I, Government: Is Industrial Policy Making a Comeback?

April 25, 2023
By **Alberto Mingardi**

Industrial policy used to look so 1970s. Its rhetoric was abandoned, by and large, during the 1980s. Back then, the late Nigel Lawson, Margaret Thatcher's Chancellor of the Exchequer, propelled "privatizations": new jargon came with what seemed to be a change of paradigm.

Up to the 1980s, governments tended to acquire—not to sell—stakes in businesses. We cannot assume that wide-ranging nationalizations were pursued simply because of the generally held idea that government could wisely steer the economic development of a country. Rather, trade unions played a role, and so did political bargaining. The need to keep a particular constituency quiet, by avoiding the closing of a factory that put bread on the tables of a large enough number of people, is an urge powerful enough to nationalize a company. Still, a broadly shared belief was that the government should be in charge, one way or another, of economic development and that it was capable of turning the wheel in the right direction. In such a widespread belief, "industrial policy" was a central tenet: the notion that even while the factors of production were still in private hands, the government should wisely provide rules and incentives so that private companies could fit into the wider societal plan and the inevitable shortcomings of a free economy would be "fixed." A set of rules and institutions was to be designed centrally, aiming at one specific object and capable of prevailing over the set of incentives at work in a mere market economy.

There are countries in the world that openly pursued an industrial policy with clearly defined goals. One case is my native country, Italy. For instance, government aid was generously showered on private business so that they would invest in "depressed areas," thereby "supporting communities"—to use more contemporary jargon—to create (manufacturing) jobs. The government experts thought that productivity in the south of the country could be raised by increasing the capital endowment of the southern regions. Occasionally, the state did it directly by establishing or strengthening government-owned firms, and sometimes it did it through aid and special rules.

The result wasn't pretty. Private companies eagerly cashed in the subsidies, building what were later called "cathedrals in the desert": big factories that were soon of no use, because when and if the subsidies expired, those businesses exited the south as speedily as they went in. It was generally assumed that industrial development was the only way forward for the south of Italy, a very rich place from an agricultural point of view and potentially a dream land for tourism. "Forced industrialization" met with a local culture that often considered it on par with some kind of economic colonialism. Its effect turned out to be negligible: GDP per capita in the south is still roughly half of GDP per capita in the north. The two sections have been on a diverging path, with the exception of the decade after WWII. Some maintain that in those ten years the convergence was due to successful infrastructure spending and industrial policy, and not to the general sense of hope and opportunity that the country experienced right after the end of the war. If that is so, then, such a success was short-lived.

While the world hardly ever lived under a hegemonic "Neo-liberalism," a word that came to mean the idea that charting the course of economic development ahead of time is more difficult than it seems, it exerted some influence in the 1980s and 1990s. Countries that used to have a muscular industrial policy, like Italy, privatized firms and tried to develop the tools of a modern regulatory state. Politicians did not altogether abandon the notion that economic growth lay within their immediate responsibility, but they seemed to accept that they should do it indirectly: by allowing the market economy to work and by using regulation to solve specific problems, rather than taking the pilot seat.

This experiment had limited success as well. Decisionmakers often did not realize that "privatization" meant the end of government control of a company, hence they tried to nudge it one way or another, regardless of the fact that ownership was now in private hands. Regulation was also loaded with too many goals and perhaps given too many circles to square: promoting economic growth, growing competition and market access, taking care of environmental quality, creating the adequate demand for knowledge intensive jobs, etc.

Expectations were too high, and results did not match them, hence some started to wonder, "Wasn't it better when we actually could tell these CEOs what to do?"

For their part, CEOs missed subsidies and lobbied for them, for the same reason my students lobby me for shorter reading material for their exams. Government aid may not foster economic development at large, but it is certainly nice to acquire it. And in their attempt to acquire it, companies prepare meticulously, waging a contest that can be as furious as market competition, but which has different goals. The goals are not necessarily to please the consumer—the ultimate decisionmaker in the economy—but to seduce government experts and ministers. It is a different war and can be handled with less demanding weapons.

Still, in countries like Italy and the few that curtailed their industrial policies in the 1990s (beginning, of course, with the post-Communist bloc), a kind of shame remained associated with the concept of government aid, at least until the 2010s. Industrial policy was dressed up as "a policy for industry"; subsidies and incentives were targeted to specific purposes (like increasing the adoption of digital technologies), and they were, at least, smaller in size. The smart politician knew the subsidies and incentives helped lubricate their relationships with business leaders, but was not thinking that the future of economic growth was at stake. The future of the economy could not be divined from a government office.

Or could it? In recent years the notion of an "industrial policy" has been revived, and it is now alive and kicking. The Biden Administration's "Chips Act" is a clear case in point: industrial policy is evoked in order to answer a temporary shortage of supply, something even the most interventionist economist used to assume the market could manage by itself. In Europe, the Next Generation Europe funds, which were the EU's answer to the pandemic, are by and large aimed at selectively propelling this or that industry, based on governments' superior judgment.

Its re-evaluation is an interesting case that proves that "ideas have consequences," though one can certainly argue that circumstances played a role in its ostensible triumph. Insofar as circumstances are concerned, however, one should mention the financial crisis, which—rightly or wrongly—engendered an increased distrust of the market economy and a growing geopolitical tension between the West and the rest. This is a key concern, particularly (but not exclusively) on the right side of the political spectrum. In particular, the previously astronomical growth rates of China, the new manufacturing powerhouse of the world, made sectors of the American economy weary of the potential loss of economic supremacy. This created a market for ideas promising to solve whatever "innovation crisis" it could diagnose.

This new gospel of industrial policy was spread, at first almost single handedly, by Mariana Mazzucato, author of *The Entrepreneurial State*, a book which was originally a think tank monograph published by Demos in England and later, in the 2013 edition, turned into an international bestseller. Mazzucato was, in her own words, engaged in a "discursive battle," to restore the credibility of the state as an economic actor. Such credibility, in Mazzucato's account, was weakened not by government failures but by a narrative that overemphasized them, forgetting the essential contribution of government investing in technologies that later were turned into consumer goods. Mazzucato attempted to solve this "PR problem" of industrial policy not by revisiting the evidence on its success in countries that openly and proudly engaged in it, such as Italy, but by claiming that industrial policy was there even where you did not notice it, like in the United States. The most famous of her claims is that the iPhone is the product of such enlightened investment rather than the genius of Steve Jobs.

Notice that Mazzucato (and so her epigones) was not claiming simply that public investment (either in the military or in base research) ultimately can have spillover effects that reach and benefit consumers. Such a contention would be relatively uncontroversial—though one could always wonder about the opportunity cost of such investment (or believe that military investment is dangerous per se, regardless of the fact that former military technologies mutated into daily appliances for most of us). Mazzucato claims that bureaucracies exercise "mission-directed directionality": that they are *directly* responsible for consumer goods that ended up carrying technologies that were developed for other purposes.

Though when she speaks, she tends to be more nuanced and moderate, in print Mazzucato diagnoses the disease of short-termism in the market economy. Her argument can be presented in the following way: scarcity of capital stands in the way of many discoveries and innovations, as some research programs are not pursued as long as they should be, because of the apparent lack of (immediate) results. Hence if we do away with the scarcity of capital altogether, and research programs can be pursued whatever their immediate shortcomings, we will end up having far more innovations. The closest thing that we have to an investor for whom capital isn't scarce is the government, and thus it should be in charge of innovation.

In a 1974 interview with *Reason* magazine, Milton Friedman argued that "it's fortunate that the capitalist society is more productive, because if it were not, it would never be tolerated. The bias against it is so great that, as it is, it's got to have a five-to-one advantage in order to survive." Mazzucato's work is superbly suited to confirm the biases of those who do *not* like a capitalist society, but it also suggests to them that capitalism is actually not more productive, as they were mistakenly brought to believe by free market propagandists. Why then not go for more public involvement in the economy, if it has proved to be the thing that is really behind our cornucopia of innovative goods?

The argument is greatly persuasive on the left, but now increasingly so on the right. Even before Donald Trump, American right-wingers had difficulties in squaring their defense of a free economy with nationalism, which is becoming a more and more central tenet of their rhetoric. The right-wing equivalent of Mazzucato may be Oren Cass, a more nuanced scholar and think-tanker. Different than Mazzucato, the right-wingers claim that they are regaining a proper understanding of capitalism, after the free-trade bonanza. In his most famous essay, Cass poses the following false dichotomy: one should choose between a (national) free market and international free trade. While the latter is often identified with globalization, globalization as we know it implies a complex legal and regulatory infrastructure, in which countries mutually harmonize their own regulations and in so doing some of them (most notably the U.S., according to Cass) are "importing distortions." More free enterprise measures can paradoxically come only from increasing political discretion, which may include unleashing market forces regardless of mutual harmonization of rules.

Globalization is certainly very different from a free-trade world, in which trade agreements consist of a sentence or two and simply allow the free exchange of goods and services across borders. But in fact, Cass's organization, American Compass, is advocating—to balance this state of affairs—the adoption of an internal industrial policy that is at odds with the dream of a national market, however "free."

In particular, these preachers of "conservative economics" aim to find strategies to "direct" capital to domestic rather than to international production: namely, to domestic manufacturing. Also, they seem convinced, like Mazzucato, that the government "picked" winners for technologies that ultimately produced Silicon Valley—and apparently did so before globalization erupted. Logically, this should lead one to ask for something rather different than a free market, even at the national level, but of course the American Compass's discursive battle is different from Mazzucato's. And for the base of the Republican Party, though globalization may no longer be a good word, capitalism still is.

The evidence provided by the American Compass studies can be summarized as the fact that government agencies have for years been the main consumers of innovative technologies, later to be translated into daily appliances. This may well be, but it hardly means that R&D in American companies that supplied such technologies to the government were "designed" by government itself. The free market assumed the sovereignty of the consumer, who ultimately decides what product is worth her money and what is not. But this sovereign is not assumed to be enlightened: that is, somebody who could envision and design the very product she is buying. It is the consumer's *wants and needs* that drive production, not her knowledge. We may concede that government officers signing contracts are better informed than the average iPhone customer, but the very fact that they are buying rather than making something seems to suggest that the *knowledge* relevant for a certain production lies outside the parameters of that agency.

The advocates of industrial policy, left and right, present us with a caricature of free market arguments. In particular, they consider the "spontaneous order"—to use the expression dear to F.A. Hayek—an idealization, the sketch of perfectly self-adjusting machinery which knows no problem whatsoever. This is the old Nirvana fallacy: if you assume that a free market economy ought to be Nirvana, it is very easy to consider the real market economies to be hellish, for they exist in the world of men, not in the province of dreams.

No free market economist ever thought that economic freedom was going to free us from problems; they regarded it as an approach to find a solution to such problems. The free market is not a system that avoids mistakes, but one that enables us to learn from mistakes. That is the crucial difference. If we assume that people (researchers, businessmen, workers) make mistakes, which economic system makes it more probable that such mistakes will be properly assessed and there will be opportunity to correct them?

This is the question that ought to be asked. Whatever our political preferences, we should understand that it is not "the free market" or "the government" or even this or that company that does innovation. It is people. The creativity of human beings we can assume to be constant in time and space. Free marketers point out that this creativity was put at the service of the individual consumer—producing goods and services that are of use to the common person—with the Industrial Revolution. None of our societies were or are 100% "free market." But in some societies people experienced more economic freedom than in others. Which means that in those societies, decision-making was decentralized, production decisions were made by private businessmen, and consumers were not compelled to buy this or that product or service. In these societies, innovation and economic growth tended to flourish more than in others. When a controlled society experienced a modicum of economic freedom, like in China, that was sufficient to unleash tremendous creativity in the development of goods and services for the common consumer.

A conversation on industrial policy and the market economy should not be blind to this fact. But, of course, one could easily attempt to circumvent it by claiming that in comparatively more free market economies like the U.S., innovation was actually spurred by industrial policy. The evidence for that is meager, but the argument is instinctively appealing to those opposed to the free market. In a sense, if you are biased for "visible hands", you see them all over. And most of us are so biased. Hence the battles of ideas tend to be won and lost on the battlefields of biases and emotions.

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