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The Future of Industrial Policy in a Globalizing World: What are the Options?

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I. Introduction: What is Industrial Policy?

Industrial policy is about how a nation or a region develops economically, and about how government structures incentives and relationships across different economic sectors, in order the foster economic growth and increase standards of living. Broadly, this can mean pretty much anything that government does that has an impact on economic performance, including policies, regulations, tax structure and subsidies.[1]

The extent of government intervention and participation in the economy has changed over the course of the 20th century and across nations and regions. The prevailing orthodoxy is that governments cannot create wealth directly, but can only create the conditions for wealth creation in the private sector. This leads to a framework that stresses policy changes to reduce taxes, to privatize state enterprises and public services, to deregulate environmental protections, labour laws, consumer protection, and to stress export-oriented economic development. While not generally thought of as industrial policy, these measures are a "passive" form of industrial policy, at one end of a spectrum of choices around the degree of intervention by the state.

Historically, industrial policy has had a more interventionist flavour that is consistent with the idea of an activist state. Such "active" industrial policy has been based on protecting infant industries, developing infrastructure, placing restrictions and conditions on foreign investment, plus other forms of government intervention to subsidize and support wealth creation. A wide range of public sector activities, including state monopolies, state trading enterprises and public services, also fall within this conception of industrial policy. The key point is that there is something deliberate or strategic in terms of intervention, whether or not successful in terms of actual outcomes.

Industrial policy is important because markets alone are insufficient to achieve high levels of economic and social development. While there is debate around the *degree* to which markets work effectively—the extent of market failure in economies—it is fair to say that there are specific markets that work relatively well, some that produce less than ideal results, and others that fail altogether. The market mechanism can be effective to the extent that it coordinates decentralized deci-

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sion-making, but left on its own, "the market"—or capitalist economic development—leads in many cases to sub-optimal outcomes within specific industries, and across society more broadly. Hence, the critical question is not *whether* the state should intervene in the market, but *how* to intervene in a way that improves standards of living.

In the context of globalization, industrial policy takes on a renewed importance because of the divergent levels of economic development across the world. The degree of flexibility different nations have to enact laws, regulations and policies aimed at promoting domestic capabilities and economic growth is of utmost importance for industrial policies. This speaks to the *terms* on which countries integrate into the global economy, including the pace and timing of reforms and liberalization vis-à-vis domestic industrial considerations. The range of industrial policy instruments used in the past have generally been designed to foster the domestic industry by deterring imports (tariff walls, import substitution policies) and/or increasing exports (subsidies, drawbacks[2] and other incentives). Globalization and the advent of multilateral trade rules have dramatically shifted the parameters of this trade context.

The topic of industrial policy, then, is of vital interest to poorer countries seeking to raise the standard of living of their citizens, and is an essential ingredient of a more far-reaching development policy. Industrial policy is also of interest to advanced economies, including middle-powers with small domestic markets, like Canada. Many regions in Canada are still heavily reliant on the export of primary commodities, and Canada faces distinct challenges in terms of its proximity to the US.

There has been a great deal of thinking about and practice of industrial policy since the end of World War II, in particular as it relates to the development (or under-development) experience of countries in Asia, Latin America and Africa. The next section looks at the history of industrial policy, from the early industrializers to the much-heralded Asian economies in recent decades. Section III considers the demise of active industrial policy under the rules of the World Trade Organization. Section IV looks at the implications of WTO rules and the remaining options available to countries. It argues for a renewed public sector as an anchor for industrial policy in the future.

II. A Short History of Industrial Policy

A look at the history of industrial policy is instructive in the context of lectures from Northern governments that poor countries need to open up their markets and integrate into the global economic system to increase economic growth and reduce poverty. While export markets can be very important, a historical view reveals that no country has gotten rich by pursuing trade liberalization as a "catch up" strategy. Indeed, contrary to free market rhetoric, there has always been a strong role for government protection and intervention in industrial development. The US, the UK and other European nations pursued deliberate industrial strategies historically, as have the most successful Asian economies in recent times. This section provides a condensed review of these experiences.

Early Industrializers

Early industrializers (such as the United States, United Kingdom, Germany, France and Canada) protected their domestic "infant industries" through tariffs, and had substantial government involvement in trade flows. The state played a large role in boosting capital accumulation, institutional development, building infrastructure, and undertaking research and development. Military might and colonial structures were also very important in meeting political and economic objectives.

Industrial policy has its origins around trading relationships at the time of early industrialization. Britain was the dominant world power during the late-18th and 19th centuries. High tariff levels (45-55% average tariff in 1820, although preferences were given to Commonwealth countries) prevailed up to about 1850, when Britain began the shift to a free trade policy. However, free trade came only *after* Britain had consolidated its industrial base—it was preceded by many decades of selective industrial protection in the areas of wool and cotton products, iron and other metals, ship-building and fisheries. Imports of silk and cotton from India, which had great cost advantages over Britain, were prohibited altogether. Exports of machinery were also prohibited. By the 1860s, when free trade was fully implemented, Britain was in the very advantageous position of exporting manufactured goods (well-established and subject to economies of scale) while importing raw materials (see Shafeaddin 1998). Free trade can thus be considered an adjunct to domestic industrial policy, serving to expand export markets, while lowering production costs through economies of scale.

Like Britain, the United States greatly protected its domestic market through tariffs (also the principal source of government revenue at the time which added to protectionist pressures). Protection was selective, and included cotton cloth, wool and iron. Raw materials were allowed in duty-free and drawbacks were provided for commodities re-exported within 12 months. Protective tariffs lasted from the post-independence period up to the end of the Second World War (although there were ebbs and flows of liberalization and protection). When the US shifted to a trade liberalization framework it held a large post-war industrial lead over European countries devastated from the war (Shafeaddin 1998).

For both the US and Britain, the locus of government intervention around industrial policy was for trade. Both placed less emphasis on direct intervention in the domestic economy than other early industrializers, although government involvement was still a major factor in the expansion of infrastructure, support for R&D, institutional development, and controls on navigation. Both also benefited from having large domestic markets.

Only when countries become powerful do they tend to be more supportive of free trade. (Indeed, in the case of Britain, "free trade" was forced on other countries by military force if need be—witness the Opium Wars with China from 1839-42, leading to the establishment of Hong Kong as a British colony.) This pattern is also evident in today's advanced economic sectors, with the leading nations pushing for liberalization in services, e-commerce, telecommunications and biotechnology—all areas where they have the upper hand. It is also the case in the push for strong intellectual property rights to maintain technological and commercial advantages.

Industrial policy in Canada emerged in the shadow of the US and UK. Canada's National Policy was introduced in 1879, based on the belief that the domestic market, linked by a transportation infrastructure, would be reserved for Canadian companies. High tariffs were put in place to develop a domestic manufacturing base. However, this policy came in conflict with the need for export markets, since the small Canadian market limited the ability of producers to benefit from economies of scale. This meant that Canadian policy efforts sought to secure market access to either the US or Britain—an early version of an export-led growth strategy—while at the same time "developing ever more sophisticated versions of the National Policy. Successive governments gradually sharpened their use of export and production subsidies, valuation procedures, tariff classification, special antidumping duties, and other devices meant to give Canadian producers advantage over their foreign competitors in the domestic market" (Hart 1998).

Other examples of Canadian industrial policy have centred on the needs of the domestic market. Like many other countries, Canada limited the application of patents in the domestic market by issuing "compulsary licenses" that enabled domestic producers to use a patent without the authorization of the patent holder. This led to a significant reduction in prices, and also to the development of a Canadian generic drug industry (Lexchin 2001, Correa 1999). Cultural policy is another rich area where Canada has enacted numerous policy measures to ensure the development of domestic cultural industries.

Canada is also an illustrative case of a "mixed economy" approach to industrial policy. This includes the expansion of public services and the creation of Crown corporations. These public sector initiatives shaped the development of particular sectors, such as health care, education, rail and electricity, which in turn had spin-off benefits through to other sectors of the economy. While privatization of Crown corporations and erosion of public services have occurred in recent years, the public sector still represents a major presence in the Canadian economic scene.

Asian "Miracles"

High rates of economic growth and development in East Asia (Japan, Korea, Singapore, Taiwan and Malaysia) constituted a modern "miracle", according to the World Bank (1992), at least up until the Asian crisis in 1997-98. The "Asian model" is essentially a pragmatic strategy based on addressing a number of market failures: uncertainty problems related to investment in infant industries; externalities of investment and innovation; first-mover "disadvantage" due to spillovers; small, under-capitalized companies, but that require massive investment and fixed costs. The Asian model encompasses the idea that governments do manage and plan economies, and channel resources into strategic areas. It is rooted in the notion of manipulating markets to their competitive advantage, usually to reduce the amount of risk and uncertainty (Kwon 1998).

As the World Bank points out, trade played a significant role for the Asian economies through a highly successful export-led growth strategy. But this trade context was very different from the unilateral opening of borders generally advocated by the Bank. Exports were stimulated through subsidies, tax credits and other incentives to producers, but protecting the domestic market was also given high priority through foreign exchange controls, import quotas and tariffs. When the Asian economies did liberalize, it was on a more gradual basis, as domestic industries became more internationally competitive (UNCTAD 1994). This step-by-step process is still evident with China and India.

The Asian lessons are interesting because they are those of late industrializing countries, pursuing technological catch-up strategies to compete in already established world markets. Countries face formidable barriers to entry in such circumstances due to the advanced states of technology, capital accumulation, market power, and presence in established markets of advanced industrial economies. Market forces alone in such cases are unlikely to sufficient, while more intervention by government may be necessary the later the timeframe of industrialization.

Development and Industrial Policy

In a recent study, Weisbrot et al (2001) looked at changes in economic growth, plus health and education indicators for 116 countries, comparing the 1960-80 period against the 1980-2000 period. After sorting countries into five groups based on common starting points, they found that economic growth rates for all five groups were much lower in the second period than the first period. Indeed, the poorest group went from average per capita GDP growth of 1.9% per year from 1960-80 to –0.5% per year from 1980-2000. The

second lowest group dropped from 3.6% to less than 1%. While such changes may not seem striking, the cumulative impact of slower growth rates is immense. The study also found that progress in health and education indicators was reduced for most countries.

This empirical result is an indictment of the period of globalization of the past 20 years. The authors note that this presents "a very strong prima facie case that some structural and policy changes implemented during the last two decades are at least partly responsible for these declines. And there is certainly no evidence in these data that the policies associated with globalization have improved outcomes for most low and middle income countries."(Weisbrot et al 2001)

The latter period reflects a timeframe that increasingly saw the IMF (and to a lesser extent, World Bank) tie access to loans and the international financial system to economic reforms through structural adjustment programs. These programs required that countries: reduce the public sector by cutting back on public services like health care and education, privatizing state enterprises, deregulating the economy, and eliminating government supports and subsidies; reorient the domestic economy towards export production, and remove constraints on trade and capital flows; and, maintain high interest rates in order to control inflation and stimulate the confidence of foreign investors. These policy frameworks have been increasingly locked into place through international trade agreements.

In contrast, the initial 1960-80 period of study was characterized by more inward-looking development strategies, such as import substitution policies, protections for domestic industry, as well as performance requirements for foreign investors that required purchases of local inputs or the transfer of technology. Like the Asian examples, many countries in the South used these tools to develop their own industrial bases. Import substitution had its problems, such as cases of corruption, and "dead-ends", where the supporting infrastructure was weak or non-existent. But by and large, this strategy was successful, producing good results in terms of industrial development and economic growth, accompanied by improved standards of living. Rodrik (2000) notes that there is little evidence that these policies were plagued by inefficiencies that would justify the knee-jerk pessimism that they invoke from neoliberal commentators.

Import substitution policies were abandoned not so much due to their own failings, but due to a period of immense turbulence in the international economy: two oil price shocks, higher interest rates, commodity boom and bust cycles, and the collapse of the Bretton Woods fixed exchange rate system. The combined impact of these forces precipitated the 1982 "debt crisis", with massive debt problems that continue to this day. Neoliberal structural adjustment programs became IMF and World Bank policy in the wake of the debt crisis, and have been used as leverage to diminish the capabilities of debtor countries to engage in active industrial policy.

III. Industrial Policy meets the WTO

Trade agreements fundamentally restrict the potential role of the state in economic management. Ostensibly, these prohibitions are intended to promote freer trade and investment flows, although increasingly trade agreements specify rules that go well beyond border measures to include domestic regulation, public services and investment. The launch of the World Trade Organization in 1995 expanded the scope of multilateral trade rules to new areas not previously considered in "trade" negotiations.

As a result, the rules of the WTO have dramatic consequences for countries in terms of limiting the options and strategies available

for economic development. Trade agreements and industrial policy intersect in a multitude of ways (Bora et al 1999). Seven broad areas under the WTO framework are of importance with regard to their implications for industrial policy: tariffs and quotas; subsidies; investment; services; intellectual property; safeguards for the public sector; and, exemptions for national security.

Tariffs and Quotas (GATT)

Industrial policy has long been associated with protection of the domestic market from foreign competition. To this end, tariffs, quotas and bans have been used, typically in a bid to enable "infant industries" to grow through capturing the domestic market prior to the onset of international competition. The WTO system, premised on the notion of opening markets, puts restraints on the ability of states to protect emerging industries.

Article XI of the General Agreement on Tariffs and Trade (GATT) generally prohibits the use of quantitative restrictions, such as bans or quotas.[3] Instead, tariffs are the only legal border measure for controlling inflows and outflows of trade. At the end of the Uruguay Round (1986-94), many Southern countries had to convert existing quotas into tariffs in order to be WTO-consistent. The GATT seeks continual reductions in the level of tariffs specified by countries. Tariffs are subject to downward pressure due to "progressive liberalization", the ongoing process for lowering barriers to trade through new negotiations.

Despite such downward pressures, it is worth noting that countries retain the right to impose tariffs to protect the domestic market in areas of importance. However, countries are effectively locked in at existing tariff levels—there is a ceiling but no floor. Countries that wish to raise tariffs in specific areas must negotiate compensating concessions to parties with a "substantial interest" at amounts equivalent to the value of the change (or else face trade sanctions). Only in the event of emergency—such as a balance of payments crisis or import surges—can a country *temporarily* introduce higher tariffs.

Subsidies, Antidumping and Countervailing Duties

The WTO system also puts restrictions on the ability of states to subsidize domestic producers. Based on the notion of creating a "level playing field", WTO rules specify that countries cannot unfairly subsidize their industries in a way that affects trade, and that if they do, other nations are allowed to impose countervailing duties against imports equivalent to the amount of the subsidy.

The WTO Agreement on Subsidies and Countervailing Measures specifies different rules for different categories of subsidies. Export subsides are prohibited altogether due to their impact on trade.[4] This includes subsidies contingent on export performance or on the use of domestic goods over imported goods. Very poor countries are allowed to maintain export subsidies until their per capita GDP reaches a certain level. Most developing countries have negotiated a phase-out period for certain prohibited subsidies.

Subsidies are permitted, and cannot be challenged by other WTO members, in certain areas. This includes subsidies to disadvantaged regions, subsidies for research and development, and subsidies for environmental purposes. These represent potential loopholes for a limited range of industrial policy activity, although in practice subsidies of this nature provide the most benefit to richer nations that can afford to provide them.

In a final grey area of subsidies, called "actionable", a subsidy is allowed, but if another Member can prove "adverse effect" as a result of the subsidy, the Member can take action through the WTO dispute settlement process or by imposing countervailing duties. This latter area places a "chill" over the use

of subsidies, in that countries may not be willing to use them for fear of retaliation.

Subsidy issues in international trade are also notable because countries can use countervailing duties to protect domestic industries. Since the advent of the WTO, there has been an increase in the use of countervailing duties by many countries. In particular, many countries have long had concerns over the unilateral application of US trade law. In sensitive areas, countries that have been successful in exporting products to the US have often been accused of illegal subsidization, and have had their products hit with punitive duties.[5]

For affected countries, this has meant insecure market access, long delays and legal battles, which consume time, money and resources. The use of countervailing and antidumping duties primarily benefits those with large markets, i.e. the already rich countries. Thus, even with the so-called "rules-based system," power politics plays its role, and the strong have significant advantages.

Investment (TRIMs)

Investment rules pose challenges for industrial policy to the extent that they codify the rights of investors to move where and when they want with minimal government interference. The inclusion of investment issues into trade agreements has been controversial. The Trade-related Investment Measures (TRIMs) Agreement emerged from the Uruguay Round negotiations that created the WTO. Proponents intended that a global investment agreement would be a centrepiece of the negotiations, but due to objections from Southern countries, the resulting TRIMs was much watered down, amounting to a restatement of existing GATT provisions with interpretive examples.

The essence of the TRIMs Agreement is to ban any laws, policies or administrative arrangements that favour domestic producers. The TRIMs Agreement specifically highlights as prohibited measures: local content policies; trade balancing measures (that limit the import of inputs relative to the level of exports); and foreign exchange balancing requirements (that limit foreign exchange outflows relative to inflows).

For Southern countries, this means that most of the policies used successfully by East Asian countries are forbidden under the TRIMs Agreement. As Bello (1999: 75) notes:

> In Malaysia, for instance, the strategic use of local content policy enabled them to build a "national car", in co-operation with Mitsubishi, that now has achieved 80 percent local content and controls 70 percent of the Malaysian market. Thanks to the TRIMs accord, these mechanisms are now illegal.

The launch of the Doha Round of WTO negotiations in November 2001 marks the return of investment to the negotiating table. The Quad countries (Canada, Japan, EU and US) have been the major proponents of deeper investment liberalization at the WTO, seeking to consolidate thousands of bilateral investment treaties into a multilateral framework. The "ideal" model for investment agreement can be found in the North American Free Trade Agreement, which contains an expansive definition of investment, and recourse to an investor-to-state dispute settlement process. At this point, it is unclear how new investment negotiations at the WTO will unfold. Southern countries were highly resistant to new talks on investment prior to the WTO Ministerial in Doha.

Services (GATS)

The General Agreement on Trade in Services (GATS) is another new area for multilateral trade rules since the advent of the WTO. Like the GATT in the goods-producing sector, the GATS has implications for the development of domestic capabilities in services

sectors, and the ability to retain the fruits of economic activity.

GATS rules are a hybrid of horizontal rules that apply across all sectors and more liberalizing rules that apply in sectors where countries have made full commitments. In the case of the latter, countries must abide by "national treatment" and "market access" commitments that place constraints on the ability of states to retain domestic benefits in the supply of services. Under national treatment commitments, countries cannot require foreign suppliers to involve local people in management, to hire and train local staff, to pay differential taxes on their earnings, or to transfer technology. Market access commitments prohibit countries from putting limits on the number of service suppliers or on the number of people employed in a sector, and from placing restrictions on foreign involvement and on the total value of an activity (see Sinclair 2000 for a detailed exposition of the GATS).

These GATS commitments have implications for local control over, and benefits from, service industries. For many Southern countries, tourism services are important sources of revenue, but many have difficulty keeping the income from tourism ventures in the domestic economy, due to the presence of foreign corporations that gain the lion's share of airline and hotel revenues. Environmental measures may also come under attack. In the example of whale watching tours, a country that had made full commitments under the GATS would not be able to limit the number of boats as a conservation measure (Gould 2001).

The GATS contains a "progressive liberalization" clause that mandates new negotiations even in the absence of agreement by Members to launch a new round of negotiations. GATS negotiations have been underway for a couple of years, and are now rolled into the new Doha Round. The commitment to ongoing negotiations means that countries seeking to protect key service sectors will face continuing pressure to liberalize.

Intellectual Property (TRIPs)

Copying, imitation and adaptation greatly enhanced the diffusion of technology industrialized countries. Indeed, the theft of others' intellectual property was effectively a legitimate development policy until quite recently. US and German industrialization made great use of British manufacturing innovations without paying compensation, Japan borrowed extensively from US technological innovations, and Koreans copied US and Japanese product and process technologies (Bello 1999).

This is no longer the case with the advent of global intellectual property rules, backed by strong dispute settlement through the WTO. The Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPs) strongly protects the interests of those that control technology, rather than those who favour technology diffusion. In the area of patents, TRIPs provides a general level of protection for 20 years. This includes semiconductors, computer chips and other technological innovations that are necessary ingredients to industrial processes, and thus raises the cost of acquiring technology. The beneficiaries of IP protection are companies with large investments in technology that are patentable, and the countries within which these companies are based (usually the advanced industrial countries). Copyright laws have a similar bent with regard to protecting the works of the software and entertainment industries.

The implications for industrial policy are much higher costs of acquiring technology, and limited possibilities for reverse engineering (Bora et al 1999). The scope of the TRIPs agreement and the costs of establishing institutions to, in effect, protect the rights of foreign corporations, has been a point of contention among Southern countries.

Public Sector Services and Enterprises

As noted above, the broader public sector can be considered an important component of industrial policy. Public sector delivery of core services, such as health care and education, is evident in Canada and many European countries, as is the use of state monopolies (Crown corporations in Canada).

In many countries, WTO entry has been accompanied by "grandparenting" of existing public enterprises that might otherwise be contrary to the spirit of the WTO Agreements. This puts many Southern countries, that have been coerced by IMF or World Bank structural adjustment programs to privatize state enterprises or public services, at a disadvantage.

Protections for public services are, however, arguably thin (see Sanger 2001 and Sinclair 2000). Under the GATS Article I.3, services "provided in the exercise of governmental authority" are excluded from the agreement. But this is defined very narrowly, as "any service which is supplied neither on a commercial basis nor in competition with one or more service suppliers." This exemption poses challenges due to the mix of public and private delivery of public services in many countries, leaving a grey area that has not yet been tested in WTO case law.

State trading enterprises, another mechanism of collective action, are allowed under WTO rules (GATT 1947, Article XVII). However, an important caveat is that they act "in a manner consistent with the general principles of non-discriminatory treatment" and make purchases or sales "in accordance with commercial considerations". These have the effect of blunting a potentially powerful instrument for shaping outcomes for domestic producers and consumers.

State enterprises and monopolies (Crown corporations) are loosely covered by Article VIII of the GATS. State monopolies are allowed, provided that they do not act in a manner inconsistent with most-favoured nation commitments, and that they do not abuse their monopoly position in competition with services outside of the scope of the monopoly. Establishing new state monopolies under WTO rules, while permitted, faces a hurdle in that a country must offer alternative and equivalent concessions.

National Security Exemptions

Interestingly, the dominant mode of US industrial policy—the US$300 billion plus military budget—is exempted from international trade agreements. While not all of this money funds industrial development, a sizeable share is allocated to science and technology research, plus massive procurements of weapons, vehicles, planes, and other technologically-sophisticated equipment.

Large US government expenditures in this area would violate any number of WTO rules, but are cleanly carved out of the WTO through "national security" exemptions, Article XXI of the GATT and Article XIV of the GATS. More importantly, unlike other exemptions in the WTO Agreements, national security exemptions are self-defined, which makes spending through military channels immune from challenge by other countries via WTO dispute panels. Indeed, this model of an exemption demonstrates how other important areas, such as public services, could be removed from the purview of trade agreements, if there was political will to do so.

The national security exemptions allow the US to pour billions into the development of basic and advanced research. They enable the US, and US corporations, to maintain a massive technology advantage in areas that are ostensibly about the military but that have massive spillover effects into commercial markets (the Internet and the software industry are the latest and most potent examples).

Given US technological and economic hegemony, and the nature of intellectual property protection and the massive barriers to entry in this field, the national security ex-

emptions offer only a veiled hope of being loopholes that countries can use for industrial development. But to the extent that they are (for larger countries), these exemptions skew the allocation of vital resources toward military ends. Staples (1999) notes that South Africa is moving down such a road, using its military spending to leverage new foreign investment.

IV. What's Left of Industrial Policy

The policy landscape in the wake of trade agreements suggests a creeping return to the pre-Great Depression-era faith in free markets, with a corresponding shift in the nature of the state. This is reflected in the dismantling of public services, Crown corporations, public interest regulation and so on. Such moves have ideological roots that are independent of trade agreements like the WTO. But neoliberal initiatives at national or subnational levels are linked to globalization to the extent that such moves in the face of trade agreements become very difficult to reverse.

This section critically examines this policy landscape, and in particular the emphasis on attracting foreign direct investment as a "passive" industrial policy. It then looks to what instruments of industrial policy remain, and concludes by arguing for a revitalized public sector as an alternative industrial strategy that is rooted in democracy not the interests of transnational capital.

Arrested Development

The rules of the WTO, supported by a powerful dispute settlement system to ensure compliance, greatly limit the capacity of nations to engage in a variety of industrial policy measures. The Uruguay Round has served to reinforce the position of the already developed nations, while weakening the capabilities of less developed nations.

At the top, the United States emerged from the Uruguay Round in a strong position. It gained from new international rules on intellectual property and moves to liberalize trade in services, two areas of strength. Like Britain in the post-1840 era, free trade benefits the US because it can export high technology goods and services, while importing primary commodities and light manufacturing. US industrial policy came out relatively unscathed from the Uruguay Round, as national security is exempted from both the GATT and GATS Agreements. And the US continues to be able to use countervailing and antidumping duties to protect the domestic market. Indeed, the results of the Uruguay Round, embedded in the WTO, pose a development framework that resembles the current (but not historical) US model. But ultimately, this model benefits the US most, as the world's industrial, military and technological leader. To a lesser extent, the same can be said of EU.

Middle-power nations like Canada generally held their ground in the Uruguay Round negotiations, although there may be slippery terrain ahead as new negotiations demand further liberalization. A major loss is in the capacity to attach conditions to foreign investment. However, as a wealthier nation, Canada is able to provide very generous R&D tax credits, as well as interest free loans and export credits through bodies such as Technology Partnerships Canada and the Export Development Corporation. Canada has also maintained core public services, Crown corporations, dairy and milk marketing boards and the Canadian Wheat Board, although these areas continue to be subject to trade challenges at the WTO and erosion from within. A serious threat for Canada is that internal pressures to outsource and privatize services and Crown corporations will be largely irreversible, locked in by WTO rules.[6]

Weiss (2001) looks at industrial policy transformations in Korea and Taiwan[7] in the context of globalization pressures. In these

cases, the state's capacity for industrial transformation has been limited by WTO rules, but not ruled out altogether. Non-actionable subsidies and a shift of the costs of industrial policy to industry itself are cited as areas of focus for Taiwan, although this is rooted in very tight networks of government, business and research institute players. In Korea, the state is leading the drive to restructure the chaebol industrial conglomerates in order to create new "national champions" to withstand market entry of foreign companies.

For poorer countries, however, many tools used by advanced and newly industrialized countries have been banned as a condition of WTO membership. This leaves the poorest countries with much less flexibility to choose policy instruments that would serve their development ends, and greatly reduces their bargaining power vis-à-vis transnational capital. Indeed, these rules not only limit the scope of action by Southern countries, but have also strengthened the hand of advanced countries through the inclusion of intellectual property rights and services liberalization. The newly launched Doha round (November 2001) will, in all likelihood, exacerbate this dynamic.

The areas of industrial policy that remain may be a mirage for Southern countries, although much depends on their current position in the international hierarchy, and on delays negotiated for implementation of some of the WTO's disciplines. In countries with large foreign debts, many public services and state enterprises have already been privatized, as a result of IMF and World Bank conditionality. Other aspects, such as defence spending and R&D tax credits, may be theoretically feasible but not be readily affordable. While there may be some wiggle room for creative policy initiatives, the WTO framework generally strips the use of core aspects of early industrial development policy: tools to develop domestic capabilities; and the ability to exert leverage over foreign investment.

In effect, the WTO system serves to lock in place the pre-existing hierarchy of economic development (McBride 2001). While this case should not be overstated, the WTO entrenches a form of globalization highly favourable to the large transnational corporations and financial services firms that are based in advanced countries. Given the historic role of state activism in enabling and coordinating economic development through industrial policy, these measures in the WTO that limit such capacities in the future reduce the odds for successful economic development projects along the lines of South Korea or Malaysia.

Neoliberalism vs. Democracy

The WTO and leading industrial nations strongly recommend that the poorest countries integrate themselves into the global economy, but at a handicap. This limits the options countries have to set the terms of integration into the global economy, instead advocating neoliberal restructuring to entice foreign direct investment and to stimulate exports of primary commodities or light manufacturing. Without the tools to step up to the next level of development, many Southern countries risk ongoing marginalization within the world trade system, while limiting the scope for more democratic forms of development.

A passive industrial policy based around integration into the global economy amounts to a leap of faith and a foreclosure on alternative development options. Rodrik (2000) argues that integration into the world economy is not a substitute for a development strategy. There are significant costs to integration, including the financial costs of implementing changes to comply with WTO Agreements and the opportunity costs related to alternatives (such as providing infrastructure, education and health care). At the same time, the benefits of integration are highly uncertain.

Calls to "get the fundamentals right" to attract foreign direct investment (FDI) should be taken with appropriate caution because of

their impact on national economies. Balanced government budgets, lower corporate income taxes and lower personal income taxes at the high end (lower top marginal tax rates), more "flexible" labour markets, and looser environmental regulations, among other things, are supply-side "carrots" designed to make locales more appealing to foreign capital. In many countries, promoting FDI also consists of measures that cost the treasury: offering tax holidays, waivers of duties on imports, providing generous subsidies and land.

Interestingly, however, there is little empirical support to justify such extravagant and costly measures. One prominent argument for FDI is the supposed presence of large, positive externalities through the channel of workers learning by brushing up against superior technology. In practice, however, these spillovers tend to be insignificant, while the presence of foreign firms may actually diminish the productivity of domestic firms by reducing their markets and pushing them into narrower market niches (Hanson 2000).

Promoting FDI as a strategy of encouraging economic growth and development explicitly favours expanded foreign control of domestic assets over other options, such as licensing of technology for use by domestic companies. From the investor perspective, motives for FDI are relatively straightforward—it links with the corporate objective of maximizing shareholder value (i.e. short and longer term profits). Attempts by officials of international financial institutions to paint FDI as acts of benevolence and goodwill must be viewed as more spin than substance. To the extent that new investments generate income, the essential issue is distributional: what share flows outside the country to shareholders, and what share stays inside in the form of wages paid to workers. This calculus must also include the environmental consequences of investment, in terms of depletion of resources, pollution from wastes, loss of biodiversity and so on.

Of course, FDI inflows can be beneficial in some cases. The general difficulty with FDI in a WTO world, however, is that countries cannot attach conditions to investment. Trade balancing requirements, local content policies and agreements to transfer technology and train workers and managers would all greatly enhance the domestic spin-offs of foreign investment. FDI may have a place in an industrial development strategy, but it alone is a poor substitute for more active measures involving the state.

While the prospects of a passive industrial policy based on foreign investment and primary commodity exports seem bleak, this should not be taken to mean that active industrial policy is dead. A first step is to recognize what has been lost and not to go further down the path of neoliberal rule-making that seeks to limit the scope of what is possible. Gill (2000) sees the rules of the WTO as part of a "new constitutionalism", but adds that this project is not complete because it is premised on the subordination of democracy, which provokes resistance.

Secondly, within the current paradigm there is some room to manoevre in terms of a more active industrial policy, although as noted above this space is larger for wealthier countries. In the short-term, given the more limited prospects of rolling back certain WTO rules, countries should at least make full use of available options so that their industrial policies are tangential to WTO rules.

One clear space noted in the previous section is provided in the WTO Subsidies Agreement. Subsidies for R&D, environmental purposes and regional development are legitimate options available under WTO rules. Numerous other subsidies not conditioned on exports are also permitted, although they may be challenged. The dangers of a challenge could be mitigated by provision of subsidies on equal terms to domestic and foreign companies.

In the area of drug policy, Canada eliminated compulsary licensing in 1993, despite

its proven success in lowering drug prices for Canadians and stimulating the growth of a domestic generic drug industry. The Canadian government argued that this was necessary due to international trade agreements, but the TRIPs Agreement permits the use of compulsary licensing in certain circumstances, such as public health emergencies (as does the NAFTA). While these circumstances are limited, the federal government should at least ensure that Canada uses available tools to the extent permitted by trade agreements. Not to do, as is currently the case, amounts to foreclosing on a potentially valuable policy option. A bolder Canadian state might use this first step to treat drug policy as a public health matter to move towards a national, public drug (pharmacare) program.

The lack of state's political will to act is as much an issue as the actual rules negotiated in trade agreements. In many aspects of trade agreements, there are grey areas that have not been tested before dispute panels. While being cognizant of the narrow, trade-liberalizing interpretations that panels might take, if history is any guide (see Shrybman 1999), this does not nor should not preclude the state from being bold for fear of litigation. Self-censoring by governments is exactly the "chill effect" intended, and this serves as yet another form of the discipline of capital over the state.

Reinventing the Activist State

The future of industrial policy is integrated with the role of the state more broadly. The state has been the author of neoliberal globalization as much as its victim (at least in the case of the advanced industrial countries). In countries like Canada, the state has become more accomodating to the needs of capital (foreign and domestic), diminishing its role in areas of interest to the majority of citizens (especially the most poor and vulnerable), while enhancing its role in areas of interest to capital (such as strengthening intellectual property rights) (McBride 2001).

However, despite the success of the political right in spurring antipathy towards the state among the population, the degree to which the state has been cut back in certain areas is testimony to the potential of the state to play a stronger, more activist role. The challenge is to recreate, as an idea and in practice, the state as a space for democratic decision-making rather than a space for supporting the interests of capital. A large part of the equation is moving towards a more meaningful concept of democracy than the current formal democracy based on voting in elections. This must acknowledge legitimate criticisms of bureaucracy and decision-making in the public sector, balanced against the need for a public sector due to market failures and imperfections. The alternative is improving the accountability, transparency and democratic input and oversight of the public sector, not shrinking it.

Thus, industrial policy should not be limited to what the public sector does to stimulate the private sector, but must include the activities and roles of the public sector itself. This includes "traditional" public services, such as health care and education, as well as state enterprises and monopolies, but with a reform agenda based around democratic and progressive alternatives. It also includes new areas, such as the development of public child care, and renewed investments in social housing and mass transit, all areas where market mechanisms are insufficient to meet needs.

Expansion of pubic services and Crown corporations pose challenges in the context of trade agreements, which seek to curtail such moves and lock in privatization when it happens. The bottom line in trade agreements, however, is compensation. The state retains the right to take such actions provided compensation is provided, either directly to those with an "interest" or indirectly by accepting sanctions on other export sectors. These cannot be taken lightly, but neither should they prevent governments from taking action in vital areas.

Translating public action into broad-based gains should also include actions that have served to shape markets in the past. These might include the role of fiscal and monetary policy in relation to a full-employment strategy, a tougher competition policy to diminish excessive market power, labour market policies that support workers' rights through collective bargaining and minimum wages, new public infrastructure projects and utilities, and public support for collectivist institutions that enhance the market power of consumers and small producers (marketing boards, trading enterprises, cooperatives).

Exploring innovative alternative approaches with regard to industrial policy is important in the context of resources. Countries like Canada are rich in resources, but these must be developed within a framework of public policy in order to ensure ecological sustainability and employment stability for communities. In a recent study, Marshall (2001) sets out a number of institutional changes to promote value added investment in British Columbia's resource sector, while meeting goals of environmental sustainability and job creation. Stanford (1999) proposes a number of strategic investment areas that a public investment fund might support. In particular, water and energy are two vital resource areas whose importance seems likely to increase in coming decades.

New approaches, like public investment funds, may brush up against existing WTO rules to varying degrees. The potential for challenges, however, should not scare governments away from developing new policy frameworks that meet local needs. Ensuring market access to the US will continue to be an issue for Canada, but trade challenges should be met as they arise and fought to the greatest extent possible.

An alternative approach should reframe the debate in terms of the very nature and types of institutions required to meet the basic needs of everyone in society, and this means moving beyond dependence on market/capitalist institutions. So rather than courting transnational companies and trying to integrate further into a global economy by negotiating ever more trade agreements, the alternative would be not to maximize trade flows but to find their optimum level, while insulating core sectors of the economy to the greatest extent possible from transnational corporations and global finance.

This path would be return to the idea of a "mixed economy" by balancing private, public and other institutional activity. It recognizes and reasserts the capacity of the state to alter market outcomes. This may already be the direction that social movements are moving towards through initiatives such as the Council of Canadians' *Citizens Agenda*, which aims to move from protest and opposition toward building and creating economic alternatives through grassroots mobilization.

Conclusion: Towards a New Industrial Policy

This paper has taken a broad view of industrial policy, including the range of public sector activities that have economic development consequences for citizens. While the history of industrial policy was in the context of an activist state, this has changed over the past few decades of neoliberalism. A focus on industrial policy is a microcosm of the broader discourse on the role of the state in the face of globalization.

This paper concludes that industrial policy is too important to be left to the market. That is, the sort of passive industrial policy advanced by neoliberals has little basis in history and little support from empirical evidence. Ongoing efforts to constrain states with legally binding international rules at best maintains the existing hierarchy of power and development, and suggests further marginalization of the poorest countries.

Instead, the path forward should be to capture the best elements of an activist state

for industrial policy, while immersing it in deeper democratic participation and development. Because it involves issues of governance and democracy, industrial policy is about how people together create the institutions and organizations that support a high standard of living. Industrial policy is about democratically thinking about the economy. It is about holding economic and political institutions up to the light and seeing them as capable of being changed by an engaged and effective citizenry.

Historically, the state, as a prominent force of collective action, has played an important role in the development of advanced capitalist economies. Unfortunately, this lesson is frequently absent from policy advice given to (or imposed on) Southern governments, instead posing neoliberal policies and integration into the world economy as holding the largest development payoff. Rather than one-size-fits-all prescriptions, policy should emphasize flexibility for countries to choose among industrial policy options based on local needs and priorities. A diversity of approaches should be promoted, particularly when the experience of successful industrialized countries runs so counter to the neoliberal orthodoxy.

The WTO places restrictions on industrial development that constrain countries' ability to engage in industrial development, and this is most severe for the poorest countries. Although the door is not completely closed, industrial policy in this context will entail trade-offs and difficult choices. Countries must use all existing space available under the WTO agreements, while pushing back further attempts at liberalization and pushing for renegotiation of elements of the WTO. The biggest obstacle may be finding the political will to act.

Endnotes

1 But would not include a large number of non-market institutions, such as courts, central banks, and financial supervision, necessary for the conduct of commerce and for mediating between commercial and other interests in society.

2 A drawback is a reimbursement for tariffs paid on imported goods that are subsequently exported.

3 There are some general exceptions to this, listed under GATT Article XX, and other exceptions for industrial sectors sensitive to industrialized countries such as clothing and textiles.

4 This agreement only applies to non-agricultural trade. Export subsidies in agriculture remain a contentious issue at the WTO.

5 A similar story can be told in the case of alleged dumping and the imposition of antidumping duties.

6 Canada also faces industrial policy limitations through the North American Free Trade Agreement. The NAFTA's implications are not discussed here.

7 Taiwan became a member of the WTO in December 2001. Weiss looks at the changes taking place in preparation for joining the WTO.

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