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Big push or big failure? On the effectiveness of industrialization policies for economic development ☆

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Bjorvatn, Kjetil, and Coniglio, Nicola Daniele—Big push or big failure? On the effectiveness of industrialization policies for economic development

The role of the government in industrialization is heavily debated. Some claim that extensive government involvement is key to initiate a sustainable development process, others see the government as an obstacle to it, pointing to the importance of government failure. We formulate a model, which explains why even a highly inefficient industrial policy can successfully promote big-push development. Moreover, we show that extensive government intervention is more likely to be successful when the initial level of development is low. *J. Japanese Int. Economies* **26** (1) (2012) 129–141. NHH Norwegian School of Economics, Helleveien 30, 5045 Bergen, Norway; University of Bari, Piazza Umberto I, 1-70121 Bari, Italy.

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1. Introduction

What role should the government play in the process of industrialization? Active state intervention appears to have been an important ingredient in the development of many of today's rich countries, including the Western European economies, Japan, as well as the first generation of the East Asian Tiger economies. Rodrik (1995) argues that a large component of the "economic miracles" of Taiwan and Singapore should be ascribed to the active role of the governments in implementing big-push

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policies aimed at removing coordination failures in investment.[1] Cassen and Lall, 1996, in a critical comment of the East Asian Miracles study by the World Bank, argue that selective industrialization policies, and not just export promotion, were key to the rapid economic growth experienced in the region in the 1970s and 1980s, and moreover that there are important lessons to be learned for other countries from this experience. Similarly, Kohli (2004) analyzes the growth experience of Korea, Brazil, India and Nigeria. He emphasises the key role that State intervention has played in promoting industrialization in the least developed countries (LDCs) by supporting the profitability of private investments in early phases of economic development. However, it is fair to say that the focus amongst economists and donors in recent decades has shifted from the importance of market failure to that of "government failure" . Indeed, the World Bank and the IMF have emphasized the need for privatization and deregulation as conditions for their continued support of developing countries.[2] Consequently, we have witnessed a trend of overall reduction in the relative (and often absolute) weight of the State in the economies of many developing countries. For instance, the share of public investment over total GDP fell in developing countries from approximately 10% in the early 1980s to 5% in 2000 (Chang, 2007).

Several observers have raised concerns about the potentially negative effects of reduced State intervention on economic growth in developing countries. For instance, Stiglitz (2002, p. 55) argues that the IMF simply assumed that markets arise quickly to meet every need, when in fact, many government activities arise because markets have failed to provide essential services. Similarly, Stein (1992, p. 83) claims that the World Bank/IMF model is likely to de-industrialize the existing manufacturing base without encouraging any significant replacement. Clearly, the presence of government failure is not by itself a justification for reduced government intervention.

A quick look at the data lends support to these concerns. Fig. 1 illustrates the change in government intervention from the 1980s to the 1990s (where a positive value means *less* intervention) and the average GDP per capita growth rate in these two decades for 81 developing countries.[3]

Evidently, a reduction in the role of government (i.e., a positive change in the Intervention Index in the period) is negatively associated with economic performance (the slope of the curve is -0.21 and statistically significant at 10% level, p-value = 0.06.). A closer inspection of the data shows that the negative correlation is driven mainly by developments in the 1990s.

Although this quick look at the data provides no conclusive evidence about the (causal) relationship between government intervention and economic growth, the simple correlation at least suggests that developing countries that liberalized their industrial policies did not necessarily experience more rapid economic growth. Fig. 1 is thus broadly consistent with concerns raised by Stiglitz (2002) on the risks of removing government intervention in order to let the markets do the job more efficiently. The data presented above are also consistent with more in depth empirical research on today's developing countries and on the long-term development of today's developed countries. For instance, Atukeren (2005) finds that the likelihood that public investments (including those carried out through state-owned enterprises) crowd out private investment is lower in relatively less stable and less developed economies. Evidence of a non-linear effects of government intervention on growth also emerges from the study by Grossman (1988), who studies the development of the US economy in the period 1929–1982. The author finds that the effect of government spending on growth is initially positive but that "the positive contributions of an increasing size of government are virtually offset by the inefficiencies created by the provision process" (Grossman, 1988, p. 199).[4]

[1] See also Wade and Robert (1990) and Greenwald and Stiglitz (2006). For a critical survey, see Pack and Saggi (2006).

[2] For a critical assessment of the so-called "Washington consensus" policies in developing countries, see Gore (2000) and Rodrik (2006).

[3] As measure of government intervention we consider the Index of Government Enterprises and Investment (which we shall simply refer to as the Intervention Index) from the Economic Freedom Index developed by Gwartney and Lawson (2009). The Intervention index ranks countries from zero ("The economy is dominated by SOEs and government investment exceeds 50% of total investment") to 10 ("Only few SOEs operate and government investment is generally less than 15% of total investment"). See the Appendix A for a further description of the Intervention Index and Appendix B for the intervention and growth data for the countries in our sample.

[4] For a survey of the relationship between the size of the government, and specific areas of government intervention, such as education and infrastructure, and long-run economic performance, see Poot (2000).

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