



Industrial Policy is Back. Is That a Good Thing?

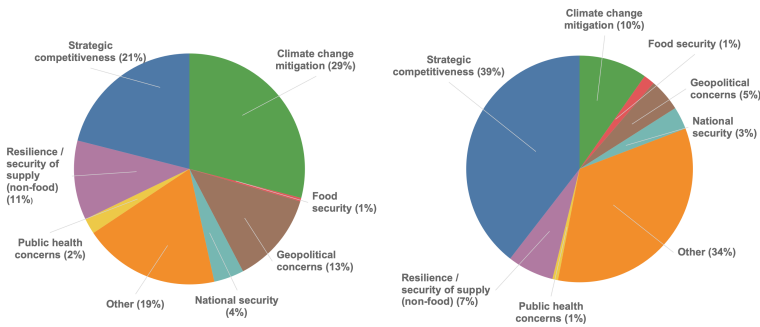
By [Anna Ilyina](#), [Ceyla Pazarbasioglu](#) and [Michele Ruta](#)
International Monetary Fund

SHARE OF TRADE-DISTORTING INDUSTRIAL POLICIES BY MOTIVE

JANUARY 2023 – JUNE 2024

Advanced Economies

Emerging Market and Developing Economies



Source: Evenett, Jakubik, Martin, Ruta (2024).
Note: Cumulative stock of measures since January 2023. For measures with multiple motives, each motive is given equal weight.

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The Issue:

Industrial policy is experiencing a revival. This time it is the largest countries that are leading the resurgence as they seek to actively steer the structural transformation of their economies to advance green transition, to boost resilience of critical supply chains and to encourage innovation and domestic production for economic or national security reasons. The latest prominent example of what could be viewed as a call for a large-scale industrial policy is Mario Draghi’s report on the “[Future of European Competitiveness](#)” (https://commission.europa.eu/document/download/97e481fd-2dc3-412d-be4c-f152a8232961_en) (September 2024). However, the renewed enthusiasm for industrial policy should be tempered with some [caution](#) (<https://www.ft.com/content/4e884cb1-7300-460d-885d-f667640c7812>), and care must be taken with industrial policy design, implementation, and governance to get it right.

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There have been about 4,000 trade-distorting industrial policy measures worldwide between January 2023 and June 2024.

The Facts:

- **Industrial policies**

(<https://www.annualreviews.org/content/journals/10.1146/annurev-economics-081023-024638>) typically refer to targeted government interventions that aim at steering the structural transformation of the domestic economy to achieve certain economic or non-economic objectives. Because industrial policies aim at supporting specific domestic firms, industries, or even activities, they are often referred to as 'vertical' policies in contrast to the so-called 'horizontal' policies that apply to all firms and sectors. **Economists** (<https://academic.oup.com/wbro/article-abstract/21/2/267/1682363>) have long debated the merits and drawbacks of industrial policies. Such policies can potentially deliver net economic benefits if well-designed, directed to address well-identified market failures, and based on competition-enhancing principles and sound cost-benefit analysis. Examples of market failure include a lack of know-how or capital-market imperfections that unjustifiably hold back investment and can be countered by government support such as supporting scientific research and providing financing opportunities.

- **However, because industrial policies aim to alter the incentives of private firms, they also entail a risk of resource misallocation and sizable fiscal costs that can become more apparent over time.** Reflecting government capture, such policies tend to be maintained for much longer than justified, because the benefits are concentrated in a few who can exert strong political pressure to keep them in place while the costs are diffused over a wide population and hard to measure. These policies can also affect trade, investment, and financial flows as well as global market prices, which could have significant implications for trade partners and the global economy.

- **Historically, the track record of such policies is mixed.** Many developing countries in Latin America and Asia sought to develop their economies after the Second World War through import substitution based on high tariffs and domestic subsidies to encourage growth particularly of manufacturing sectors. In many cases, the end-results of these policies were highly inefficient industries lacking in innovation and dynamism, since protected local markets curtailed incentives to domestic entrepreneurs to maintain international competitiveness. By the 1990s, it became clear that the most successful cases in Asia of sustained rapid growth, such as Korea, were successful because of their commitment to fostering a competitive environment for exports, more than the use of industrial policy (<https://www.elibrary.imf.org/view/journals/022/0060/002/article->

[A004-en.xml](#)). Other features of their economies (such as high domestic saving rates) as well as a favorable global economic environment played a role as well. With some exceptions, the golden age of globalization up to the 2008 global financial crisis saw industrial policies mostly falling into disuse.

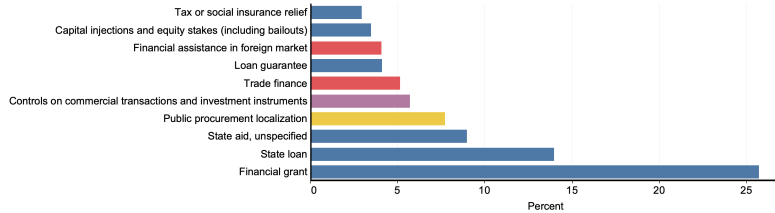
- **As the global environment became more challenging in recent years, there has been a remarkable resurgence of interest in industrial policies.** It's noteworthy that this surge in interest seems to reflect both the traditional concern with encouraging domestic industrial growth at a time when global markets seemed to offer more limited opportunities as well as a range of new, more strategic objectives. For example, first China and then the United States have launched major efforts to encourage domestic production of computer chips (<https://www.piie.com/publications/working-papers/how-united-states-marched-semiconductor-industry-its-trade-war-china>), electric vehicles, and solar panels, using combinations of domestic subsidies and import barriers, such as tariffs and local content requirements.
- **There have been about 4,000 trade-distorting industrial policy measures worldwide between January 2023 and June 2024.** This figure comes from the [New Industrial Policy Observatory](https://www.imf.org/en/Publications/WP/Issues/2023/12/23/The-Return-of-Industrial-Policy-in-Data-542828) (<https://www.imf.org/en/Publications/WP/Issues/2023/12/23/The-Return-of-Industrial-Policy-in-Data-542828>) (a joint initiative of the IMF with Global Trade Alert) which was created to help track and understand this new wave of industrial policy measures. The 4,000 measures are defined as those that potentially discriminate against foreign commercial interests by restricting market access or by altering the conditions in favor of local firms. Advanced economies account for 60 percent of the new measures implemented over the period, while emerging markets and developing economies account for 40 percent. The largest economies like China, the European Union and the United States have been most active in the new industrial policy space.
- **While competitiveness, the traditional motive for industrial policy, has still been behind 26 percent of industrial policy interventions since January 2023, new motives are now far more dominant.** Overall, 24 percent of all such recent measures are aimed at climate change mitigation, 14 percent at addressing national security and geopolitical concerns and 10 percent at improving supply chain resilience (see chart above). Indeed, these new motives, especially climate change mitigation and geopolitical concerns, seem to be increasingly more prominent: they accounted for 52 percent of all such measures in the first half of 2024, up from 45 percent in 2023. This pattern has been mainly driven by advanced economies, while in emerging markets and developing economies industrial policies are still more often motivated by competitiveness.
- **Subsidies appear to be the most commonly used policy instrument.** However, here again there are differences between advanced economies and emerging markets and developing economies (see chart below). Advanced economies are more likely to use direct financial grants, state loans, and state aid, while trade restrictions are more frequently used by emerging markets and developing economies. Moreover, the popularity of instruments such as local content

requirements, controls on foreign investment, and public procurement localization has been on the rise in the first half of 2024 relative to 2023. This may be an indication that governments are becoming less hesitant to use openly discriminatory measures, including those that are in clear breach of the WTO commitments.

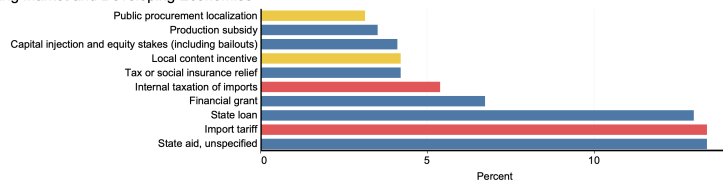
TYPES OF INDUSTRIAL POLICY TOOLS USED

JANUARY 2023–JUNE 2024

Advanced Economies



Emerging Market and Developing Economies



Source: Evenett, Jakubik, Martin, Ruta (2024).

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- Recent analysis of the “new industrial policies” confirms a need for caution (<https://www.ft.com/content/a1a99a43-eca1-42ac-942b-30351daba248>). In some cases policies that aim at improving the general business environment rather than targeting specific sectors would have been more appropriate as they carry a much lower risk of resource misallocation and potentially lower fiscal cost. There is also evidence that industrial policy interventions focusing on a certain product are more likely if that same product has been the target of interventions by other trading partners. Thus, industrial policy measures often create cross-border spillovers (<https://www.imf.org/en/Publications/WP/Issues/2024/03/01/Trade-Spillovers-of-Domestic-Subsidies-545453>) that may induce other governments to react in a similar way. There is also evidence that industrial policies can be captured by political interests that may be at odds with economic efficiency. Analysis (<https://www.imf.org/en/Publications/WP/Issues/2023/12/23/The-Return-of-Industrial-Policy-in-Data-542828>) shows a correlation between industrial policy measures and political economy variables such as the presence of an upcoming election and that such measures often favor sectors already well established in global markets.

What this Means:

While industrial policy can, in principle, help address market failures, the bar to get it right should be high. Careful industrial policy design, implementation, and governance are critical to minimize distortions, avoid or mitigate government failures,

contain fiscal costs, and avoid negative cross-border spillovers. A recent [IMF policy paper](https://www.imf.org/en/Publications/Policy-Papers/Issues/2024/03/11/Industrial-Policy-Coverage-in-IMF-Surveillance-Broad-Considerations-546162) (<https://www.imf.org/en/Publications/Policy-Papers/Issues/2024/03/11/Industrial-Policy-Coverage-in-IMF-Surveillance-Broad-Considerations-546162>) outlines some principles drawing on a growing literature on industrial policies. Policies should be: well-justified by addressing market failures and overseen to reduce the risk of political interference; appropriately targeted and temporary; and based on a comprehensive cost-benefit assessment and compatible with fiscal sustainability, domestic and external stability, as well as with countries' international commitments. International organizations such as the IMF, OECD, World Bank, and the WTO can help collect information, develop analytical frameworks for assessing benefits, costs, and cross-border spillovers, analyze the uses and appropriate design of industrial policy measures, disseminate best practices, and promote multilateral dialogue. Direct dialogue and cooperation across countries is also important to achieve common objectives, such as a green transition, and to avoid harmful retaliatory measures.

TOPICS: [TRADE](#)

Written by [The EconoFact Network](#). To contact with any questions or comments, please email contact@econofact.org.