

# Rethinking Productive Development

SOUND POLICIES AND INSTITUTIONS FOR ECONOMIC TRANSFORMATION

Edited by

Gustavo Crespi,  
Eduardo Fernández-Arias,  
and Ernesto Stein

DEVELOPMENT IN THE AMERICAS

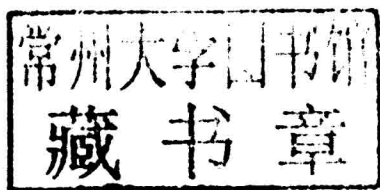


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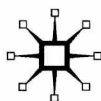
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RETHINKING PRODUCTIVE DEVELOPMENT

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# Preface

Latin America and the Caribbean represent around 8.5 percent of the world's GDP and a similar proportion of the planet's population. In the last three decades, the region has grown, has managed to reduce poverty, and has been able to lift the income of its citizens, adjusted for purchasing power parity, to US\$ 13,000. However, it has been unable to close the gap in well-being that separates it from the most developed countries.

The Inter-American Development Bank (IDB) has dedicated a good part of its research agenda to delving into the factors that limit the region's convergence with the levels of income and well-being in the most prosperous countries. The analyses carried out, particularly our 2010 edition of the flagship series, *Development in the Americas (DIA)*, titled *The Age of Productivity: Transforming Economies from the Bottom Up*, have identified the region's insufficient growth in productivity as the principle cause of this relative lag. During the past fifty years, the region's active population and capital stock have grown far more than those of the United States. The region's level of education and its access to technology have improved. But the sustained increase in the gap in relative productivity has meant that compared to citizens of the United States today, citizens of Latin America and the Caribbean today have per-capita incomes less than those of their fathers and grandfathers.

For that reason, the principal goal of the region's sustainable development strategy is to create conditions that will boost the rates of productivity growth.

There is no single recipe for achieving that goal. For example, productivity increases could be achieved simply by reassigning the factors employed in companies and sectors of lesser productivity to more productive activities. But the same goal could also be achieved by creating the conditions and incentives needed to accelerate the

process of productive factor accumulation and improve the quality of human and physical stock.

Many analytical efforts have emphasized the importance of the first path. The validation of the close link between labor informality and the financing of contributory and noncontributory schemes of social insurance, fiscal and labor policies, and at the level of the company, the access to credit, and the limited capacity to incorporate new technologies, has led us to identify reducing informality in labor markets as a priority for improving long-term productivity and sustainable growth. On the other hand, last year's DIA, *More Than Revenue: Taxation as a Development Tool*, focuses on the second path, emphasizing the region's need to undertake tax reform that, in addition to improving collection, reestablishes fiscal neutrality, increases fairness, eliminates distortions, and promotes saving and investment.

Although progress has been significant, the persistence of the productivity gap testifies to how much must still be understood and achieved.

The motivation for this book lies in that concern, as expressed in its very title: *Rethinking Productive Development: Solid Policies and Institutions for Economic Transformation*. Our goal is to present a perspective that complements those used to date to address the productive transformation of Latin American and Caribbean economies. This book is a collective effort by professionals from eight departments and operational divisions of the IDB and was coordinated by Gustavo Crespi, Eduardo Fernández-Arias, and Ernesto Stein.

It is not an ideological book. Nor is it an instruction manual for productive reforms. The methodologies are still being developed and cannot provide flawless answers to all our doubts. It is not a compilation of possible good practices either. Rather, it is a work, supported by the best available data and a common methodology, that addresses how Latin America and the Caribbean can rethink its policies of productive development both in terms of content and with regard to the institutions necessary to execute them and measure their impact.

What we here denominate productive development policies might to some evoke memories of the “industrial policies” that took root in the continent during the last century.

They are not.

Their scope is the totality of the economy and not accelerated industrialization; their emphasis is competitiveness and integration with global value chains, not import substitution; and the instruments of intervention are not public companies or subsidies to declining sectors or SMEs of low competitive potential but rather policies of innovation, improvement in human capital, facilitating entrepreneurship and clusters, promoting internationalization, and, especially, an active public and private collaboration.

But they are not unprecedented either.

In the world and, of course, in Latin America and the Caribbean, policies of a very varied nature and effectiveness continue to be implemented to promote productive transformation.

Rethinking productive development in Latin America and the Caribbean allows us to review our immediate past and learn from its successes and failures, with a ready openness to new perspectives and approaches. The emphasis in this publication is on the cause and quantification of the direct and indirect effects of some of the policies of productive transformation recently developed within and beyond the region. These policies cover a spectrum ranging from subsidies to projects of innovation, the opening of agencies promoting exports and investment, the establishment of incubators for new companies, development clusters, programs to create and attract technology, and specialized companies in very specific sectors.

In order to draw clear conclusions from this diversity of experiences, we have subjected each policy to an examination, including three conceptually clear and concise questions:

- What failure of the market—static or dynamic—does it try to fix?
- What instrument could be used to resolve this failure of the market?
- What types of institutions, with what characteristics, are necessary to develop the policy with success?

We have differentiated productive development policies applied to specific sectors or companies—vertical policies—from horizontal policies, which potentially affect the entire economy. And we have differentiated policies whose direct effects are entirely on the firm's profitability from those that constitute public inputs to facilitate production.

Of the many lessons contained in the book's eleven chapters, five deserve emphasis.

The first is that the nonexistence of—or partial or insufficient access to—a good, service, or critical factor for development does not necessarily justify intervention or the creation of a productive policy. What makes productive development policies necessary is the existence of a market failure, static or dynamic.

The second lesson to highlight is that the solution to this market failure lies in choosing the most appropriate policy in terms of efficiency, cost, risk, and simplicity. Consider a simple example: low financial penetration does not necessarily justify the creation of a public bank. Rather, it urgently calls for examining the financial sector's degree of competence, the protection of the property rights of creditors, and access to reliable registries that provide the financial records of potential clients.

The third is potentially controversial but nonetheless indispensable. Even in the case of a market failure, and even when the productive development policy needed to address it is plainly identified and is the most efficient alternative, an adequate institution or institutions is needed to develop that policy. If those institutions do not exist, it is preferable to invest first in creating them rather than insisting on applying the correct policy without them.

The fourth lesson is that the policies that assume intervention in markets entail more risks than those limited to producing public goods. And the policies that assume vertical interventions pose more complex scenarios than the horizontal policies from which no sector or agent can be excluded.

Finally, given the specifics of each economy and the proven absence of exclusive solutions, is that instead of seeking out best practices, policymakers must choose the policies that effectively correspond with the economy's institutional capacities.

The goal of this book is to reorient the focus of productive development policies in Latin America and the Caribbean, in terms of both policy design and the institutional capacities needed to carry them out. It accepts that the methodologies used are not definitive and that it does not offer all the necessary answers, or even all the necessary questions.

Nonetheless, the book is a valuable contribution to the already pressing debate over what Latin America and the Caribbean should do to grow in a sustainable and inclusive manner.

LUIS ALBERTO MORENO  
President  
Inter-American Development Bank



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- The Next Step in Evaluating Productive Development Policies: Spillovers, Program Complementarities and Heterogeneous Impacts: <http://www.iadb.org/en/research-and-data/project-details,3187.html?id=8709>

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The authors and editors are responsible for any errors in information and/or its analysis. Likewise, the opinions and policy recommendations stated in this book are those of the authors and do not represent the official position of the IDB, its president, or board of directors.

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