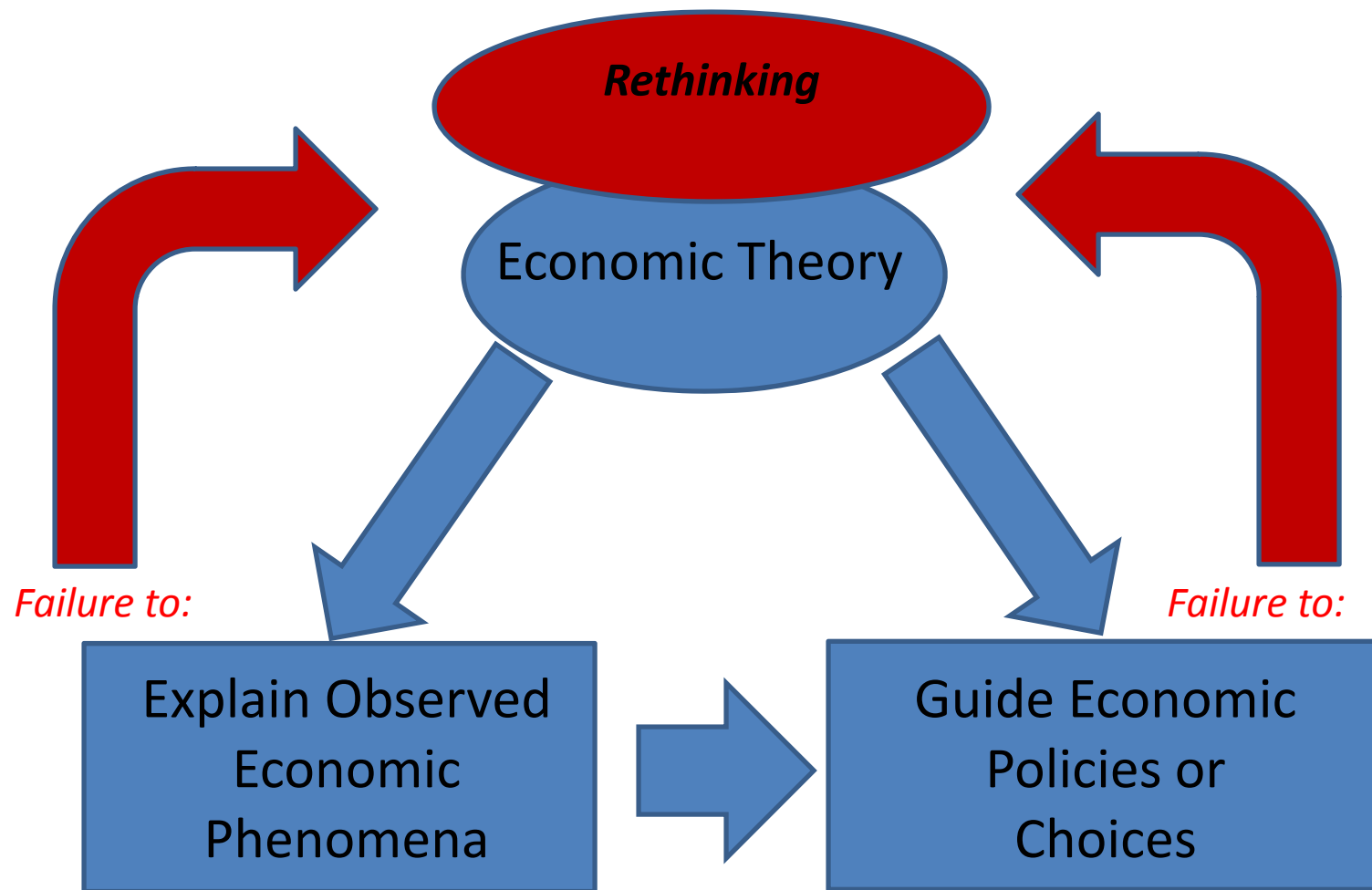


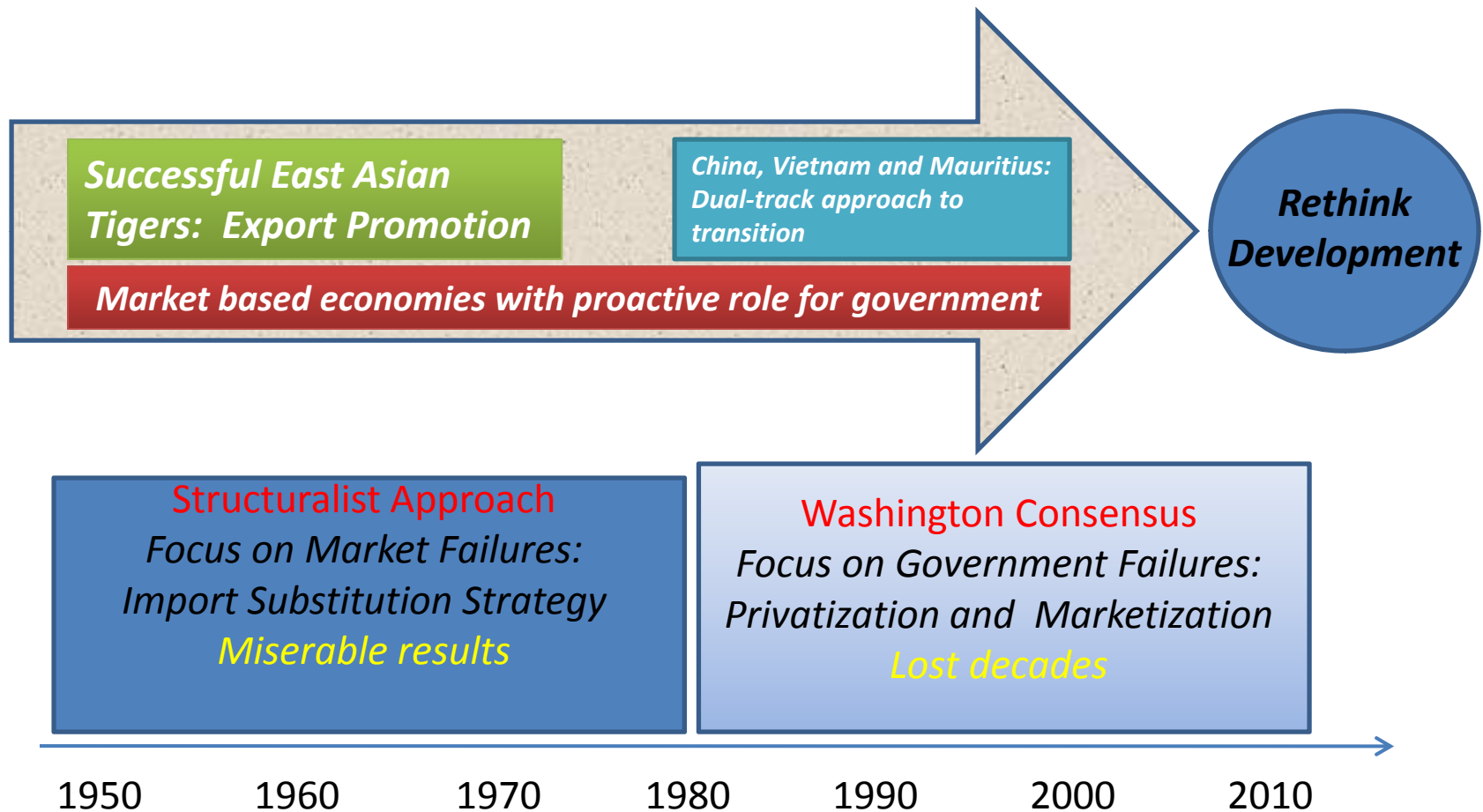
The New Structural Economics
A Rethinking of Development Economics and Policy

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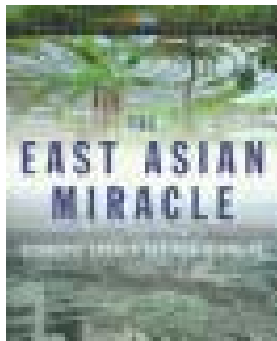
Why Do We Need Rethinking?



Development theory is in need of rethinking



World Bank has been in the process of rethinking economic development



Export
Orientation and
Market Friendly
Government



No one-size fits all

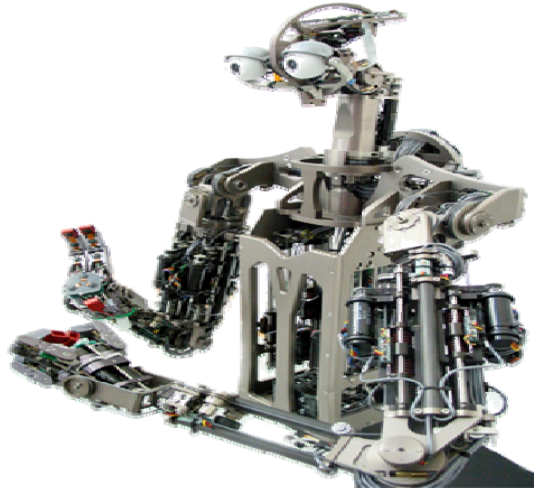


- (i) Openness;
- (ii) Macro stability;
- (iii) High rates of saving & investment;
- (iv) Market mechanism;
- (v) Committed, credible & capable government

New Structural Economics

- Application of neoclassical economic approach to understand the determinates of **economic structure and its evolution** in development
- Why do I call this approach New structural economics?
- Why do I focus on structure?

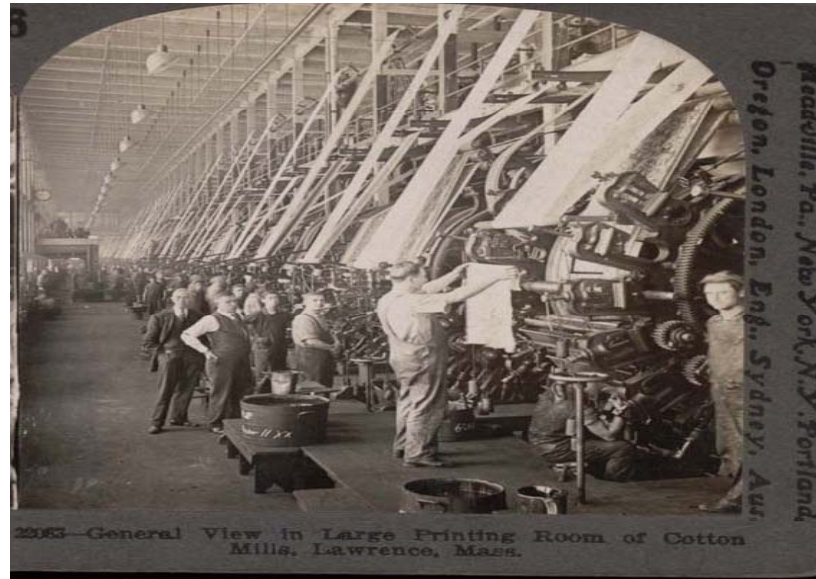
By nature economic development of a process of structural change
Example: USA, Now



Industrial Structure in New England, 1600s



Industrial Structure in New England, 1800s



SPECIALTIES.
 The light, fine shoes manufactured by the
BOSTON MANUFACTURING COMPANY

The best class of goods manufactured by this Company has received
 the highest award, or shown better the quality of "Boston" goods.
 The amount of their lightness, cheapness and perfect fit.

<p>Men's LIGHT REGULARITY (Shoe Upper, Wood Sole)</p> <p>The shoe represents the class of which the most perfect, which will be made for the very best of the world (See also, and see)</p>	<p>Men's LIGHT RELAXING (Shoe Upper, Rubber Sole)</p> <p>A shoe which is well constructed which which affords a perfect fit and is very light, for the (See also, and see)</p>		
			
			
<p>Regular</p>	<p>Relaxing</p>	<p>Regular</p>	<p>Relaxing</p>

The shoes which have been prepared for the market
 light shoes, that are made in the very best of the world
 (See also, and see). The name of these shoes are shown above.

For the Complete List of Styles of These and Men's and Women's Shoes, see page 11 and 12.

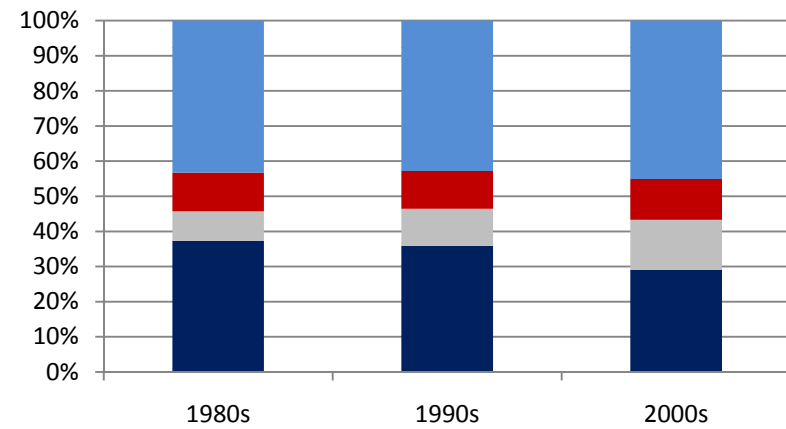
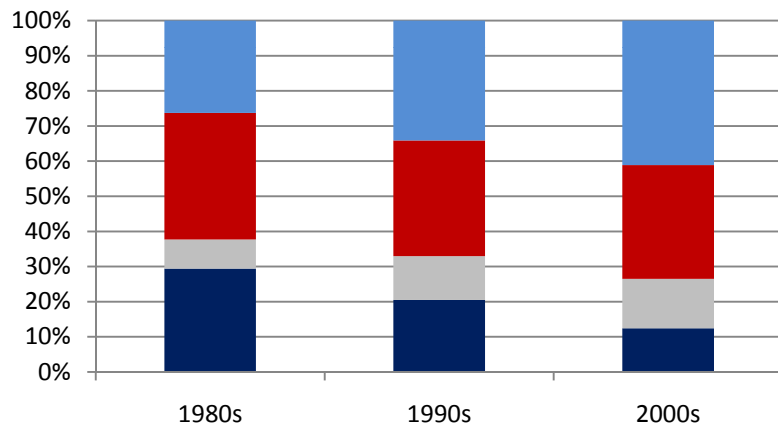
Structural Transformation

China versus LDCs

Sectoral Contribution to GDP (in %)

China



LDCs



■ Agriculture ■ Non-Manufacturing Industry
■ Manufacturing ■ Services

■ Agriculture ■ Non-Manufacturing Industry
■ Manufacturing ■ Services

What Determines Structure and its Change?

- The main hypothesis: Industrial structure is endogenous to endowment structure
- Initial Endowments (determine the economy's total budgets and relative factor prices at time t) 
 - Comparative advantage 
 - Optimal industrial structure (endogenous).
- Dynamics: Income growth depends on
 - Upgrading industrial structure, which requires
 - Upgrading of endowments as well as
 - Improvements in “hard” and “soft” infrastructure
- *Following comparative advantage determined by the endowment structure to develop industries is the best way to upgrade endowment structure and to sustain industrial upgrading, income growth and poverty reduction.*

Market and State

- Firms maximize profits...choice of technology and industries based on relative factor prices...

 *Need for competitive market system*

- Industrial upgrading needs to
 - Address externalities
 - Solve coordination problems

 *Need for a facilitating state*

NSE and The Growth Commission's Stylized Facts

Growth Report

Stylized Facts:

- Policy Recommendation from NSE
 - Following comparative advantage : Conditions
 - Market economy #4
 - Facilitating State #5
- The results:
 - Openness #1
 - Competitiveness and strong external as well as fiscal accounts: fewer home-grown crises and larger scope for countercyclical fiscal policies. #2
 - Large economic surplus and high returns to investment: high rate of savings and investment. #3
- The NSE's recommendations are consistent with the *East Asian Miracle's* findings.

NSE and the Failure of Structuralism

- The structuralism advised the government to develop industries which were too far advanced compared to their level of development and went against their comparative advantages
- The firms were non-viable in competitive markets and required government policy supports for their initial investment and continuous operations.
- This led to rent-seeking, corruption, and political capture.

Country	Industry	Time	Main producer at Time	Real GDP pc Latecomer Country	Real GDP pc Leading Country	Income Ratio Follower versus Leader
China	Automobile	1950s	USA	577	10,897	5%
DRC	Automobile	1970s	USA	761	16,284	5%
Egypt	Iron, Steel, Chemicals	1950s	USA	885	10,897	8%
India	Automobile	1950s	USA	676	10,897	6%
Indonesia	Ships	1960s	Netherlands	983	9,798	10%
Senegal	Trucks	1960s	USA	1,511	13,419	11%
Turkey	Automobile	1950s	USA	2,093	10,897	19%
Zambia	Automobile	1970s	USA	1,041	16,284	6%

Source: Author's calculations based on data from Maddison (1995).

NSE and the Failure of Washington Consensus

- All transitional economies started with the existence of many nonviable firms in old priority sectors due to their previous comparative advantage-defying development strategy.
- The Washington consensus failed to recognize the distortions were endogenous in responding to the needs of protecting nonviable firms in the priority sectors and advised the government to eliminate all distortions immediately, which caused the collapse of old priority sectors.
- The Washington consensus also opposed the government to play a proactive role for facilitating the firms' entry to sectors that are consistent with the country's comparative advantages
- The dynamically growing transitional economies adopted a dual-track approach:
 - The government continued to provide transitional supports to nonviable firms in the old priority sectors and removes distortions only when firms in those sectors became viable or the sectors become very small
 - The government facilitated private firms' entry to sectors that were consistent with the country's comparative advantage and were repressed before the transition

Industrial Policy in a Market Economy

- Industrial policy is a useful tool for the state to play the facilitating role for industrial upgrading and diversification in a market economy:
 - Contents of coordination will be different, depending on industries.
 - The government's resources and capacity are limited. The government needs to use them strategically.

“Aim before you fire”

- The key lesson, from the new structural economics, is that for an industrial policy to be successful, it should target sectors that conform to the economy’s latent comparative advantage.
- But how to do it?

Growth Identification and Facilitation

Step 1:

Find fast *growing countries* with a similar endowment structure and with about 100% higher per capita income. *Identify dynamically growing tradable industries* that have grown well in those countries for the last 20 years.

Step 2:

See if some *private domestic firms* are already in those industries (of which may be existing or nascent). Identify constraints to quality upgrading or further firm entry. Take action to remove constraints

Growth Identification and Facilitation

Step 3:

In industries where no domestic firms are currently present, seek FDI from countries examined in step 1, or organize new firm incubation programs.

Step 4:

In addition to the industries identified in step 1, the government should also pay attention to spontaneous self discovery by private enterprises and give support to scale up the successful private innovations in new industries

Growth Identification and Facilitation

Step 5

In countries with poor infrastructure and bad business environment, special economic zones or industrial parks may be used to overcome these barriers to firm entry and FDI and encourage industrial clusters.

Step 6:

The government may compensate pioneer firms in the listed identified above with

- Tax incentives for a limited period,
- Direct credits for investments,
- Access to foreign exchanges

Two additional points

- Agricultural development is crucial for developing countries:
 - For poverty reduction, and
 - For providing capital and a market for industrial products.
- A resource-abundant country's resources will be a blessing if:
 - It has a good management of resources. (E.g., some of it must be saved for future generations, and enclave rent capture avoided.)
 - It uses (part of) the wealth generated from resources to facilitate structural transformation.

Concluding Remark

- **Every developing country, including those in sub-Saharan Africa, can grow at 8 % or more continuously for several decades, to become middle-income or even high-income countries in one or two generations,**
- **if its government has the right policy framework to facilitate the private sector's development along the line of its comparative advantages and tap into the latecomer advantages.**

THANK YOU