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Competing through Innovation and Learning

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Foreword

THE CURRENT PREDICAMENT OF MOST DEVELOPING COUNTRIES AND the state of the global economy deflate the optimism in the United Nations Millennium Declaration and the Millennium Development Goals. The problem is not just the apparent wedge between targets and trends. It is the more fundamental differences in what to expect of the future and how to get there.

Take equity and efficiency. Proponents of each see themselves as offering the best possible way to maximize both social fairness and economic progress in the long run. But even a partial marriage of the two (often) polar views is not yet in sight, despite the development community's sorely felt need.

Productivity growth, equity, poverty eradication and security can all reinforce one another. But for that to happen requires attentiveness to the widespread access to wealth-creating assets, especially through education, the basis for acquiring skills and grasping opportunities. Countries need to pass thresholds on the route to becoming productivity-driven economies. They also need to put in place strategies and policies to sustain productivity gains over time. UNIDO's research agenda centres on these efforts—to advance today's development agenda.

With more ability to create wealth, people and countries can achieve sustainable livelihoods, begin to attack poverty and have the rule of law take hold. But this requires a massive mobilization of skills and capabilities, while fostering greater equity. In turn, an economic and social system that offers the right public goods and that rewards the opportunities for equitable and efficient growth is the best guarantee for the rule of law and security for all.

Poor countries stay poor when low productivity leaves poverty and inequity untouched, slowing growth and hobbling the innovative forces of society. The challenge for policymakers is to move to a virtuous circle where productivity gains reduce poverty and enhance social equity—which can then feed economic growth.

A strand of contemporary thought on development holds that reducing poverty and promoting equity need not compromise growth. UNIDO strongly subscribes to this view. Indeed, UNIDO views social progress as an essential part of sustained growth. To break the negative links between equity and efficiency, direct policy action is needed to enhance the complementarities among equity, productivity and growth.

Recent cases of countries catching up strongly suggest that improvements in equity and reductions in absolute poverty do much for attaining sustainable productivity increases and for sharply narrowing the income gap with the advanced economies. That productivity growth has the salutary effect of also favouring further improvements in social equity.

The ingredients of growth with equity

Development thought now stresses innovation, technological change and other intangibles at least as much as capital accumulation. Trickle-down effects through cross-border capital and technology flows have benefited only a handful of developing countries. Why? Because those are the only countries that paid attention to increasing productivity and creating a good climate for investment. Too many other countries are still missing the domestic links between productivity growth, equity and poverty. And they are not taking advantage of increasing returns and agglomeration economies. Their real problems: weak commitments to development and poor implementation of policy reforms.

So, trickle-down effects, though desirable, now seem far from automatic. Needed instead is deliberate action. Developing countries have to foster the diffusion of technology to them and within them, both in quantity and quality. They also have to break the negative links between low equality and low productivity. In short, they need development policies directed explicitly to reducing poverty. Only with such policies will it be possible for a substantial part of the developing country population to share in the benefits of globalization.

Economic growth, so essential for eradicating poverty, rests on the accumulation of physical and human capital and, very importantly, on the gains in productivity. Catching up rapidly rests, in addition, on a fast rate of structural transformation.

Normally associated with the initial phases of catching up quickly are rapid capital accumulation, dramatic increases in labour participation and the large-scale absorption of foreign technology. To maximize productivity, each requires significant learning—so that society can assimilate, adapt, master, develop and efficiently use foreign technology. This learning, and the institutional and policy setups that enable it, starts with mobilizing domestic innovative capabilities to fuel sustained structural change.

Opening the economy fosters both domestic competition and inflows of embodied and disembodied technology. And given the drive to export, it spurs the domestic diffusion of international productivity and quality standards through exposure to international competition.

As countries begin to catch up, innovation-driven productivity gains have to become the engine of growth. The reason is that input-driven growth eventually runs into rapidly diminishing returns—unless supported by the assimilation, adaptation and mastery of rapidly changing technologies. In a world where continuous innovation and international competition drive one another, countries have to devote special effort to keeping up with the advancing technological frontier.

Faced with this challenge, the development agenda needs to give pride of place to policies for sustainable productivity growth. Countries have to establish framework conditions for the rich interplay of resources, markets and institutions. They have to expose themselves to the spurs of competition in the international economy. And they have to supply the public goods needed to match gains in efficiency with improvements in equity.

The predicament of the least developed countries

The least developed countries, still struggling to meet the basic human needs of their population, have had their health, social and economic standards slip over the last few decades. Indeed, the real per capita income of 30 developing countries is lower today than it was 35 years ago.

For the more advanced developing countries the development priority is to deepen and upgrade their links with the world economy so that they can apply their innovative capabilities to international competition and domestic development. For the least developed countries the key development priority is to take the first steps towards being able to do this. They need to set policies that allow them to take a greater part in international trade, investment and technology flows. Yes, macroeconomic stability and a sound incentive system are important. But so is attending to basic human needs, strong institutions and the building of social capital.

Shortcomings of today's policy models

Much economic reform in developing countries was based on the assumption that equity and wealth creation would come from market-led structural reforms. But the record shows that countries heeding the prescriptions saw equity deteriorate—and efficiency gains turned out to be short-lived and elusive.

The reason is that the policy reform packages of the 1990s were unbalanced—in the best of cases having only two of the three legs to support a durable social consensus in the fight against poverty and the drive for sustainable development. Macroeconomic and institutional reforms have made some difference. But the third leg—ensuring enduring productivity gains by mobilizing the innovative potential of society—has been missing.

Innovation and technological learning were expected to follow. But for the most part they did not. Hence the attenuated effect of the macroeconomic and institutional reforms. Overcoming this deficit is still a major task—one that UNIDO addresses as a fundamental part of its mandate.

Spreading access to income-generating assets

The ability of a social system to achieve high rates of economic growth and at the same time improve equity lies in its capacity to ensure ample access to income-generating assets across the population. That is one of the key lessons from the recent industrialization experience.

The most sustainable income-generating assets are not necessarily physical or financial—they are human, embodied in people and institutions. These assets comprise entrepreneurial, management, technical and scientific knowledge as well as governance systems and codes of conduct. A society that makes universal access to knowledge and skills a key priority is much more likely to marry equity and efficiency than a society that does not.

Investing in formal education is just one aspect of this. An innovative and competitive private sector is essential. So are institutions and incentives geared to eradicating corruption, ensuring the rule of law, promoting social capital and easing resource reallocation. At the base, of course, is a competitive business environment and sound macroeconomic management. Efficiency with equity can be achieved only when markets, agents and institutions interact to diffuse the fruits of technical progress and so to improve all sectors of society.

Providing greater symmetry in the costs and benefits of international compacts

The new development round of trade negotiations addresses the perception that the opportunities to draw on the benefits of the Uruguay Round agreements have not been evenly distributed across countries.

The substantial protectionism still prevailing in international trade is clearly biased against activities in which developing countries enjoy greater comparative advantages, such as agriculture and labour-intensive manufactures. Moreover, developing countries can take advantage of market access to industrialized countries only by conforming to their stringent sanitary, phytosanitary and other regulations and standards. To do this, they have to overcome their technical and scientific underdevelopment.

A rule-based international system in which most members cannot play is doomed. Developing countries, especially the least developed, should not be held to standards they cannot meet today. What would be fair is to hold them to relaxed standards they can meet—and to give them assistance for increasing their capacities. Only a major concerted effort by the international community to remove obstacles to market access and support developing countries' capacity building to conform with the rules can redress intercountry disparities.

Caring about future generations

Natural resources are as much for creating wealth as for improving human welfare. When economic activity is harmful to the environment, resource productivity today is augmented at the expense of resource productivity tomorrow.

To the extent that the neglect of natural capital affects global commons, international norms need to be set and complied with—just as when the health, safety and security of the population are at stake. But developing countries have to conform to the emerging international norms as well, and for this they need home-grown scientific and technical capability.

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These are the main messages of this report, the first of a new UNIDO series devoted to the various dimensions of industrial development highlighted in this foreword. This new series is intended to build on development policy experience and to advance the frontiers of current thinking, with a focus on the least developed countries.

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