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The inconvenient truth about industrial policy

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For the past few decades, governments in advanced economies have been discouraged from using "industrial policy" - that is, targeted interventions in particular sectors that are by definition not neutral in their impact across the economy. The long-standing conviction is that governments should not attempt to pick winners and save losers, be they industries or specific firms.

Increasingly, however, this policy stance is being revisited as governments seek to promote economic growth in the wake of the global financial crisis, particularly in light of the apparent success of more interventionist approaches in faster-growing emerging economies like China.

Like other countries, Canada is once again engaging actively and more openly in industrial policy. The last federal budget provides support to the manufacturing sector by renewing funding for FedDev (a regional development agency) and to Canada's defence industry by reforming its purchasing processes, among other measures. Canadian provinces are also getting in the act.

In a recent report published by the Institute for Research on Public Policy (IRPP), we find that despite the established prejudice against it, the truth is that Canada and most advanced economies have long histories of using industrial policy - albeit some more successfully and some more openly than others.

In fact, an inconvenient truth for those who shun industrial policy as a matter of principle is that the developed countries all resorted routinely to industrial policies in order to become developed. Moreover, in recent decades, the very same countries that fought the hardest to support vital sectors have come to dominate them today. This includes the United States, Japan and Korea in semiconductors; the United States and EU in large-body civil aircraft; and Canada and Brazil in regional aircraft, among others.

We should welcome the opportunity provided by the current - how shall we put this - "rehabilitation" of industrial policy to think critically and unapologetically about where Canadian policy interventions should be aimed to maximum effect. An adult conversation that rises above knee-jerk reactions is required.

Neutral, horizontal policies are for the most part unsuited to the real world - a complex and competitive environment where playing fields are not level (however much purists might wish them to be). The unique circumstances and challenges faced by different sectors necessitate different policy actions. Realistically, this makes industrial policy - the use of "vertical" rather than "horizontal" policy - unavoidable.

The global financial crisis brought us face-to-face with the fact that the private sector at times bails out. But the public sector cannot bail out. And so government had to bail in - not across the board, but in particular sectors. The same basic point applies for noncrisis situations.

Theory and evidence show that governments can and should help develop sectors that have positive spillovers like infrastructure, energy supply and transportation. Moreover, governments cannot ignore interventions by others who are actively tilting the playing field in their favour with producer supports, as in agriculture, or through concerted use of public policy instruments in the case of next-generation industries.

The heterogeneity across sectors means that there are places where governments should not be encouraged to go, even as there are some where all logic dictates they must go, and others still where ministers of the Crown must earn their handsome stipends by making wise decisions about whether they should go. Economic research can help: for instance, a substantial body of evidence suggests that we should limit support to existing economic clusters, rather than try to create them where they don't already exist.

Given Canada's unique circumstances - our small domestic market, vast geography, and head-to-head competition with the world's largest economy next door - our governments need to make smart policy choices that play to our strengths. This means cultivating Canadian-friendly niches that can later be scaled-up to compete with the world. To give two examples, Montreal is a leading centre for translation services and Canada has world-class expertise in long-distance energy transmission.

But we also have to look to the future. The next battleground industries are hardly secrets - the United States has identified industries that it is "not prepared to concede"; the EU has its list, as does Japan. And then there is China, which couples market incentives with the use of state-owned enterprises, much fiscal clout and domestic regulation to advance its economy up clearly identified economic ladders.

Our point is simple: Canada cannot afford not to compete.

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