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ECONOMIC VIEWPOINT
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Industrial Policy Revisited

Industrial policy has always been controversial and practiced by many countries in some fashion or other. The development experience that most exemplifies successful industrial policy (IP) is that of South Korea, where despite its excesses and negatives, it was part of a package of successful policies pursued by a government-led development strategy.[i] Given the later benefits from this heavy interventionist period of the 1970s and 1980s, as seen in the example of Samsung, Hyundai and other global firms, many countries have flirted or experimented with IP, usually at their own peril. The dominant flaw has been the adoption of IP without 1) the requisite underlying economic fundamentals; 2) the coordination of a range of complementary but necessary policies to make IP work; 3) the clear export yardstick to gauge efficiency of production; and 4) the existence of a viable concordat between the public and private sectors.

That said, the most recent example of a strong IP has been that of China, and there are often comparisons to what Korea did. There are huge differences between China's IP efforts and those of Korea in previous decades. First, the sizes of their respective economies are quite dissimilar; second, global economic circumstances are distinctly different; and third, the geo-political position of China and its role in Asia is quite unlike that of a divided Korea.

To be specific, China is the second-largest economy in the world, an economy wielding substantial economic power, whereas Korea was a small player by comparison, whose actions didn't unsettle markets or affect global outcomes. Moreover, Korea's export push that led to prodigious growth rates came in a time of relative openness in international trade and generally robust global growth. Neither of these circumstances exists today, when prospects are dimmer and the gains from trade are increasingly offset by national economic challenges. And finally, Korea has been in a defensive mode since the end of the Korean War, not flexing any geo-political muscle, nor tangling with East Asian nations over disputed islands, nor expanding its military reach.

For many of these reasons, China's current IP and, even more worryingly, its future IP aims are of legitimate concern to many advanced economies. Abstracting from the Trump Administration's rhetoric, threats and faulty analysis, there is a strong case for the largest and arguably most open economy in the world to seek defensive measures in the face of an avowed policy of state capitalism. The bipartisan U. S. Intellectual Property Commission has argued in favor of actions against technology theft for many years[ii], although to be fair, U. S. corporations have often been complicit, driven by short-term profit motives and immediate shareholder value concerns rather than strategic positioning.

The issue of 21st century industrial policy has come into sharp focus with the publication in 2015 of the *Made in China 2025 Report*, staking out sectors where economic dominance was being sought.[iii] The report extends China's innovation focus to 10 strategic sectors in which it strives to become a manufacturing superpower. This push into smart manufacturing will prove to be a challenge to advanced economies. According to the Mercator Institute for China Studies, South Korea will actually feel the greatest competitive pressure, followed by Germany, the Czech Republic and Japan. [iv] The process by which foreign technology will be replaced by local capacity and the top-down implementation of the government's strategy can well be described as 21st century industrial policy. It is being driven in part by the realization that the excess capacity of China's low-end manufacturing will persist and that it is therefore essential that movement up the value-chain be accelerated and actively fostered.

What makes China's new IP different from that of other East Asian economies is not only the scale of state funding and the aggressive pursuit of foreign technology via joint ventures, acquisitions or appropriation, but also the use of other powers of the state. When combined with local content goals, efforts to control essential core technologies, and concerted plans to develop dominant national technologies, it is fair to say that non-market mechanisms will be seen in the coming decade in a way not seen deployed heretofore by a major economic power.

The *2025 Report* clearly identifies the major industries—artificial intelligence, robotics, electric cars and new materials, among others—that China aims to dominate in the coming decade. This would not have been an attainable goal, had China not been allowed to skirt the rules on intellectual property over the past two decades or more. While defensive actions now may be too little too late, it does raise the question of what governments should do when the second-largest and fastest-growing economic machine has a clear strategy in mind to obtain dominant positions in advanced high-tech industries, and is willing and able to deploy all powers of the state in that quest.

Globalization is under attack, and often, national industrial policies are now spoken of in polite company. We have seen France list several dozen strategic industries where government would like to see a French presence, however, little has come of this. Germany has more clearly defined “Industry 4.0” approach that may bear fruit and may have been the harbinger for China’s own innovation cum technology push. However, none of these programs can be seen as being in the same realm as the Chinese commitment to an active industrial policy.

As Prof. Dani Rodrik noted a few years ago in *The Globalization Paradox: Democracy and the Future of the World Economy*, democratic regimes that need to satisfy their electorates through smart national policies may not have the luxury of being super-globalists. [v] Naturally, national governments, including the U.S. government, have misplayed their hands considerably and essentially aided and abetted worsening economic prospects at home for a large part of the population; however, they have also turned a blind eye to misbehaviors, both by their own corporations (e.g., tax sheltering, tax inversions) and by state capitalists masquerading a private firms. [vi] Global checks and balances put in place to prevent abuses of globalization have not worked well, either. This has led us to an unfortunate choice: join the new IP phase of global policy, which can be damaging for many, or continue to keep one’s head in the sand and hope for a change of direction from China that is unlikely to happen.

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[i] See Kim, Kihwan and Danny Leipziger, “Korea: A Case of Government-led Development,” in D. Leipziger (ed.), *Lessons from East Asia*, U. of Michigan Press, 1997

[ii] See The Intellectual Property Commission’s recent “Update Report on the Theft of Intellectual Property: Reassessment of the Challenge and U. S. Policy,” 2017.

[iii] State Council of China, “ Made in China 2025,” Beijing, 2015

[iv] Mercator Institute for China Studies (MERICS), “Made in China 2025: The Making of a High-tech Superpower and Consequences for Industrial Countries,” Berlin, 2016

[v] Rodik, Dani, *The Globalization Paradox: Democracy and the Future of the World Economy*, W. W. Norton, New York, 2011

[vi] See Leipziger, Danny, “Make Globalization More Inclusive or Suffer the Consequences,” *VoxEU*, Dec. 8, 2016.