Industrial Policy Discussion
David McKenzie, Pritish Behuria, and Tristan Reed

Ana Cusolito

2024 ANNUAL BANK CONFERENCE ON DEVELOPMENT ECONOMICS

July 9, 2024
Three complementary papers with primary focus on the HOW instead of on the WHY.


Different and challenging times, so let’s not disregard the WHY (Lederman et al., 2024).

Unclear that governments use IP based on the economic principles that justify it.

Limited fiscal space and debt distress call us to be prudent in using public funds.
Poor targeting: a bird’s-eye view of the Bank’s debate

- D: let’s not pick winners but attract high-growth firms (HGFs) and screen out zombies.
  - Simple and help us get rid of the problem. First best or second best approach?
  - Horizontal solution for a vertical problem.
  - Horizontal IP may not be universally useful. Attrition problems.
  - A small proportion of HGFs, so IP can be very costly, despite being cost-effective.
  - Highly differentiated firms will not compete! (Aghion et al., 2011; Dewatripoint 2023).

- T: let’s use a productivity-based and trade-guided approach to pick winners.
  - Help us discipline our thinking.
  - Too much emphasis on variable costs.
  - It disregards fixed costs, which can justify IPs! Services less scalable and more atomistic.
  - Role for EPAs in helping service firms cover the fixed cost of exporting (Cusolito et al., 2023).

- A: let’s design ic-mechanisms to channel public funds toward those with skills to target.
  - If well-trained investors find good opportunities, targeting is not an impossible task.
  - Do we want bureaucrats to learn investors’ skills?
  - Find approaches to partner with those who know how to do it (IRPs) (Cusolito et al., 2018).
Poor targeting: a bird’s-eye view of the Bank’s debate

D: let’s not pick winners but attract high-growth firms (HGFs) and screen out zombies.
- Simple and help us get rid of the problem. First best or second best approach?
- Horizontal solution for a vertical problem.
- Horizontal IP may not be universally useful. Attrition problems.
- A small proportion of HGFs, so IP can be very costly, despite being cost-effective.
- Highly differentiated firms will not compete! (Aghion et al., 2011; Dewatripoint 2023).

T: let’s use a productivity-based and trade-guided approach to pick winners.
- Help us discipline our thinking.
- Too much emphasis on variable costs.
- It disregards fixed costs, which can justify IPs! Services less scalable and more atomistic.
- Role for EPAs in helping service firms cover the fixed cost of exporting (Cusolito et al., 2023).
Poor targeting: a bird’s-eye view of the Bank’s debate

D: let’s not pick winners but attract high-growth firms (HGFs) and screen out zombies.
- Simple and help us get rid of the problem. First best or second best approach?
- Horizontal solution for a vertical problem.
- Horizontal IP may not be universally useful. Attrition problems.
- A small proportion of HGFs, so IP can be very costly, despite being cost-effective.
- Highly differentiated firms will not compete! (Aghion et al., 2011; Dewatripoint 2023).

T: let’s use a productivity-based and trade-guided approach to pick winners.
- Help us discipline our thinking.
- Too much emphasis on variable costs.
- It disregards fixed costs, which can justify IPs! Services less scalable and more atomistic.
- Role for EPAs in helping service firms cover the fixed cost of exporting (Cusolito et al., 2023).

A: let’s design ic-mechanisms to channel public funds toward those with skills to target.
- If well-trained investors find good opportunities, targeting is not an impossible task.
- Do we want bureaucrats to learn investors’ skills?
- Find approaches to partner with those who know how to do it (IRPs) (Cusolito et al., 2023 2018).
No additionally: we can get more from industrial policy

- IP aggregate additionally, even with business-stealing effects (e.g., quality upgrading).
  - Aghion et al., 2006, Aghion et al., 2013.
- IP aggregate additionality, even with reallocation effects (e.g., higher productivity).
  - Aghion et al., 2012.
- IP to help domestic firms cope with the effects of persistent shocks (climate change).
- Revisit the ”no impact” evidence with Bayesian IE
  - McKenzie et al., 2024.
Overlooked micro-macro complementarity and an ill-equipped single-policy approach

- Coordination with regulations to avoid specific risks (e.g., entry deterrence).
- Complementarity to achieve a policy goal or maximize gains from IP & non-IP reforms.
- Economic growth debate: "removing distortions vs. relying on IP" (vs. infrastructure)
  - IP opponents argue it is costly and ineffective, so Govs should remove distortions.
    - Juhász et al., (2024), Caliendo et al., (2022), Hornbeck and Rotermberg (2024).
  - They see different policy approaches as perfect substitutes, while they may not.
  - Though very necessary (attractive), removing distortions (IPs) may not be sufficient. Why?
  - A single-policy approach may be deficient in bringing both sides of a market together!
    - Example of perfect complementarity: financial market reforms and investment readiness IP.
    - Whited and Zaho (2021), Cusolito et al., (2023a,b), and Goldberg and Reed (2023).
Underdeveloped state capacity: Bank’s lessons learned

- Design flaws impede targeting, risking the allocation of public funds to the wrong firms.
  - Write broad and vague eligibility criteria (activities and firms eligible for public support).
  - Use unmeasurable indicators to ex-ante evaluate applications for state aid.
  - Rely on subjective scoring mechanisms to select beneficiaries.

- Implementation flaws make IP expensive but dull and impactless.

- Allocate public staff inconsistently: risk-averse bureaucrats run risky innovation programs.

- Centralize (delay) beneficiaries’ selection to avoid political capture but decentralize IP.

- Allocate public funds ineffectively: fixed vs. variable costs (IA’s rents vs. firms’ support).

- Lose bargaining power with IAs, which demand more money to implement IPs (hold-up).

- Misalign public-private incentives, creating moral hazard problems, by working in silos (e.g., firms match public with public funds instead of matching public with private funds).

- Overall failures make evaluation unfeasible and all of us unaccountable.

- Prohibit the expansion of the global stock of knowledge to make IP operationally impactful.

- Render us (governments and MDBs) unaccountable for using public and Donor funds!
Underdeveloped state capacity: Bank’s lessons learned

- Design flaws impede targeting, risking the allocation of public funds to the wrong firms.
  - Write broad and vague eligibility criteria (activities and firms eligible for public support).
  - Use unmeasurable indicators to ex-ante evaluate applications for state aid.
  - Rely on subjective scoring mechanisms to select beneficiaries.

- Implementation flaws make IP expensive but dull and impactless.
  - Allocate public staff inconsistently: risk-averse bureaucrats run risky innovation programs.
  - Centralize (delay) beneficiaries' selection to avoid political capture but decentralize IP.
  - Allocate public funds ineffectively: fixed vs. variable costs (IA’s rents vs. firms’ support).
  - Lose bargaining power with IAs, which demand more money to implement IPs (hold-up).
  - Misalign public-private incentives, creating moral hazard problems, by working in silos (e.g., firms match public with public funds instead of matching public with private funds).

Overall failures make evaluation unfeasible and all of us unaccountable.

Prohibit the expansion of the global stock of knowledge to make IP operationally impactful.

Render us (governments and MDBs) unaccountable for using public and Donor funds!
Underdeveloped state capacity: Bank’s lessons learned

- Design flaws impede targeting, risking the allocation of public funds to the wrong firms.
  - Write broad and vague eligibility criteria (activities and firms eligible for public support).
  - Use unmeasurable indicators to ex-ante evaluate applications for state aid.
  - Rely on subjective scoring mechanisms to select beneficiaries.

- Implementation flaws make IP expensive but dull and impactless.
  - Allocate public staff inconsistently: risk-averse bureaucrats run risky innovation programs.
  - Centralize (delay) beneficiaries' selection to avoid political capture but decentralize IP.
  - Allocate public funds ineffectively: fixed vs. variable costs (IA’s rents vs. firms’ support).
  - Lose bargaining power with IAs, which demand more money to implement IPs (hold-up).
  - Misalign public-private incentives, creating moral hazard problems, by working in silos (e.g., firms match public with public funds instead of matching public with private funds).

- Overall failures make evaluation unfeasible and all of us unaccountable.
  - Prohibit the expansion of the global stock of knowledge to make IP operationally impactful.
  - Render us (governments and MDBs) unaccountable for using public and Donor funds!
Thank you!