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## **Boosting economic dynamics and job growth: The potential of industrial policies**

**Monday, 04 March – Tuesday, 05 March 2013**

### **A concept note**

#### **Issues and Challenges**

Industrial policies, productive transformation and catch-up growth have once again become the focus of attention of development economists and policy makers in many developing countries. The impetus has emerged out of the current economic and jobs crisis, and the success of recent growth poles in the South that have used industrial policies to generate high performing productivity and job growth, increase in income and wages, and rapid poverty reduction.

As a consequence, many developing countries are formulating and implementing New Industrial Policies with the aim to boost economic dynamics, create productive jobs and achieve development goals. While old style industrial policies have been criticized for aiming at “picking winners,” using heavy-handed trade protection or creating inefficient “trophy industries,” New Industrial Policy approaches take a different perspective. They focus on triggering and shaping productive transformation, structural change and technological upgrading, and promoting diversification of the private sector into new, higher value added economic activities in agriculture, industry and service sectors.

This new perspective on industrial policies highlights the role of Governments in shaping and accelerating a dynamic process of productive transformation. Governments need to develop industrial policies in a country-specific context. There is no “one-size fits all” approach. The question is, whether we can identify some fundamental principles for sound design and implementation of industrial policies in the light of lessons learned from industrial policies in the past, and in the light of new economic and institutional environments such as global production systems, value chains, or trade and investment agreements.

The ILO’s focus on employment and decent work shifts attention to the creation of jobs and the role of industrial policies in supporting the evolution of job-rich productive transformation patterns and paths. Productive jobs are created in the real economy and they provide the foundation for decent

employment, increasing wages, improved living standards and social cohesion.<sup>1</sup> Experience from developing countries shows that increasing productive capacities, GDP growth and structural transformation are not automatically reflected in more productive jobs and increased employment opportunities. The pattern of structural change, investment and diversification, and the nature of technological advancement in enterprises determine the performance of the economy in terms of productivity and job growth. Different jobs have different developmental value as they differ in the technology and skills content and the potential for learning on the job. Furthermore, jobs in value chains, in the informal and formal economy have different impact on employment opportunities for women, for young people, for rural workers or for workers in cities. This has important implications for industrial policies.

Industrial policies are also about building domestic capabilities. Country-specific capabilities define the feasible productive transformation patterns a country may follow and those economic activities and technologies it may easily imitate and adopt. Domestic capabilities explain why countries even with similar factor endowment may show very different performance in economic development and catching up. Capabilities are embodied in a society's knowledge base, in the particular structure of general, vocational, occupational, technical knowledge and in the competences acquired at the level of firms, industries and the economy. A large part of such capability-creating knowledge is tacit, and domestic capabilities can only be acquired in a long-term process of learning and experience. This has important implications for policies to enhance domestic capabilities through education, training and learning by doing in industries.

The level of development determines the country-specific challenges and needs, and industrial policies need to be designed in the light of these challenges and needs. This workshop is specifically designed to focus on lower and upper middle income economies. Middle income countries, in contrast to LDCs, have achieved some level of productive transformation and industrial development, however, so far could not generate a sufficiently strong catching up dynamics observed in emerging economies. Furthermore, a rapidly emerging literature provides empirical evidence for the so-called middle income trap and highlights the risk of middle income countries to lose growth dynamics as they approach higher income thresholds. Industrial policies in middle income countries therefore are challenged with accelerating the dynamics of productive transformation, jobs creation and private sector dynamism. Equally important, as middle income countries approach higher levels of technology, more complex industries, and certain income thresholds, they risk falling into the so-called "middle income trap". The challenge of industrial and education policies in middle income countries therefore is to sustain the dynamics of productive transformation, and develop those capabilities that are critical for shifting from imitation to the innovation phase of economic development.

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<sup>1</sup> Labour market, training and employment policies are important instruments to promote employment of workers in existing and newly created jobs, effective reallocation of resources, decent work outcomes, and skills demand meeting skills supply.

Finally, governments themselves are challenged with building developmental capacities and policy-making capabilities to tackle new challenges and to enhance the potential scope and effectiveness of industrial policies. Such capacities and capabilities are accumulated in a learning process. Governments need to learn to choose models and frameworks for the design, implementation and evaluation of policies in the light of development objectives. The policy framework determines the scope and mix of different policies, sequencing of policy interventions, rules leading to good governance etc. Furthermore, Government teams are challenged with developing in a process of learning by doing, experience and practice high performing industrial policy design and implementation procedures, competences and “knowing how to do”.

### **Scope and organization of the workshop**

The main objective of the workshop is to share information and exchange experience in the area of industrial policies, productive transformation and job creation between government representatives from African, Asian and Latin American countries, representatives of international organizations as well as researchers from the Geneva community.

The workshop is structured according to three larger themes:

1. Promoting productive transformation – investment, finance, and trade policies
2. Promoting domestic capabilities – a comprehensive learning strategy
3. Government capacities and capabilities – getting the industrial policy right

The workshop addresses the following issues and questions for lower and upper middle income countries. These questions will guide the debate during the workshop.

- What patterns of productive transformation have high potential to in lower and upper middle income countries to generate productive jobs and jobs with high developmental value?
- What is the role of social capabilities and learning in shaping country-specific catching up and productive transformation paths?
- What policy areas and measures should governments choose and combine to achieve the multiple goals of productivity increase, accelerated job creation and rapid accumulation of social capabilities?
- How can the informal economy be integrated into a productive transformation process?
- What patterns of economic and social transformation helps countries to avoid falling into the middle income trap?
- How can the state and private sectors work effectively together to promote new production, trade and job opportunities and enhance the dynamism of the private sector?
- What are effective mechanisms and policy design and implementation procedures that avoid political capture and limit rent-seeking?
- How can Governments effectively develop policy-making capabilities?

Different panels are organized under each of these themes with presentations followed by open discussion.

## I. Promoting productive transformation

Investment, finance and trade policies are discussed as key areas of industrial policies, and their potential to accelerate productive transformation and to sustain a high performing development process allowing countries to move into advanced income levels.

### 1. Investment policies and institutions

#### a. Structural change, FDI, MNE and value chains (Richard Kozul-Wright, UNCTAD)

Enhancing public and private investment in advanced technologies and more productive economic activities is key to promote the dynamics of productive transformation and catching up. While manufacturing has been considered as the leading sector in catching up, recent studies also highlight the relevance of investment in agriculture and the service sector. Furthermore, the role of foreign direct investment, multinational enterprises as well as global value chains and production networks are discussed as a source of structural transformation and job creation.

#### Guiding questions:

- What is the relevance of investment in manufacturing, agriculture and the service sector in accelerating economic dynamics and job creation?
- How can middle income countries take advantage of FDI, MNE and global production networks in promoting a high-performing productive transformation process?
- What is the space for investment policies?
- Is there a trade-off between fostering technological advancement and job creation? How can investment policies address this issue?
- What is the role of investment policies in supporting middle income countries to avoid the middle income trap?

#### b. Investment Agreements (Aaron Cosbey, IISD)

Almost all middle income countries have signed a number of international investment agreements (IIAs), both as stand-alone treaties and as constituent elements in broader free trade agreements. While the resulting heterogeneous patchwork of treaties defies general description, there are some elements that many agreements have in common, and which may present problems from the perspective of states seeking to practice industrial policy. The vacuum of multilateral governance in the area of investment law complicates the prospects for any quick fixes, but that does not mean progress is impossible.

#### Guiding questions:

- What specific types of policies might be proscribed by IIAs?
- How big a problem is this? Are those policies actually desirable, effective?
- How might IIAs be written/revised so as to allow for the policy space necessary for governments to pursue effective new industrial policy?
- Even if new IIAs follow such a template, what are the challenges to revising the thousands of *existing* IIAs?

## **2. Financing productive and social transformation (Katja Hujo, UNRISD)**

Governments and institutions need to secure access to finance in order to invest in productive capacities and to foster socio-economic transformation. Mobilizing revenues, and in particular, domestic resources, is critical if governments aim at transforming their economies and meeting the needs of their citizens. Countries that are rich in natural resources or minerals have the option to mobilize revenues from production and export of primary products. Fiscal space can also be expanded by reforming tax systems or by contracting external debt or development aid, although the developmental and redistributive effects of each option have to be considered carefully.

### Guiding questions:

- What are effective policies and institutions to mobilize domestic resources from mineral production and commodity exports and to translate them into productive and social transformation leading to more diversified, equitable and sustainable growth patterns?
- How can tax reforms expand fiscal space and contribute to productive as well as distributive goals? What can we learn from the political economy of tax reforms and the linkages with expenditure policies? How can governments achieve a reasonable balance between economic and social expenditures?
- What role does aid and external credit play for financing productive and social development?
- What are the linkages between the politics of domestic resource mobilization and fostering of domestic capabilities?

## **3. Trade Policies and institutions**

### **a. GVCs, the New Trade Narrative and the Industrial Policy (Faizel Ismail)**

Trade policies played an important role in the rapid catching up countries in East Asian. These countries diversified their production and export structures, upgraded technologies, created new comparative advantages and created productive jobs. This has provided the rationale for the development of “infant industries”. Import protection as well as export promotion were applied in most successful catching up countries to develop “infant industries”, and to emulate into leading techno-economic paradigms. Many of the instruments applied by these countries are no longer sanctioned by the WTO rules. More recently, integration into global supply chains and the development of regional production networks are discussed to support countries in particular in Africa and Latin America to engage in international trade and to industrialize.

### Guiding questions:

- What is the space for low and upper middle income countries under WTO rules to use trade policy instruments for the development of new comparative advantages and new industries in advanced and more complex technologies?
- What was the role of trade policies in creating regional supply chains in Asia and high trade volume in components and parts. Why did the African and Latin American region fail to develop such strong regional supply chains?

- What is the potential of African and Latin American countries promote regionally integrated production and trade networks?

#### **b. Trade agreements (Esther Busser, ITUC)**

Trade agreements impact on the use of trade policy instruments such as tariffs, non-tariff barriers, intellectual property rights, and investment requirements etc. which are among the instruments used in industrial policies. Trade agreements therefore tend to limit the policy space that countries have at their disposal to foster the process of structural transformation. At the same time rapid and deep trade liberalization, whether unilateral or through trade agreements, has led to reversing processes of structural transformation and in some cases led to de-industrialization. Trade policy therefore seems to be an important component of an industrial policy and trade agreements should be assessed on their impact on structural transformation and policy space for structural transformation and diversification.

#### Guiding questions:

- What are the major objectives for developing countries to sign trade agreements?
- What is the scope of bilateral and regional trade agreements?
- Which trade policy instruments are important for structural transformation and how have they been limited in trade agreements?
- How have trade agreements/trade liberalization impacted on structural transformation?
- How do trade agreements impact on regional integration and possible promotion of regional industrial development?
- What kind of trade regime is needed for low and middle income countries to enhance structural transformation?

## **II. Domestic Capabilities**

Social capabilities determine the options and boundaries for productive transformation. They define the feasible products and economic activities that a specific country and enterprise may develop, possible diversification patterns, and technologies that may be imitated. Social capabilities exist at the collective level, that is at the level of enterprises, industries, value chains, the labour force, societies etc.

Capabilities are embodied in the knowledge base of these social groups. The nature, variety and complexity of this knowledge base – the knowledge structure – determines the options space. The social knowledge structure is shaped by cultural knowledge provided in social networks such as families and communities, by formal knowledge taught in schools and by technical, commercial or occupational knowledge acquired in enterprises and industries. In addition, procedures or “knowing how to do” embodied in institutions and routines of enterprises determine the competences to translate options into investment and productive capacities.

Education, training and industrial policies have the potential to fundamentally shape and transform the social knowledge base, enlarge the options space for productive transformation and the creation of productive jobs. Policies to expand domestic (social) capabilities therefore form a central element of productive transformation and economic development strategies.

## **1. Enhancing options and competences for productive transformation (Irmgard Nübler, ILO)**

Formal education represents a main determinant of economic growth and productive transformation. While economists find it difficult to demonstrate the link between education levels, growth and job creation, the capability approach shows that the education structure rather than aggregate levels translates formal schooling into growth and productive jobs. Education structures differ between countries, and different educational structures provide different options space for diversification, for structural and technological change. Education policies are therefore challenged with transforming the education structure in a way that creates wide options and competences for productive transformation and job growth. A high performing process of catching up requires a comprehensive learning strategy: Education policies to open space for diversification and new technologies, training policies to meet skills demand for efficient use of technologies, and industrial policies to promote industries and technologies which provide learning opportunities with steep learning curves.

### Guiding questions:

- What is the link between education, capabilities and production transformation?
- How can education policies expand the options space and competences for productive transformation?
- What is the challenge of industrial policies in the light of country-specific capabilities?
- What is the role of capabilities and educational transformation patterns in avoiding middle income countries falling into the middle income trap?

## **2. Infrastructure investment: from productive capacities to domestic capabilities (Christoph Ernst, ILO)**

Public and private investments in physical infrastructure are critical for growth and development since they have the potential to create domestic capabilities in addition to physical assets and employment. Infrastructure investment contributes to the accumulation of physical capital and to creating or improving physical connectivity through transport and communication as well as energy supply which facilitates trade, crowds in private productive investment and increases productivity. The process of infrastructure investment, building and maintenance of infrastructure creates new jobs, temporary and longer term jobs, in particular by choosing labour intensive technologies. Finally, infrastructure development provides the opportunity to create domestic capabilities in the labour force and in enterprises and has a high potential and leverage to contribute to the dynamics of productive transformation.

### Guiding questions:

- How should infrastructure development policies and procedures be designed to accumulate domestic capabilities for diversification?
- What is the role of the Governance structure, involved enterprises, local contractors and big companies, and the workers? How does a successful environment look like?
- How should technologies be chosen in the light of job creation, productivity and capability creation objectives?

### **3. Informal economy, capabilities and productive transformation (Christine Hofmann, Mario Berrios (tbc), Uma Rani, Per Ronnas, ILO)**

The informal economy plays an important role in most middle income economies. It relates to the craft sector, small firms in manufacturing and services, both in urban and rural areas. The informal economy is characterized by low levels of technology, jobs with low levels of productivity, and low wage. In addition, informal institutions governing relationships, and formal institutions often limit incentives as well as competences of micro and small enterprises to diversify, switch into higher value added products and grow. In other words, institutions in many middle income countries reflect low social capabilities. This challenges governments to integrate the informal economy into a strategy of productive transformation and to develop institutions that demonstrate high social capabilities in creating options and in translating options into productive transformation.

#### Guiding questions:

- Are formal institutions serving the needs of informal enterprises?
- How can informal institutions be transformed to support productive transformation in the informal economy?
- How can Governments and institutions support technological and occupational learning in the informal economy and in informal enterprises for improved productivity, quality of products and quality of jobs?
- How can industrial policies and institutions enhance incentives, pressures and support for informal enterprises to learn and search for new activities, diversify and to facilitate linkages and transitions to the formal economy.

### **III. Government capacities and capabilities**

**Experience from Latin America (Robert Devlin, Johns Hopkins School of Advanced International Studies**

**Experience from Asia and Africa (Tilman Altenburg, German Development Institute)**

Governments are challenged with formulating and implementing industrial development strategies, creating interactive collaboration among key stakeholders in public and private sectors and getting the industrial policy process right. In this context, many Governments need to strengthen industrial policy-making capabilities to tackle new challenges and to enhance the potential scope and effectiveness of industrial policies. This is highly relevant in many countries, in particular where the neglect of pro-active industrial policies during the past two decades prevented governments from advancing knowledge and experience in the design and implementation of industrial policies. The question is how Governments in Africa, Latin America and Asia can rapidly learn, accumulate knowledge and in particular strengthen policy making capabilities.

#### Guiding questions:

- What are the challenges and major objectives and aspirations of industrial policies in Asia/ Latin America/ Africa?



- What are the implications of global / regional supply chains for industrial policies?
- How are the state and private sectors working together to promote new production, trade and job opportunities?
- Are there effective operational procedures and processes that foster consensus, cooperation and align incentives between public and private actors to achieve the goals of industrial policies?
- Are policy formulation and implementation procedures and institutions preventing political capture and limiting rent-seeking?
- How have Governments accumulated good policy formulation, implementation and evaluation procedures and how can this learning process be enhanced?