International Growth Centre

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Growth through exports: should governments intervene?

“A thriving export sector is, as the Commission on Growth and Development states, “a critical ingredient of high growth, especially in the early stages.” [1] There is microeconomic evidence to support this claim: recent research suggests that increases in exports lead firms to produce higher-quality products, pay higher wages, and adopt more advanced technologies.[2] There is also evidence that the sophistication of a country’s exports, where the sophistication of a product is measured by the average income of countries that produce the product, is positively correlated with countries’ future growth rates.[3] It appears that growth is closely associated with moving up the quality ladder within industries, and exporting more technology-intensive and capital-intensive, higher-value-added products.

The question then is: Should governments intervene in markets to increase exports? The answer is not obvious. One has to weigh the costs against the benefits. In the perfect markets of economics textbooks, government interventions to promote particular activities move firms away from an already efficient resource allocation based on comparative advantage to a less efficient allocation, generating welfare losses. On the other hand, if there are what economists would call externalities between firms, for instance spillovers of technical knowledge between firms producing similar goods, then industrial policies can help to correct market failures, for instance under-investment in innovation by firms that cannot capture the full benefits of their investments.

Unfortunately, this last idea is easily stated in theory, but hard to implement in practice. It is difficult to know exactly which firms or products or sectors are likely to generate knowledge spillovers. Governments cannot simply imitate what other countries have done in the past, both because countries differ along many dimensions and because the fact that, say, several East Asian countries have succeeded in semiconductors makes it harder for latecomers to succeed in semiconductors too.

Given this uncertainty, what is a policy-maker to do? The view advocated by two economists at the World Bank, Daniel Lederman and William Maloney, which I share, is that policy-makers should focus first of all on ways to provide broad-based support for innovation. Governments should not try to figure out precisely which firms or products are likely to generate spillovers. Instead, they should seek to implement policies that reduce costs for a broad range of activities that are likely to lead to greater innovation and greater exports. What type of policies

fall in this category? One is infrastructure investments: better roads, more reliable electricity supplies and better port facilities. Another type of broad-based policy is reducing import barriers for high-quality inputs, which in turn can promote production of higher-quality products by domestic firms. Both these strategies would benefit a wide set of firms, without requiring governments to identify beforehand the firms, products or sectors with the greatest potential.

It is also important to recognise that state effectiveness matters crucially for industrial policy. Governments have to be willing and able to "pull the plug" on policies that are not working. There is the danger that officials tasked with promoting an industry come to be unduly influenced by the firms under their regulatory supervision. Governments should strive for transparency and independence from vested economic interests. At the same time, policy needs to be made with the governments that we have, not that we would like to have. My own view is that modest industrial policies, of the sort suggested above, can be effective even when states are relatively weak. Indeed, they can help to develop states' expertise and competence. We should not simply take the view that governments need to wait until all corruption has been removed before undertaking such policies. In that view, we may be waiting a very long time indeed.

The challenges in implementing effective industrial policy are great, and we need more research on precisely what works and what doesn't. But at the same time, there is a strong conceptual case for certain types of industrial policies. It is also clear that many countries that have successfully developed have done so through extensive government intervention in markets. Africa should not give up on industrial policy just because mistakes have been made in the past.

Further Reading

Harrison, Ann and Andrés Rodríguez-Clare, "Trade, Foreign Investment, and Industrial Policy in Developing Countries," in Dani Rodrik and Mark Rosenzweig, eds., Handbook of Development Economics, vol. 5, North-Holland, 2010, pp. 4039-4214.

Lederman, D. and Maloney, W. 2012. Does What You Export Matter? In Search of Empirical Guidance for Industrial Policies, Washington DC: The World Bank.

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[1] "Commission on Growth and Development. 2008. The Growth Report: Strategies for Sustained Growth and Inclusive Development. Washington, DC : World Bank.

[2] See Verhoogen, E., 2008. "Trade, Quality Upgrading and Wage Inequality in the Mexican Manufacturing Sector," Quarterly Journal of Economics, 123 (2), 489–530; Bustos, Paula, "Trade Liberalization, Exports and Technology Upgrading: Evidence on the Impact of MERCOSUR

on Argentinian Firms," American Economic Review, 2011, 101 (1), 304-340 ; Lileeva, A. and Trefler, D. 2010. "Improved

(1), 304-340., Lileeva, A. and Trefler, D. 2010. "Improved Access to Foreign Markets Raises Plant-Level Productivity … For Some Plants," Quarterly Journal of Economics, 125 (3), 1051–1099.

[3] Hausmann, Ricardo, Jason Hwang, and Dani Rodrik, "What You Export Matters," Journal of Economic Growth, March 2007, 12 (1), 1-25.

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