The uncertain return of industrial policy

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Iceland’s industrial policy, 2003, 2026

- I gave public talk about industrial policy in **Rvk, 2003.** Not well received. Jonas Haraldz
- Iceland announced its first-ever national industrial policy on Friday 10 April 2026, from Prime Minister’s office.
- *Industrial Policy of Iceland: Growth Plan to 2035*
- *Iceland’s Industrial Policy Action Plan 2026-2027*

“Industrial policy” was outside the “window of discourse” for 40+ years

- From early 1980s “industrial policy” has been **outside the “window of discourse”** (“Overton window”) in western intellectual and political circles. That is, IP in **“bad currency”**.
- This reflects the dominance of the **“neoliberal” zeitgeist or world view or ideology** among mainstream economists and among western political leaders

HISTORY OF “INDUSTRIAL POLICY” SINCE 1980s

- I did long-term field-work on the government bureaucracies in India, South Korea and Taiwan in late 1970s and 1980s. In Taiwan and SK I studied industrial policy, its tools, its organization, its effects.
- My conclusion: Taiwan and SK had used industrial policy effectively. *Governing the Market* (1990/2004)
- **World Bank:** For several years in mid 1980s and again in late 1990s I worked as economist in World Bank in WDC. The very words “industrial policy” were **toxic.** Even when I visited Bank in **2022**.
- **IMF:** “Industrial policy” toxic, even in **2022**

US economists, US government have rejected calling any of their interventions “IP”

- American political discourse associated **“IP” with market skepticism, central planning, Soviets**
- But US did plenty of IP. (1) Hamilton (2) New Deal: eg Works Progress Administration (WPA) (3) Cold War: US govt created large number well-funded national labs, eg Los Alamos, Oak Ridge (4) NSF, DARPA, NASA, NIH pushed military-related research & investments, which spilt into civilian use (5) high-tech and biomedical industries
- **See Wade, 2017, “The paradox of US industrial policy: the ideology of free markets and the hidden practice of directional thrust”, Cambridge J. Economics, v.41**

IP HAS SUDDENLY RETURNED TO “GOOD CURRENCY”

- Suddenly in past few years “industrial policy” has come back into the “window of discourse”, returned to “good currency”.
- “Good currency” does NOT mean “consensus”, “no controversy”

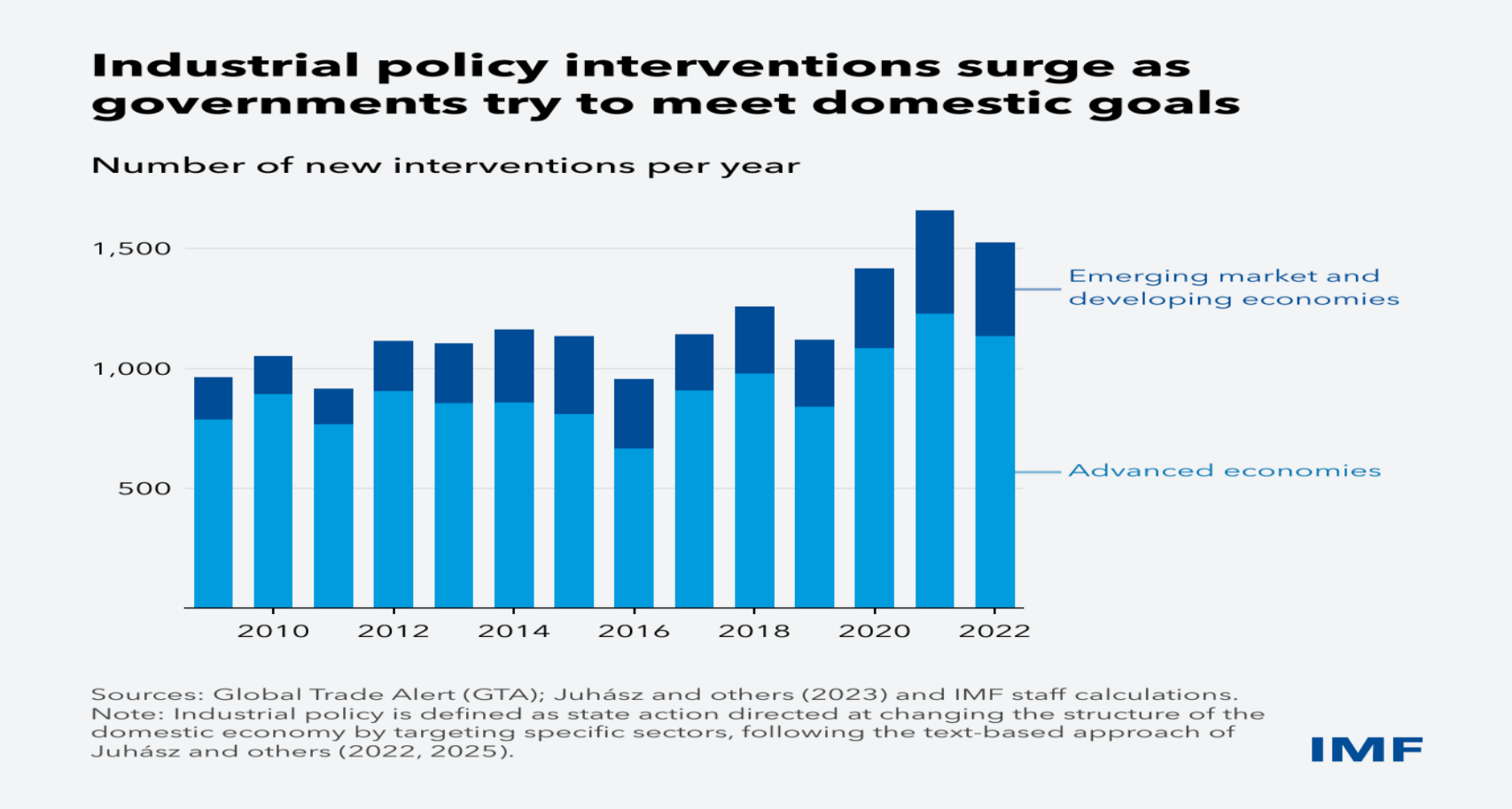
“Industrial strategies are all the rage around the world”

- Andy Haldane, ex chief economist, Bank of England, 2025, “Industrial strategy needs more than stars”, Financial Times 17 September
- **“Industrial strategies are all the rage around the world.** The prompt for this newfound passion has been the **combination of lacklustre growth in many western economies** and the apparent **success of such strategies in stimulating growth in much of Asia**, from South Korea to Singapore.”
- Notice what is obviously missing from his “causes of the return”

IMF and World Bank – first-time-ever official policies on IP

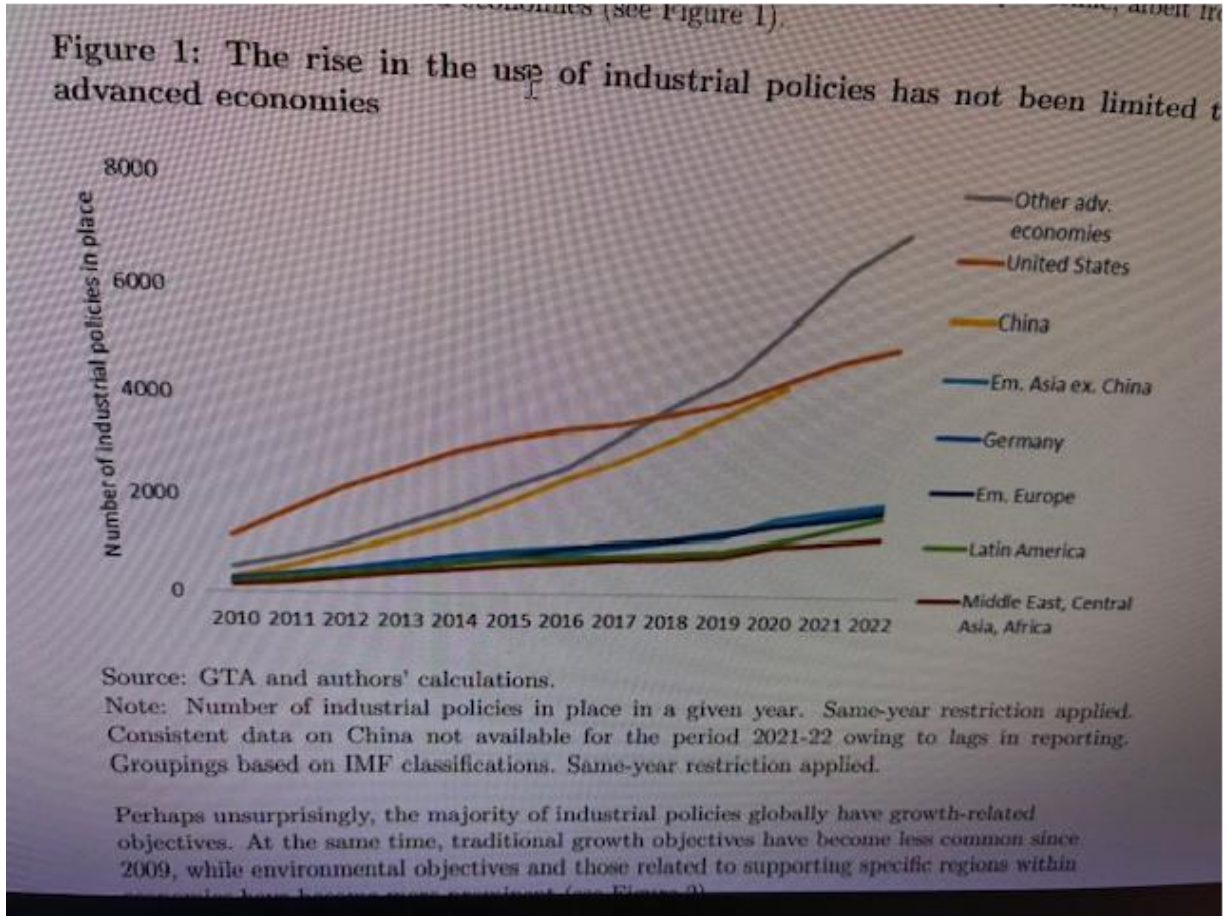
- **IMF**, *World Economic Outlook 2025*, chp 3, "Industrial policy: managing trade-offs to promote growth & resilience" .
- Conclusion begins: **"Industrial policy has returned to the center of the policy debate"**
- **World Bank**, 2026, *Industrial Policy for Development: Approaches in the Twenty-first Century*. Almost 300 pages
- **Shift in thinking can be summarized as from "why" to "how": from "why do IP at all?" to "how to do IP well?"**

IP interventions have been surging since 2010: IMF data, **new** interventions per year



Use of IP s 2010 – 2022 by regions

EBRD, 2025, “Moving the goalposts: the changing objectives of industrial policy”, Working Paper 311



Terminology problem with “industrial policy”

- “Industrial policy” not refer only to “policy to promote **industry**”.
- IP refers to policy aimed at **changing sectoral composition of production**. Targets specific “industries of the future”, even specific firms, to help them grow faster, upgrade faster; may target industries of the past to ease decline.
- **Not part of IP**: tariffs which vary between products but are **intended to raise revenue**
- **Not part of IP**: **“horizontal” policies** that aim to promote growth or employment or exports across the economy, eg tax reductions, improvements in “business environment”, fuel subsidies, R&D subsidies.
- **Better phrases:** “sector-selective policy” (SSP), “directional thrust policy”, “technology & productivity policy” (TPP), or **“upgrading policy”**

Bank and Fund conclusions about use of IP

- (1) IP can only be justified when a **“market failure”** has been identified. No “market failure”, no case for IP.
- (2) **Structural policies** (= horizontal policies, not sector selective) can often bringing higher gains even for the targeted sectors
- (3) **Empirical evidence** shows: (a) targeted sectors can show better economic outcomes than without IP; (b) but the net gains are small; (c) “**…larger gains can come from structural reforms** to improve the overall business environment and better enable credit access for all firms.”

EFFECTS OF IP: IMF FINDINGS

(https://www.imf.org/en/blogs/articles/2025/11/25/industrial-policy-can-lift-productivity-but-comes-with-risks-and-trade-offs

- "**IP is associated with better econ outcomes in targeted industries,** particularly in countries with strong institutions. **But the gains are small.**"
- "Direct subsidies to an industry are associated with about a 0.5% improvement in value added … three years after implementation, reflecting higher capital accumulation & employment. [This is] modest compared with sample average industry value added growth of 6.5% per year …"
- IMF analysis shows that "…employment, productivity and output all improve in targeted industries. But, b/c resources are drawn away from untargeted sectors, those sectors end up shrinking and losing productivity, potentially delivering a negative impact on aggregate productivity…. our analysis suggests **[IP] can … create misallocation of resources & dampen aggregate outcomes, leaving the economy worse off**."
- "**…larger gains can come from structural reforms** to improve the overall business environment and better enable credit access for all firms."

Problem with IMF findings on effects of IP

- IMF findings on effects of IP are averages across large number of countries. No account of differences in production structures, state capacity (including rule of law)

POLITICAL ECONOMY RESEARCH ON IP: STARTING POINT

- IP has : **concentrated & immediate benefits, with identifiable beneficiaries; and diffuse costs across taxpayers, with long-term societal benefits.**
- **Govt leaders** have incentives to use IP for **political objectives** more than economic objectives (eg future growth)
- **Private firms** have incentives to capture IP funds and **use as "rents"**, not to finance upgrading
- **Environmental policy** tends to opposite: diffuse & long-term benefits (eg less air pollution), concentrated & immediate payers (eg carbon tax) (R. Juhasz & N Lane, 2024, "The political economy of industrial policy", J. Econ. Perspectives 38 (4)

Twin risks of IP: unbalanced power b/w state & privates

- Risk (1): **Powerful / cohesive state dominates private actors.** State may focus on large, visible projects, on clientelistic policies, to **exclusion of effective upgrading**. State IP agencies may ignore needs of private sector, elicit little buy-in to the IP projects
- Risk (2): **Concentrated private actors dominate weak state.** State gives them public funds while allowing them to treat the funds as **rents, to exclusion of effective upgrading**

The matched or balanced cohesion / power hypothesis

- Charles Hankla, 2025, *In Pursuit of Prosperity: Industrial Policy and the Politics of Economic Upgrading*
- **Argument:** IP more likely to be effective when there is balanced or matching degree of cohesion/centralization b/w state & privates:
- (1) where the state agencies dealing with IP are **cohesive / centralized**, and private interest groups **also cohesive / centralized**. Eg Japan: MITI-Keidanren. SK: EPB & KDI-Federation Korean Industries (FKI)
- (2) where state IP agencies **not centralized / cohesive** & private groups similarly **not centralized / cohesive** Eg US: DARPA-SRC (Semiconductor Research Corp.), -IQT, -SBIR (Small Business Innovation Research), universities, many more

Degree of cohesion / centralization of state ?

- **A state is more cohesive** when there are fewer “veto players” who must agree to changes, fewer “veto points”
- **State more fragmented,** less centralized when multiple “access points” through which privates can influence / block policy
- **Cohesion / centralization of state may be measured at national level, or at disaggregated sector level**. A state may be fragmented at national level (eg US) while having high cohesion in certain sectors

Degree of cohesion / centralization of private interest groups ?

- Private interests more cohesive when:
- (1) a single group represents the sector,
- (2) this group represents a large part of the members of the sector
- (3) executive of this group can determine the group's bargaining position & impose that position on the membership, or the membership is already united on the bargaining position
- Cohesion of private interest groups may be high at national level (eg strong peak business associations) or low at national level but high in some specific sectors

Hypothesis: IP successful when **balance of power in state-private coalitions or networks**

- **IP "coalitions" or "networks"** link IP state agencies with business associations, universities, think tanks, trade unions, agricultural unions, etc. who come together to support a cooperative approach to IP nationally or in specific sectors
- Sometimes **IP coalitions** incorporated directly into IP agencies (eg **advisory councils within a department of govt**). Sometimes the state-private coalitions are separate from the IP agencies.
- Coalitions / networks may operate at the **peak level of national economy**, or at **lower levels of centralization in specific sectors**

Typology of state-private coalitions

State	Privates	
	Centralized	Not
Centralized	corporatist	statist
Not	capture	pluralist

Summary: 4 institutional configurations

- Each configuration supports a distinct “upgrading coalition”, which is the agent most involved in making IP.
- (1) centralized/cohesive state + centralized/cohesive private interests = “corporatism”. Likely effective in upgrading
- (2) decentralized state + decentralized private interests = “pluralism”. Likely effective in upgrading
- (3) centralized state + decentralized private interests = “statism”. Likely not effective
- (4) decentralized state + centralized private interests = “capture”. Likely not effective

WHY **UNCERTAIN** RETURN? Anti-IP forces

- (1) **Industrial policy is risky, likely to be flashpoint for political conflict.**
- Governments have to navigate their industrial policy through the the **"twin risks"**:
- (1) **Cohesive state dominates private actors.** State may focus on large, visible projects, on clientelistic policies, to exclusion of effective upgrading. State IP agencies may ignore needs of private sector, elicit little buy-in to the IP projects
- (2) **Weak state is captured by concentrated private actors.** State gives them public funds while allowing them to treat the funds as **rents** without trying to upgrade and boost productivity.

Anti-IP forces

- (2) **A “leading” or “pilot agency”, with real power, is essential – but difficult !**
- Sectors have different requirements for upgrading. IP must be tailored to these requirements
- Many requirements are a priori unknown & change over time. Job of agency is to **“learn by doing”** – to accumulate context-specific knowledge, much of it TACIT, based on experimentation & feedback
- The high-level agency must coordinate ministries, monitor their actions, hold them to account; and ditto with firms / sectors, & cut off support when appropriate
- It should have similar autonomy as central bank, NASA, NIH; & build **networks** with firms, public agencies, unions

Anti-IP forces

- (3) **The continuing power of neoliberal zeitgeist and its embedding in economic institutions raise the probability that IP is pushed out of "window of discourse" in foreseeable future.**
  "Government cannot pick winners", etc
- Especially when combined with the difficulties facing most states of navigating the twin risks (especially the risks of private firms using IP resources as rents, without accountability).

Pro-IP forces

- (1) **Slow growth in OECD**
- (2) **China's export surge** since 2001 has knocked out industries and industrial employment in OECD.
- Federal Reserve: 2016, 46% of American adults said they could not meet emergency spend of $400 without borrowing or selling
- (3)**US IP propelled by competition with China**

Pro-IP forces

- (4) **High levels of geoeconomic tensions raise the incentives on governments to undertake IP for "naational security" reasons**
- **Mark Carney**: "… great powers have begun using economic integration as weapons, tariffs as leverage…, supply chains as vulnerabilities to be exploited." (Davos speech 20 January 2026)
- **Chris Miller**: "Beijing, Brussels & Washington are all searching for the most efficient and asymmetric ways to **gum up their adversaries' supply chains**" (Chris Miller, 2025, "Why China keeps winning the trade war", FT 28 Oct)

Munich Security Report 2024

- “As more & more states define their success relative to others, a vicious cycle of relative-gains thinking, prosperity losses, & growing geopolitical tensions threatens to unroll. The resulting **lose-lose dynamics** are already unfolding in many policy fields and engulfing various regions”
- Bunde et al. 2024, emphasis added

Iceland's industrial policy

- Action Plan lists 35 measures + the 10 ministries assigned responsibility for implementing. Coordination across government will be vested in Prime Minister's office, plus independent council of 5 experts.
- The Growth Plan and the Action Plan give vision, goals, **not strategy**
- Almost no reference to **financing**, except to say that most of 35 measures will be carried out "within existing budget constraints"
- Almost no mention of **policy tools**
- No mention of a **"pilot agency"**
- No reference to **how the private sector (eg unions, business associations) will be involved**

Recent papers on IP by Reda Cherif & Fuad Hasanov, IMF economists

- https://www.imf.org/en/publications/wp/issues/2026/03/27/institutions-for-industrial-policy-the-foundation-of-economic-development-575070
-
- https://www.aeaweb.org/articles?id=10.1257/jep.20251448
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- https://voxdev.org/topic/macroeconomics-growth/modern-industrial-policy-asian-miracles-blueprint-developing-economies

APPENDIX

The design of IP: desirable characteristics of IP tools

- Those few economists who have focused on the design of IP have tended to focus on : the policy tools.
- Must contain **performance conditions**, so benefits withdrawn if performance criteria not met.
- Must contain **sunset clauses**, so the benefits do not become entrenched.
- Taiwan's fiscal investment incentives had built-in sunset clause, in that the tax incentive available only to producers producing specific products at the top level of product capacity or quality then being made in Taiwan. Every two years the standards were raised to keep them on the frontier
(Wade, Governing the Mkt, appendix)

The missing IP tool: exchange rate

- Exchange rate strangely ignored in most discussions about IP.
- Overvalued ER makes it more difficult for IP to accelerate production upgrading or re-industrialization.
- Ian Fletcher & Marc Fasteau, 2026, “There will be no reindustrialization without devaluing the $. It can be done. Limiting inflows of foreign money into US capital markets is the key”, Feb 1, Substack.
- $ overvalued by 17-18% (if reduced by that amount, trade balance).
- US average tariff 14%. That implies, US has net **negative** tariff. That may be why trade partners have not strongly responded to Trump tariffs, because T tariffs do not offset the benefits their exporters get from US ER overvaluation.
- US must introduce capital controls — Market Access Charge (MAC): tax on foreign purchases of US assets (especially financial assets), and on US creditors of foreign debt.
- Plus, must stop talking of **“strong” dollar**; rather, **“overpriced”, “uncompetitive”** dollar.