

Stop Blaming Industrial Policy

Industrial policy—or the promotion of particular investments, technologies, industries, regions and enterprises—has been practised by a variety of governments to try to accelerate economic growth and transformation.

The ascendance of the Washington Consensus, inspired by the neoliberal counter-revolution in economics, focused on alleged national macroeconomic mismanagement in developing countries and, later, transition economies. This was typically blamed on ‘[soft budget constraints](#)’ (SBCs) in [socialist states and enterprises](#), [macroeconomic populism](#) and industrial policy.

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Blaming Industrial Policy

Enterprise-level SBCs have also been wrongly blamed on industrial policy that promotes certain economic activities, usually manufacturing with more advanced technologies. In practice, most in-

dustrial policy is quite selective, involving the [support of some industries](#), regions and enterprises at the expense of others.

While such selective support may or may not have been successful in promoting targeted industries, industrial policy has been wrongly, and sometimes deliberately, blamed for both enterprise- and national-level fiscal SBCs. In socialist states, fiscal SBCs have been wrongly blamed on enterprise-level SBCs, macroeconomic populism and industrial policy.

But contrary to many economists’ presumptions, in most economies, including many [centrally planned](#)

[‘socialist’ ones](#), few enterprises were exempted from budgetary discipline. SBCs were therefore the very rare exception, not the rule, to promote desired new economic activities.

Enterprise-level SBCs did not ‘permeate all organisations’ in socialist countries, as is often claimed and assumed, but were instead quite selective. Subsidies were provided to some enterprises, industries or regions, typically at the expense of others.

All centrally planned economies had both explicit and implicit subsidies. In most Eastern European and Soviet countries between 1989 and 1992, on the eve of transition, direct subsidies in the government budget amounted to 10–15 per cent of national income.

In addition to direct subsidies for public utilities, housing and food, there were implicit price subsidies, particularly for users of fuel, energy and raw materials. Besides explicit subsidies from government budgets, rents from unsustainable, non-renewable resource extraction were shared with industries and consumers via lower prices.

Dwarf Infant Industries

The fiscal problem was not due to subsidisation per se, or even to the subsidisation of manufacturing at the expense of resource industries, trade and financial services. Rather, the problem was in the way such subsidisation was carried out—by maintaining higher domestic prices for manufactured goods.

Such import-substituting industrialisation (ISI) typically created industries that rarely became internationally competitive and viable. There have been all too many ex-

amples of failed ISI requiring the ongoing subsidisation of ‘infant industries’ that were incapable of ever becoming internationally uncompetitive.

Trade liberalisation and the end of Soviet-era trade arrangements in the 1990s exposed these industries as unviable and unsustainable. Soviet industrialisation from the 1930s had survived before that due to its insulated economic environment, with the ratio of Soviet exports to GDP not rising until fuel sales abroad rose with higher prices from the 1970s.

Perestroika reforms, initiated by reformist Soviet leader Gorbachev after the mid-1980s, failed to accelerate economic growth. Instead, they were followed by the 1990s’ [‘transformational recession’](#). This was greatly exacerbated by ‘shock therapy’ reforms during Boris Yeltsin’s first presidential term.

Many other enterprises—mainly in heavy industries, and often relying on Soviet technology, advice and aid—in other ‘socialist’ economies and developing countries subject to Soviet influence, experienced similar fates.

Thus, nations that tried to challenge Western hegemony met similar fates, despite trying to make a virtue of ‘self-reliance’, compelled by the need to cope with Western-led trade and investment sanctions.

Successful Industrial Policy

Most countries trying to industrialise or to accelerate industrialisation started with ISI, with effective protection enabling new enterprises to produce for domestic markets by keeping out imported foreign substitutes by means of prohibitively high tariffs and non-tariff trade barriers.

But many IS enterprises continued to survive, even profit, from such supposedly temporary tariff protection and other government support, never becoming internationally competitive as promised by the ISI strategy.

In more successful ‘late-developing’ economies, government support was conditional on meeting performance criteria, which effectively attracted private investments. Such investors sought more handsome ‘rents’ by accelerating technological progress, productivity and international competitiveness.

Thus, for example, ‘effective protection conditional on export promotion’ enabled the emergence of internationally competitive enterprises in some East Asian economies. Export orientation has been especially important in improving output quality to meet internationally competitive product quality and performance standards while achieving cost competitiveness.

Without more effective means for disciplining enterprises to accelerate development, export-orientation—promoted by government policy, incentives and other support—has contributed to successful catch-up growth. East Asian economies subsidised competitive export-oriented industries that accelerated economic growth and transformation, some more successfully than others.

In China, for instance, exports compared to GDP increased from 5 per cent in 1978 to 35 per cent in 2006, before declining to 20 per cent in 2018, while its GDP grew at an average of 10 per cent annually, with its population rising slower than in most other developing countries due its ‘one child’ policy.

Appropriate Industrial Policy Needed

Budget constraints in socialist economies were generally stronger than in developing countries and no less strict than in developed countries on average. SBCs in socialist economies were never pervasive, as widely believed, but selective, subsidising some enterprises or industries at the expense of others.

Such selective support, while typical of industrial policy, may or may not successfully promote internationally competitive enterprises, but certainly provides no empirical support for the claim of pervasive SBCs in 'socialist' economies.

With state-owned enterprises, strict fiscal and enterprise-level discipline, including budget constraints,

have led to restructuring and, more rarely, closures. But even when budget constraints have been less than strict, they have not been pervasive, as fiscally disciplined 'socialist' economies could not afford otherwise.

National-level macroeconomic mismanagement in developing countries and transition economies has mainly been defined by neo-liberal economics. Macroeconomic challenges are real, and need pragmatic policy responses. Hence, they should not be confusingly explained in terms of neoliberal chimera of alleged SBCs, variously blamed on socialism, populism and industrial policy.

Unfortunately, the mythology surrounding SBCs has been used to throw the industrial policy baby

out with the ISI bathwater. Much more appropriate, yet pragmatic, industrial policy is needed for developing countries and transition economies to 'catch up', as achieved by some East Asian and other economies.

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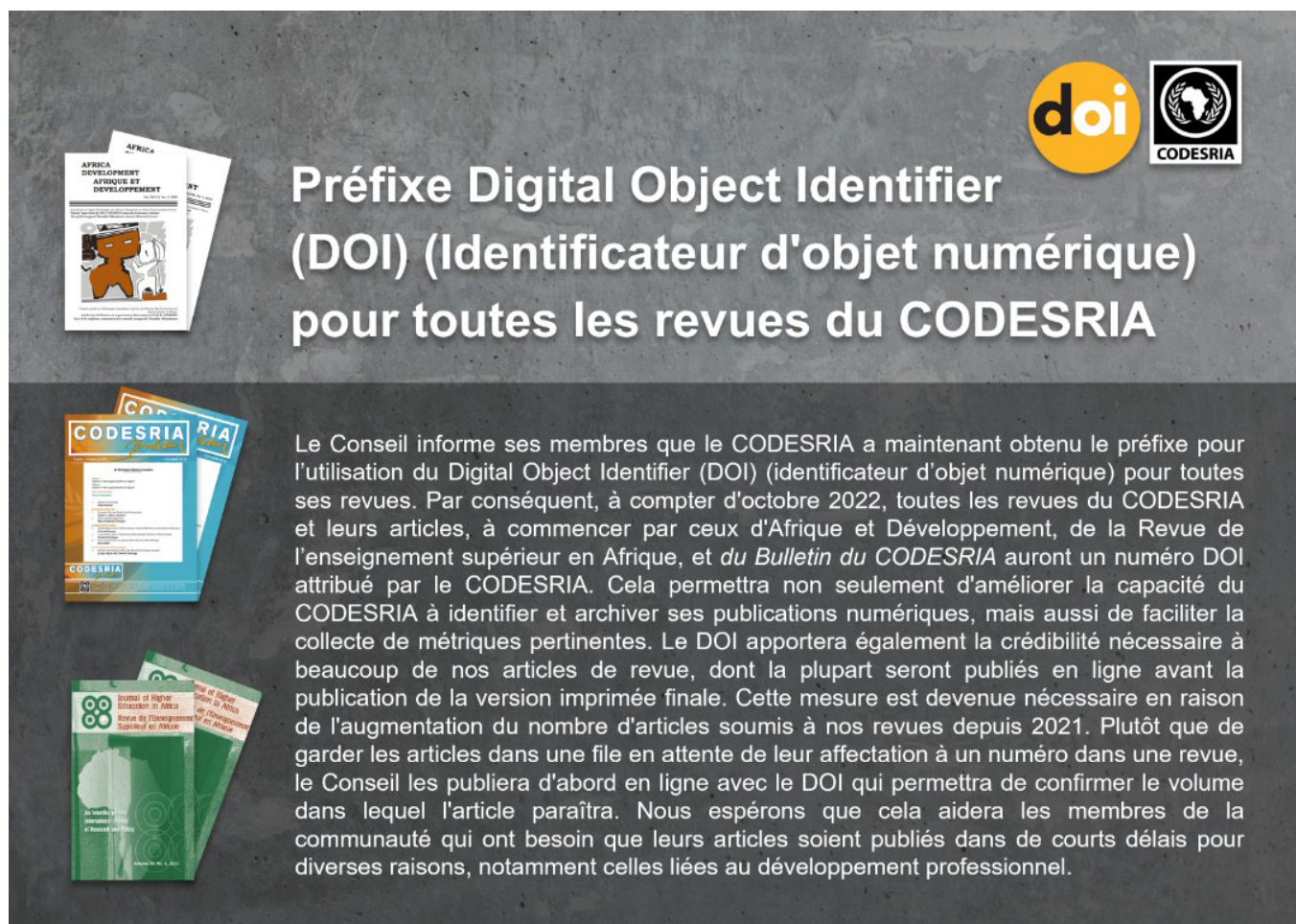
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