‘Financing Learning’: The Challenge of Developing New Sectors

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Capabilities and Competitiveness

- Low wages and formal skills do not ensure the development of new competitive sectors
- The capital equipment and technology in many sectors is also freely available
- A critical missing factor is usually the know-how of organizing production in a modern workplace/factory
- Traditionally described as the absence of 'entrepreneurship' this actually involves a broad range of missing capabilities, most of which can be acquired
- The knowledge involved is not 'codified', it is 'tacit knowledge' that can only be acquired through 'learning-by-doing'

Learning and Finance

- Acquiring competitive capabilities through learning-by-doing implies that investments in new sectors will not be immediately profitable
- The purchase of assets like machinery or land can be financed by banks with the assets serving as collateral
- But financing an unknown period of loss-making is much more difficult unless the entrepreneur is willing to back the borrowing with personal collateral
- This raises a very difficult financing problem which typically precludes investment in new sectors
- Policies are only likely to succeed if important governance and design problems can be solved

Learning and Finance

- In the past states approached the learning problem with protection or subsidies for 'infant industries' but the infants often refused to grow up and these strategies were abandoned
- The new consensus is that if 'good governance' can be established with strong rule of law and contract enforcement then private investors will be able to finance learning in new sectors
- However, the evidence suggests that improvements in good governance are likely to be insufficient for this

Opportunities and Compulsions

- The core of the problem is that learning-by-doing requires the opportunity to learn (***hence the requirement of loss financing***) but it is only successful if ***high levels of effort*** are put in by all the stakeholders
- Learning requires continuous experimentation with the organization of production and involves significant costs for the participants: the time frame is difficult to predict and there will be inevitable failures
- Learning is different from innovation because the successful entrepreneur will earn 'normal' profits if they succeed; but they already earn normal profits with loss-financing

Financing Instruments

- The ‘design’ of the financing instrument is critical and depends on what we believe is the fundamental ‘market failure’ that the public financing instrument is trying to address
- The problem is not just to organize ‘trials’ but also to ensure high levels of effort during the trials
- Successful learning has typically involved a public **and** a private component of financing that together created both opportunities and strong compulsions for effort
- The garments industry takeoff in Bangladesh was based on a ‘public policy’ component (the MFA) and a private component based on a financing agreement between Desh and Daewoo that together financed a very successful learning project

Financing Instruments

- The details of the design were critical: both the technology provider and the learner had strong incentives to transmit and acquire the know-how
- The learner had a lot to lose (their investments in assets) but was not expected to fully finance the learning: indeed Desh expected it would take 5 years to become competitive but they achieved the learning in 18 months
- The Indian auto takeoff in the 1980s was similar: implicit public subsidies came from a protected domestic market with private co-financing by multinationals
- Design was again critical: 70% domestic content requirements (no longer possible now with WTO) and the expectation that domestic market protection would come down resulted in strong compulsions for effort

Financing Instruments

- The policy environment is changing (no more MFA, no more domestic content, and certainly no significant import barriers for protection)
- This strengthens the case for well-designed public financing instruments targeted for capability development in new sectors
- There is a critical governance implication for designing effective financing instruments: the contractual conditions supporting effort have to be enforceable and this implies limiting financing to firms and sectors that the financing institution can discipline OR improving targeted governance capabilities that can make contract enforcement credible