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Latent comparative advantages – discussing a new concept

Comments on Justin Lin

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Policy messages

- Very balanced perspective
- Recognises importance of technological learning, industrial upgrading, role of government interventions to overcome market failures in this process
- … other World Bank units send out different messages.
- I fully endorse main idea: Pervasive market failure calls for active role of governments in promoting technological capabilities, industrial upgrading and diversification
  … but attempts to nurture too advanced sectors are bound to fail.

Policy messages

1. Industrial policy works if we get the identification of *latent comparative advantages* right.
2. The *Framework for Growth Identification and Facilitation* provides a tool for selecting the right industries.

Critical issue 1: Defining "latent"

Traditional neo-classics
Assumption: Markets reasonably good at signalling comparative advantages
Strategy: ‚industry-neutral' state intervention

Risk: efficient in the short-run, but foregoing dynamic knowledge spillovers

Comparative-advantage-following strategy (Lin)
Assumption: Investors often fail to acknowledge latent comparative advantage
Strategy: Subsidise search processes, invest in complementary assets as long as this does not defy comparative advantages
Risk: may be too slow for catching up

Clearly defined borderline???

Competitive-advantage-pushing strategy
Assumption: Lengthy learning processes and coordinated investments needed to develop competitive advantages
Strategy: Proactive investment in promising technologies even if it requires deviating from current comparative advantages; high levels of protection temporarily justifiable
Risk: Losses due to wrong decisions, rent-seeking

Critical issue 1: Defining "latent"

„Good" policies develop „soft infrastructure" (e.g. new skills, new marketing arrangements) for activities *that private investors have not yet discovered*.

⇒ How can governments know ex-ante whether they promote the right activities? …

… and how far shoud they go?

Critical issue 1: Defining "latent"

Not a merely academic question:

- **Vietnam's ship-building industry is developed by a large SOE; targets simple, labour-intensive market segment; may gradually upgrade into more demanding segments … *but currently depends on considerable (hidden) subsidies***
- **Ethiopia's big push in engineering skills: Builds 15-20 technical universities, large national vocational training programme; sets up university business-linkage programmes, etc … for which there is no immediate demand … *but in 5-10 years?***
- **India's space programme develops satellites and related software; contributed to skill base that enabled India`s success in software exports; satellites used for agricultural programmes … *but not (yet?) commercially viable.***

Critical issue 2: Practicality of the tool

- Lin rightly identifies shortcomings of existing tools (ICS; Growth Diagnostics); calls for the combination of macro and micro economic tools and country-specific analyses. YES!
- How practical is the proposed tool („ *Framework for Growth Identification and Facilitation*“)?
- Tool suggests to identify tradables that have been produced > 20 years in countries with similar endowment structures but 100% higher per capita income (PPP)

Critical issue 2: Practicality of the tool

- **Main critique: very technical.**
  - **Technologies and markets constantly change – and thus entry barriers ! Technological paradigms may change (e.g. low carbon)**
  - **Per capita income may not be the best predictor of structural change: e.g. initial level of business sophistication and governance capabilities matter far more.**

Critical issue 2: Practicality of the tool

Competitiveness **(WEF, Global Competitiveness Indicators 2008 – 2009)**				*Government effectiveness* ***(World Bank)***
> 4,2	*3,8 – 4,2*	*3,4 – 3,8*	*< 3,4*	
Tunisia	**Namibia**			*Fairly high > 0,0*
			Mozambique	*Moderate - 0,3 – 0,0*
	Egypt, Vietnam	**Ethiopia**		*Low - 0,7 - - 0,3*
		Syria		*Very low < - 0,7*

Critical issue 2: Practicality of the tool

- ***Industrial policy management capabilities*** **matter: include ability to formulate „national transformation projects"; to create and withdraw rents; to manage policy cycles.**
- **Varies considerably: High in Tunisia and Ethiopia, low in Namibia and Mozambique.**
- **Neither correlated with per capita GDP nor with WB definition of „government effectiveness".**

Summing up:

- Concept of „*latent comparative advantage*“ and respective „*identification tool*“ important contributions to the debate, but both need further operationalisation.
- Hopefully, Justin Lin convinces many colleagues of his balanced approach.

Thank you for your attention

