

Interaction between Competition and Industrial Policies

Industrial policy has seen renewed focus across the globe, with many countries taking a protectionist approach to their policy. It then becomes crucial to debunk the traditionalist view that industrial and competition policies conflict with each other.

Complementarity of competition and industrial policy to foster a robust economic system should be the aim of the governments in today's globalised world. This is crucial not only for the country's economic development but also for consumer welfare and participation in a multilateral world order. It should be realised that the efficacy of industrial policies depends on how competitive markets are. There needs to be an optimal degree of competition in the market for a successful industrial policy.

Introduction

In the wake of challenges, the world has been facing such as the COVID-19 aftermath, vaccine nationalism, global supply-chain instability, net zero transitions, and geopolitical competition, the industrial policy regime has been in focus. Governments around the world are adopting industrial policies that incentivise domestic manufacturing to create jobs and reshoring the value chains.¹ The efforts are to improve the performance of key manufacturing and business sectors.² This trend was accentuated due to the COVID-19 pandemic and is a shift towards the real economy comprising jobs, production, and localisation.³

¹ [New industrial policy for New India - The Hindu Business Line.](#)

² *Ibid*

³ [The COVID-19 pandemic and the internationalization of production: A review of the literature - PMC](#)

The noted Harvard economist Dani Rodrik has termed it ‘productivism.’⁴ The earlier emphasis was on finance, consumerism, and globalisation. Industrial policy, shunned in the heydays of globalisation, is now back in fashion in industrialised as well as developing countries. There is renewed debate about the role of industrial policy and government support for firms and industries deemed strategically important.⁵ Therefore, it is important to ensure these efforts do not subvert competition and support special interests.

Apparent Conflict between Competition and Industrial Policy

The objective of an industrial policy, as traditionally understood by some, may conflict with that of a competition policy. Governments in the past have given primacy to industrial policy, often at the expense of fair and free competition in the market. At the same time, it is important to realise that both competition and industrial policies should complement each other for building a successful economic system.⁶

The same was noted by Jean Tirole, Nobel Laureate in Economics, as he raised the issue of ‘participatory’ antitrust in the relationship between industrial policy and competition policy.⁷

It should be understood, that focus on industrial policy would be a priority for any developed or developing country. No country has been able to sustain growth or reduce poverty without the manufacturing sector driving that growth.⁸

The productivity levels in industry are much higher than in either agriculture or services. Manufacturing is the engine of economic growth, as it offers economies of scale, embodies technological progress, and generates forward and backward linkages that create positive spillover effects in the economy.⁹ Moreover, it is employment-led

⁴ [ON PRODUCTIVISM | Dani Rodrik](#)

⁵ [Industrial Policy and the Growth Strategy Trilemma](#)

⁶ [Interaction between Competition and Industrial Policies, Contribution, Mr. Pradeep S. Mehta, CUTS International](#)

⁷ [Competition Policy and Industrial Policy: Towards a new era?](#)

⁸ [Growth, Structural Transformation and Poverty Reduction: Issues and Challenges with special reference to India](#)

⁹ [Why an industrial policy is crucial | Latest News | The Hindu](#)

growth. Therefore, economic development is complemented by a sound industrial base.¹⁰

Industrial policies are major cornerstones of a country's economic policy. In the same vein, competition policy aims to ensure that market practices and strategies do not reduce consumer welfare. Competition policy aims to protect and promote competition in the market.

Effective competition policy removes market-entry barriers imposed by incumbent players. It provides innovation incentives to new entrants who want to improve their market position and increase customer bases. It also incentivises the existing market players to innovate and protect their market share from competitors.

Therefore, competition policy fosters innovation which leads to better-quality products and services being offered at a competitive price, thus increasing both consumer and producer welfare.

Complementarity between Industrial and Competition Policy

As per OXERA research,¹¹ before the global financial crisis that began in 2007, there was a general transatlantic consensus that effectively functioning and competitive markets were the best instruments to deliver the goods and services that consumers need. At the same time, it was accepted that rules were needed to ensure free and fair competition so that businesses competed on a level playing field and consumers were not exploited or harmed by a powerful combination of firms acting together.¹²

On this basis, competition law was deemed the most appropriate and least intrusive way of regulating markets. Cartels were rightly regarded as undermining competition.¹³

While competition provides increased incentives for firms to innovate, industrial policies can help by improving their capacity to undertake growth-inducing investments. A successful model of industrial development thus needs both,

¹⁰ [Industrial development and economic growth: Implications for poverty reduction and income inequality](#)

¹¹ [Competition and industrial policy in Europe: how can they work together? - Oxera](#)

¹² *Ibid.*

¹³ <https://www.oxera.com/insights/agenda/articles/competition-and-industrial-policy-in-europe-how-can-they-work-together/>

competition as the basis, and carefully designed industrial policies on top of that, without violating competition rules.¹⁴

The efficacy of industrial policies highly depends on how competitive markets are. Industrial policies are more likely to be successful when they are implemented in markets of some optimal degree of competition. A study conducted based on data from China found that the more competitive the sector that receives state aid, the more positive the effects of state subsidies to that sector on total factor productivity, its growth and product innovation.¹⁵

By contrast, for sectors with a low degree of competition, the effects are negative. However, even in a competitive environment, there might be market imperfections that impose constraints on investments in innovation and growth.¹⁶

Then, there is a need for industrial policies that can remove these constraints and motivate investments. Such impediments may arise due to capital-market imperfections and credit constraints, administrative burdens, or complicated labour or tax rules.¹⁷

Well targeted industrial policies can provide, for example, tax incentives for innovating firms, re-design the rules to reduce the administrative burden for innovators, and relax credit constraints by protecting intangible assets.¹⁸

Constraints may also limit the reallocation of firms towards new, growth-enhancing sectors (e.g., ICT, nanotechnology, biotechnology). If markets are competitive, state intervention can be more effective in providing some assistance to firms to enter and scale up in these sectors.

An important criterion for this complementarity model to be successful is that vertical industrial policies should not provide selective advantages to specific firms. Various countries have promoted specific firms or industries as national champions, such as semiconductors in Taiwan, renewable energy in Germany, and aerospace in France.

¹⁴ [How should the relationship between competition policy and industrial policy evolve in the European Union?](#)

¹⁵ [Do subsidies increase firm productivity? Evidence from Chinese manufacturing enterprises - ScienceDirect](#)

¹⁶ [Competition, Innovation, and Inclusive Growth1 in: IMF Working Papers Volume 2021 Issue 080 \(2021\)](#)

¹⁷ Ibid.

¹⁸ [Policy incentives for private innovation and maximising the returns | OECD Journal: Economic Studies](#)

This approach aims to create globally competitive companies, ensuring economic growth and security.

Although the use of industrial policy to establish national champions has been successful in some cases, it remains controversial. Economists worry that picking winners and losers can lead to market distortions and inefficient allocation of resources.

Sector-wide industrial policies that apply to many firms without discrimination will work better at inducing sustainable growth. Indeed, picking a specific firm as the champion of the sector, instead of letting the market's competitive process decide which firm will emerge as the leader, can be ineffective. This is because the government cannot assess the chances of commercial success better than the market (it may pick a winner that is not the most efficient). Also, the government's selection process may involve the risk of capture and rent-seeking, especially if the selection process is not transparent and the rules of selection are not clear. Despite the concerns, the revival of industrial policy shows no signs of slowing down.

Notable Global Developments and Trends

In the US, industrial policy is a priority of the government. There is bipartisan support for the Creating Helpful Incentives to Produce Semiconductors and Science Act (CHIPS Act),¹⁹ which aims to revitalise the US semiconductor industry. More than 90 percent of advanced chips, crucial for defence and artificial intelligence (AI), come from Taiwan which raises concerns about US industry vulnerability due to China's presence.²⁰

To address such risks, the US government is allocating US\$39bn in funding from the US\$280bn CHIPS Act to support the development of advanced semiconductor manufacturing capability.²¹ The Biden administration's industrial policy is far-reaching, and at least two semiconductor manufacturing clusters are planned by 2030.²²

Funding recipients also face extensive conditions, such as a 10-year ban on expanding advanced chip capacity in China and a commitment to affordable childcare. These

¹⁹ [Learning from the CHIPS Act of the U.S. - The Hindu.](#)

²⁰ [The CHIPS and Science Act: Here's what's in it](#)

²¹ [FACT SHEET: CHIPS and Science Act Will Lower Costs, Create Jobs, Strengthen Supply Chains, and Counter China | The White House](#)

²² [Industrial Policy and the Growth Strategy Trilemma](#)

policies are part of the administration's broader approach to industrial policy, which also includes US\$370bn in subsidies for clean energy in the Inflation Reduction Act. The use of domestic content regulations on solar panels has also been authorised under the Buy America Act.²³

Meanwhile, Japan is providing subsidies worth more than US\$500mn to 57 companies to encourage them to invest domestically, as part of its efforts to reduce reliance on China.²⁴ Similarly, the European Union is scaling up its industrial policy, including setting aside €160bn of its COVID-19 recovery fund for digital innovations such as chips, batteries, and climate adaptation.²⁵ In response to massive subsidies in the US Inflation Reduction Act, Italy's Economy Minister recently called for a common EU approach to support competitiveness and protect strategic production.²⁶

India as well as its recent manufacturing push with Make-in-India²⁷ for job creation is a part of the global trend. India's new industrial policy has unfolded with ease-of-doing-business,²⁸ production-linked incentives,²⁹ tariff protection, and sectoral missions, such as the Semiconductor Mission,³⁰ and Gati Shakti,³¹ among many initiatives. India's recent emergence as a net exporter of mobile handsets and toys gives confidence that the industrial policy can work.

India's past was dominated by an inward-oriented strategy for industrial development for almost 40 years after independence. The main reason behind this was to foster industrialisation and save foreign exchange. The developments since then clearly prove that the industrial policy of a country should not be an isolated matter that stands in conflict with other policy strands like trade policy, competition policy, monetary policy, fiscal policy, etc.

²³ [Inflation Reduction Act of 2022 – Policies - IEA](#)

²⁴ [Japan's post-COVID-19 approach to supply chains | East Asia Forum](#)

²⁵ [Production Linked Incentive \(PLI\) Schemes in India](#)

²⁶ <https://www.reuters.com/markets/europe/italy-urges-eu-subsidy-package-response-us-ira-scheme-2022-12-05/>

²⁷ <https://www.makeinindia.com/>

²⁸ <https://economictimes.indiatimes.com/news/economy/policy/new-industrial-policy-aims-to-focus-on-one-nation-one-standard/articleshow/96746058.cms?from=mdr>

²⁹ [Production Linked Incentive \(PLI\) Schemes in India](#)

³⁰ <https://ism.gov.in/>

³¹ [PM Gati Shakti - National Master Plan for Multi-modal Connectivity](#)

Absolute clarity on the role of these policies and their ability to achieve convergence will be critical to achieving desired growth and employment in an economy. It would be a mistake to analyse their interaction in isolation and without taking into account other important related policies, especially competition policy and monetary, fiscal, taxation, and sector-specific policies.

Conclusion and the Way Forward

A review of the literature including IMF research³² suggests an industrial policy in the market economy which is not against or outside the markets, especially international ones. Industrial policy must necessarily be part of an economy open to international trade. It should not impose constraints that expose companies to additional costs that would downgrade them in the domestic market or international competition. A highly misunderstood aspect of industrial policy is that it ignores market mechanisms.

On the contrary, a good industrial policy intervenes in the domestic economy to kickstart a 'virtuous cycle' of industrialisation but then relies on market mechanisms to sustain it.³³

There is a need to also look towards fair-market capitalism which offers a different path to achieving national security goals than the protectionist industrial policy approach. Instead of each country promoting national champions, the approach encourages a diversified global supply chain based on open and fair trade, thus avoiding an economic arms race.³⁴

This approach can lead to greater efficiency and innovation in the long run while mitigating the risks of supply-chain disruptions through diversification and international cooperation.

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³² [Global Trade Liberalization and the Developing Countries -- An IMF Issues Brief](#)

³³ [Trading up can unlock India's industrial potential | Lowy Institute](#)

³⁴ [Industrial Policy and the Growth Strategy Trilemma](#)