RETHINKING DEVELOPMENT: THE ROLE OF INFRASTRUCTURE AND FACILITATING STATE IN THE PATH TO STRUCTURAL TRANSFORMATION

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Industrialization and structural transformation have been central to the development experience of countries in Europe and North America. Similarly, East Asia's development success demonstrates the key role that industrialisation has played in the economic growth of developing countries in the past fifty years. Yet, in the same period, the economic performance of countries in Latin America and sub-Saharan Africa (SSA) rapidly deteriorated. In this paper we explore SSA and Latin American premature deindustrialization hypothesis from the New Structural Economics (NSE) perspective. Our analysis confirms NSE's propositions that variation of (de)industrialization patterns across countries is linked to the type of development policy, as captured by the Technology Choice Index (TCI), black market premium, and two indicators of trade openness, and the supply of both hard and soft infrastructure.

Objectives/ Motivation and research questions

Several scholars have documented and interpreted de-industrialization trends in much of the developing world in recent decades (Felipe et al. 2014; Palma 2005; Rodrik 2016). Rodrik (2016) points out that developing countries have experienced falling manufacturing shares in both employment and real value added at much lower levels than those at which the advanced economies started to deindustrialize in the past. Taking into consideration supply and demand side issues at the global economic level, he argues that premature industrialization in Africa and Latin America can be explained by a combination of technology, trade and globalization.

This paper contributes to this literature by revisiting the deindustrialization hypothesis in Latin America and Africa from the New Structural Economics perspective and through the lenses of infrastructure and facilitating state. The NSE starts with the observation that the economic structures (including the structure of technology and industry, which determines labour productivity) and hard and soft infrastructure (which determines transaction costs) are endogenous to the factor endowment structure of a country, which is given at any specific time and changeable over time. The key question that this paper investigates then is: what are the fundamental reasons that create variations in structural transformation and industrialization patterns across developing countries?

Methods

To study the role of infrastructure and facilitating state in the economic reallocation from agriculture to manufacturing, this project assembles data from various sources that provide detailed information on sectoral employment and value added, infrastructure, institutional quality, as well as government policies. Referring to Rodrik (2016), we calculate the level of income where the turning point of industrialization is. We then compare the gap in income at the turning point between developing economies and developed economies, which is an indicator of premature deindustrialization happening in developing economies. Finally, we show how the extent of the gap might vary in developing economies with different features, including developing strategy before trade liberalization and development of hard and soft infrastructure after trade openness.

Results

This paper revisits the deindustrialization hypothesis in Latin America and Africa from the NSE perspective and show that the provision of infrastructure and a facilitating state are critical factors to explain the heterogeneity in industrialization and structural change across developing countries. Our results demonstrate that deindustrialization is more likely to happen within countries that have followed a CAD strategy and that lack both soft and hard infrastructure.

Recommendations

The development strategy is critical to explain the heterogeneity in economic performance and capital in and across developing countries. Successful industrial upgrading is a dynamic process where the government proactively plays a facilitating role to allow market to function properly. In particular, the government has the essential role of facilitating rapid technological innovation, industrial upgrading, and diversification through addressing externalities and solving coordination problems in the improvement of infrastructure and institutions. This facilitating role can be achieved through an effective development strategy that is coherent with the country's latent competitive advantage. With the right development strategy and ideas, the state is able to pragmatically adopt and implement policies that set structural transformation in motion.

The present one-pager is based on the working paper entitled "rethinking development: the role of infrastructure and facilitating state in the path to structural transformation".