Putting industrial policy experience to use

The department of industrial policy and promotion (DIPP) has released a substantive discussion paper on industrial policy which identifies several key policy aspects, constraints on industrial growth, and a range of objectives and policy targets. The paper provides a basis for the government's consultations to "formulate an outcome-oriented actionable industrial policy that provides direction and charts a course of action for a globally competitive Indian industry which leverages skill, scale and technology".

Such a focus on industrial policy is not new. Previous industrial policies emphasized import substitution and restrictive trade policies, a focus that was significantly replaced by the "Washington Consensus" and open market-oriented policies. There was, however, a renewed interest in industrial policy, with evidence that both developed and developing economies had relied on this, and that several high-growth economies (particularly China) had used it actively for their development process. Detailed studies of recent industrial policy strategies show that these more recent initiatives have been different from the import substitution era. Moreover, some important lessons have emerged from these studies on steps to enhance the effectiveness of these policies.

As shown by the Dipp paper, industrial policy covers a large number of objectives and subject areas. Effective management requires developing a priority ordering among the various objectives and initiatives. To establish credibility, it is important to first identify and seek quick wins ("low-hanging fruits"). Experience suggests a need to "focus on interventions that help build systems, create networks, develop new institutions, and align evolving strategic priorities", while enabling clusters to function efficiently, and establishing systems-oriented policies that affect multiple sectors or objectives.

Any process of industrial policy involves both successes and failures. To quote economist Dani Rodrik: "Good industrial policy does not rely on government's omniscience and ability to pick winners; indeed, failures are an inevitable and necessary part of a well-designed program... Intelligent industrial policy requires mechanisms that recognize errors and revise strategies accordingly. Clear objectives, measurable targets, close monitoring, proper evaluation, well-designed rules, and professionalism provide useful institutional safeguards." Thus, it is important to develop industrial policy programmes with benchmarks for success and failure and in-built time limits, i.e. sunset clauses.

While Rodrik is correct to question government omniscience and ability to pick winners, industrial policy has involved identifying certain specific sectors. For such a choice, instead of ad hoc methods, it is better to consider methodologies based on structured analysis, such as those proposed by Justin Lin (growth identification and facilitation framework) or Ricardo Hausmann (product space analysis). But the results from these processes would provide only initial indications and would need to be tested in discussions with domestic industry and lead firms in global value chains (GVCs), to verify the results and help develop coherent and system-oriented industrial policy initiatives.

GVCs require consistent quality products made available in a timely manner for further processing. The relevant policies would be those that facilitate transactions and not restrictive policies. Thus, the primary focus has to be on facilitation rather than restriction of trade and investment.

A major point often overlooked is that it is not possible to link up with GVCs without connecting with lead firms that oversee the quality and timeliness of products/producers that are part of the chain. Policies are needed to both connect with such lead firms and nurture them through

mechanisms that enable small and large domestic producers to interact with them.

A key insight is that the relevant industrial policies change as countries develop, i.e. any single industrial policy package does not remain relevant as economies evolve. For a large and diverse country like India, a corollary is that different policy packages may be needed to address the diverse issues identified by Dipp. Likewise, different policy packages may be required for old, established industries and new industries. The policymaker would thus need to distinguish between investment focused on new activities and others, with implications for the relevant infrastructure.

Experience suggests that industrial policy is likely to be more successful with investment promotion in comparison to trade policy reform, especially if investment promotion measures are part of a larger effort for technological upgradation. Though some limited trade protection has been used as part of industrial policy, experience suggests that: (a) what you protect matters i.e., it is better to focus on activities where there is latent comparative advantage; (b) increasing exposure to competition and trade raises the possibility of domestic firms becoming more competitive.

Furthermore, countries should identify and use regional or international mechanisms which could help with the implementation of industrial policies, including promoting GVCs or sharing successful experiences.

Thus, several specific insights from industrial policy experience since the 1980s are available, and could be an important part of any large-scale industrial policy initiative.

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