

# Policies for Diversification and Structural Transformation

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# Traditional industrial policy

- Investors lack either money or incentives
- ...maybe because of positive externalities or missing financial markets
- Solution: give them credit or subsidies
- They will buy what they need
- Implementation: line item in the budget of the Ministry of Industry + selection mechanism on who to give the money to

# The problem

- Production requires potentially many capabilities
- Many are missing
- Some are private goods
- Others are publicly provided inputs
- Giving money to firms does not solve the problem
  - They cannot buy what they need
- You need to sort out what is missing
- ...but you have no clue what are the missing capabilities that prevent the appearance of new industries
- The obstacles may lurk anywhere
- You cannot assign ex ante the area of legislation or the government ministry under whom the solution space lies

# Missing private inputs

- Missing private inputs may involve coordination failures
  - E.g. Hotels and airport in Cancun
- They are rather specific and often face hold-up problems
- Across the board “big push” solutions don’t work
- Some solutions:
  - Public investment
  - Public procurement
  - Guarantees
- All require information revelation, discretion and...
- ...dealing with hanky panky

# How are private inputs coordinated?

- Coordinating private inputs looks daunting
- ...but it is aided by the invisible hand:
- **Prices** provide **information** about costs of production and willingness to pay
- The **profit motive** provides an **incentive structure** for agents to respond to information
- **Capital markets mobilize resources** by targeting firms that are expected to be profitable
- This fails when markets are missing

# Coordinating public inputs

- Governments have  $\sim 10^3$  agencies and  $\sim 10^6$  pages of legislation
- No prices
  - Article 32 of Law X
  - Traffic jams, crime
- No profit motive
- No decentralized capital market
  - Resource allocation mechanism
- How does the government decide on changes to its provision of public inputs?
  - Where does it get its **information**
  - **Incentive** to respond to the information
  - **Resource mobilization** to address the issue

# What does manufacturing need?

- Power
- Water and water treatment
- Urban transport
- Physical connectivity
  - Ports, airports, roads
- Logistic services
- Security
- Medical services
- Day care centers
- Labor training
- Banks
- Other suppliers, customers
- Regulatory services
- Worker safety
- Environmental safety
- Product safety
- Corporate law
- Standards
  - E.g. no use of child labor
- Certification of standards
  - Not the same thing
- Other suppliers
- Other customers

# An emergent solution: industrial zones

- Government typically assures the provision of some of these elements in parts of the country
- ...but unless it is able to assure that they will *all* be present *somewhere* productivity will be low
- Business or industrial zones are a way to make sure that everything is there
- They can be private investments, as there is willingness to pay for these services
  - 51 privately owned industrial zones in the Dominican Rep.
- They can internalize the agglomeration externalities through the rental rate or industrial real estate prices
- They have an incentive to promote investment in order to rent out the space
- So, they talk to new players, provide them with information and identify more specific needs

# Other emergent solutions

- Development banks 2.0
  - Learning by lending
- Investment promotion 2.0
  - Example Ireland's IDA, reinterpreted
- Government procurement
  - From DARPA to education and health
- Public challenges
  - Mexico: the most useless regulation
- Wiki-legislation
  - Annual competitiveness omnibus bill
- Self organizing deliberation councils
  - Japan's MITI, reinterpreted