

For S'pore, more activist policies could pay off

Korean academic makes robust case for industrial policy at Economic Roundtable

Vikram Khanna

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(SINGAPORE) For most of the last three decades, during the ascendancy of free-market economics, industrial policy has had a bad name. The idea that government bureaucrats could successfully 'pick winners' among industries to promote and, in some cases, stage manage an economy, was considered implausible, if not absurd. The fact that some countries in East Asia, including Singapore, had successfully practised industrial policy in some form was considered exceptional to the rule.

Perhaps because of the rise of China - where industry is still dominated by state-owned enterprises - or the discrediting of free-market ideology following the global economic crisis, or the continued success of highly interventionist and social welfare-minded Scandinavian economies, industrial policy is being revisited. At the vanguard of this effort is a Korean academic, Ha-Joon Chang, who is Reader in Economics at the University of Cambridge.

Mr Chang shared some of his unorthodox ideas at the 15th Singapore Economic Roundtable on Monday. He made a robust case for industrial policy, about which he believes conventional wisdom is 'too pessimistic', and for a more activist social policy as well.

He broadly defined industrial policy as including the following: the targeting of certain industries by the government; the state acting as a venture capitalist; promoting exports through subsidies and other assistance from government agencies and the rationing of foreign exchange to generally favour capital goods imports.

East Asian countries have practised some or all of these policies. In Singapore for instance, the government has targeted industries such as electronics, the biomedical sector and banking and finance; the government is by far the biggest venture capitalist in the economy and agencies such as Spring and IE Singapore provide valuable support to local companies. (One entrepreneur with global operations describes IE Singapore officials in far-flung countries as 'my unpaid marketing team'.)

Nor has industrial policy been confined to East Asia. Mr Chang produced research to show that France, Finland, Norway and Austria have had national industrial policies, while Italy and Germany have had regional ones. He claimed that the United States has also practised industrial policy: From the 1950s through the 1980s, the US government funded between about half to two thirds of all national R&D (compared with 20 per cent in Japan and 30 per cent in Europe). 'But Americans don't call it industrial policy,' he noted. 'They call it defence research.'

As for whether industrial targeting works, Mr Chang suggested that governments practise it all the time, whether they know it or not. Every policy has discriminatory effects. For instance, government spending on infrastructure and R&D does not benefit all industries equally; some industries are more tech-intensive than others. Thus the whole debate over whether governments should target industries is futile, he says; they already do. The real question is how they should target well.

The state is also capable of beating the market, he contends, citing examples of successful state-owned companies such as Posco of Korea and Embraer of Brazil (to which, one might add, a host of GLCs in Singapore). So the debate should be not about whether government companies should be in business but how to improve the quality of their decisions.

To be sure, Mr Chang - perhaps to drive home his case - did not dwell on many of the failures of industrial policy - including in Asia. Participants at the Roundtable mentioned, for example, the attempts by the Indonesian government to build an aircraft industry in the 1990s. Malaysia's national car project has been another flop. In Korea, too, the chaebols overinvested in various projects and borrowed too much from banks, which contributed to the Korean crisis of 1997. India was a particularly stark case of industrial policy failure. Such a policy, in the form of the licence raj, was in force for more than 40 years till the 1990s, with suffocating effects on growth. The Indian economy only began to take off after industrial policy was dismantled, starting in 1991. More extreme cases include Maoist China and North Korea, where the thoughtless pursuit of industrial policy had disastrous results. So, while it would be wonderful if governments get industrial policy right, history shows there is a danger that they can get it seriously wrong as well and, in such cases, might have been better advised not to try it at all.

Fortunately, Singapore has, by and large, got it right. But to continue doing so, Mr Chang suggests that it must identify areas where it is able to sustain its edge in a more competitive world. Healthcare, green industries and consulting on urban design and management might be possible bets for the longer term. Ramping up some of these industries might require industrial policy.

But Singapore can also do more to enhance the productive capacity of its citizens, says Mr Chang. The way to do this is through more activist social policies, notably stronger social safety nets, including unemployment insurance as well as health and education subsidies.

Here too, he goes against the grain of a lot of conventional thinking. Like industrial policy, some social policies also have a bad name. They are considered expensive and wasteful, and if wrongly designed, they can also erode incentives to work. However, Mr Chang highlighted their plus side. By making people feel more economically secure, social policies can encourage more risk taking and help create an entrepreneurial culture. He drew the analogy of a car. If you have a car with weak brakes, you would drive only very slowly, if at all. But if you have a car with good brakes, airbags and side impact bars - in other words, if you felt secure - you would be prepared to drive faster. It's little wonder, he says, that Scandinavian countries, such as Sweden and Finland (which provide generous social safety nets for their citizens), have grown faster than the United States over the last half century, and have fewer social problems. Therefore social safety nets are not just about helping unfortunate people, he says. They are also about

making people more productive. Indeed, the lack of social safety nets can actually be a hindrance to economic development.

However, as with industrial policy, there are good social policies and bad ones. Badly designed policies can be expensive, as is starkly evident in some European countries such as Greece, where excessive pensions and other social benefits have indeed eroded work incentives, and contributed to a sovereign debt crisis.

But it is possible to design social policies prudently, for example in the case of unemployment benefits, by building in incentives for job search, making schemes self-funded (through workers being required to set aside a portion of salaries as unemployment insurance during their working years - as they do for medisave) and using state provided insurance schemes, including targeted subsidies for certain groups.

Mr Chang may at times have overstated his case, to drive home the point. However, in advocating more policy activism, especially on the social side, he has a good point to drive home.