The return of industrial strategy

By Paola Subacchi
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Industrial policy is making a comeback in many advanced economies. Dismissed out of hand in the go-go 1980s as a contributor to the previous decade's stagnation, it is increasingly viewed as a means to stem working-class voters' defection to right-wing populist parties. But developing a modern and effective industrial strategy will be no easy feat.

The European Union has been trying to define a consistent framework for addressing the topic since 2014, when it published an analysis of industrial policy's advantages and disadvantages. The United Kingdom is further along, having released in January a green paper on building an industrial strategy. US President Donald Trump has also focused on industrial policy, though his version would presumably entail substantial state intervention and protectionist measures.

Trump's regressive vision, despite remaining short on details, already seems defective. But Europe's approaches to industrial strategy show some promise, not least because they are likely to eschew the broad interventions of the past that emphasized "picking winners." In the United Kingdom, for example, the government expects to focus instead on "targeted interventions" designed to create positive incentives, correct market failures, and address social, geographical, and sectoral imbalances. Clearly, political leaders have learned some important lessons from history.

But serious problems remain. Europe's governments seem to think that they can implement ad hoc policies that strengthen their "invisible hand" today, and that those policies will somehow end up fitting neatly into a coherent framework. That seems optimistic, at best.

The UK's new plan does not even pinpoint the strategy's main objective. Is it to buttress GDP growth when the UK is no longer part of the European single market and customs union? Or is it to boost the British economy's potential output (that is, to increase long-term trend growth)? The government's plan mentions both objectives, but says little about how they will be balanced.

UK leaders must recognize that, where the strategy is aimed at strengthening post-Brexit growth, it will probably have to be set in the context of higher tariffs *vis-à-vis* the EU, which would remain Britain's main market. Such a strategy would also have to take into account the global competitiveness of British industry, and complement the country's new independent trade policy.

At the same time, the British government must not get so caught up in preserving short-term growth and employment amid Brexit that it loses sight of the need to boost long-term growth potential. Worryingly, however, the proposed strategy may over-emphasize ring-fencing the government's own involvement in the economy.

While governments are right to shy away from picking winners, they must remain active in other ways. Specifically, they must analyze which sectors and industries are more likely to contribute to long-term growth, and help to enable their success – potentially even in ways that imply real financial risks.

For example, governments should consider large infrastructure investments that have positive externalities – say, shorter commuting times, with their economic and social benefits – and that may be too large or too risky for the private sector. This is particularly relevant where the government has access to a wider range of information than the private sector, strengthening its ability to optimize its investments.

Another component that is missing from current discussion of industrial policy in Europe is a clear timeline. The reality is that a strategy developed today could take a generation to deliver results (think education reform). So an effective industrial strategy must establish not only an overall timeframe, but also important milestones along the way.

In the UK's case, those milestones should include shorter-term goals and outcomes associated with the Brexit process. After all, an effective modern industrial strategy requires a careful accounting of the assets and resources, including human capital, that the economy will need in the coming years. For the UK, such an accounting cannot be decoupled from Brexit. In particular, UK leaders must identify which resources are tied to Europe's single market, how they can be replaced, and how long that process will take.

The final critical element of an effective industrial strategy is the institutional framework on which it depends. The UK government acknowledges the importance of creating the right institutions to address regional disparities. But institutions must go beyond linking up sectors and regions to ensure transparency and accountability, especially in the relationship between the private and public sectors.

With that in mind, British leaders should reflect on which of the necessary institutions are already in place and which need upgrading. It is important to resist the urge simply to shut down weak or inefficient institutions, and to consider, instead, how they can be reformed and strengthened.

Major changes are coming to the British and European economies. Leaders must act now to define a comprehensive strategic vision that will enable them to cope with the challenges ahead. That vision must be bold and ambitious. Above all, it must be shared. At a time of intensifying polarization, that may well be the hardest part.

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