

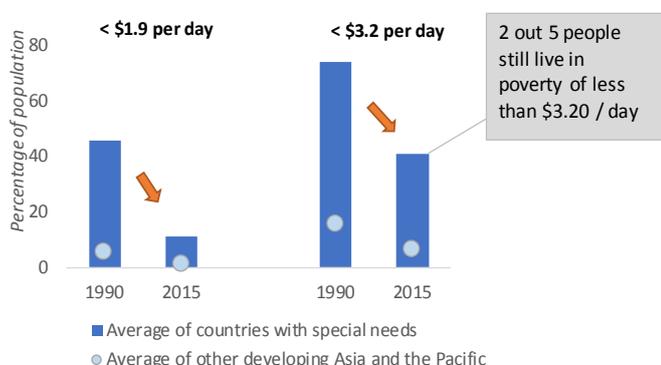
Industrial policy for structural transformation to reduce poverty in LDCs, LLDCs and SIDS

Industrial policy is once again becoming a favoured tool to address countries' development challenges. As the *Asia-Pacific Countries with Special Needs Development Report: Structural Transformation and its Role in Reducing Poverty*¹ highlights, industrial policy is particularly relevant for effective structural economic transformation in least developed countries (LDCs), landlocked developing countries (LLDCs) and small island developing States (SIDS), a group collectively referred to as 'countries with special needs', and one that is characterised by various vulnerabilities and significant challenges to reduce poverty. Indeed, the report demonstrates that poverty cannot be reduced sustainably without productivity enhancing structural transformation. It also shows that structural transformation in Asia-Pacific LDCs, LLDCs and SIDS has been sluggish and thus the poverty reduction has been slow. Despite some evident successes, particularly in reducing extreme poverty, 2 out of 5 people still live for less than \$3.20 a day in these economies, compared to 1 out of 15 among other developing countries of the Asia-Pacific region.

The East Asian development miracle

Structural transformation evokes memories of the East Asian development miracle, which ranks perhaps as the most illustrative success story of development advancements. However, while some general lessons from the East Asian development miracle may indeed be useful, policy recommendations drawn from it may not be entirely replicable today. For one, the East Asian development miracle took place during a time when economic interdependencies were more limited, the forces of globalisation less advanced and consequently the availability of protectionist and interventionist measures perhaps greater. In addition, Japan, the Republic of Korea and China (the leading examples of economic success) were then, and are today, very different from the Asia-Pacific countries with special needs. Importantly, the East Asian development model also ignored environmental considerations; consequently the economic success was accompanied by significant environmental degradation. In the era of the 2030 Agenda for Sustainable Development, in which sustainability is an indispensable element of development, environmental concerns of development outcomes must be brought to the fore.

Figure 1. Poverty reduction between 1990 and 2015 at the international poverty lines



Source: ESCAP.

The centrality of the State

An important lesson from the East Asian development miracle that applies to the contemporary conditions of least developed and landlocked developing countries, as well as small island developing States, is, however, the centrality of the State and the important role of Government to guide and enable structural transformation. Indeed, this contrasts with the theory that the role of the State should be limited and the market forces should take over the development agenda.

The State has a fundamental responsibility to design development strategies. Strategies for creating competitive advantage through integrated

policies for agriculture, manufacturing, trade, finance, human resources and technology are crucial to accelerated and successful structural transformation. Nevertheless, although the State has the responsibility for initiating and implementing policy reforms, it must not act alone. Rather, policy reforms will have maximum political feasibility if they are nationally owned. For this, a participatory approach, involving various stakeholders and facilitating a social dialogue, is necessary.

Industrial policy

The state can influence the development trajectory through industrial policy. The question, however, is what type of industrial policy is indeed the most effective in addressing development challenges and sluggish structural transformation of countries with special needs. Industrial policy can be a package of interactive strategies and measures aimed at building enabling industrial systems (infrastructure and financial system) and productive capacity (including productive assets, technology and skills), and supporting the development of internal and export markets². The *Asia-Pacific Countries with Special Needs Development Report: Structural Transformation and its Role in Reducing Poverty* details the various features of industrial policy and their applicability.

Building on lessons learnt from the past, countries may either extensively interfere in the market through “picking the winners” (the selective industrial policy) or can promote a “new” industrial policy. As far as the latter is concerned, rather than the “top down” approach where a government pushes for the development of specific sectors, the state responds to private sector needs, facilitating its development (by creating an enabling environment), and mitigating and eliminating barriers and obstacles to trade, investment and innovation. This improves the business climate and promotes competitiveness, property rights, access to credit, enabling infrastructure, and labour market flexibility. This approach emphasizes the role of the private sector, working closely with the government in the design and implementation of industrial policy, as part of a “state-business alliance”. Moreover, while the state

must be a proactive partner in this alliance, it must also resist being captured by particular interests of various stakeholders to ensure that society’s needs are also adequately addressed.

Moreover, investment and trade policy packages are integral components of industrial policy and use a variety of instruments, including incentives, special economic zones (SEZs), performance requirements, investment promotion and facilitation, and screening mechanisms. Special economic zones can indeed be useful to kick-start industrial sectors’ development or promote technology transfer.

Beyond comparative advantage

In the case of Asia-Pacific LDCs, LLDCs and SIDS, development challenges may also require a more direct approach taking the form of selective industrial policy, which is more interventionist, as the state explicitly facilitates the development of certain sectors. Such an approach typically defies a country’s comparative advantage, recognizing that the productive structure of an economy is not pre-determined by comparative advantages derived from its current factor endowments. Creating competitive advantages is a substantial component of development and implies deciding upon which sectors could be strategic for an economy. This selection must consider factors such as potential “backward” and “forward” linkages with other sectors, and the potential for technological innovation. Foremost, it needs to consider the future vision of the national economy. Details of specific industrial policies for Asia-Pacific least developed countries, landlocked developing countries and small island developing States are examined in forthcoming MPFD Policy Briefs.

¹ United Nations, Economic and Social Commission for Asian and the Pacific (ESCAP), *Asia-Pacific Countries with Special Needs Development Report: Structural Transformation and its Role in Reducing Poverty*, Sales No. E.19.II.F.5 (Bangkok: ESCAP, 2019). Available at www.unescap.org/publications/asia-pacific-countries-special-needs-development-report-2019.

² United Nations Conference on Trade and Development (UNCTAD), *World Investment Report 2018*, Sales No. E.18.II.D.4 (Geneva: UNCTAD, 2018).

The MPFD Policy Briefs aim at generating forward-looking discussions among policymakers, researchers and other stakeholders to help forge political will and build a regional consensus on needed policy actions and pressing reforms. Policy Briefs are issued without formal editing. The content of this issue, prepared by Andrzej Bolesta, is in part based on material from the *Asia-Pacific Countries with Special Needs Development Report: Structural Transformation and its Role in Reducing Poverty* (Sales No. E.19.II.F.5). This policy brief benefited from comments by Jose Antonio Pedrosa Garcia, Nyintgob Pema Norbu, Oliver Paddison and Yusuke Tateno, under the guidance of Hamza Ali Malik. For further information on this issue, please contact Hamza Ali Malik, Director, Macroeconomic Policy and Financing for Development Division, ESCAP (escap-mpdd@un.org).