

Chapter 19

Growth Identification and Facilitation Framework: A pragmatic Approach for Promoting Economic Structural Transformation

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New Structural Economics (NSE) is a framework proposed by Professor Justin Yifu Lin—the former, and first developing country, Chief Economist at the World Bank—for rethinking development.² NSE proposes that developing countries focus on ‘*what they can potentially do well*’ (latent comparative advantages) based on ‘*what they have*’ (current factor endowments). This stands in sharp contrast with mainstream development thinking, which is preoccupied with using developed countries as a benchmark for identifying ‘*what a developing country lacks*’ and prescribing how developing countries should emulate developed countries regardless of their initial conditions.

Turning latent comparative advantages into competitive advantages entails policy-makers proactively deploying effective industrial policies in collaboration with the private sector to overcome first mover and coordination problems during the process of industrial upgrading. While the popular perception that most industrial policies fail miserably has tempted us into saying ‘no’ to all kinds of such policies, a more constructive approach is to delve deeper into comparative studies of both successes and failures in an effort to make prudent recommendations on how to make industrial policy work better in practice.³ In short, NSE aims to bring new insights into

development policy-making by helping policy-makers in developing countries unleash their potential with regard to industrial upgrading and economic structural transformation.

NSE aims to generate a better understanding of the complexities and nuances of industrial policy-making in an effort to make it work better. From the perspective of NSE, the effective implementation of industrial policy entails three essential elements. First, governments need to work together with the private sector to target industries compatible with the country’s latent comparative advantages. Second, governments need to identify sector-specific binding constraints in a dynamic manner whose solution may go beyond the capacity of private firms themselves. Third, governments can play a facilitating role in mitigating the binding constraints and turning the latent comparative advantages into competitive advantages in the global economy (Lin, 2014).

To make the above insights implementable, NSE has proposed a practical policy tool—the Growth Identification and Facilitation Framework (GIFF)—to help policy-makers in catching-up developing countries to develop feasible and sharply focused policies in an effort to identify and unlock their latent comparative advantages to achieve structural transformation

(Lin and Monga, 2011). At the heart of the GIFF is the principle that developing countries should not focus on *what they do not have* but rather on *what they do have* in an effort to unleash their latent comparative advantages. The GIFF offers practical development paths to enable developing countries to follow their comparative advantage in their industrial development and to tap into the potential of advantages of 'backwardness' in industrial upgrading in an effort to achieve sustained, dynamic growth.

The application of the baseline GIFF entails six steps (Lin, 2012b):

Step 1: Choosing the right target.

Governments in developing countries can identify the list of tradable goods and services that have been produced for about 20 years in dynamically growing countries (so-called benchmark countries) with similar endowment structures and a per capita income that is about 100 to 300 per cent higher than their own (or that had a similar per capita income about 20 years ago).

Step 2: Removing binding constraints.

Governments may give priority to those domestic private firms that have already entered spontaneously, and try to identify constraints to quality upgrading or further firm entry. Take action to remove these constraints.

Step 3: Attracting global investors. In industries where no domestic firms are currently present, or only a few domestic firms are doing exports, seek foreign direct investment (FDI) from countries examined in Step 1, or organise new firm incubation programmes.

Step 4: Scaling-up self-discoveries. Given that every country may have unique endowments, which may produce goods

valuable for the market, and some new technologies/industries that may not have existed 20 years ago, in addition to the industries identified in Step 1 governments should pay attention to spontaneous self-discovery by private enterprises and give support to scale up successful private innovations in new industries.

Step 5: Recognising the power of industrial parks. In countries with poor infrastructure and bad business environments, special economic zones (SEZs) or industrial parks may be used to overcome barriers to firm entry, attract FDI and encourage industrial clusters.

Step 6: Providing limited incentives to the right industries. Governments may compensate pioneer firms identified above with tax incentives for a limited period; direct credits for investments; and access to foreign exchange.

While the six-step method is useful in that it offers a ready-made practical guide accessible to policy-makers, applying the GIFF is by no means a mechanical process. The above baseline GIFF has been applied to a series of country studies based primarily on desk research. The GIFF was first applied to the case of Nigeria by Justin Yifu Lin and Volker Treichel (Lin, 2012a). Later, the application of the GIFF was extended to small island economies (Lin and Dinh, 2014). The UN Industrial Development Organization (UNIDO) has proactively applied the GIFF to the case of Senegal (UNIDO, 2016). The pilot effort to apply the GIFF to least developed countries occurred in Uganda (Lin and Xu, 2016) and later was extended to Nepal (Xu and Hager, 2017). It is worth noting that these case studies are first-cut efforts, mainly serving an illustrative purpose. It is not intended that they will be used to demonstrate that the GIFF analysis has to stick to certain static methods

or indicators such as revealed comparative advantage and the ranking of export products.

Rather, GIFF analysis entails a *multi-stakeholder, interactive* and *pragmatic* approach to identifying latent comparative advantages and exploring feasible policy levers to mitigate binding constraints. It involves multiple stakeholders, including policy-makers, entrepreneurs, foreign investors, international buyers, zone developers, financial institutions, researchers and international development institutions. It is an interactive process: the GIFF shuns a top-down approach driven by bureaucrats or experts; rather, effective diagnosis and solution requires dynamic interactions of self-discovery among the public and private sectors as well as international and local actors. It is a pragmatic approach because it rejects a one-size-fits-all blueprint and embraces a tailored trial-and-error exploration of learning and experimentation. In short, the GIFF does not stick to any specific method, but rather represents a set of adaptive tools for identifying latent comparative advantages or binding constraints.

To refine and enrich the GIFF, the Center for New Structural Economics (CNSE) at Peking University, of which Professor Justin Yifu Lin is the Director, has been undertaking policy-focused and action-oriented projects in African countries such as Benin, Djibouti and Nigeria. Based on solid first-hand data collection and stakeholder engagement, we help governments analyse their factor endowments (*'what the country has'*) and their latent comparative advantages (*'what the country can potentially do well'*) and propose how the government can use Special Economic Zones (SEZs) to mitigate binding constraints on the path to economic transformation. These pilot projects can help distil success factors and sober lessons for refining the GIFF in a dynamic learning process.

Awareness that the GIFF analysis is a multi-stakeholder, interactive and pragmatic

approach can help dispel some uninformed critiques or misunderstandings.

First, one critique of GIFF is that neither policy-makers nor researchers are able to 'pick the winners'. In other words, it is dangerous to choose the target industry by simply taking a mechanical step to select benchmark countries and benchmark sectors through the use of international trade data. This critique fails to understand that the first step of GIFF—choosing the right target—does not aim to *precisely* pin down viable sectors with latent comparative advantages in catching-up countries, but rather to identify potential 'flying geese' from more advanced economies and then make an *initial* assessment as to whether these flying geese can be viable in the catching-up countries.

Historical waves of industrial transfers have revealed a rule-of-thumb pattern that the gross domestic product per capita of benchmark countries is about 100 to 300 per cent higher than that of catching-up ones. This ratio is not something that is set in stone; rather, it serves as a safeguard against too ambitious goal-setting, which often results in the targeting off too advanced industries in too mature industrialised economies that defy the latent comparative advantages of the catching-up countries.

After identifying the potential flying geese, it is important to take a step further to examine *when* and *where* these manufacturers decide to relocate their production line. Analysis this of cannot simply rely on the numeric trade data alone; in-depth case studies are needed to uncover the firm-level decision-making process in an effort to obtain a better understanding of the kinds of firms that are more likely to go abroad and where they are likely to go. Special attention needs to be paid to the following aspects:

1. How will the automation mitigate the pressure of rising labour costs, hence postponing the relocation decision by labour-intensive light manufacturing firms?

2. How does the cluster-based economic geography in the benchmark countries exacerbate the coordination problem among small and medium-sized enterprises along the supply chain, compared with the vertically integrated firms?
3. How does the relocation decision by processing trade firms where global buyers often control the sales market differ from that by ordinary trade firms?

After identifying the potential flying geese and their likely destinations, the next step is to make an initial judgment on whether these products are in line with latent comparative advantages in the catching-up economies. Such preliminary assessment often involves a process of negation—that is, deleting those sectors that are unlikely to be *viable* in destination countries. First, labour and capital are two important factor costs, which can help in detecting sectors without latent comparative advantages. Sectors with latent comparative advantages are those with relatively lower factor costs but that suffer from high transaction costs as a result of poor hard and soft infrastructure. For instance, a labour-intensive garment firm will not be viable in a country with prohibitive labour costs.

Second, apart from labour and capital, it is essential also to take into account more tailored sector-specific factor endowments. For example, some fashionable products are very time-sensitive, requiring timely and reliable transportation. A landlocked poor country without transportation routes in place may encounter a hard binding constraint on firm entry and scaling-up, at least in the short run. More often than not, the private sector has the best knowledge about the sector-specific factor endowments. As such, it is desirable to bring the potential flying geese—that is, possible foreign investors—to conduct the in-depth feasibility study in the destination country. This can help generate a more thorough

understanding of the pull and push factors regarding investing in a particular product in a specific geographical location.

A second critique of the GIFF is that it appears to ignore the growing trend of global value chains (GVCs) in international trade. This critique is based on the impression that the pilot country studies, based primarily on desk research, rely mainly on the UNComtrade database to come up with a list of tradable goods and services that have been produced for about 20 years in the benchmark countries. These data fail to capture the growing trend of GVCs, which means the trade structure is often misrepresented. The CNSE has well noted this limitation. To complement the UNComtrade data (i.e. sectors at the 4 or 6 digit code), the CNSE has drawn on databases on trade in value added in order to obtain a better understanding of a country's participation in GVCs. More importantly, the CNSE team has further conducted firm-level surveys to delve deeper into binding constraints along the value chain at the product level. This bottom-up approach complements numeric analysis on revealed comparative advantages based on trade databases.

Last but not least, another critique of GIFF is that it is too optimistic about the power of SEZs. The rationale for focusing on SEZs is that developing countries often suffer from poor overall soft and hard infrastructure. For example, administration is often riddled with inefficiency and corruption and transportation is in a poor state. Given poor initial conditions, it is difficult, if not impossible, to bring the overall nationwide environment to an acceptable level within a relatively short period of time. To break the vicious cycle, it is important to achieve a breakthrough in a demarcated area, given the limited resources at hand. Building on initial success, the pilot SEZs can play a catalytic role in stimulating economic reforms nationwide later on. Indeed, SEZs provide an opportunity for significant

small-scale trials that can enable a process of learning and experimentation among key stakeholders, including government, enterprises, zone developers and foreign investors.

Despite the huge potential of SEZs in terms of achieving quick wins and wider economic reforms, the GIFF does not suggest they represent a silver bullet. Rather, it accepts that not all SEZs deliver on their promise. The success of SEZs depends largely on how they are designed, run and managed. That is why the CNSE team has made persistent efforts to study the successes and failures of SEZs in order to obtain a better understanding of what works and why.

Following a multi-stakeholder, interactive and pragmatic process, the GIFF is a pragmatic tool for turning a trilemma (lack of manufacturing capability, confidence of international buyers and the necessary infrastructure and business environment) into a triple-win collaboration to facilitate the new wave of industrial transfer. It is hard to appreciate the value of the GIFF without putting it into the global perspective of industrial transfer in an era of globalisation. An integral part of Kaname Akamatsu's 'flying geese' model of Asian economic integration is the phenomenon whereby a region as a whole becomes more economically developed through a cascading process in which a more advanced country (the 'lead goose') transfers capital, technology and management skills to a less developed country (a 'follower goose') and so facilitates its economic structural transformation (Kojima, 2000). As wages have been increasing rapidly in China as average incomes rise, the pending relocation of Chinese light manufacturing presents a historical window of opportunity for catching-up countries to break into GVCs. China has 85 million jobs in light manufacturing; its upgrading to higher industries will leave a huge space for many low-income developing countries to enter a labour-intensive

industrialisation development phase (Lin, 2012c).

Despite the tremendous opportunities for large-scale industrial transfer, however, the catching-up developing countries, African countries in particular, face basic challenges such as the so-called trilemma alluded to above. To overcome these challenges, developing country governments can take a proactive approach centring around SEZs/industrial parks, given the overall poor business environment. The strategy is to attract existing export-oriented light manufacturing firms that have the technological and managerial knowhow and the confidence of international buyers to relocate their production to SEZs/industrial parks in Africa. The aim is to create quick wins that produce a snowball effect, attracting FDI and domestic investment into these zones and parks and others that are inspired by them. Such success stories serve as inspiration and experience for other developing countries to kick-start their own sustainable and inclusive industrialisation.

In a nutshell, the GIFF is an instrument for taking a *multi-stakeholder, interactive and pragmatic* approach to identifying latent comparative advantages and exploring feasible policy levers to mitigate binding constraints in an effort to help developing countries achieve economic structural transformation. Applying the GIFF involves a process of constant refinements, as it aims to tackle practical development challenges on the ground that defy any universal standardised formula. A GIFF study is not an ordinary research report that will go to the shelf. Rather, conducting such a GIFF study entails creating an integrated platform for engaging in a journey of co-discovery of latent comparative advantages and binding constraints as well as co-generation of tailored and feasible policy recommendations. The shared goal is to unleash the potential

for economic structural transformation among key stakeholders, including policy-makers, entrepreneurs, international buyers, international organisations and researchers in the catching-up developing countries and abroad.

Notes

- 1 Dr Jiajun Xu is Assistant Professor in International Development and Executive Deputy Director at the Center for New Structural Economics at Peking University. Dr Xu holds the copyright of the present briefing paper. Email: jiajunxu@nsd.pku.edu.cn
- 2 NSE proposes using a neoclassical economic approach to study the determinants of economic structure, including technology, industry, finance, infrastructure and institutions, and their evolution in the process of economic development. The starting point of analysis is an economy's endowments and its structure, which are given at any specific time and changeable over time. From the perspective of NSE, the best way to achieve dynamic, inclusive and sustainable growth in a country is for the country to develop its industry according to the comparative advantage determined by its endowments in a market economy with a facilitating state. As the third wave of development thinking, NSE aims to advance theoretical innovations in economics discipline by systematically analysing structural differences between advanced economies and developing economies (Lin, 2012a).
- 3 Most industrial policies in the past have failed because they have involved supporting industries that were against the latent comparative advantages and thus were not going to be viable in the setting in which they were promoted.

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