Interview with Dr. Karl Aiginger, Director of the Policy Crossover Center: Vienna-Europe

# Industrial Policy to Be Highlighted in the Age of the Pandemic

By *Japan SPOTLIGHT*

**Industrial policy is today attracting growing attention mostly due to emerging nations' economic progress, in particular China. In this age of Covid-19, industrial policy will have significant implications for economic performance through its diverse impact on productivity, growth, competition, employment, and social needs. The range of its impacts on economy and society will be noteworthy compared with macroeconomic policy, the impact of which is limited to growth and employment. With the pandemic, there will be significant changes to industrial structure, such as a rise in IT software business due to the expansion of teleworking and a decline in face-to-face services deriving from a change in social needs.**

**Dr. Karl Aiginger is the director of the Think Tank Policy Crossover Center Vienna-Europe and teaches at the Vienna University of Economics and Business Administration. He served as director of the Austrian Institute of Economic Research (WIFO) from 2005 to 2016, is a distinguished expert on industrial policy, and has contributed to many studies commissioned by the European Commission and the OECD. Our interview with him via email is as follows.**

**(Interviewed on July 17, 2020 by email in answer to our questionnaire)**

## Background to the Growing Interest in Industrial Policy

**JS: Could you please explain the background to the increasing interest in industrial policy worldwide?**

**Aiginger:** A variety of trends have contributed to the renewed interest. In the developing world, there has been a pushback against the market-fundamentalist approach, typically associated with the Washington Consensus. Even when growth rates have been high, economies in Sub-Saharan Africa and Latin America have experienced unsatisfactory rates of productive transformation and shortfalls in generating quality jobs in manufacturing or modern services. And growth is too low relative to high population growth. This has created a demand for proactive government policies to diversify and upgrade economies beyond simply freeing up markets. In the advanced economies, generalized labor market malaise and the lingering effects of the financial crisis have produced similar effects. Low growth dynamics occurred especially in the eurozone, as countries with trade and budget double deficits with a common currency struggled to come out of the crisis. The continuing decline in the employment shares of manufacturing in the United States and persistent high unemployment in Western European countries and the increasing competitive threat posed by China on world markets have pushed in the same direction. Interest in industrial policy is being further stimulated by disruptive technological change – from automatization to digitalization, Industry 4.0, and the Internet of Things.

*Dr. Karl Aiginger*

## Success & Failure of Industrial Policy

**JS: You have done research on industrial policy success stories. Could you tell us about some successful cases or cases of failure?**

**Aiginger:** As the greatest success we can mention East Asian countries like South Korea, Japan and their type of market-driven approach, combined and directed by technocratic state planning (dual approach). In Europe remarkable progress has been seen in Ireland, where a lagging country achieved high per capita income that led to the return of emigrants. The success was built on inward investment and low corporate taxes – where the latter would have been punished by competition policy if Ireland was not so small (see the struggle about tax exemption for Apple, where a European court recently cancelled a high penalty caused by forbidden subsidies). But Ireland insisted also that multinationals investing in Ireland cooperated with Irish small and medium-sized firms and it upgraded its educational system from preschool to vocational training and universities to provide an excellent workforce.

The biggest failure we saw was in France. Here a small insider group of mainly male managers and civil servants, trained in elite universities, all unused or unwilling to speak English and opposing diversity, supported domestic champions in the airline, space, nuclear energy and armaments, and finally heavy industries. The French have always advocated a sectoral approach in industrial policy, originating in

planification. This defines sectors thought important in the future, a policy approach which becomes more and more difficult in a time of quick technological change and digitalization. Thus, the share of manufacturing has declined to less than 15% due to a lack of firms in machinery and consumption industries. High-speed trains and Airbus are the rare success stories. France now has a trade deficit, low research expenditures, large regional differences and suburbs bursting with nonintegrated migrants. Italy has lost a lot of successful industries too, since it could not industrialize the south of the country and did not engage in partnerships with countries on the other side of the Mediterranean (called *Mare Nostrum* but neglected by industrial policy as a driver of exports), and its governments based on unstable majorities aggravated the problems.

The backlash in Japan is another sign of failure. In the 1990s, US universities where I had the opportunity to research and lecture had been focusing their industrial development efforts on high value-added and sophisticated industries like the car industry. But two lost decades followed in which growth was anemic. Japan discovered that high research efforts and good schools do not suffice if the workforce is declining, management is aging and forced to retire at the obligatory retirement age, immigration is restricted and industry is dominated by old-boy networks and the advantages of change and diversity are neglected. No changes have been seen in the planning system, chances to pursue renewable energy have been neglected (remaining at between 5% and 10%) and the country has the lowest rate of females in parliament and the media.

**JS: What major factors do you think are key to the success or failure of industrial policy?**

**Aiginger:** It is all important that industrial policy supports a high-road path. It has to be driven by technological, societal, and ecological demands. Looking for low wages, restricting imports, and opposing globalization yields only short-term relief and aggravates problems in the long run. Research and lifelong training is an enabler, as is heterogeneity of managers, lifelong learning and sabbaticals. And maybe the most important features of success are that industrial policy does not fine-tune, but defines broad areas of advantages, and that the goal of industrial policy has to be steered by societal goals. If fighting climate warming is a priority, energy saving is an all important goal. If society is aging and the population shrinking, migration should be made possible and technologies shared with the leading industrial countries, and cooperation with rising stars should be seen as a source of innovation. Japan's absence in Africa is a disadvantage for Africa, but even more for Japan because its perspective is dwarfed.

**JS: Do you think China's industrial policy has achieved great success?**

**Aiginger:** China now enjoys the highest share in manufacturing, higher than the US and Europe. It is lagging in natural resources and in resource productivity, and still has a high share of low quality products. The government addresses these problems in the China 2025 strategy and even more in its vision for 2050, in which it plans to lead in several important industrial sectors by 2050 and has started to do so already in electric batteries and photovoltaic panels. Its Belt and Road Initiative will support its quest for raw materials and fossil fuels, but it is also a very egoistic project so that backlashes are to be expected. China will learn that success in manufacturing cannot be combined with strategies to extend its territory (such as in Hong Kong or artificial islands in the South China Sea) or to suppress the Uighurs in the north or cheat on intellectual property rights.

**JS: In the light of the current trend of evidence-based policy making, do you think industrial policy needs to be subject to cost-benefit assessments or can it be assessed by quantitative analysis of its impact on the economy?**

**Aiginger:** Cost-benefit is a technical term. I would like to monitor the success of industrial policy as a recurrent evaluation of its goals, what instruments are planned *ex ante* and which worked or were counterproductive. If you take as a societal goal not only income growth but fighting climate change, you see immediately that an industrial policy based on coal and oil is not sustainable, and it is even counterproductive, as are resources imported from faraway countries using ships and trucks with high emissions. Such a low-road path may lead to a short-term advantage but it reduces the quality of life and health in the long run and cannot be the result of an industrial policy steered by societal goals.

## Competition Policy & Industrial Policy

**JS: If one of the key missions of industrial policy is to raise the overall productivity of the economy, should it be devised to encourage inter-firm competition to achieve this goal? If so, would competition policy be important as well?**

**Aiginger:** My answer has two elements. First, increasing productivity is an essential element of a high-road policy, but it is important which type of productivity is concerned. Increasing labor productivity makes ever higher growth necessary to provide jobs for an increasing workforce but may on the other hand increase greenhouse gases and omissions. Increasing energy and resource productivity yields the same cost-saving and profit-increasing effect but lowers emissions and smog. Redirecting productivity from labor saving to resource saving should be a part of a renewed industrial policy.

Secondly, industrial policy has to be no silo policy but a policy with synergies – e.g. with the competition policy. Without competition, incentives for technological improvements would be very low, but it is also important that firms which invest in innovation and training its workforce have profits to recover the costs and risks of innovation. So industrial policy, innovation policy and competition policy, and also environmental goals, have to work together to yield the optimum outcomes for society

## Goals of Industrial Policy

**JS: Do you think the objectives of an industrial policy must be diversified, including goals such as job security, energy saving, and health promotion? In**

**this light, how do you assess Japanese industrial policy? It seems to have been pursuing a variety of policy goals, like dealing with the needs of an aging society or promoting high value-added industrial structures.**

**Aiginger:** Japan has managed an extremely successful postwar performance. A destroyed and occupied country achieved high growth over decades, approaching the technology frontier in 1990. An ambitious industrial policy targeted sectors and supported horizontal *Keiretsu*. Collusion between large firms steered by the industry ministry, cross-ownerships and cheap finance were the pillars of this success. Industrial policy was so impressive that the US questioned what Japan did better, for example, in the automotive industry. However, since the 1990s growth has decelerated and two lost decades ensued. Fiscal deficits piled up to a public debt more than double GDP. Up to now, corporate Japan, pension funds and citizens have been willing to buy government bonds, despite their low returns.

But to answer this question I would repeat my remarks that industrial policy should be directed by societal goals and must not be a silo policy but one that develops synergies with competition, innovation, education, and climate policy, as well as an intelligent immigration policy to prevent the aging and petrification of society.

**JS: What issues do you think need to be urgently resolved by industrial policy in Japan?**

**Aiginger:** Japan had been in the vanguard of modern industrial policy up to 1990. When I was a researcher at MIT everybody looked at Japan since it was expected to surpass the US in various high-technology markets. Industrial policy in Japan is no low-road policy: research expenditures and achievements in tertiary education are higher than in the US and Europe, for example. Japan shifted its policy from sectoral priorities to a cluster approach, trying to imitate the success of Silicon Valley, which proved impossible for 20 clusters spread all over Japan. Six reform priorities were set by the government of Prime Minister Ryutaro Hashimoto in the late 1990s, among them corporate law, social security, administration and regulation requiring government involvement. Since then economic growth has remained slightly below 1 percentage point. Japan has given up some of the constituent elements of its old industrial policy, such as targeting sectors and protecting firms from competition, but it does not use the accelerators of a new industrial policy based on the driving forces of societal goals.

Japan signed the Paris Agreement on climate goals, but this is reflected in neither its industrial nor its tax policies. Small-particle air pollution is above the recommended maximum and causes 500 early deaths per million people. The share of renewable energy is half of the OECD average. Thirty new coal-fired power plants are still being planned today, which makes it impossible to reach the Paris climate goal neutrality by 2050. This is clandestinely acknowledged in the statement asserting that neutrality should be achieved "as early as possible" in the second half of this century. This is not just incompatible with the signing of the Paris Agreement; it is also to the disadvantage of the economy. An ambitious policy would boost growth: a technology leader enjoys first-mover advantages and saves lives.

## Pandemic's Possible Impact on Industrial Policy

**JS: Will the pandemic today possibly change the nature of industrial policy?**

**Aiginger:** The pandemic helps us to discover hidden problems. Single sourcing to exploit small-cost advantages make no sense, but this should not be the end of globalization but a change from a turbo globalization to a responsible globalization. Countries in which an industrial policy is not a silo policy but connected with health management, equality of races, and openness of hospitals for all strata of society have been much more successful in preventing the worst negative consequences for the economy. The pandemic will increase inequality and lead to racial conflicts and new waves of immigration if leaders first deny the problems and then react abruptly to them.

**JS: Would industrial policy be effective in restoring global supply chains damaged by the pandemic?**

**Aiginger:** Global supply chains will not be damaged by the pandemic but will need to be reconsidered, such as the locations of production facilities. But working conditions may also need to be considered under labor policy, a kind of industrial policy, because there will have been large differences in health support for the rich and the poor during the pandemic. There will also be competition between large companies and SMEs, in particular in the small service or retailer sectors, which could push the latter out of the market.

**JS: Like competition policy or intellectual property rights, do you think there is a need for international harmonization of industrial policy?**

**Aiginger:** Harmonization of instruments and outcomes is neither advantageous nor feasible. It is important that goals are defined and agreed, and then countries can define their priorities and preferences. An international organization has to monitor the adequacy of country strategies.

This three-stage approach is well documented and optimal in climate policy. Some 180 nations have agreed that the problem of climate warming exists and that a large proportion of it is caused by human beings. Each country that has signed the Paris Agreement has to present a strategy to contribute to the common goals. The strategies are then evaluated and must be adjusted if the combined effect is not large enough.

This is for me the best combination of top-down elements which are necessary with bottom-up elements which support commitment and searching for the unknown. That may be a good summary of a forward-looking industrial policy: it is a process of searching which will help improve our societies and individual well-being.

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