Comment on "Industrial Policy and Development: A Political Economy Perspective," by James A. Robinson

BERT HOFMAN

Professor Robinson has written an eloquent, insightful, relevant, and somewhat provocative paper. The paper draws on his rich historical and institutional knowledge and is in many ways an application of the analysis of his seminal paper "The Colonial Origins of Economic Development" (Acemoglu, Johnson, and Robinson 2001) and his more recent paper "Persistence of Power, Elites, and Institutions" (Acemoglu and Robinson 2008). The paper's core thesis is that the outcome of industrial policies in the end depends on the political equilibrium in which these policies are applied and that this political equilibrium explains why those policies work well in some countries, including some East Asian countries, and not in others, including some African and Latin American countries. The implication for policy advisers such as myself, the paper argues, is that analyzing and understanding the political economy of a country are as important as, if not more important than, the technical-economic design of industrial policies themselves.

The core insight of the paper is a major step in the direction of a positive theory of industrial policy, one that is very welcome. Rather than arguing that (a) government failures, erroneous economic theories, or rent seeking undermine industrial policies or, in contrast, that (b) industrial policies can work in the presence of a number of technical success factors such as openness and a competent bureaucracy, the paper proposes that the underlying power structure is the true determinant of the outcome of industrial policies. This power structure, Robinson argues, is the outcome of long historical processes, often dating back to colonial times. It can change, of course, through shocks such as wars, revolutions, and technology, and the paper presents examples of such shocks, which can in the end lead to a new equilibrium that is conducive to good outcomes of industrial policies. But dramatic shocks and revolutions

Bert Hofman is World Bank country director for the Philippines.

Annual World Bank Conference on Development Economics 2010, Global

aside, the policy adviser is usually confronted with an environment in which power elites are well established and the outcome of any policy is predetermined to be in the interests of those power elites. These interests often diverge from the "common good" of the greatest advantage for the largest number of people. While entirely plausible, the core thesis is hard to prove or disprove empirically. Professor Robinson does provide several examples of industrial policies gone right and wrong. But because the "interests of the power structure" are not directly measurable, the thesis becomes almost tautological: "The outcome of industrial policies was the way it was because the underlying power structure determined it to be the way it has turned out to be."

Fortunately, there are also examples of industrial policies that are clearly in the interests of the power elite and at the same time also provide benefits to the general public. The dual-track reforms in China may well be an example of that. Reforming the Chinese economic system at the margin—leaving the planned system in place, while allowing the market to work with above-plan output—was not only an astute political compromise between reformers and old-fashioned communists, but also appropriate economic policies for the broader masses. For that matter, even the "crony capitalism" under Suharto's Indonesia, which clearly benefited a select group of entrepreneurs in a disproportionate way, also lifted more than half of the population out of poverty in the course of 30 years. So Robinson's conclusion that all successful industrial policies serve the power elite need not be as dismal as it first sounds. Indeed, good outcomes, he argues, can still be achieved in an environment of selfish power elites, but again, this makes Robinson's theory rather Panglossian: "Every outcome of industrial policy is the best possible outcome imaginable given the underlying political equilibrium."

Robinson raises some important questions on the role of the policy adviser, including the role of the World Bank. He recommends that the economic policy adviser should pay attention to political economy factors and the specific political equilibrium that will determine the outcome of the policy actions he recommends. Being a policy adviser myself, I am slightly bemused by the recommendation because this is indeed what we do on a daily basis, even though considerations of political economy may not always be prominent in official reports for obvious reasons. The fact of the matter is, however, that such analysis is hard to do, and the consequences of policy recommendations—in other words, the trajectory from one equilibrium to the next—are rarely obvious, even if one tries to analyze the actions from a political economy perspective.

And indeed, the equilibrium is not static. Take China again: even if more standard market-based reforms would have been economically beneficial in 1978, they were simply not politically feasible, and the World Bank, which started to engage with China in 1980, was well aware of this. But by the early 1990s, after 15 years of reforms and the creation from scratch of something that might be called an entrepreneurial class, much more was possible, and the Bank (and others) felt much more confident in recommending the type of market-based reforms that were approved in 1993. Or take Indonesia, where industrial policies that by and large drew on the comparative advantage of the country worked well in the first two decades of Suharto's reign, but became increasingly captured by connected insiders and in the end contributed to the severe economic crisis (and the fall of the Suharto government). Hard as it is to determine the political equilibrium so as to offer the right policy advice, it becomes even harder as this political equilibrium is dynamic and sometimes changes under the influence of the very economic reforms recommended in the past.

Nevertheless, I believe that more insights into the political economy and dynamics of the countries we work in are indeed most welcome, and, as mentioned, Professor Robinson's paper makes a valuable contribution toward those better insights. In the meantime, though, we have to do with our amateurish insights and, indeed, trial and error, because the political power structure often only reveals itself in the outcome of policies advised, and the results, as Professor Robinson and others show elsewhere, are often unintended or unexpected.

Finally, Professor Robinson seems to put little value on ideas and economic theory themselves as determinants of the outcomes of industrial policy. In fact, he hardly bothers to define those policies, saying "all policies that influence industry." This is somewhat surprising, as those ideas have evolved dramatically over the last five decades. In the 1950s it was a respected view that the state should take "control over the commanding heights of the economy," and import substitution—so maligned afterward—was considered a viable development strategy. By the 1980s, under the influence of new academic ideas as well as disappointing outcomes of the earlier strategies, and I may add Professor Anne Krueger's seminal contributions (Krueger 1974) and intellectual legacy at the World Bank, structural adjustment and "getting the prices right" were the new paradigm, preached and practiced in many diverse political environments. Of course, Robinson's point is that this was wrong, as both strands of policy recommendations neglected the political equilibrium. Maybe so, but the technical design of the policies themselves still has a role to play. Even with a conducive political environment, a policy adviser can advise the wrong thing and get the recommendations accepted. Indeed, even the success stories in East Asia show numerous examples of wrong turns and dead ends in the pursuit of industrial development. The difference with the unsuccessful examples is perhaps that they did not persist in doing the wrong thing and instead dropped unpromising ideas and switched to better ones. Thus my conclusion is that there is more than political economy to the art of industrial policy making.

References

Acemoglu, Daron, Simon Johnson, and James A. Robinson. 2001. "The Colonial Origins of Comparative Development: An Empirical Investigation." *American Economic Review* 91 (5): 1369–401.

Acemoglu, Daron, and James Robinson. 2008. "Persistence of Power, Elites, and Institutions." *American Economic Review* 98 (1): 267–93.

Krueger, Anne. 1974. "The Political Economy of the Rent Seeking Society." *American Economic Review* 64 (3): 291–303.