

TOWARDS A RETURN OF INDUSTRIAL POLICY? ARTNeT SYMPOSIUM 25-26 JULY 2011 ESCAP, BANGKOK

Middle-income developing countries and industrial policy

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University of California, Davis The Earth Institute, Columbia University, NYC Central University of Finance and Economics, Beijing *wtwoo@ucdavis.edu* Development economics repeats itself, first as tragedy, second as farce [paraphrase of opening sentences of Karl Marx's "The Eighteenth Brumaire of Louis Bonaparte" (1852)]

- First Wave: Part of movement to replace neoclassical economics – Keynesian macroeconomics for the First World, and Development Economics for the Third World
- Second Wave: Subsumed both as applications of neoclassical economics – Monetarist and New Classical counterrevolutions in macro, and Washington Consensus in development economics

Latin America vs East Asia: IS vs EP

- Little-Scott-Scitovsky: Import Subtituting (IS) vs Export-Promoting (EP); or Balassa: Inward-oriented versus Outward-oriented
- World Bank: Export-Promoting is "neutral incentives" → get your prices right
- Cooper-Corden-Little-Rajapatirana: profligacy vs prudence -> get your macrobalances right
- John Williamson combined above to arrive at Washington Consensus (WC)
- There have been two incarnations of WC: WC Mark 2 (WC2) emerged in mid-1990s

Understanding Why the World Bank Interpreted the Industrial Policies in the Republic of Korea (ROK) and in Taiwan Province of China (TPC) as Having Zero Net Effect on Resource Allocation

The secrets in "The More Things Change, the More They Remain the Same" Neutral incentives? (1/2): Link between domestic prices and world prices $(P_I/P_X) = PW_I(1+t) / PW_X(1+s)$ $- P_I = domestic price of imports$ $- P_X = domestic price of exports$ - t = effective tariff rate

- s = effective subsidy rate
- PW₁ = world price of imports
- PW_X = domestic price of exports
- $(P_I/P_X) = PW_I(1+t) / PW_X(1+s)$
 - $> PW_1 / PW_X$ when t > s > 0
- Import-substitution is when t > s > 0

Neutral incentives? (2/2): Link between domestic prices and world prices

- Export-promotion is when t = s with t > 0, which is the case for ROK and TPC
- Free trade is when t = s = 0
- $(P_I/P_X) = PW_I / PW_X$ under EP and free trade
- World Bank: EP is neutral incentive regime
- Don't bother with the administrative burden of EP, just go for free trade (e.g. Deepak Lal)
- ROK and TaC policymakers were lucky in that their import tariffs and export subsidies fortuitously offset each other.

Washington Consensus Mark 1 (1/2)

- Washington Consensus I (emerged in mid-1960s, comparative studies on trade regimes e.g. Krueger): Get the prices right and get the macro-balances correct
- 1. Fiscal discipline.
- 2. A redirection of public expenditure priorities toward fields offering both high economic reforms and the potential to improve income distribution, such as primary health care, primary education, and infrastructure.
- 3. Tax reform (to lower marginal rates and broaden the tax base)

Jton Consensus Mark 1 (2/2) rate liberalization. stitive exchange rate. eralization. ation of inflows of direct foreign ent ion. tion (to abolish barriers to entry



property rights.