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What Role for Industrial Policy in the Asia-Pacific after the Crisis?

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Any discussion on contemporary industrial policy in the Asia-Pacific region ought to start with a caveat. That is, while this subject may "be back" for some, to others it "never left." In this respect, this region has probably given more credence to industrial policy for longer than others. Still, the profile of industrial policy has risen over the past few years.

Part of the difference in perception is a difference in definition. Once the WTO asked me to include a discussion of industrial policy in a report and I thought it would be sensible to start with a clear definition of the term (WTO 2003). Having reviewed the extensive literature on industrial policy in the Asia-Pacific region in particular, almost every non-macroeconomic policy had been labelled at least once an industrial policy!

For some, industrial policy involves the direct targeting of specific (typically manufacturing) sectors of an economy; for others, it included economy-wide measures that must surely promote economic growth, such as training more first class engineers. Contemporary accounts of industrial policy show no tendency to converge on a single definition of industrial policy either.

Even so, the more frequent mention of resort to industrial policy does mark something new. Rather than highlight any one cause, it may be instructive to discuss a number of reasons why industrial policy has moved closer to centre stage in the region's policymaking. The purpose of this Policy Brief is to do exactly this, drawing out some lessons for policymaking that follow from different perspectives.[1] Hopefully this overview will better identify which ideas are "old wine in old bottles" and which are newer in vintage--not that there is necessarily any good about younger wines!

The discrediting of the Washington Consensus

One reason for that greater profile is the fallout from the global financial crisis on the "battle for ideas." Each major economic crisis has the potential to undermine the credibility of the reining policymaking orthodoxy. In present circumstances, this probably amounts to the final nail in the coffin of the Washington Consensus. After all, declines in support for this Consensus have been witnessed ever since the earlier East Asian Financial Crisis in the late 1990s.

On this view, policymakers are looking for alternative schema around which to organise economic development strategies, and promoting industrial policy seems to signal an intention to intervene in markets more often, but not necessary to replace all markets with state allocation of resources. Fair enough, but this is using the term industrial policy for public relations purposes. Signalling is not a strategy, nor alone does it represent a coherently formulated policy.

If the desire to intervene in markets is based out a lack of faith in the private sector, then a good place to start thinking about the role of industrial policy is to identify which tasks the private sector is prone to fail at and why. It may be that little finance is available to small and medium sized enterprises (SMEs), in which case policy analysts should ask why banks and finance houses systematically overlook lending opportunities among SMEs?

Putting the question like this often reveals more than one reason why the bad outcome has occurred. It may be, to continue the example, that SMEs are more likely to fail and go bankrupt than larger borrowers, in which case it would be natural for any lender--private or state--to charge a risk premium on lending to SMEs. It may also be that SMEs have little experience preparing documentation to support their loan applications, in which case this problem can be directly targeted. Sometimes the solution may be an indirect one. For example, some SMEs may not be able to borrow because it is difficult for them to demonstrate they own the title to the land that they operate on. Highly costly procedures to register land and the like will then have adverse knock-on effects as SMEs can pledge less collateral than might otherwise be the case.

In short, just because benign neglect of the Washington Consensus may have led to unwelcome outcomes, it does not follow that industrial policies cannot be poorly designed. One paradigm's apparent failure does not guarantee another paradigm's success. There is no escaping this logic.

[1] This Policy Brief draws in part on the discussions at the ARTNeT Symposium "Towards a Return of Industrial Policy?" 25-26 July 2011, Bangkok. See Report from the Symposium at www.unescap.org/tid/artnet/symposium11.asp

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A nascent jobs crisis?

The search for an alternative development paradigm may be driven by other factors too. As labour forces expand more quickly, and productivity growth limits employment growth in agriculture and manufacturing, increasingly the service sector is being called upon to absorb more employees. But for reasons--frequently unarticulated--the service sector is seen as being less respectable than manufacturing, and industrial policy is seen effectively as bolstering the latter (cf. Tower and Waite, 2011)

What is for sure is that the service sector is far less well understood than agriculture and manufacturing. Some might ask what is so different about services? Still, to the best of my knowledge, no country has ever made promoting high quality services the principal driver of its development and, without precedents, no doubt policymakers are nervous about the potential contribution of the tertiary sector to long term economic development.

Having said this, there are plenty of examples of countries--principally industrialised countries--that have used the service sectors with lower levels of productivity as the employers of last resort. Nowhere is this more apparent than in much retailing in Continental Europe and in Japan. Restrictions on shop size, limitations on entry by new shops (in many cases new entry is regulated by committees that are heavily influenced by incumbent shops!), and rules stopping foreign takeovers of retail outlets have hobbled productivity growth in the retail sector. Occasionally the overstaffing generates a payoff for customers in terms of higher quality service but this is the exception rather than the rule.

The service sector is also extraordinarily diverse, ranging from services enjoyed by private individuals, to business-to-business services (which can be an important source of specialisation and advantage for buyers), and services sold to governments and to the non-profit sector. Generalising across these different types of service sector is probably unwise. The flip side of this coin is that--beyond the obvious calls for abolishing unnecessarily burdensome regulations--there is little in terms of broad-brush policy initiatives to recommend to decision-makers concerning the service sector.

There is a substantial knowledge gap here which the ARTNeT community and others could fill. Knowing how to stimulate productivity growth in the service sector would take the "manufacturing versus services" debate forward, certainly beyond the recent debate between Professors Bhagwati and Chang in the online version of *The Economist*. The emphasis on promoting manufacturing appears by default, not because any service sector initiative has been discredited.

Other rationales for a higher profile for industrial policy

Completeness requires acknowledging other contemporary arguments advanced in support of industrial policy. First, a small group of relatively prominent scholars have put forward new arguments--often based on **experimentation, innovation, and uncertainty**--in support of government interventions for private sector development. It is remarkable how little resonance these arguments have in public policy fora. When used, these arguments appear almost always to be used in support of a pre-determined policy position. (This is often evident by the mismatch between the conditions the scholars have examined and the circumstances the policy advocate wants to intervene in.) Another rationale for abandoning *laissez- faire* approaches to private sector development has been the phenomenal rise of China since the 1980s and the fast rate of growth of Russian Federation over the past ten years. Implicit assumptions that a self-reinforcing cycle of economic freedom and economic growth have been set to one side as more evidence of the success of "**Authoritarian Capitalism**" or "**State-led Capitalism**," as two leading authors have recently put it.[2] While this rationale for industrial policy is probably more relevant outside of the Asia-Pacific, nevertheless these developments have fuelled interest in alternatives to the Washington Consensus policy prescriptions.

Finally, the search for new "poles" of long run economic growth intensified during the recent global economic crisis and has led many to advocate policies that promote "**green growth**" or "green technologies." It is important to remember that the latter is not the former and may not even lead to the former! Here decision-makers want to satisfy two major policy objectives at the same time, about which more will said in the next section.

As deliberations at the WTO and elsewhere have shown, attempts have been made to classify almost any good as "green" (apart say coal and oil)! Ironically, to the extent that a green policy is implemented so broadly that almost every sector or product is eligible for support, then the policy ceases to be selective--which was one of the hallmarks of traditional industry policy. The targeting of selective green industries, such as solar power, has now become so widespread that it is now the subject of multiple trade disputes between leading members of the G20 nations. There are considerable fears that the good intentions of decision-makers during the global economic crisis may have been hijacked by savvy firms with excellent connections. Selectivity--or favours--and favouritism once again go hand in hand.

What prospects for successful industrial policy implementation?

Having established the different reasons why industrial policy has made a comeback in public policy fora, attention now turns to the likelihood of its successful implementation. Surely there are lessons to be learned from the past? Can new institutional designs and implementation procedures overcome the deficiencies of industrial policies from yesteryear? Or is there little evidence that much thought has beyond resurrecting an old slogan for a new era? The first comment relates

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[2] See Halper (2010) and Bremmer (2010).

to the **multiplicity of objectives** of industrial policy. Having listened to participants' interventions at the recent ARTNeT Symposium of scholars and officials, I am quite concerned that we are expecting industrial policy to deliver too much. There seems to be no limit to the objectives that governments have attributed to industrial policy. Some of those objectives are vague, even if they are very popular. "Inclusive growth" being a good example of the former and the latter! Objectives of industrial policy should surely be clearly stated and related to observable outcomes, which in turn will facilitate ex-post evaluations.

Moreover, having multiple objectives inevitably creates **trade-offs in implementation and evaluation**. There are no guarantees that officials or the private sector will treat each objective with the attention that decision-makers had intended. Nor is it easy to come to an assessment of a policy measure that delivers on one criteria but not the other. Just because the world is a complicated place doesn't provide the rationale for a laundry list of objectives. Focus has plenty of advantages. Many important matters relating to the **implementation of industrial policy** should receive greater attention. The information necessary to successfully implement such policies is a case in point, as misleading or incorrect information is unlikely to lead to desired outcomes. Moreover, the fact that governments have multiple options when implementing industrial policy implies that sensible policymaking needs to contrast across alternatives. In this regard it was disturbing that some speakers at the ARTNeT Network Meeting erroneously assumed that industrial policy provides a general rationale for discriminating against foreign commercial interests. A case for state intervention in markets is not necessarily a case for restricting foreign commerce. Governments should be encouraged to adopt the most effective and least costly measures and this requires careful analysis.

Another concern is that industrial policy could benefit some interest groups that, in turn, will organise themselves to retain the policy measure even if circumstances evolve, as they inevitably do. **Industrial policy should never become a tool of entrenched incumbents.** Nor of those government ministries responsible for their implementation. Reviews of industrial policy, conducted at regular intervals by technocrats and independent bodies, should be required.

The availability of alternative market mechanisms to fix identified problems is another important lesson. If the upgrading of firms is to be encouraged, then **more vigorous competition between firms** is an alternative to offering a subsidy from the public treasury. While many policymakers openly acknowledge the importance of promoting competition within their economies, without considering the extent to which this step might be preferable to other forms of state of intervention. Once again this highlights the importance of comparing policy alternatives at the time of implementation as well as conducting ex-post evaluations to assess the effectiveness of implemented measures.

With respect to **ex-post evaluations of industrial policy interventions**, there is a major knowledge gap here. Much of the literature that claims to show industrial policy has been effective in the Asia-Pacific region shows no such thing. Is it one thing to show that governments intervened---it is quite another to show that that intervention had its intended effects. The confusion of the former with the latter pervades the literature on industrial policy in the Asia-Pacific.

Proper quantitative assessments are needed here and these assessments should take account of all of the other relevant factors, so that any success is not incorrectly attributed to the industrial policy interventions under consideration. Insisting on such assessments on a regular basis is essential if industrial policy measures are to deliver on their promise. Forcing proponents of industrial policy to specify precisely what constitutes success--in measurable terms--over what timeframe would focus minds. Without such assessments, the potential for waste is substantial.

Finally, it became clear during the discussions that the **substantial knowledge gaps** concerning industrial policy imply that there are no ready off-the-shelf recipes for success. Descriptions of government initiatives are not enough, we need to know what government objectives can be reliably and effectively met by which policies. We need to know when to intervene directly into markets or whether to intervene to alter how the markets architecture and so how firms compete.

Concluding remarks

If newspaper column inches and ministerial speeches were any guide, then industrial policy has enjoyed a tremendous revival since the global economic crisis began in 2007 and politicians sought something to blame, new mantras, and promising sources of growth. While industrial policy probably never really left this region--it was effectively banished in some parts of the developing world--the revival of interest appears to be motivated by a wider range of factors than before. Careful examination of the logic linking market failure to policy objective to policy action, implementation, and evaluation is required and much needs to be learned in this regard.

Given the totemic status given to industrial policy by many in this region the existence of such knowledge gaps may come as a surprise. Worse, while those gaps clearly exist for manufacturing, our understanding of how to derive greater benefits from service sector growth for development is desultory. Nor is there any reason to believe that national policymaking processes are less prone to special pleading than in yesteryear. Much remains to be done to identify policy packages that will deliver for the Asia-Pacific region in the 21st century.

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