And in any case **international rules no longer leave scope for industrial policy interventions**.

## (5) Concluding Remarks (Cont'd)

- Yes, the government **cannot pick winners**, but effective industrial policy is predicated **less on the ability to pick winners** than on the ability to **cut losses short once mistakes have been made**.
- **Competent bureaucracies** are a **scarce resource** in most developing countries, but most countries do have (or can build) pockets of bureaucratic competence.
- Industrial policies can be captured by the **interests whose behavior they aim to alter**.