Trade and industrial policy must converge

Economic development is essential for economic growth...that's a motherhood statement. But economic development cannot take place without a sound industrial base and trade strategy. Both complement each other. This is one of the reasons why globally trade and industry are with one minister though the two departments can be separate. In India, they enjoy working in silos (sometimes even within the department itself). Thus Suresh Prabhu, the minister, has an onerous role to run both of them as the two wheels of a motorcycle without which there would be no forward motion.

In the last two-and-a-half decades, India has primarily used export promotion policy (in the garb of trade policy) to reap benefits of globalization. While this approach has benefited countless people, it has also left many dissatisfied. The divide between rich and poor has only increased, and so has the productivity gap between frontier firms and the rest. The country is now staring at premature deindustrialization and significant unemployment. To find a fix, introduction of an industrial policy for a concerted push towards industrialization and job-creation is being considered. The objective of industrial policy, as traditionally understood by some, conflicts with that of trade policy. Absolute clarity on the role of these policies and the ability to achieve convergence will be critical to achieve growth in the economy.

The use of industrial policy by advanced economies like Japan and South Korea in their initial growth phase, before globalization reached its zenith, is well documented. However, its impact on growth is not entirely clear. While several experts have attributed economic growth to government support of specific industries in these countries, renowned economists Howard Pack and Kamal Saggi have argued that Japan and Korea did not achieve success because of industrial policy, but in spite of it.

They show that 80% of industry subsidies in Japan were given to agriculture and mining. The idea that Japan provided significant subsidy support to the industries that became strong global competitors in sectors like auto, steel, and machine tools, is a myth. Korea allowed relatively free imports of capital goods for many years and relied quite heavily on foreign aid. For instance, Posco, the state-owned Korean steel company, had access to capital and then commissioned German companies to lay out the most productive steel plant they could construct using state of the art German machinery.

Despite different approaches to industrial policy, productivity, research, technology and infrastructure investment have been the critical keys to growth. As globalization was in its infancy, both countries had restrictions on their financial sectors and broad limitations on imports and foreign direct investment. This channelled high rates of national savings into industrial development and made sure domestic companies had a sound base of domestic demand for their products without facing foreign competition.

India cannot afford to replicate these success stories for two primary reasons: the declining rate of domestic savings, and an extremely interconnected world wherein unreasonable restrictions on movement of goods and capital conflict with commitments under international trade agreements. Given the prevailing limitations, how can India design an industrial policy which promotes economic growth with the trade dimensions upfront?

Economist Dani Rodrik points out that the answer lies in the process of industrial policy design. Industrial growth can be constrained due to diverse factors, which may differ with sector and time. Consequently, an industrial policy aimed at uncovering the most significant obstacles to restructuring and growth and identifying interventions most likely to remove them, is essential.

This can be achieved through a setting in which all stakeholders come together to solve problems in the productive sphere, each one learning about the opportunities and constraints faced by the other. Thus, focus needs to shift from industrial policy outcomes to its processes. An industrial policy achieved through good processes can encourage and support innovation, and help develop the companies of the future. It can avoid limits on competition and thus need not be antithetical to trade policy.

Nobel laureate Joseph Stiglitz argues that the role of industrial policy can be much larger. Markets are not likely to produce sufficient growth-enhancing investments, such as learning, knowledge accumulation and research. This gap can be addressed by an industrial policy through recording and fostering the diffusion of best practices in research, entrepreneurship and skills throughout an economy. An industrial policy focusing on right processes with good professionals in command can easily achieve this feat.

Once necessary processes are put in place, the government can prioritize the design of industrial policies to identify and address constraints that keep the country from benefiting from global value chains. By enabling the development of appropriate skills, productivity enhancements, technological upgradation and catering to specific infrastructure needs; integration in global value chains and markets for manufacturing linked services will be possible. An industrial policy will thus seamlessly complement trade policy for rapid economic growth and the job creation agenda.

Pradeep S. Mehta is secretary general of CUTS International.

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