

Making a Miracle in Africa

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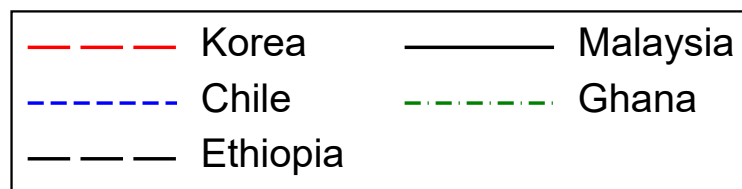
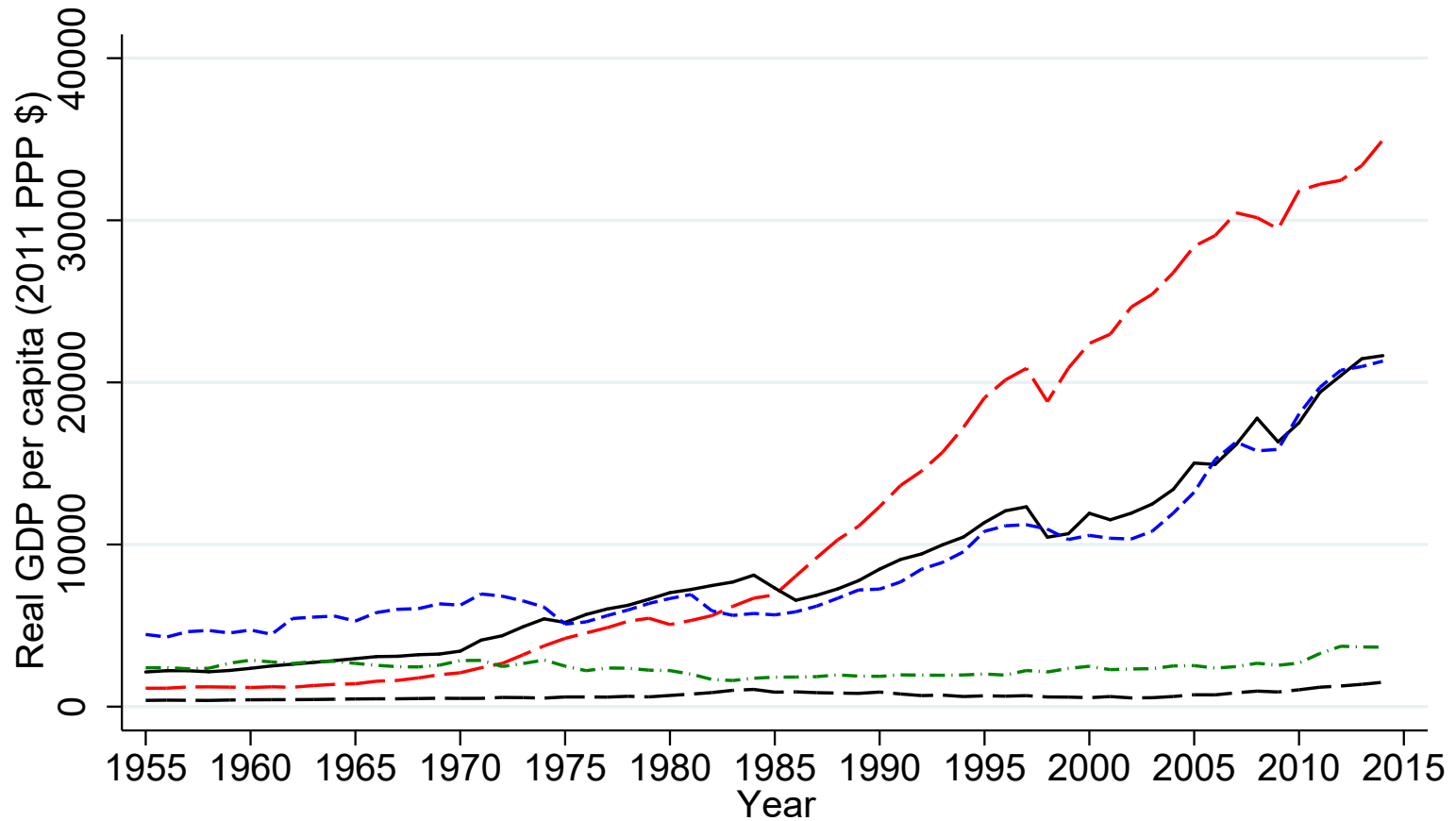
International Monetary Fund

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Addis Ababa, Ethiopia

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What is the Grail of Development?

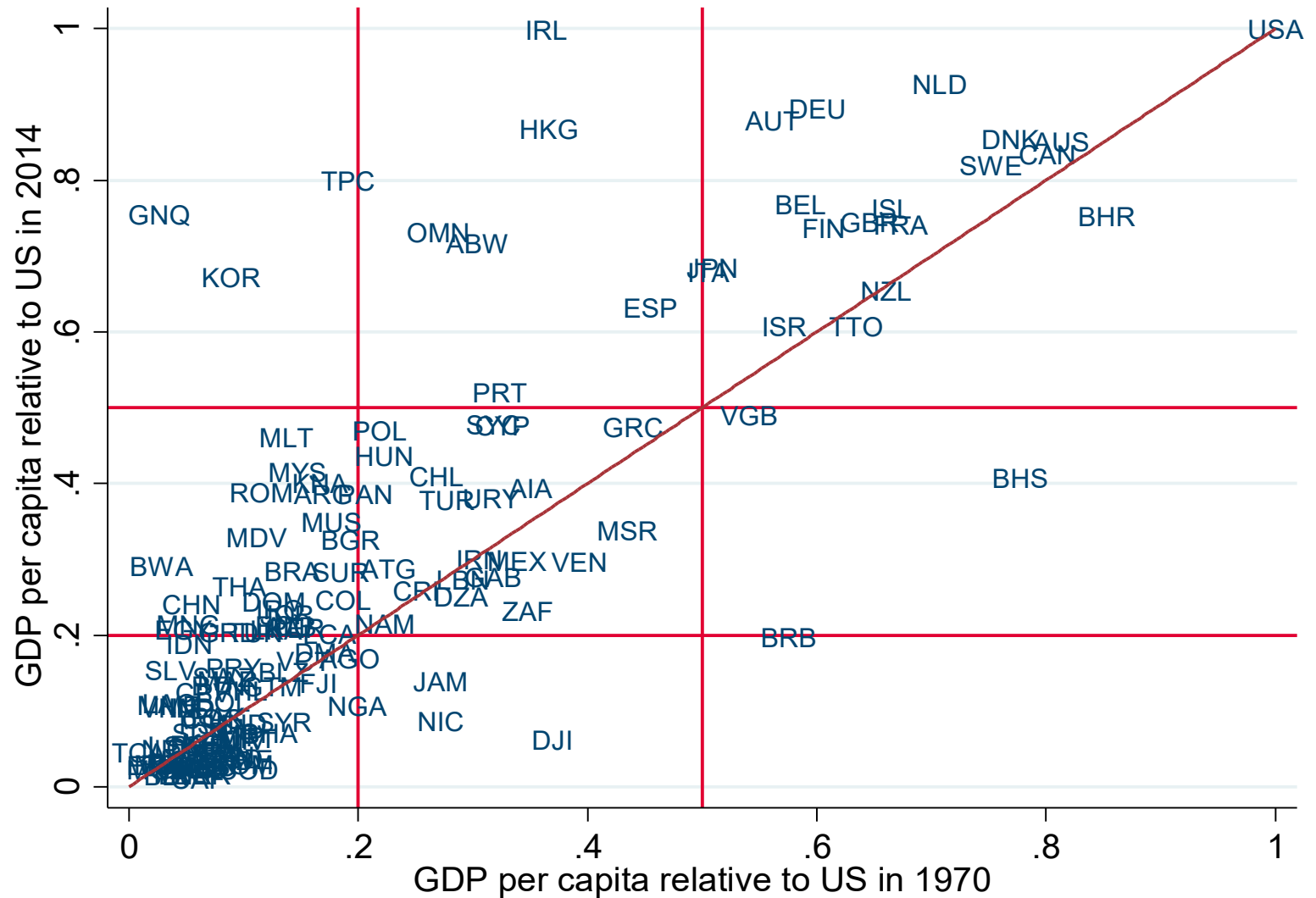


What Can We Learn from Asian Miracles?

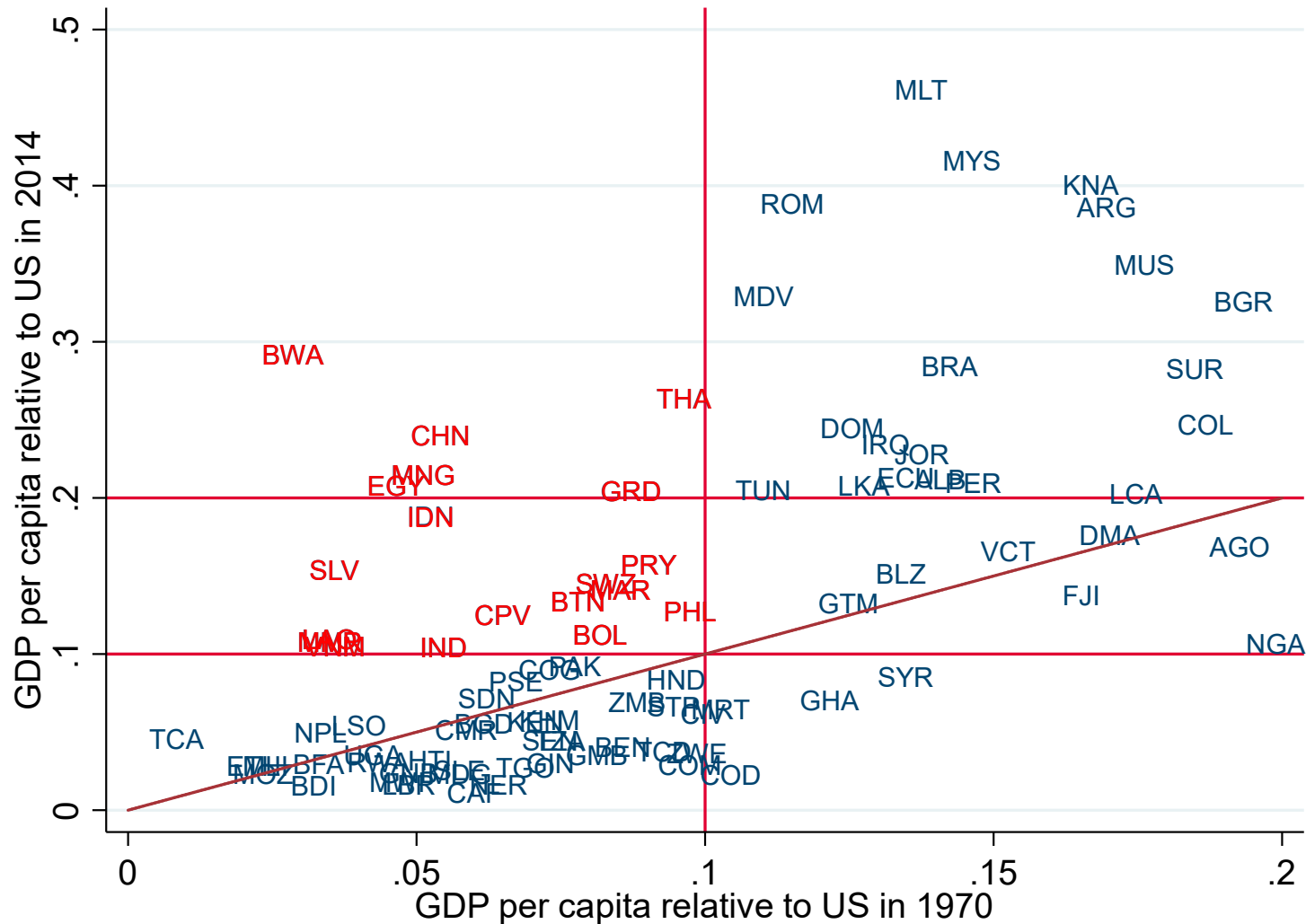
“Much of the real world is controlled as much by the tails of distributions as [by] means or averages...by the exceptional not the common place; by the catastrophe, not the steady drip...we need to free ourselves from ‘average’ thinking.”

- Phil Anderson, Nobel laureate in physics

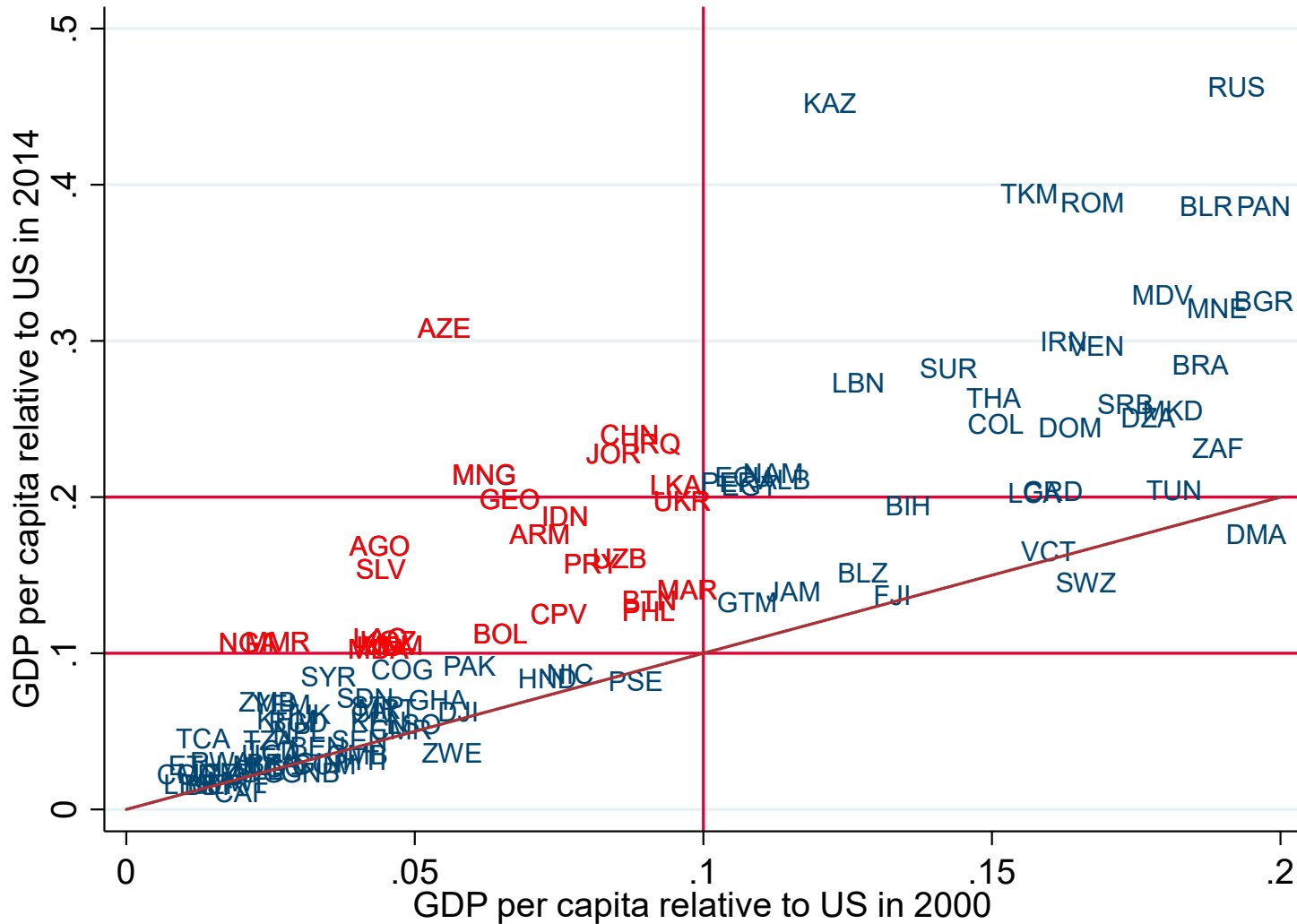
Almost Half-Century of Development



Low-Income Trap

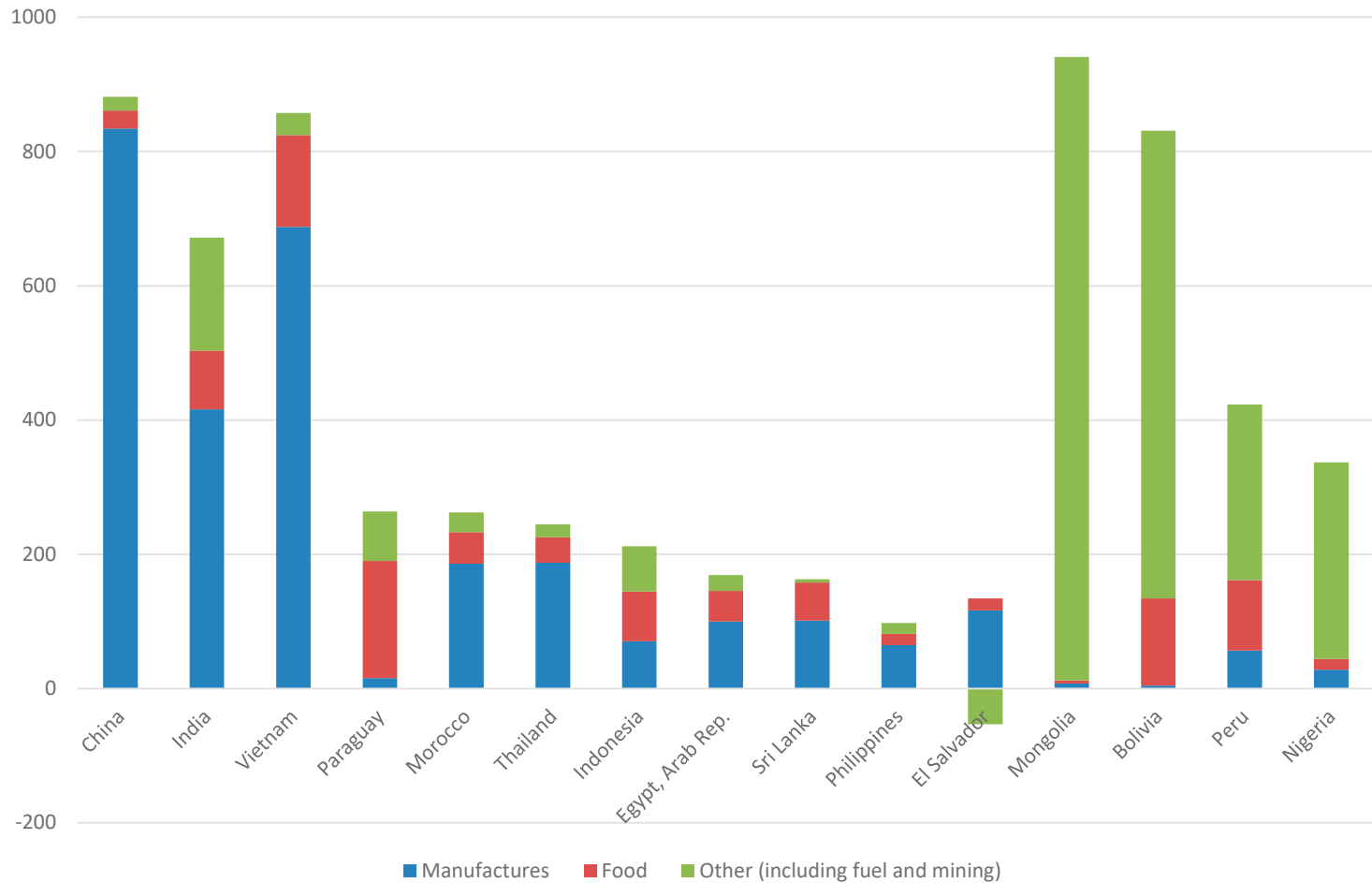


The Roaring 2000s

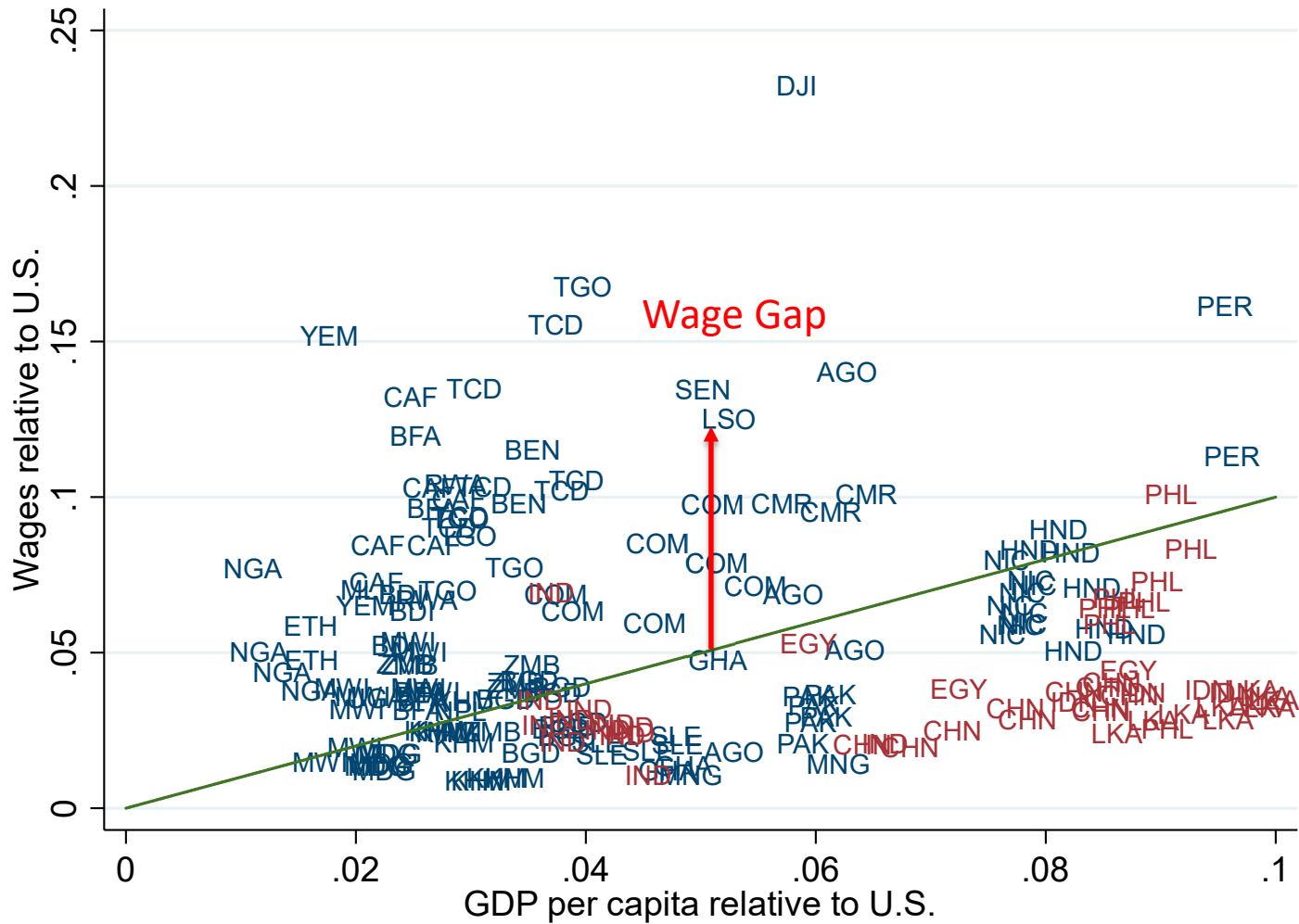


Driven by Manufacturing and Commodities

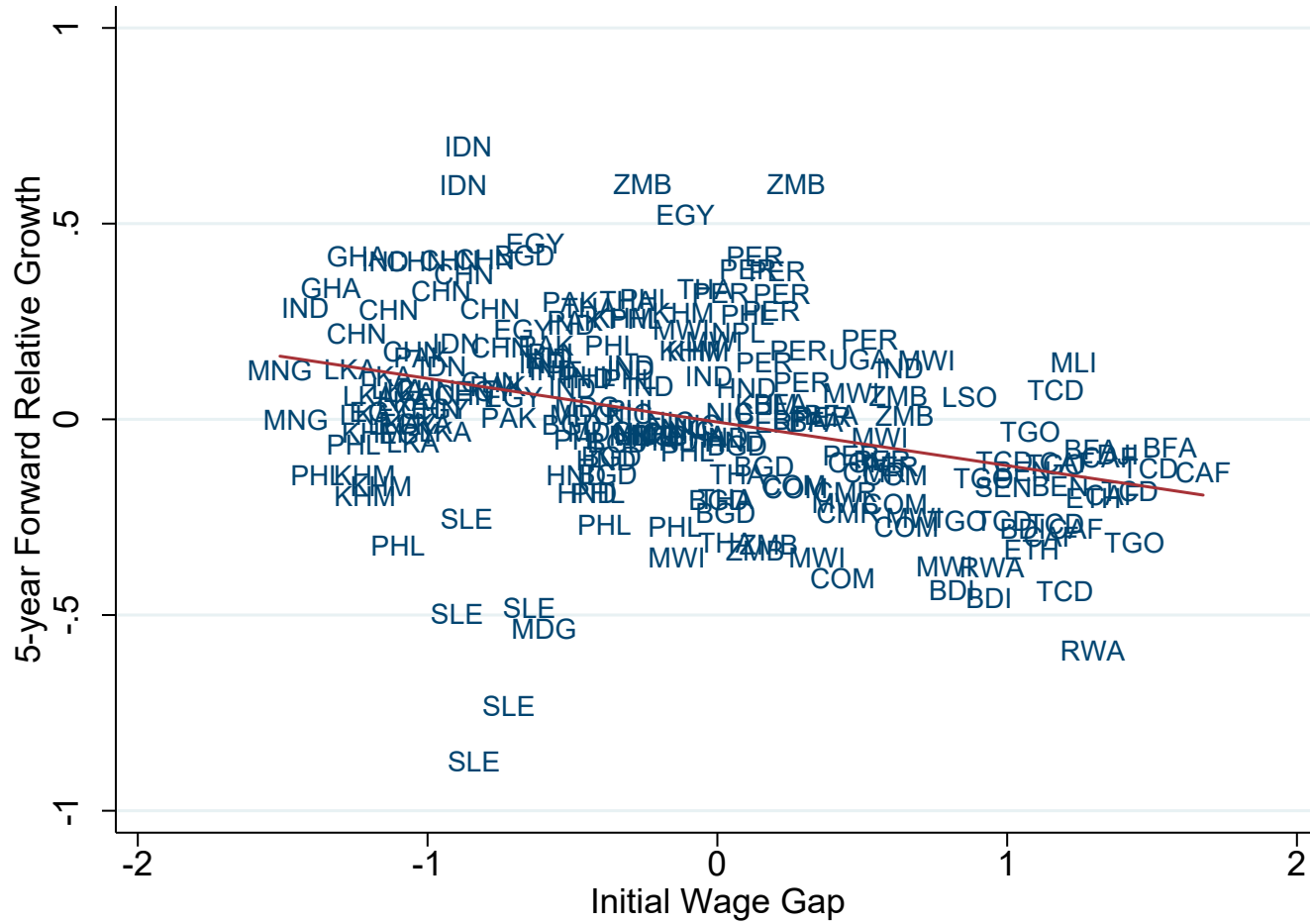
Growth of Merchandise Exports in USD (2000-2014, in percent)



A Large Wage Gap...

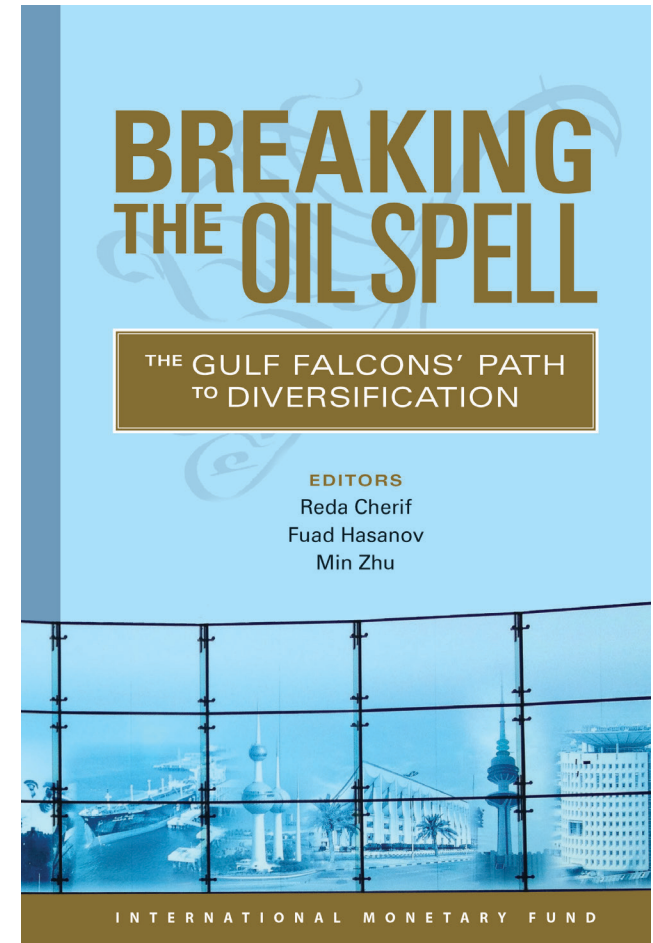


...Could Impede Growth



Standard Growth Recipe is Important But May Not Be Sufficient

- Standard policy prescription includes macroeconomic stability, minimum state intervention and an enabling environment conducive to investment in both physical and human capital. It consists of tackling “government failures” (Rodrik 2005)
- A quasi-natural experiment: the Gulf Cooperation Council (GCC) countries have improved dramatically in most of these dimensions outperforming many AEs but they have been diverging (see *Breaking the Oil Spell* by Cherif, Hasanov and Zhu 2016)
- “Market failures” necessitate government intervention (e.g. LBD in Krugman 1987), i.e. *the leading hand of the state*



Three Key Principles

- **Intervene to create new capabilities in sophisticated industries:**
Pursue policies to steer the factors of production into technologically sophisticated tradable industries beyond the current capabilities and existing comparative advantage
- **Export, export, export:** A focus on export orientation from the onset and the use of market signals from the export market as a feedback for accountability
- **Fierce competition (at home and abroad) and strict accountability:**
No support was given unconditionally although performance assessment was not always based on short term profits. As conditions change, both the state and the firms need to adapt fast

Source: Cherif, R. and F. Hasanov. 2019. "The Return of the Policy That Shall Not Be Named: Principles of Industrial Policy," IMF Working Paper 19/74

Creating a Dynamic Export Sector

- Export orientation vs. import substitution/non-tradables (e.g. real estate)
- Domestic capabilities vs. portfolio diversification (e.g. Norway in the 1970s vs. petrochemicals/metals in other oil exporters)
- Sophisticated exports vs. agriculture and services such as tourism and finance
- Beyond vs. within comparative advantage (e.g. Korea/Malaysia vs. Chile)

Indonesia

- Experiment with Import-substitution/Invest investment strategy in the 1970s through SOEs
- In the 1980s, policy focused on attracting FDI in export oriented (labor intensive) manufacturing based on a large devaluation and trade free zones, tax incentives, etc.
- Meanwhile, some strategic industries were retained (e.g. steel and aircraft) until the Asian crisis
- Was investing in Aircraft industry misguided (or a white elephant)? What can we learn from it?

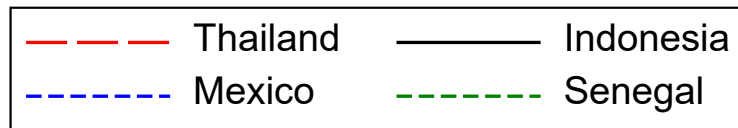
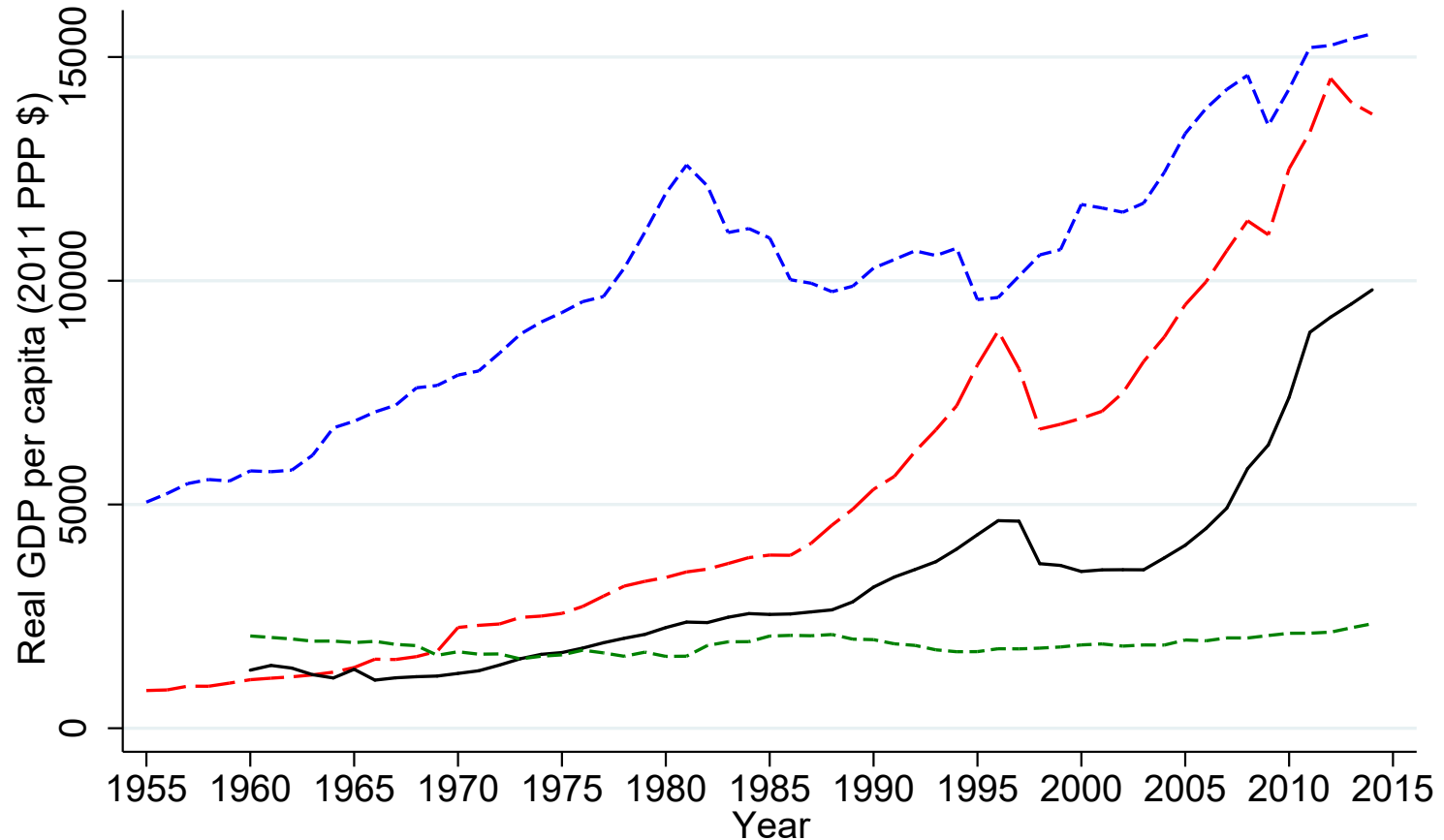
Mexico

- Mexico and Indonesia share several similarities: Mexico focused on attracting FDI in labor intensive manufacturing along the border with the U.S.
- However limited quality upgrade and linkages with the rest of the economy
- The success of the automobile industry in Mexico (mostly in central states vs. border states)
- The purpose-specific investment policy of the state of Guanajuato far from the border (NAFTA and devaluation was not enough)
- Recent attempts into aerospace industry

Chile

- Followed standard growth policy and less state intervention
- Used indirect tools to spur export growth with a special emphasis on SMEs (CORFO and Fundacion Chile)
- Targeted “comparative advantage” sectors (e.g. salmon and blueberries)

Growth Performance



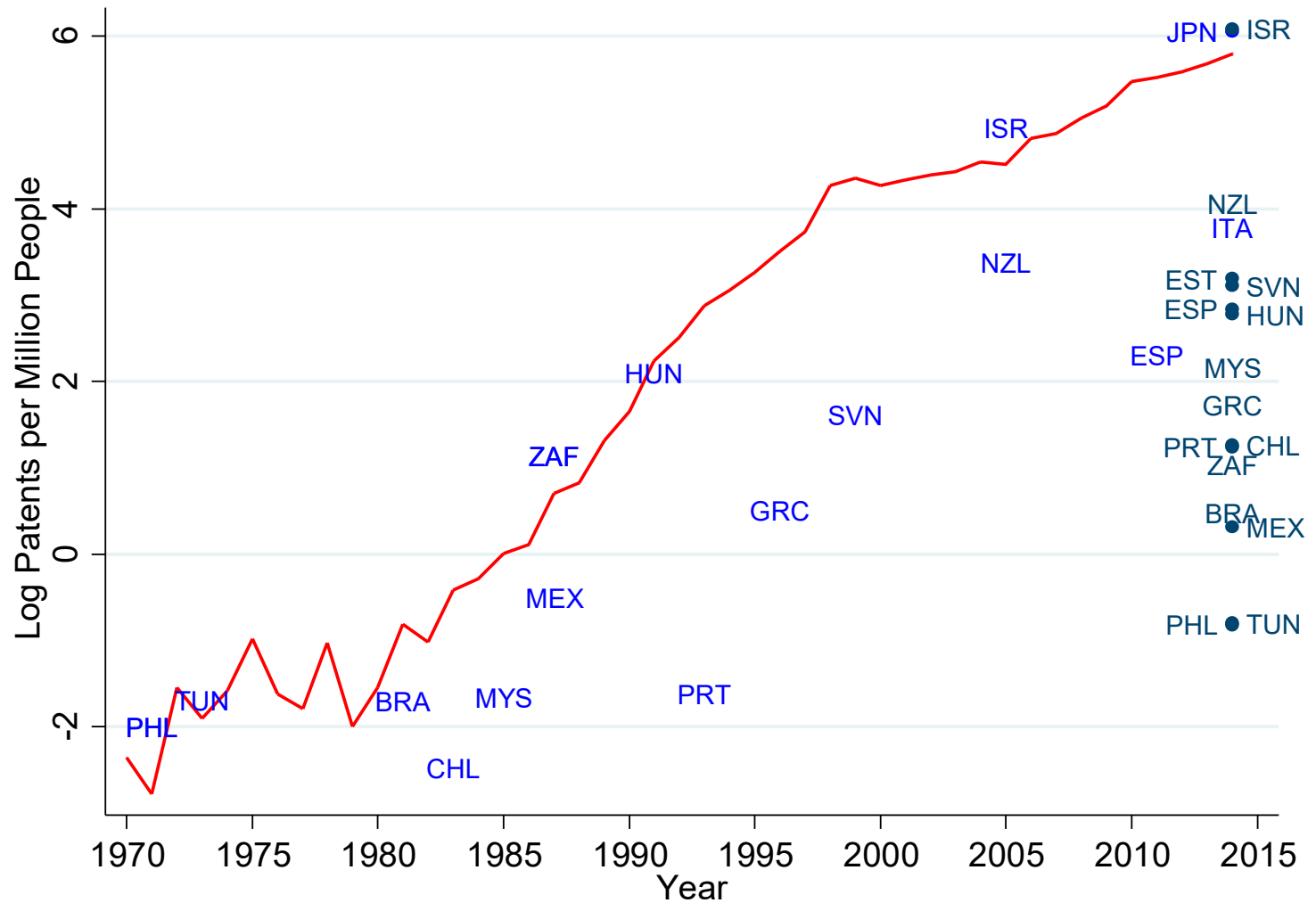
Korea

- Hyundai was originally a family owned construction company in Korea until the 1960s
- With no previous experience in shipbuilding (and none in the country), it entered the industry ...
- ... by building the world's biggest shipyard...
- ... and simultaneously its first ship
- Same for steel and automotive industries

Automotive: Malaysia vs. Korea

- Malaysia's Proton car
 - Established in 1985 and reached annual production of 500,000 cars
 - Lack of innovation, vested political interests, and mismanagement
 - Import-substitution strategy
- A few key elements for the success of Hyundai
 - The push to export from the outset
 - “Move first, then learn and adjust” strategy (huge annual production targeting the US, own dealership network and investment in advertisement)
 - Large state support with strict accountability
 - High R&D spending and own engine produced in 1991
 - Competition across several chaebols in international markets

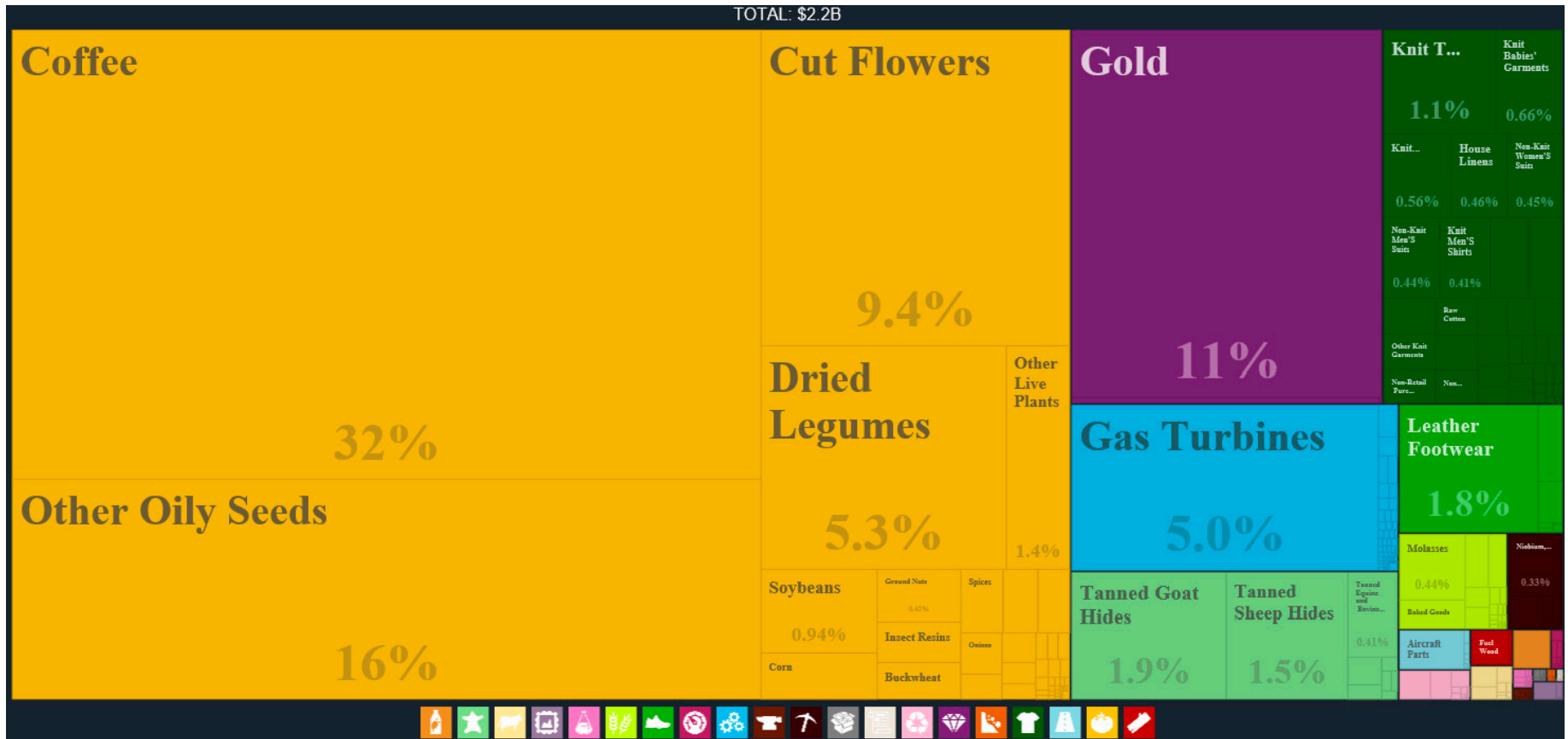
Korea's Race All the Way to the Top



Diversification Dashboard: Key Issues

- Objectives:
 - Growth
 - Employment
 - Exports
 - Productivity
 - Innovation
- Time horizon:
 - Short term, i.e. “quick wins”
 - Medium-long term, i.e. “transformative”
- Sectors:
 - Existing
 - Potential

What does Ethiopia Export (2017)?



Failures and Policies

- Binding constraints (survey firms)
 - Government failures
 - Governance (e.g. customs, taxation, regulation)
 - Public goods (e.g. infrastructure)
 - Market failures
 - Key inputs to industries
 - Financing
 - Coordination (export promotion, clusters, specific skills)
- Policies for existing and potential sectors
 - Purpose specific (e.g. industry clusters, FDI)
 - Geographic focus
 - Accountability

Concluding Remarks

- The standard growth recipe consists mostly in tackling “government failures” rather than “market failures”
- Sustained high growth is likely to be achieved by policies geared toward manufacturing rather than real estate, finance, agriculture, or tourism
- Diversification requires *the leading hand of the state* to create a dynamic export sector and local technology by domestic firms
- Picking sectors rather than firms while preserving competition and “creative destruction”
- It takes decades to develop industries
- The main challenge is to fix incentives for firms and workers, including social incentives

Creativity always comes as a surprise to us; therefore we can never count on it and we dare not believe in it until it has happened. In other words, we would not consciously engage upon tasks whose success clearly requires that creativity be forthcoming.

Albert Hirschman

“The Principle of the Hiding Hand”