

**Eleventh Meeting of the UNCTAD Research Partnership Platform**

**17-18 December 2020**

**INDUSTRIAL POLICY AND ECONOMIC RECOVERY AFTER COVID-19**

*Presentation by Mr. Thomas K. Cheng  
University of Hong Kong*

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# Industrial Policy and Economic Recovery after Covid-19

THOMAS K. CHENG

UNIVERSITY OF HONG KONG

UNCTAD RPP

DEC 17, 2020

# What is Industrial Policy?

- Johnson (1993):
  - Industrial policy is the initiation and coordination of governmental activities to leverage upward the productivity and competitiveness of the whole economy and particular industries in it
- Lawrence (1986):
  - Industrial policy refers to “all policies designed to affect the allocation of resources between and within sectors of the economy”
- One of the hallmarks of industrial policy is selectivity:
  - Industrial policy is “selective intervention or ... an effort by a government to alter the sectoral structure of production towards sectors it believes offer greater prospects for accelerated growth” (Noland and Pack (2003)).

# What is Industrial Policy?

- Another characteristic of industrial policy is its focus on the promotion of structural change: the principal aim of industrial policy is to accelerate structural changes towards more productive and dynamic activities (Price (1981)).
- Rodrik (2007):
  - Industrial policy is “a state of mind more than anything else”, at least as applied to the East Asian countries, where the government has a singular, if not borderline obsessive, focus on the goal of economic growth and development
- Cimoli et al (2009):
  - Industrial policy encompasses policies affecting ‘infant industry’ support of various kinds, as well as trade policies, science and technology policies, public procurement, policies affecting FDIs, IPRs, and the allocation of financial resources
- Industrial policy encompasses a diverse range of policy tools to create the right environment for domestic firms to grow, improve productivity, and upgrade their technology.

# What is Industrial Policy?

- Economists have drawn a distinction between horizontal policies and vertical policies (Altenburg and Lütkenhorst, 2015)
  - What distinguishes horizontal policies from vertical policies is the lack of selectivity - vertical policies are sector-specific in their application.
  - Horizontal policies rarely, if at all, conflict with competition law.
  - By contrast, vertical policies, which are by definition sector- or firm-specific, most likely clash with competitive law enforcement (e.g. government-sanctioned cartels, permissive merger enforcement to create national champions).

# Economic Measures Adopted in Light of Covid-19

- Direct employment support in exchange for no redundancies
  - In the UK:
    - Providing firms £1,000 per furloughed employee retained until end-January
    - Paying the minimum wage for 25 hours per week for six months for young workers at risk of long-term unemployment
    - Increased resources to enhance skills and facilitate reinsertion in the job market;
    - Temporary reductions of the VAT rate for hospitality, accommodation and attractions and the real estate transactions tax
    - Increased public spending on infrastructure (including on green projects such as retrofitting houses to improve energy efficiency)
- Support for individuals and households that are unable to work as a result of the need to self-isolate
- Directly subsidized loans and loan guarantees to businesses, big and small
- Other forms of subsidy to businesses
  - In the UK: property tax holidays, direct grants for small firms and firms in the most-affected sectors, and compensation for sick pay leave
- Central bank purchases of corporate bonds
- Measures to promote consumption such as restaurant patronage and domestic travels
  - A program to subsidize dining out during the month of August

# Industrial Policy and Competitive Concerns?

- Should we be concerned about industrial policy creeping into these crisis measures? Have the crisis measures so far raised concerns about distortion of competition?
  - Government policies in response to Covid-19 so far have been mostly horizontal policies that by and large do not raise concerns and conflicts with competition law enforcement. Most measures have been available on an economy-wide basis and with no firm selectivity.
  - But there are already concerns of de facto selectivity – some of these measures may have distorted the playing field:
    - Differential access to government support



# A Time for Industrial Policy?

- Is the crisis an appropriate time for industrial policy interventions?
- Most cited justifications for industrial policy:
  - Addressing coordination failure
  - Capturing economies of scale
  - Developing dynamic competitive advantages
  - Creating rent to overcome information externalities
- Industrial policy is difficult to get right.
  - It only tends to be beneficial if used offensively to pursue efficiencies and to develop dynamic advantages.
  - It is generally ineffective for helping struggling firms that lack long-term competitiveness. Defensive of industrial policy that protects inefficient firms tend to fail, e.g. import substitution in Latin America.



# Competition Concerns Going Forward

- Concerns with competition law enforcement and competition policy may arise as governments deal with the long-term consequences of Covid-19:
  - Crisis or rationalization cartels:
    - Japan's experience
  - Mergers involving failing firms:
    - Applicability of the failing firm defense
    - Greater willingness to accept the efficiencies defense?
  - Temptation to protect national champions, especially in certain industries such as aviation:
    - National champion policy tends to only work in pursuit of efficiency rather than protection of struggling and failing firms
      - Studies have also found that government interventions to protect national champions tend to retard technological progress and growth, rather than spur productivity growth (Falck et al, 2011).
      - It was said that POSCO's success can be explained by the fact that it was subject to price cap regulation by the government which forces the firm to pursue continual improvements in productivity (Lewis, 2005), and the fact that the Korean government put in place measures to ensure its operational autonomy and shield it from political interference (Rodrik, 1995).

# Competition Concerns Going Forward

- Concerns with competition law enforcement and competition policy may arise as governments deal with the long-term consequences of Covid-19:
  - Government subsidies may retard phasing out of obsolete industries and the inevitable structural transformation of the economy:
    - What is the rationale for such subsidy and ongoing firm support?
    - When should government support be phased out?
  - Big firms growing larger as small firms fail due to lack of access to capital to withstand the crisis:
    - Bankruptcy wave in 2021?
    - What can governments do about this?