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Operationalizing ISID for LDCs
THE PATH TO GRADUATION AND BEYOND



Session 3: Making partnerships work: integration tools to foster private sector development in LDCs

Mainstreaming Inclusive and Sustainable Industrial Development (ISID) into national policies and programs

Background paper for the LDC conference, 26-27 November

1. Introduction

The Lima Declaration, adopted by UNIDO's Member States in December 2013, sets the foundation for a new holistic approach to industrial development. Inclusive and Sustainable Industrial Development (ISID) is at the core of the Sustainable Development Goal number 9: build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation. UNIDO is making the ISID approach operational through the Partnership Country Programs (PCPs), which is UNIDO's new technical cooperation modality. Making ISID part of governments' economic and development policies is one of UNIDO's main mandates.

Strategies and policy instruments to boost ISID are not new and can be broadly classified into two groups: macro-economic and industry-specific. While broad macro-economic policy instruments provide the foundations for industrialization, ISID strategies place an emphasis on industry-specific instruments including technology and innovation, investment in manufacturing, skills, industrial financing, infrastructure and competition policy.

Mainstreaming ISID in national policies calls for governments to have a sound understanding of the relationships, synergies and trade-offs of industry-specific strategies and policy instruments leading to economic growth, social inclusiveness and environmental sustainability. On the basis of this broad vision, ISID strategies should guide governments in defining the policy mix to achieve this three-dimension goal.

Conceptually ISID makes a lot of developmental sense. However, many developing countries, particularly LDCs, face severe challenges when it comes to its implementing. It is not just the complexity and trade-offs of the policy choice, but also the lack of key factors related to

government's capabilities and leadership, long-term commitment, and ISID experimentation and learning.

This short background paper addresses important factors to mainstream ISID into national policies and programs. While the challenges are relevant for most developing countries, they are particularly critical for LDCs.

2. Linking structural transformation, inclusiveness and sustainability

Understanding the relationship and trade-offs between structural transformation, social inclusiveness and environmental sustainability is possibly the most important factor for governments to integrate ISID in their national policies. In the case of LDCs, given their incipient industrialization stage, the focus has to be structural transformation policies that generate jobs while not compromising the environment. UNIDO's Industrial Development Report 2013 concludes that at low income levels, industrialization improves not only the number of jobs but also their quality. This finding has important implications LDCs – structural change can play a catalytic role for inclusive industrial growth by substituting the source of growth from agriculture to manufacturing. Wage increase is also positively correlated with industrialization and growth, becoming particularly stronger after income reaches \$2,000-\$3,000 GDP (PPP) per capita.

UNIDO's forthcoming Industrial Development Report 2016 throws further light on the relationship between the ISID dimensions. Evidence indicates that developing countries, especially at an early stage of industrialization, have more opportunities to pursue inclusive industrial development with a potential for rapid growth and limited environmental damage. Once industrialization takes off, countries at low and lower middle incomes have opportunities to create a large number of formal manufacturing jobs because their cheaper wages provide them with comparative advantage in labour-intensive industries, such as textiles and wearing apparel. Specialization in labour-intensive industries with exports to major world markets can

lead to rapid growth in both output and employment, hence promoting sustained and inclusive growth. Further, at this stage, a relatively limited output volume and a lower concentration on less polluting activities tend to make the manufacturing sector less damaging for the environment than at a later stage.

As countries acquire skills and expand their infrastructure, the opportunities for growth and employment generation rise in other industries, but usually proceed in an extensive manner by drawing in increasing amounts of production factors, as well as natural resources and energy. Most industries emerging during the middle-income stage are resource intensive with relatively poor emission performance. Thus countries emerging from the low-income stage have good prospects for continuing the path of inclusive and fast development, but start facing sustainability challenges.

LDC governments need to make conscious efforts on all three fronts – sustained economic growth, social inclusiveness and environmental sustainability – if they are to embrace the benefits of ISID. Challenges vary depending on the income level. The foremost challenge for low-income countries is sustaining the process of industrialization; for middle-income countries, it is environmental sustainability, and for deindustrializing high-income countries, it is continued employment generation and inclusive industrial development. However, whatever the income level, skill development, technological change and innovation remain crucial for all countries aspiring to achieve ISID.

3. Leadership and long-term commitment to ISID

Mainstreaming ISID in national policies and program requires political leadership and government's long-term commitment. Political leadership at the top is crucial for raising the profile of ISID and for ensuring the required coordination, oversight and monitoring. Inter-ministerial competition for resources and policy incoherence can only be prevented by strategic leadership at the highest levels. It is also essential for high-ranking government officials to be responsible for the implementation of ISID so they can be held accountable if these policies fail.

Strong leadership implies that ISID has to be championed at the highest possible level and not as an aspiration by individual Ministries. Without it, the likelihood of having ISID included in governments' national policies is limited. Successful ISID policies need of powerful Ministries or dedicated Commissions or Boards chaired by the President. In this regard, LDCs, and more advanced developing countries, have lots to learn from the East Asian experience. The importance of industrial development was reflected in the power vested in the Ministries responsible for the sector. Economic Development Boards were established and endowed with the authority to coordinate all activities relating to industrial competitiveness. They were also given the resources to hire qualified and well-paid professional staff, which is an essential prerequisite to manage discretionary policies efficiently and honestly.

LDCs also need to have a long-term commitment to ISID. The trade-offs of ISID policies can have a negative short-term impact that can only be compensated in the long run if governments continue to pursuing sustained and inclusive industrial growth. Most governments tend to be shortsighted and seek quick policy wins ignoring the long-term benefits that ISID may bring along. True political commitment requires LDCs to include ISID policies in the country's long-term vision and goals.

4. Boosting institutional capabilities for ISID

Management capabilities for industrial policy in the LDC context have been traditionally very weak. The broader ISID concept makes it even more challenging as capabilities have to be spread across a larger number of design and implementing government agencies. Thus the mainstreaming of ISID in national policies stresses the need to strengthen the capacity of government institutions to design and implement public policy.

Countries need a certain technocratic capacity to realize ISID, both at its inception phase and implementation. However, many developing countries and most LDCs lack this capacity, which has to be built slowly and pragmatically. What are these capacities and how can they be built? Effective ISID policy-making requires adequate capacities for each step of the policy cycle.

Strong analytical capacities are needed to thoroughly diagnose ISID performance, constraints and potential. Decision-making capacities are needed for the smart design of strategic directions, and the ISID policy mix needs to be understood to propose adequate instruments. Implementation requires strong management as well as technical and sectoral competencies. And forward-looking monitoring and evaluation requires not only adequate financial resources but also technical expertise.

This capability challenge is more severe in the industrial policy arena than others because the more centralized government agencies usually also succeed in securing the best talent. Particularly in many Sub-Saharan countries, ministries of finance, planning commissions, development banks and other key players in cabinet are best placed to secure government resources.

International development agencies engaged in SDG 9, like UNIDO, have a strong responsibility in making sure that the institutional capability gap is addressed properly. First, LDC governments need to be supported with a conceptual framework, operational goals, indicators and targets that are related to ISID. This is important for LDC governments to define their ISID strategies, how they relate to other economic policies and to assess impact. And second, capacity building programs in LDCs should consist of targeted hands-on efforts to achieve concrete goals. The pragmatic idea is to concentrate the available resources on executing highest priority tasks, and to incrementally build additional skills when they are really needed so as to solve emerging problems when they arise.

5. Experimenting, learning by doing and evaluating ISID

Like in the case of industrial policy, successful ISID policy design and implementation should rely less on best practices and more on a combination of experimentation, learning by doing and evaluation. While learning from other cases is desirable, replication can lead to massive policy failure. Rather than simply emulating ISID policies that have worked elsewhere, countries have to go through their own learning process. This process necessarily involves experimentation,

trial and error. For LDCs this experimentation phase is crucial as ISID has not yet been mainstreamed globally and there are fewer lessons to be learnt from more advanced countries.

For this approach to work, however, ISID experimentation has to be combined with rigorous impact evaluation of each implemented instrument to generate the evidence on which industrial policy measures work (and which do not) in a given context. Probably the most important role of ISID monitoring and evaluation in developing countries is to provide feedback for making the next cycle more innovative and effective.

In this regard the international community can support LDC governments in formulating realistic interventions that allow them experiment with ISID and learn from it. This approach would entail a) a clear definition of a target system that makes concrete the ISID objectives (including trade-offs among different objectives) that the policy instrument is aiming to have an impact on in the longer term (increased employment or economic growth, for example); b) realistic “target corridors” for judging success or failure with regard to each ISID objective ideally based on real-world benchmarks (for instance minimum and maximum expected increase in employment, based on prior achievements in the country or elsewhere); c) an explicit impact model with a comprehensive depiction of the short- and medium-term changes in industrial sectors (at the firm and sector levels) that are needed to reach these ISID long-term targets (such as required investments of manufacturing firms and structural changes in the production activities of firms); d) a detailed description of the steps required for reaching each of these ISID goals (impact paths), including a critical examination of whether it is realistic to expect to reach the goal with the time and resources available; and e) an account of possible unintended impacts and side-effects of the policy instrument (risk factors), based, say, on consultations of experts and affected stakeholders before the intervention is carried out.

This approach ensures that ISID interventions are discussed and designed reflexively and that stakeholders are well aware of the actions and achievements expected of them. If this approach is combined with less sophisticated and less costly (non-experimental) monitoring and evaluation designs, such as reflexive comparisons and qualitative research, ISID interventions are likely to be much more evidence-based, consensual and transparent more effective, without overburdening the technical and budgetary capacities of LDCs.

