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<u>FDI, catch-up growth stages and stage-focused strategies</u>

by
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This is a reply to Francisco Sercovich's commentary[1] on my *Perspective* on FDI-led industrial takeoff in which I described foreign direct investment (FDI) as an ignition for catch-up industrialization.[2] He emphasized "the rich and nuanced variety of strategic options"[3] (e.g., S&T policies, engineering education, *chaebol*-type enterprises for technology absorption, R&D capabilities), which are, however, relevant only to *higher*-stages of catch-up, but *not* to the *kick-off* stage with which my previous *Perspective* was concerned. Economic development derives from structural changes at different stages of growth, requiring stages-focused strategies.

The FDI-led takeoff applies to the *beginning* stage of catch-up in which labor-abundant emerging economies have an endowed comparative advantage in low-end manufacturing. Higher stages are obviously built increasingly on knowledge and demand more sophisticated approaches. As I stated, "China now has to reformulate and refine its growth strategy as it climbs higher on the ladder...."[4] Each stage calls for different preparatory measures, institutions and strategies.[5]

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[1] Francisco Sercovich, "Knowledge, FDI and catching-up strategies," *Columbia FDI Perspectives*, No. 53 (December 19, 2011).

[2] Terutomo Ozawa, "The role of multinationals in sparking industrialization: From 'infant industry protection' to 'FDI-led industrial take-off,'" *Columbia FDI Perspectives*, No. 39 (June 6, 2011).

[3] Sercovich, op. cit., para. 1.

[4] Ozawa, op. cit., para. 9.

[5] For a policy framework, see a "leading-sector growth" model in Terutomo Ozawa, "The (Japan-born) 'flying-geese' theory of economic development revisited -- and reformulated from a structuralist perspective," *Global Policy*, vol. 2 (October 2011), pp. 272-285.

Also, the notion of infant industry protection (IIP) has come to be stretched to cover practically any type of development measure. The FDI-led model was conceptualized as opposed to the *conventional* IIP theory epitomized in the Alexander Hamilton-Friedrich List approach that stresses import substitution to build a *locally owned* industry under protection-cum-promotion -- *not* under general development policies, *allowing* foreign advances into domestic industries.

In this respect, postwar Japan effectively pursued the Hamilton-List IIP strategy in modernizing its capital-intensive industries (e.g., steel, machinery, automobiles) by borrowing and improving on Western technologies. However, war-devastated Japan re-started *first* with then-comparatively advantaged, labor-intensive light industries and quickly redeveloped exports (e.g., toys, textiles). Japan's light industries did not need -- and in fact, *avoided* -- investments by foreign multinational enterprises (MNEs).

In contrast, Singapore, Taiwan Province of China and the Republic of Korea deliberately had to set up export-processing zones to attract labor-seeking FDI in the 1960s-70s, since they lacked the experience of producing manufactured exports. And they quickly succeeded in attracting labor-intensive manufacturing, the *first* step to industrial modernization. China, too, emulated its neighbors' successes by opening up for trade and FDI in 1978. China's special economic zones and low-wage labor enticed foreign MNEs to build China's low-cost, export-driven manufacturing, swiftly alleviating poverty.

The FDI-led kick-off has thus become a *new* jump-starter of industrialization and a more *expedient* alternative to the inward-looking IIP strategy. Such a start of industrial modernization *does not* require the sophisticated measures cited by Sercovich. In fact, this is the reason why the World Bank is urging China to relocate low-wage factories to Africa in order to help spark industrialization, although Africa (other than South Africa) *still* lacks nuanced strategic capacities (like S&T capabilities, *chaebol*-type technological competence and R&D competition with foreign MNEs).

As to *chaebol*-type conglomerates as a strategic option, they were actually not needed when the Republic of Korea was exporting labor-intensive goods (e.g., wigs, toys, footwear), initially from its Masan export-processing zone opened in 1970. Only in the *subsequent*, *higher* stages of catch-up (i.e., heavy and chemical industrialization and the development of assembly-based industries) *chaebols* became a powerful instrument -- just as Japan's postwar *keiretsu* firms did -- for building scale-driven, capital-intensive industries (e.g., shipbuilding, machinery, microchips, automobiles). True, the government sagaciously began to make efforts to establish these higher-stage industries under IIP-cum-subsidies, starting as early as the late 1960s (e.g., the Electronics Industry Promotion Law of 1969 initially to encourage *assembly* operations of monochrome TVs, i.e., from the *low*-end of a knowledge-based industry). All these industries, however, grew internationally competitive *only in later and more recent decades*. Interestingly, *chaebols* may now be even considered outdated in an era of entrepreneurship and start-ups spawned by information technology.

Thus, the criticality of a stages perspective cannot be overstressed. For instance, to ask Africa's unindustrialized countries to organize *chaebol*-type enterprises and invest in S&T capabilities is premature *at the moment*; instead, Africa should *first* apply its *limited* development resources (including policy capacity) to attracting FDI in labor-intensive manufacturing to ignite an FDI-led takeoff. This must be what the World Bank has in mind. True, there may be other options, such as fostering small and medium-size domestic manufacturers in hopes of an autonomous export-led kick-off. Some even propose a skipping-a-step strategy to enter a high-end industry. But this approach, even if workable, risks unbalanced development, leaving the region's comparative advantage in labor-intensive industries untapped -- hence, the impoverished masses still under and un-employed. Once it gets kick-started, however, more intricate higher-stage strategies are needed to sustain catch-up. In sum, it makes sense *first* to exploit *endowed* advantages and then try to "create" new ones.

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The Vale Columbia Center on Sustainable International Investment (VCC – www.vcc.columbia.edu), led by Lisa Sachs, is a joint center of Columbia Law School and The Earth Institute at Columbia University. It seeks to be a leader on issues related to foreign direct investment (FDI) in the global economy. VCC focuses on the analysis and teaching of the implications of FDI for public policy and international investment law.

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