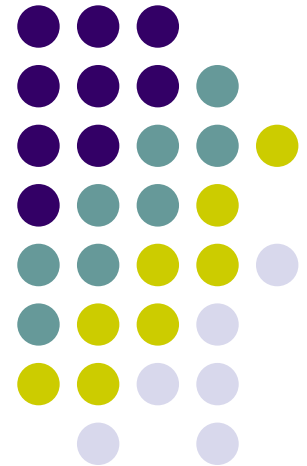


Seeking Policy Space in the Search for Development: Preliminary Comments on Rodrik's Proposals

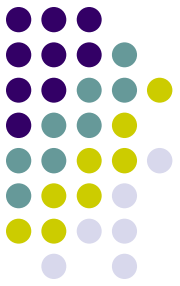
Daniel Lederman
William F. Maloney
Guillermo E. Perry

Office of the Chief Economist
Latin America/Caribbean
The World Bank

December 2006



Seeking “Space” to Do What?



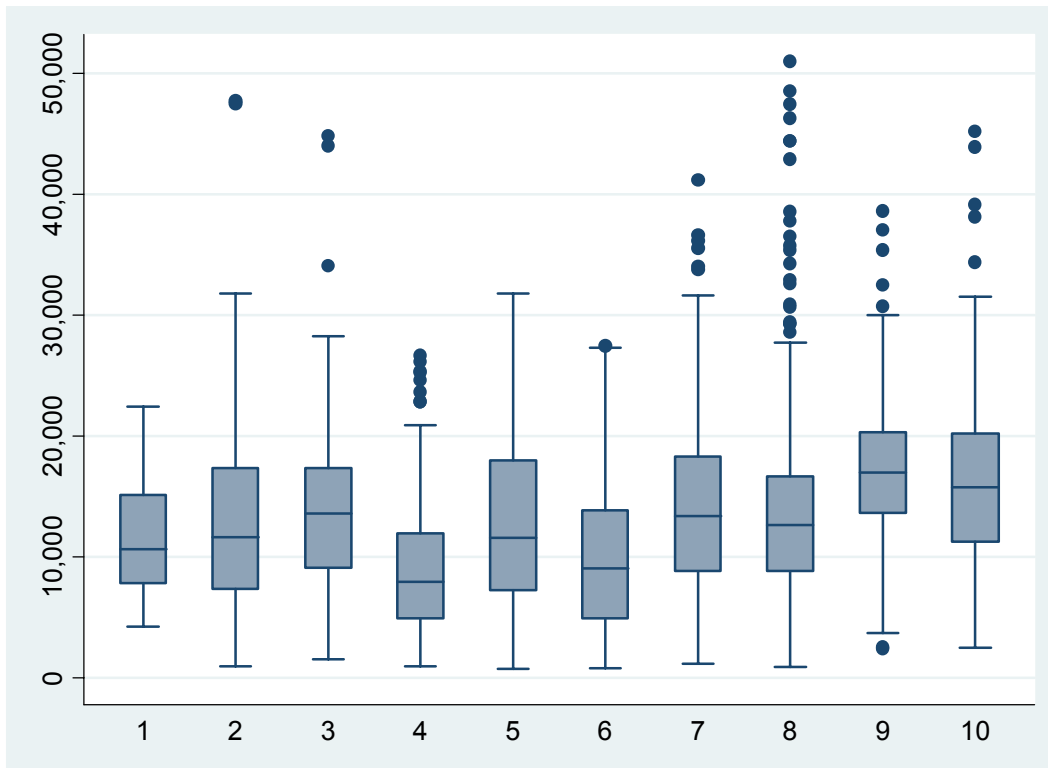
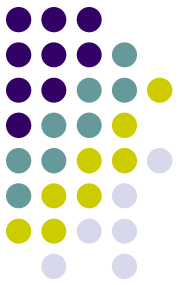
- Rodrik’s advice
 - Exchange-Rate Protection
 - “Industrial” Policies as a Process
- To stimulate export diversification
 - Especially towards export products produced by rich countries (high EXPY)

Our Comments -- Outline



- Some relevant stylized facts
 - EXPY or export diversification does not equal “industrialization” (manufacturing activities)
 - Difficult to distinguish the “effects” of EXPY and overall export diversification on economic growth
 - Data (Klinger & Hausmann) on export probabilities do not support emphasis on manufactures
 - How you produce also matters: towards a broader concept of innovation
- Rodrik’s advice: Easier said than done?
 - Exchange-rate protection might imply trade-offs
 - Ambiguities and challenges in the “process” of “industrial” policies

The Challenge of Productive Diversification – EXPY Is Not a Synonym of “Industrialization”



Cluster	Leamer Name
1	Petroleum
2	Raw Materials
3	Forest Products
4	Tropical Agriculture
5	Animal Products
6	Cereals, etc.
7	Labor Intensive
8	Capital Intensive
9	Machinery
10	Chemical



EXPY and Export Diversification as Correlates of Economic Growth – Unsurprising Collinearity Prevents Clear Identification

Growth Regressions

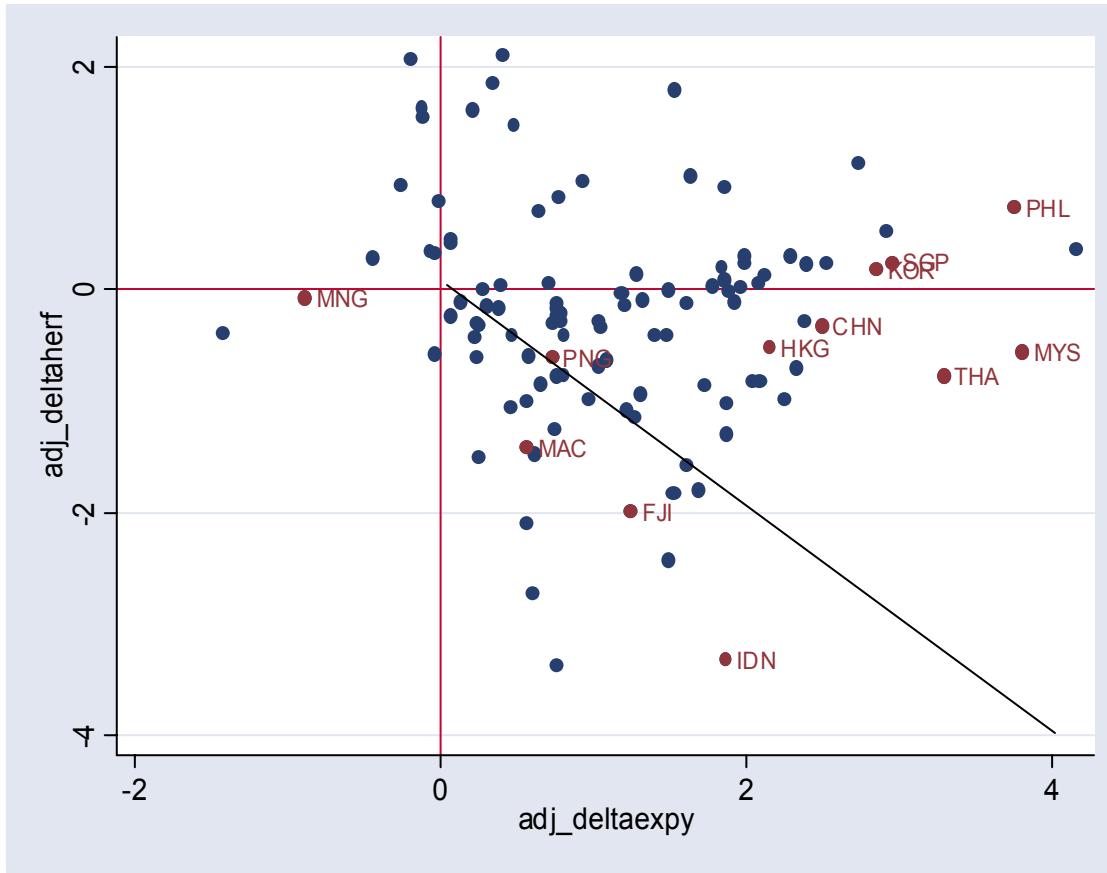
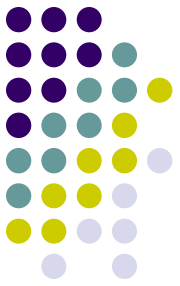
Note: Rodrik's Regressions are those presented in the paper by Hausmann, Hwang, and Rodrik, "What You Export Matters."

	Rodrik's Regressions		Including Investment Share		Including The Herfindal		Including The Herfindal and the Investment	
	IV	GMM	IV	GMM	IV	GMM	IV	GMM
log (gdp)	-0.038 [4.37]**	-0.013 [1.80]	-0.035 [4.16]**	-0.009 [1.96]*	0.12 [0.65]	-0.002 [0.22]	0.149 [0.64]	-0.008 [1.19]
lexpy1	0.092 [4.54]**	0.052 [3.52]**	0.076 [3.52]**	0.013 [1.08]	-0.466 [0.72]	-0.018 [0.39]	-0.583 [0.71]	-0.01 [0.29]
log (primary schooling)	0.004 [1.75]	-0.002 [0.23]	0.003 [1.41]	-0.002 [0.38]	0.025 [0.90]	0.01 [1.14]	0.021 [0.76]	0.005 [0.71]
lki			0.012 [2.80]**	0.031 [3.21]**			0.045 [1.05]	0.023 [2.32]*
rherf					-0.611 [0.88]	-0.079 [1.95]	-0.666 [0.81]	-0.043 [1.28]
Constant	-0.42 [4.25]**	-0.296 [3.22]**	-0.343 [3.25]**	-0.086 [1.06]	3.119 [0.77]	0.223 [0.70]	3.756 [0.73]	0.128 [0.52]
Observations	299	299	299	299	285	285	285	285
Number of wgroup		79		79		75		75
R-squared			0.1					
Hansen test of overid. restrictions: Prob > chi2 =		0.563		0.856		0.606		0.575
Arellano-Bond test for AR(2) in first differences: z Pr > z =		0.322		0.278		0.763		0.475

Robust t statistics in brackets

* significant at 5%; ** significant at 1%

The Unsurprising Collinearity between EXPY and Export Concentration



Notes: This graph shows 110 obs by country with the changes in the X herf and EXPY between 1962 and 2000. Of these, 90% had positive (or no change) changes in EXPY; 60.9% had negative changes (or no change) in Herf. Also, 76.8% of sample experienced improvements in EXPY that were larger in magnitude than the changes in favor of diversification (ie, $\Delta \text{herf} \leq 0$). Of the sample of countries that experienced both diversification and improvement in EXPY (64 countries out of the 110 in the sample), 64% -- yes 64 percent; it's not a typo -- of these experienced higher improvements in EXPY than reductions in concentration (reductions in the X herf).

Data (Klinger & Hausmann) on Two way Export Probabilities Do Not Support Emphasis on Manufactures



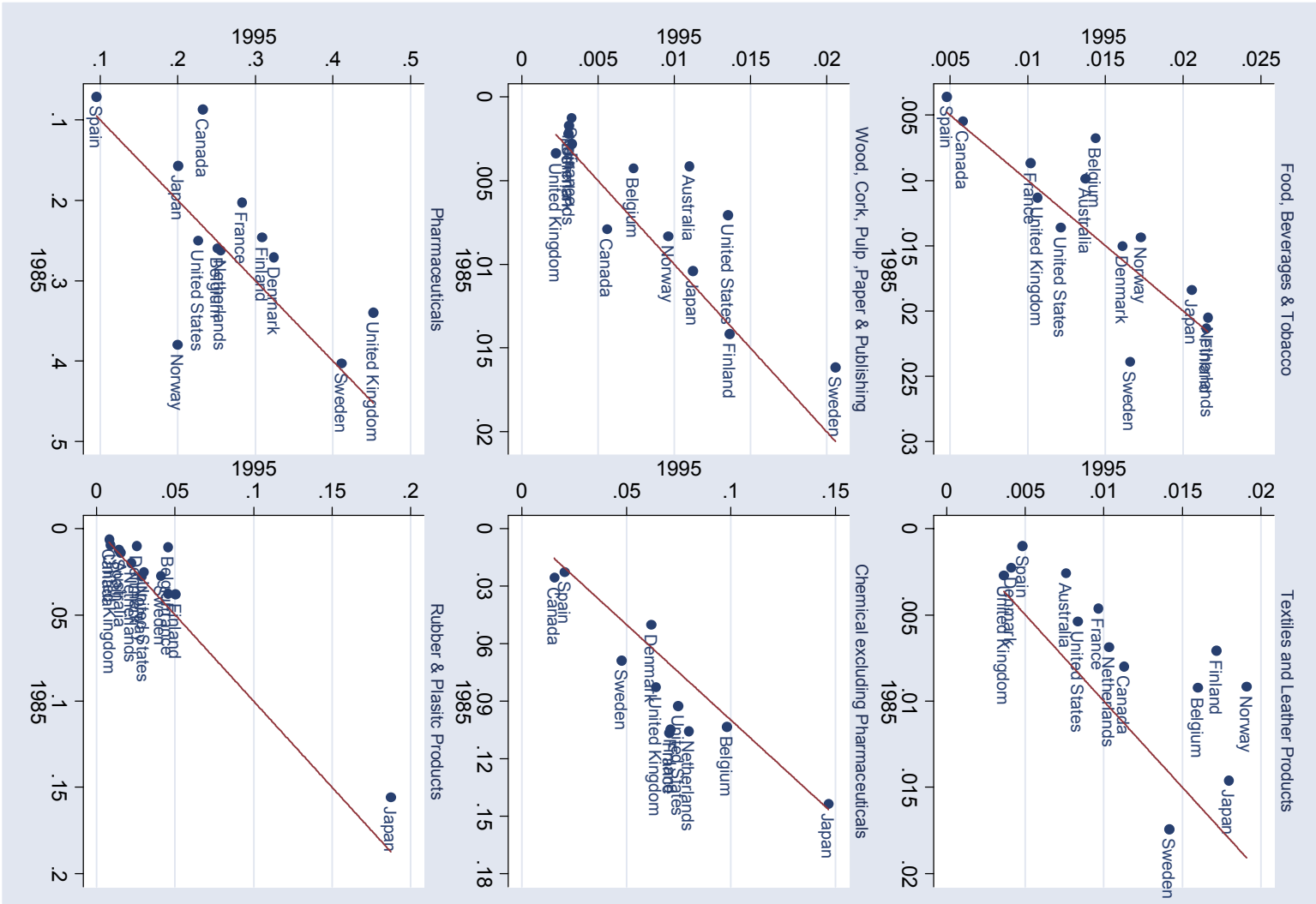
Table 3: Average ϕ Within and Between Leamer Commodity Clusters, 1998-2000

	Petroleum	Raw Materials	Forest Products	Tropical Agriculture	Animal Products	Cereals, etc.	Labor Intensive	Capital Intensive	Machinery	Chemical	Not Classified
Petroleum	0.28	0.10	0.11	0.11	0.09	0.09	0.09	0.11	0.07	0.10	0.04
Raw Materials		0.11	0.09	0.08	0.08	0.07	0.07	0.09	0.07	0.09	0.03
Forest Products			0.19	0.10	0.10	0.09	0.11	0.13	0.10	0.11	0.04
Tropical Agriculture				0.15	0.10	0.09	0.10	0.11	0.07	0.09	0.04
Animal Products					0.12	0.09	0.09	0.09	0.07	0.09	0.03
Cereals, etc.						0.10	0.08	0.09	0.07	0.09	0.03
Labor Intensive							0.14	0.13	0.10	0.10	0.03
Capital Intensive								0.16	0.11	0.12	0.03
Machinery									0.14	0.12	0.03
Chemical										0.15	0.03
Not Classified											0.25

Source: Author's Calculations



How You Produce also Matters: Towards a Broader Concept of Innovation

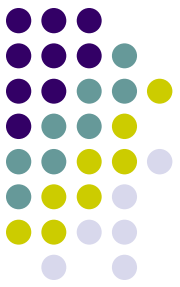


Exchange-Rate Protection: Trade-offs and Sustainability



- Distributional effects
 - Paid by consumers of importables and producers of nontradables, benefits consumers of nontradables and producers of exportables
 - Is it regressive?
 - Effect on national welfare depends on being right that demonstration externalities (the appropriability problem) or coordination failures affect exportables more than nontradables (which can be inputs for exportables) and that such gains are greater than the welfare losses (if any) to consumers

Exchange-Rate Protection: Trade-offs and Sustainability (continued)



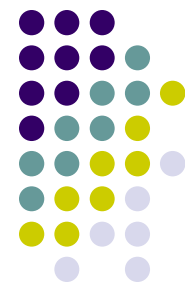
- Effects on financial development and macroeconomic stability
 - Pegs led to currency and financial crises in the past
 - Pegs led to high interest-rate volatility and hence to excessive borrowings in foreign currency and low development of capital markets in domestic currencies (Ize & Levy-Yeyaty; De la Torre & Schmukler)
 - What can be expected from under-valued exchange rates?
 - The expectation of appreciation aids financial development? But also affects its sustainability ... Is it a temporary policy?
 - Sturzenegger and Levy-Yeyati: growth effects of forex interventions might come from effects on savings and investment
 - Regressive tax on poor wage earners (when their consumption is dominated by importables) and increased capital earnings (for exporters – the largest firms)

Exchange-Rate Protection: Trade-offs and Sustainability (continued)



- Requires increases in fiscal surpluses to prevent inflation
 - Sacrifice expenditures in education, infrastructure, science and technology, that are key for competitiveness;
 - ... or higher taxation with costs for investment and efficiency
- Sequencing of reforms: we've learned the lessons, but are they still relevant?
 - Export promotion before import liberalization
 - Capital account liberalization after trade reforms
 - Capital account liberalization after financial-sector reforms
 - Current relevance, at least for Latin America/Caribbean, is questionable

“Process” of “Industrial” Policies without “Picking Winners”



- Emphasis on “process” is reasonable in principle
 - Clear challenge of rent seeking: The long laundry list of private-sector concerns...
 - In our experience → the territorial approach might work best
- Productive/export diversification is just one aspect of innovation and is closely inter-related with others
 - Same market failures (appropriability and coordination failures) that justify public policies

“Process” of “Industrial” Policies without “Picking Winners” (continued)



- Distinction between “supply” and “demand” for innovation is also tenuous in practice
 - In the presence of market failures, unlikely that private sector will demand enough innovation without innovation policies
 - IPR’s and well designed contestable matching grant funds stimulate firms demand for innovation (they might opt to do it in house or out source)
 - Some supply side interventions are also necessary (improving quality of education, supporting minimum R&D capacity in Universities)
- (Im)Possibility of evaluation ...