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Latin America's challenge: A fresh look at industrial policy

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El reto latinoamericano: una visión fresca de la política industrial

When John Price and I wrote *Can Latin America Compete?* several years ago, we were unflinching in our criticism of the region for failing to undertake sweeping microeconomic and institutional changes, such as improved access to capital, investment in infrastructure, and regulatory reform. We urged the region to undertake at the minimum incremental reforms across nearly a dozen areas (including public safety, judicial reform, and education) to boost its competitiveness, less it continue to lose out to emerging markets in Asia.

Since then, Latin America has, indeed, introduced measures to improve competitiveness; and these changes should be applauded. However, unfortunately, other regions —particularly Asia, Central Europe and Sub-Saharan Africa— have reformed at a faster rate. In addition, even within Latin America the gap has widened between countries and within cities and sub-regions *within* individual countries. Most notable are the "Asia-facing" nations of Peru, Colombia, Chile, and Mexico versus the "Atlantic-facing" nations of Argentina, Brazil, and Venezuela. One need only read the just-released World Bank *Doing Business 2015* report. The first four countries rank among the top 50 out of 189 nations whereas Argentina (124), Brazil (120) and Venezuela (182) fair miserably.

As all nations in the Hemisphere strive to boost their competitiveness, there is one thing that they would agree upon —regardless of their political and economic orientations—. Namely, that the government's role —mainly via "industrial policy"— is indispensable to compete in regional and global markets. Prior to and even after the failed experiment with the import substitution industrialization model that became so prominent in Latin America from after World War II through the early 1980s, many governments, politicians, economists, large domestic business, unions, and the public at large believed that government could pick winners to propel their economies forward. They bolstered their (mistaken) belief by citing the examples of Brazil's Embraer (while neglecting to mention that nation's disastrous policies to create a home grown computer industry) and Japan's successful electronics industry (but failure to mention the ill-fated effort to foster a semiconductor industry).

Regardless of where one comes down on the issue of industrial policy for Latin America, the role of government has been and always will be prominent. The question then becomes: What kind of industrial policy for Latin America? Fortunately, economists at the Inter-American Development Bank answer that question resoundingly and convincingly in a monumental study that will influence the economic and policymaking discussions on industrial policy for years to come. What they offer is a diagnosis and blueprint on how to get industrial policy right —with a major focus on increasing the low levels of productivity—. Entitled *Rethinking Productive Development* (they shun the term "industrial policy", due to its negative connation in many quarters) and posit that the key question to ask is not "whether" to adopt these policies but "which" and "how".

In doing so, the IDB proposes three questions as a starting point: (1) what is the diagnosed market failure that justifies government intervention/assistance?, (2) is the policy remedy at good match for the diagnosis?, and (3) what types of institutions with what characteristics are necessary to develop the policy with success?

Productive development policies (PDP) can operate along two dimensions. One dimension consists of specific sectors (vertical policies) or broad based ones (horizontal) not focused on any specific industry. An example of the first would be phytosanitary control; an example of the second would be tax exemptions for the automobile sector. The second dimension relates to the type of intervention. This may be public inputs to improve the business environment; such has upgrading infrastructure, or market interventions such as R&D subsidies or tax reductions.

There is no magic bullet, no quick panacea for Latin America's endemic problem of competitiveness. But by addressing barriers to low productivity, broadening and deepening microeconomic and institutional reform, and embarking upon productive development policies as proposed by the Inter-American Development Bank, the region can achieve significant progress in improving the environment for doing business in the Americas.

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