Discuss and Analyze the Role and Impact of Industrial Policy on Economic Development and especially in Developing Countries, (Between Opponents and Supporters)

Teacher: Dr. Maryam Saleh Shafik
Baghdad University/Ibn Rushd School of Humanities/ Department of Geography
E-mail: dr.maryamsalehsh@gmail.com

DOI: 10.31973/aj.v1i137.1105

ABSTRACT:
Different countries, especially developing ones, have resorted since the middle of the last century to using industrial policy in order to expand the industrial base and push forward the economic development wheel. Tangible results have been achieved in many Asian countries, while no such results have been achieved in the countries of Latin America and Africa. Support has been dropped for the application of industrial policy since the mid-eighties of the last century because of the negative consequences resulting from it and then return again in the recent period.

The research aims to analyze and discuss industrial policy and the extent of the need to use it in developing countries, it focuses on discussing the ideas and propositions of the two different approaches towards industrial policy. The first represents the position of those opposed to the industrial policy, and the second represents the position of those who support it. Those opposed to the industrial policy are the neoliberals in the United States of America who stress the role of the market in achieving development and point to the negative effects of industrial policy, while in favor of industrial policy book theoreticians Many economists because of the existence of globalization and the WTO rules and the changing nature of the global economy and that creates difficulties and impediments to developing countries and weaken the influence of industrial policy.

Through analysis and discussion of the various propositions and evidence, the research ends with recommending the use of a carefully formulated industrial policy as a means to achieve economic development in developing countries and overcome the negative effects on them. With the call to adjust the policies and rules of the World Trade Organization and the global economic system in line with the need of developing countries for the development of industrialization and promoting economic development.
Key words: Industrial policy, World Trade Organization, economic development, industrialization, globalization, industrial clusters, market failure.

-Introduction:

Developing countries seek, by various means and methods, to achieve economic development, whether through establishing appropriate infrastructure, encouraging investment (public and private), or diversifying the production structure and achieving economic growth. Given the importance and role of the industrial sector in the development process, these countries adopt development strategies and plans and define appropriate industrial policies. Due to the importance of the aforementioned policies, the research here will focus on analyzing, discussing and evaluating the various aspects of industrial policy that are appropriate for developing countries, whether positive or negative, in light of the prevailing global economic and trade environment and the past experiences of different countries.

In the middle of the last century, many countries in most regions of the world resorted to expanding the industrial base and developing the main sectors therein through the application of industrial policy, and industrial policy still plays a role in the general policy decisions of countries and affects the behavior of development agencies. Tangible results have been achieved in many countries (including some Arab countries) in establishing various industries, but in the 1980s the prevailing idea of industrial policy changed, as the traditional approaches to industrial policy have led to a misdistribution of labor and capital among the different industries, and the expected improvement in the long-term growth in total productivity has not been achieved, therefore, some considered that the industrial policy added many costs to the concerned economies, which were reflected in corruption and weak financial systems, as well as it works to redistribute resources between industries in the form that does not match the market signals and thus operate on the market distortion.

In recent decades, the need for industrial policy has increased in various countries, especially developing ones, due to the phenomenon of globalization and the emergence of the World Trade Organization as well as the changing nature of the global economy, especially developing ones, due to the phenomenon of globalization and the emergence of the World Trade Organization as well as the changing nature of the global economy. All these factors have created difficulties for developing countries as they strive to adapt to the new environment its capabilities and portability have been diminished by the restrictions brought about by the new international trade rules conditionality imposed by international Financing institutions on developing countries intending to borrow them that. The neo-liberal
policies have left their mark on the world economy. The neoliberals assert that there is now no place for industrial policy in development and that trade and development must be left to the work of market forces and trade liberalization is relying on it to change the structure of incentives in favor of exports and attract private investment to areas where the country has a comparative advantage leading to industrialization and growth (Shafaeddin, M. S. (2005). p. 155, 2020).

Research importance:

Comes the importance of research of the importance of industrial policy itself as an important tool of development policy implementation tools, therefore, the more appropriate and effective that industrial policy is, the more goals the said policy seeks to achieve, and vice versa.

Research problem:

There are some questions that the researcher raises and tries to answer them, the most important of which are:

1 - Is there a need for the use of industrial policy?
2 - What are the justifications for using industrial policy and what are the criticisms directed at it?
3 - What is the required position of industrial policy in developing countries in light of the rules of the World Trade Organization and the global economic reality?

Research aim:

The research aims to discuss and analyze the role and impact of industrial policy on economic development and especially in developing countries, and then access to the appropriate position on the industrial policy of the mentioned countries.

Research methodology and structure:

The research depends on the descriptive and analytical method, and on the basis of economic theory and development theories in particular. To achieve the goal will address the following topics:

1 - (Definition of Industrial Policy):

There are many different definitions of the term industrial policy, (Wilson, P., & Primi, A. (2009).) on the one hand, (Reich, R) defines the great advocate of industrial policy in the United States as a system of government measures designed to support industries that possess export potential and job creation and support infrastructure for production. There are those who use a broader definition (such as Pinder, J) to include all policies designed to support the industry including financial and monetary investment incentives, direct investment, processing programs, and incentives for research and development and policies to support small and medium industries.

Such a definition includes direct support for the establishment and improvement of physical infrastructure, social, political, trade and
competition policy and procedures for preventing the formation of monopoly. In contrast, there is a definition that uses the narrow concept of industrial policy (Johnson, C), which is viewed as those governmental activities aimed at supporting development in some industries to maintain international competitiveness. There is another approach adopted by (Lardsmann, M), which emphasizes in its definition on the selective content, Where he says that industrial policy is one that differentiates and chooses between industries, sectors and development agencies, and that it is designed for every selected industry and every sector within the national economy. There are those describing industrial policies as government measures to support the process of creating productive capacities and technology in industries considered strategic for the purposes of national development. World Bank For his part, gives a practical definition of industrial policy which emphasizes that industrial policy represents the government's efforts to change the industrial structure in order to encourage productivity-based growth (Bijit Bora, Peter Lloyd and Mari Pangestu, (2000), p, 13).

On the other hand, there is another definition of industrial policy (Gibb, H., Trade, U. A. P., & Investment Initiative, (2007).), related to a different approach to industrial policy. It serves as a fitting combines Schumpeter theory of ideas (Howard Pack and kamal Saggi, (2001),) (Schumpeter) and the evolutionary theory and structural theory, which calls for interference in the public and private sectors in industrial development, according to this approach, the industrial policy is a system of tools (procedures and forms of direct intervention in the economic) activity, So that the state can, through it, encourage and develop specific economic activities.

Accordingly, the industrial policy, even if its concepts differ in expansion or narrowing, it serves as a means to achieve the development goal of building productive capacity and manufacturing.

And the process of implementing the industrial policy depends on a set of different tools, including:
A - The establishment of basic strategic and other industries by the government directly.
B- Establishing or encouraging the establishment of industrial groupings (Conglomerations). This means the union of a number of industries with each other into one establishment.
C - The use of different price and non-price protection means to encourage industrial investment.
D - Provide tax and financial incentives in certain investment areas.
E - Providing short, medium and long term concessional financing for industrial investment.
The establishment of infrastructure and provide various services needed by the industry including the establishment of what are known as industrial clusters (Nabli, M. K. (2008).), (Industrial Clusters) it is a gathering factories similar in one place near a large factory and what looked like bunches of grapes. In addition to supporting research and development efforts, establishing and supporting banks, developing export marketing institutions, and providing information to the public and private sectors.

The government plays many roles in the field of industrial policy. It is a direct producer, and a consumer (by providing marketing opportunities to strategic industries). And regulator (by determining the level of production for some activities, and finally as a financial agent and investor (through the impact on the credit-market and encouraging the distribution of financial resources).

It should be noted that there are two types of industrial policy, the first is the vertical industrial policy the second is a horizontal industrial policy the vertical policy is one that applies different measures to certain (selected) sectors while the horizontal policy is applied by the same procedures for all industrial sectors.

Accordingly, the vertical policy aimed at influencing the production of certain industries, while the horizontal policy focus on improving the quality of inputs in the production process that will benefit all industries. And that such measures include the promotion of education, vocational training, building infrastructure and encourage the flow of technology transfer and support research and development and guarantee property rights and the legal application of the contracts (Nabli, M. K. (2008).). And the horizontal policy does not require much infrastructure and institutional, but rather few means and tools such as support measures, the accumulation of human capital, and general measures to support productive activities. It also includes incentives for infrastructure and business development.

It is indicated that even horizontal policies may have a different impact on different sectors consequently, it has an effect similar to the vertical policy, which is why it is difficult to differentiate between vertical policy and horizontal policy sometimes.

2 - Two different approaches to industrial policy:

There are two different approaches to industrial policy, the first opposing the use of industrial policy and it was adopted by the Neoliberals in the United States of America, the second supports the use of industrial policy and is adopted by opponents of the theses of neoliberals who follow an approach that combines Schumpeter's ideas with the ideas of evolutionary theory and structural theory.

The thrust of the first approach was the ideas contained in the so-called Understanding Washington (Washington Consensus), such
as the International Monetary Fund, World Bank and International Financial Institutions and the International Finance Corporation. (IFC) American and others, As well as the rules of the World Trade Organization (WTO). As for the second approach, it is represented by a group of major economic writers such as (Reading, Das Gupta, Wade, R, Lall, S, Stiglits, J, Rodrik, D) and these refer to the many factors that confirm the need to use industrial policy.

It should be noted that the Washington Understanding reflects a set of special policies imposed on developing countries that borrow from the aforementioned international financial institutions for enhance the influence of the internal free market forces at the expense of the basic role and functions of the state (Shafaeddin, M. S. (2005).p, 155, 168).

Below are a brief explanation of the most prominent ideas for each of these two approaches (Galbraith, J. K. (2007).):

A - Neoliberals (opponents of industrial policy).

Since the 1980s, changes have appeared in the prevailing economic philosophy that favored neo-liberalism which does not support government intervention in economic activities more than what is called for by the need for investments in education, health and security. According to the traditional approach adopted by these, industrial policy has no place in economic development, and their argument for that is that the development of the country should be left to the action of market forces, and that free trade is relied upon to restrict the structure of incentives in favor of exports and attract private investment (including foreign) to the fields that the country enjoys a comparative advantage helps to industrialization and growth. These propositions, theories and ideas are those adopted by the capitalist system and economic theory known to all economists and others.

Finally, the development strategy that prevailed at the beginning of the eighties reflected the proposals of understanding Washington, which is based on the fundamental doubts about the ability of the state sector to intervene effectively to develop specific sectors. Also it considered that the State's capacity is limited to determine which products will have an impact on growth and structural transformation. Thus, they say that the private sector is relied upon to diagnose and develop promising sectors.

B - Supporters of Industrial Policy:

The proponents of this approach reject the hypothesis of automatic adaptation to market forces and recognize the essential role that technological change plays in development. Therefore, the market does not necessarily ensure that the distribution of economic resources for activities that enjoy increasing returns. According to this approach,
government intervention is necessary to create incentives that make it possible to search for technological capabilities and support the accumulation of productive capacities and knowledge (Waligorski, C. (2006)).

Supporters of industrial policy assert that the space for industrial policy in developing countries is constrained not only by the effects of the rules of the World Trade Organization, but also by the effects of the terms of international financial institutions and bilateral donors. Confirms (Stiglitz, J), American economist and Nobel Prize winner for economics and a supporter of industrial policy, asserts that the argument against industrial policy is based on a naive reading of economic theory and a wrong reading of economic history. The theoretical philosophy behind the Washington Understanding and the trade policies dictated by the international financial institutions and the World Trade Organization are not appropriate for industrialization and development in developing countries. The argument against the theory of state intervention in the production and trade is mainly based on the premise of competitive markets and that it is working well and there is no case of market failure and that the government's failure is prevalent, these views are not consistent with the reality of things, but it serves as a general theoretical abstraction.

It is necessary to refer to the concept of market failure, which occurs when the market cannot achieve efficient solutions, this is when competitive markets do not exist or competitive markets are imperfect, especially when there is information asymmetry, economies of scale, or external factors. As the market failure also occurs when investment decisions are dependent on each other and require coordination. The existence of this case justifies the trend towards the use of industrial policy.

As for the failure of the government, it occurs when the government's decisions do not achieve optimal performance consequently, it leads to a misdistribution of goods and economic resources beyond the state that is achieved without intervention.

Some, including (Rodrik, D) point out that the market alone does not bring industrialization with it because market failure prevails and therefore government intervention becomes required As well as cooperation between the public and private sectors. And others are calling for a radical approach for industrial policy. For example, it refers (LaLL, S) to the speed and complexity of technological variables, as well as globalization and failure to build technological capabilities it concludes that developing competitive capabilities requires direct and indirect government intervention (selective and functional) to confront market failure, which creates obstacles to capacity building for industrialization and development.
Many advocates of industrial policy have appeared in the United States of America who justify its use based on a number of factors, the most prominent of which are:

The American economy is in a state long-term decline and needs to government intervention, and that the country is losing many industries to others, and suffers from capital flight, and that there are large parts of the US economy that are not competitive in the global economic system. Among these supporters (Walter Mondale), (Robert Reich) and them (John Kenneth Galbraith) and others.

3 - Justifications for Industrial Policy:

After the wave of strong opposition to the use of industrial policy from some quarters, Industrial policy is back again to become a mainstream fashion and in the wake of the global financial crisis as the crisis led to a review of the economic role played by governments, and gained government intervention in the economy a measure of legitimacy, where the crisis led to a review of the economic role played by governments, and gained government intervention in the economy a measure of legitimacy, it is expected that this trend will be strengthened. In the United States of America billions of dollars have been spent to support the manufacture of the hydrogen-powered car, France is borrowing millions of euros to support what it sees as the growth industries. Thus, most countries of the world use industrial policies in one way or another, including China, Singapore, Brazil, Chile, Britain and others. And there are many economic justifications used for the adoption of industrial policy and the most important.

A - And that the content of this argument is known and there is no room for explanation here. Some assert that the existence of the state of savings learning at work among industries greatly enhances the case of intervention in favor of emerging industries.

B - The international market is more concentrated than before, Global production and international trade and technology has become subject to the dominance of multi-nationality companies and technological changes have accelerated, production became knowledge-intensive. All of these factors adversely affect the development prospects of developing countries, which imposes the need for the countries mentioned government intervention.

C - That a market failure situation exists hinder the function of free markets and prevent countries' ability to achieve development goals, that is why we need in such a case to state intervention to overcome the market failure and the use of industrial policy. Therefore, the existence of a market failure situation is considered a traditional justification for the use of a vertical industrial policy.

D - Globalization has led to the expansion of large global factories activities, it's where you specify the locations of various stages of
production of the product specified in the various countries through its branches and partners, and global factory has a number of advantages (compared to smaller factories in developing countries). Where he owns local benefits associated with technology, experience, information on markets, marketing, distribution, and economies of scale at the plant level. The large factory can benefit from network service with partners, cooperate with other factories, and obtain production requirements from cheap sources, as well as it enjoys market expansion possibilities, grouping benefits, licensing agreements, long-term contracts in procurement and processing, and joint ventures. All these advantages of the large multinational factory make small and medium factories in developing countries unable to compete on an equal footing with large factories, which makes them in need of care, support and government intervention.

E - In addition to the foregoing, supporters of the use of industrial policy point out that there is room for intervention when markets are marred by distortions and the absence of conditions for competition, or when the market imperfect i.e. the absence of conditions for perfect competition.

F - Another justification is that government intervention was based on the saying of the missing factor in developing countries (it is capital, technology and leadership, which does not appear through market forces alone) therefore, the government needs many ways to achieve growth. Incomplete capital markets cannot generate sufficient savings or distribute them efficiently without some form of market intervention.

G - Developing countries usually prefer a policy of dealing with large-scale industries, which negatively affects small and medium industries. Therefore, the state’s intervention here represents an area of industrial policy that can take into account the effect of such a policy on the industries mentioned within the framework of development goal.

H - Finally, some economic theorists such as (Rodan, R), (Nurkse, R) indicate that developing countries need a strong push and development requires change because market forces alone cannot lead to a redistribution of resources towards industrial activity from the agricultural and raw materials sectors. This requires it to change the incentive structure to achieve this goal.

-Justifications for Horizontal Policy):

Horizontal industrial policies have gained widespread support in recent years as an effective approach to overcoming market failure. By facilitating access to information and strengthen legal and institutional frameworks, capacity-building and expansion and development of infrastructure, governments can provide the required
environment to promote industrial development. One of the main justifications for the use of the following horizontal policies:

1 - Horizontal policies tend to reduce distortions which is generated by the use of baptismal policies, because it promotes competition and supports the national economy.

2 - The horizontal policy works to level the ground for all industries, and at the same time it tends to weaken the incentives that drive the search for profit and get rid of the disease of corruption, As well as it enhances the status of transparency and supports social harmony. Likewise, horizontal policies help reduce the problem of government control and its failure the away problems that help to perpetuate the use of Amorite policies.

3 - Finally, horizontal policy is easier to adapt to volatile market conditions because its benefits are not harvested by specific groups which can perpetuate the status quo.

4 - **Criticisms directed for industrial policy:**

There are many criticisms directed against the use of industrial policy, especially vertical ones, the most important of which are:

**A** - That the use of industrial policy always subject to controversy and debate because of its impact on the redistribution of resources among industries in ways that were not compatible with market signals, which makes them distorted to market signals as they are inefficient and make the weak performance of the industry.

**B** - Because of its impact on the redistribution of resources among industries in ways that were not compatible with market signals, which makes them distorted to market signals as they are inefficient and make the weak performance of the industry.

**C** - The return of school ideas neoclassical had an impact on the manufacturing process as it tried to link industrial policy distorted with the weak performance. For those who justify government intervention based on the state of market failure, the followers of the aforementioned school believe that the probability of bureaucratic failure is worse than market failure.

**D** - It is also indicated that the use of quantitative restrictions on imports encouraging factories to compete for import licenses to obtain the profit resulting from them, which leads to squandering wasting resources on non-productive and rent-seeking activities.

**E** - There are those who say that the emerging industries that get protection will never mature.

As for the criticisms directed at the horizontal industrial policy, the most important ones are:

**F** - Some of the horizontal policies are inherently long-term in their effects, especially education, research and development.
G - In many cases, the failure of the market and the failure of coordination has a special sector specific nature and cannot go to him through horizontal approaches.

H - The benefits of the use of horizontal policy tends to spread among groups and sectors it is not easy to remove beneficiaries of the horizontal policy, and therefore there are no influential parties calling for this policy.

5 - (Industrial Policy under WTO):

There are many factors that impacted negatively on the effectiveness and application of industrial policy the most important of these are the rules of the World Trade Organization, globalization and the changing nature of the global economy and international financial institutions which imposes difficult conditions for lending to developing countries and the policies of the liberals mentioned earlier, however, the impact of the WTO on industrial policy was the largest and most important. Therefore, in this section we will briefly review the negative impact of the World Trade Organization on industrial policy through many means and procedures contained in the aforementioned organization’s rules.

There is no doubt that the establishment of the World Trade Organization and the resulting agreements that liberalized multilateral trade it has left its negative effects on the general economic policy and industrial policy in particular. The quota system is no longer a tool for this policy, and that the protection systems and customs forms of support to the industrial sector has been subject to the rules of the organization mentioned as the customs tariff was reduced and quantitative restrictions (quota system) were prohibited on imports. As the growing bilateral or regional agreements has led to the decline of public policy space available to developing countries. It is noteworthy here that the agreements mentioned are working to expand the area of laws and regulations over what is in the rules of the World Trade Organization (26). Such measures of course have had adverse effects on industrial policies, especially in developing countries.

There are many other aspects of the negative impacts of the World Trade Organization on industrial products and industrial activity in general and especially in developing countries that relate to many general agreements, including the Textiles and Clothing Agreement, Trade Related Investment Measures (TRIMS), Trade Related Aspects of Intellectual Property Rights (TRIPS), General Agreement on Trade in Services (GATS). In addition to other agreements with less impact.

It is evident from the above that the rules of the World Trade Organization restrict and control government intervention to support and encourage industry and thus adversely affect the developing
countries and deprive them of the possibilities of recourse to protection and support and bear additional costs as a result of the use of licenses and patents and all this would weaken the industrial policy of developing countries, in particular the impact.

- **Conclusions:**
1 - The need for trade policy is based on the facts and conditions of the international market for each country. The current global markets are distorted and vary in the distribution of incomes and assets between developed and developing countries, and increasing market concentration and the expansion of the technological gap, which leads to the length of the learning period.
2 - There is no doubt that the market has an active role to play in the industrialization and development process, but it is not sufficient by itself to accelerate growth, expand production capacity, encourage comparative advantage and raise technological capacity. Therefore, there is a need for government intervention and the price mechanism is slow to create the market and develop non-price factors. So government action complements the role of the market and does not replace it, especially in fields that the private sector is unable or unwilling to invest in because of the presence of high-risk or because of some industries facing external savings.
3 - Many economists believe that support for the emerging industry cannot be avoided.
4 - Government intervention is necessary when competition alone cannot push productive enterprises towards innovation and investment to raise the level of productivity.
5 - The theoretical argument against state intervention in production and trade is mainly based on the existence of competitive markets hypothesis that works well, and there is no case of market failure, and that the government’s failure is prevalent.
6 - The task of raising together (upgrade) the industrial structure in accordance with the relative advantage of the dynamic it cannot be done through market forces alone and that the country can develop the industry of his choice through government action.
7 - The proposals issued by developed countries within the rules of the World Trade Organization are not appropriate for development in developing countries because it pushes towards liberalizing trade in general but they do not apply the same equation for lowering tariff rates. So, the developed countries have lower levels of tariff rates compared to developing countries that lower their rates from a relatively high level, thus, the size of the reduction in the latter is much higher than in the developed countries.
8 - The trade policy is nothing but one of the means to achieve the general development goal of the country, including production
capacity and industrialization. Under the rules of the World Trade Organization, the mechanism for controlling and controlling industrial policies in developing countries is limited, as these rules restrict technology transfer, and it limits the ability of these countries to impose performance requirements in foreign factories and exposes domestic services to intense competition, these rules also prevent developing countries from the use of exemptions and subsidies to support local industries although the rules of the World Trade Organization still allow the use of government intervention in the field of trade policy in the form of selective subsidies to encourage local research and development (R&D) activities as well as regional development and environmentally friendly activities.

9 - Industrial policies have great potential to encourage economic development, but this possibility can only be achieved if the environment of industrial policy is correct and appropriate. The failure of industrial policy in many cases in Africa in the sixties is due to the fact that it was driven by the desire to preserve political power, and this is not compatible with the conditions of economic.

Recommendations:

1 - The trade policy should be development oriented, specialized in meeting the country's needs and based on the realities of the international market and allows the changes taking place in the changing roles of the market, factories and governments in coordinating the changing economic activities over time.

2 - Industrial policies should be selective dynamic and predictable nature and give attention to the role of supplementing the non-price factors, such as administrative and technical restrictions on imports in exchange for price factors such as the customs tax that directly affects import prices.

3 - The provision of protection for selected industries should not be granted without conditions and without limits the government must insist on performance in exchange for incentives and penalize industrialists in cases where their performance is below the required standard.

4 - Industrial development should start on a selective basis, whereas, some consumer goods that face a wide demand in the internal market and that include large-scale learning effects should be chosen as a first group of industries to build productive capacities, provided that the manufacture of final products for selected industries is protected, and the supplies imported for these industries must be free, meaning not subject to customs tariffs.

5 - Resorts to the use of the horizontal industrial policy as much as possible because of its many advantages over the vertical industrial policy, foremost of which is reducing market distortions, encouraging
open competition, transparency and other advantages, that is why this policy has seen significant support in recent years.

References: