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Catch-up in industrialisation

Deepak Nayyar

It was the visible hand of the state rather than the invisible hand of the market that helped the developing world catch up with the industrialised countries

The emerging significance of developing countries, which gathered momentum after 1980, is beginning to shift the balance of power in the world economy. It could lead to a profound transformation in the next 25 years. This unfolding reality must be situated in the historical perspective of de-industrialisation and industrialisation in the developing world over the past two centuries.

In the mid-18th century, similarities between Europe and Asia were far more significant than the differences. Indeed, demography, technology and institutions were broadly comparable. And, in 1750, Asia, Africa and Latin America accounted for almost three-fourths of manufacturing production in the world economy. Much of it was located in Asia with a concentration in China and India.

Profound influence

The Industrial Revolution in Britain during the late 18th century, which spread to Europe over the next 50 years, exercised a profound influence on the shape of things to come. Yet, in 1820, less than 200 years ago, Asia, Africa and Latin America still accounted for almost two-thirds of the world's manufacturing production. China and India were the manufacturing hubs that contributed 50 per cent of world industrial production even in 1820.

The revolutionary changes in the methods of manufacturing unleashed by the Industrial Revolution transformed economic life, as industrialisation spread to Europe yielding sharp increases in productivity, output and incomes. It also led to the demise of traditional industries in Asia, particularly in China and India, reducing their skill levels and technological capabilities over time.

Between 1830 and 1913, the share of Asia, Africa and Latin America in world manufacturing production, attributable mostly to Asia, in particular China and India, collapsed from 60 per cent to 7.5 per cent, while the share of Europe, North America and Japan rose from 40 per cent to 92.5 per cent, to stay at these levels until 1950. The industrialisation of Western Europe and the de-industrialisation of Asia during the 19th century were two sides of the same coin.

It led to the Great Specialization, which meant Western Europe, followed by the United States, produced manufactured goods while Asia, Africa and Latin America produced primary commodities. This created and embedded a division of labour between countries that was unequal in its consequences for development. The process was reinforced by the politics of imperialism that imposed free trade, and the economics of the transport revolution which dismantled the natural protection provided by geography implicit in distance and time, to hasten the process of de-industrialisation in Asia with a devastating impact on China and India.

For developing countries of the world economy, 1950 was perhaps an important turning point. It was the beginning of the post-colonial era as newly independent countries, to begin with in Asia and somewhat later in Africa, sought to catch up in terms of industrialisation and development.

In retrospect, it is clear that there was a significant catch-up in industrialisation for the developing world as a whole, beginning around 1950 that gathered momentum in the early-1970s. Structural changes in the composition of output and employment, which led to a decline in the share of agriculture with an increase in the shares of industry and services, were an important factor underlying this process.

There was a dramatic transformation in just four decades from 1970 to 2010. The share of developing countries in world manufacturing value-added jumped from 13 per cent to 41 per cent in current prices. In 2010, it was close to the level that existed around 1850. Similarly, their share in world exports of manufactures rose from 7 per cent in 1970 to 40 per cent in 2010. Industrialisation also led to pronounced changes in the composition of their trade as the share of primary commodities and resource-based products fell while the share of manufactures (particularly medium-technology and high-technology goods) rose in both exports and imports.

The observed outcome in terms of industrial production was attributable, in important part, to development strategies and economic policies in the post-colonial era that created the initial conditions and laid the essential foundation in countries which were latecomers to industrialisation. The import substitution-led strategies of industrialisation, much maligned by orthodoxy that was concerned with comparative statics rather than economic dynamics, performed a critical role in this process of catch-up.

Of course, a complete explanation would be far more complex as it would need to recognise specificities and nuances. All the same, it is clear that the role of the state in evolving policies, developing institutions and making strategic interventions, whether as a catalyst or leader, was also central to the process. Indeed, even among the small East Asian countries — success stories that orthodoxy portrayed as role models of markets and openness — development was more about the visible hand of the state rather than the invisible hand of the market, particularly in South Korea and Taiwan but perhaps even in Singapore.

Thus, industrialisation was not so much about getting-prices-right as it was about getting-state-intervention-right. Indeed, it is plausible to suggest that, for a time it might even have been about getting-prices-wrong. It may be argued that state intervention in the form of industrial policy should recognise and exploit potential comparative advantage, but it is just as plausible to argue that instead of climbing the ladder step by step it could be rewarding to jump some steps in defiance of what comparative advantage might be at the time. In either case, state intervention is critical.

Apart from an extensive role for governments, the use of borrowed technologies, an intense process of learning, the creation of managerial capabilities in individuals and technological capabilities in firms, and the nurturing of entrepreneurs and firms in different types of enterprises were important factors underlying the catch-up in industrialisation. The creation of initial conditions was followed by a period of learning to industrialise so that outcomes in industrialisation surfaced with a time lag. This accounts for the acceleration in growth of manufacturing output that became visible in the early 1970s.

Clearly, it was not the magic of markets that produced the sudden spurt in industrialisation. It came from the foundations that were laid in the preceding quarter century. In this context, it is important to note that much the same can be said about the now industrialised countries, where industrial protection and state intervention were just as important at earlier stages of their development when they were latecomers to industrialisation.

Uneven

However, this industrialisation was most uneven between regions. Asia led the process in terms of structural change, share in industrial production, rising manufactured exports and changing patterns of trade, while Latin America witnessed relatively little change and Africa made almost no progress.

The catch-up in industrialisation was uneven not only among regions but also between countries within regions. There was a high degree of concentration among a few: Argentina, Brazil, Chile and Mexico in Latin America; China, India, Indonesia, Malaysia, South Korea, Taiwan, Thailand and Turkey in Asia; and Egypt and South Africa in Africa. These countries could be described as the 'Next-14'. The emerging significance of China in the Next-14 is particularly striking.

Of course, there is enormous diversity within the few, reflected in their size, their engagement with the world economy, and industrialisation. Yet, it is possible to group them into clusters based on similarities in terms of geography, size, economic characteristics and development models. These clusters suggest such a wide range of attributes that most developing countries would have something in common with at least one if not a few of them. The Next-14 had even more in common across clusters. Initial conditions, enabling institutions and supportive governments were the factors that put them on the path to industrialisation. Hence, their experience carries valuable lessons for other countries that follow in their footsteps as latecomers to industrialisation.

(*The author is Emeritus Professor of Economics at Jawaharlal Nehru University and former Vice-Chancellor of the University of Delhi. His latest book,* Catch Up: Developing Countries in the World Economy*, has just been published by Oxford University Press, Oxford.*)

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