

# Structural transformation in the Asia-Pacific CSN: A conceptual framework for the role of the State

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# Historical experience tells us:

- **No reason** to believe in the “institutional primacy of the market” or to take **free markets as the ideal point** of reference;
- **Success or failure** depends on a **range of socially specific institutions** and not just on the efficiency of the market;
- **Case studies** offer **important insights** about the theory of state intervention;
- **Neo-classical** assumption that **less intervention** is always better is **not sustainable**;
- **Relevant factor** is **what States do and how** they do it.

# Historical experience suggests

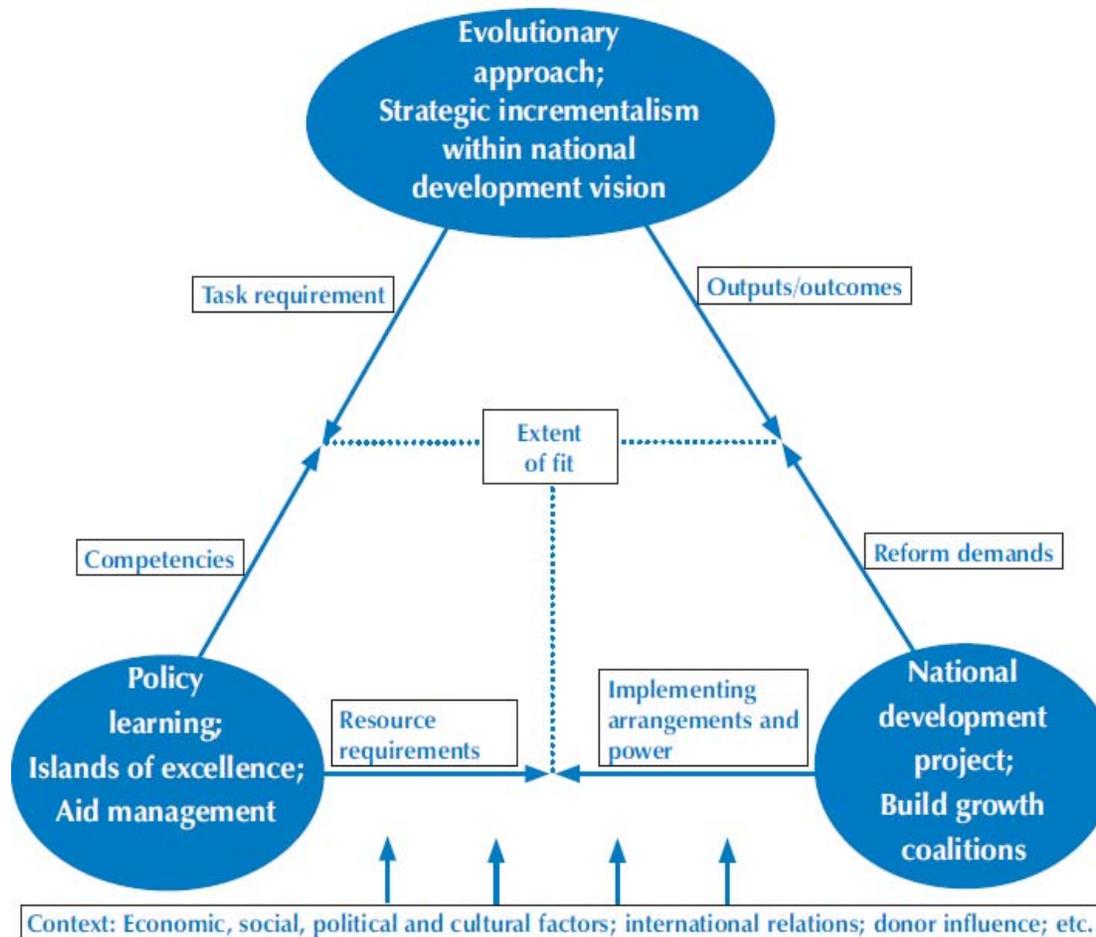
**SIX** different, but **inter-related**, roles, the State as:

1. creator of **institutions**,
2. policy **reformer**,
3. guardian of **macroeconomic stability**,
4. **entrepreneur**,
5. **manager of conflicts**, and
6. **Enhancer of productive factors**

# Building State capabilities

- “Good governance” NOT Good enough
- “Good enough governance”
- Pragmatic & evolutionary approach
  - Institutional capacity develops over time through learning
  - Focus on a small number of key agencies and institutions
  - No one-size-fits-all magic bullet

# Evolutionary pragmatic approach



- But building State capabilities needs resources
- Reforms are not cheap

# Resource mobilisation

- Tax revenues
  - Widen tax base, improve administration, etc.
  - But **limited scope in low-income countries**
    - Informality & large agricultural sector
    - Tax avoidance & evasion, illicit transfer of funds
- Alternative sources
  - Borrowing – **forward-looking macroeconomics**
  - Tapping diaspora
  - FDI
  - ODA
  - South-South cooperation

# Industrial policy

- Broad definition – **horizontal/functional**
  - Neutral – e.g., Macroeconomic stabilization, infrastructure and education & skill development policies, etc.
  - Economy-wide; but individual actor may feel differently
- Narrow definition – **vertical/selective**
  - Non-neutral – e.g., Tariff protections, tax concessions, subsidies, specialized credit, etc.
  - Prone to rent-seeking; but can be overcome with a “carrot-stick” or EPconEP approach
- Combination of **horizontal & vertical policies needed**
  - ESCAP, UNCTAD position

# Comparative vs. competitive advantage

- Comparative advantage following (CAF)
  - Flying-geese;
  - Product cycle
- Comparative advantage defying (CAD) –
  - Strategic trade theory
  - Competitive advantage
  - State’s entrepreneurial role to “Leap-frog”; “Big push”

# Wage & exchange rate policies can be

- Market determined – CAF
- Institutional/policy determined – CAD
  - Higher industry-wide minimum wage pushes out below average performers; but creates rent/extra profit to encourage expansion
  - Under-valued exchange rates promote exports; create dynamic gains

# Contrasting tales: Azerbaijan & Uzbekistan

- Azerbaijan:
  - IMF's prescription - austerity based stabilisation & liberalisation;
  - Resource curse; de-industrialised; productive capacity lost, agriculture declined; Baku-centric; failed to integrate with the region
- Uzbekistan:
  - Defied IMF – social protection; targeted reforms & industry support; public investment
  - Faster recovery; diversified economy; created productive capacity (e.g. profitable car industry for the regional markets); inclusive growth;

# Contrasting tales: Solomon Islands & Vanuatu

- Solomon Islands
  - Restrictive macroeconomic policies; market-oriented; passive approach to industrial policy
  - Resource curse; failed diversification
- Vanuatu
  - Used local customs/values to build State vision & development goals; Heterodox & pragmatic policies to incentivise & support private sector
  - Diversified economy with a vibrant tourism sector

# Key policy messages

- Small LDCs, particularly geographically or culturally fragmented one, need buttress the **legitimacy of the State**. **Peace & political stability** are vital.
- **Avoid** the risks of the **resource curse** & **ensure sustainable use** of natural resources
- **Policies matter**, but planned and targeted industrial and sectoral policies, be it ‘soft’ or ‘hard’, matter even more for promoting economic specialization.
- **Overly restrictive fiscal policy** can be an important **constraint** to expanding productive capacity.
- **Devote** more efforts to **foster** the ingredients of **sustainable productive capacity** – human assets, physical assets and linkages – than on domestic or international liberalisation;
- **International support** is **crucial for LDCs** with limited resources for development. **Ensure** productive use of **ODA**
- **Strengthen** South-South & regional cooperation

Thank-you

