

**DIRECTORATE FOR FINANCIAL AND ENTERPRISE AFFAIRS
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**LATIN AMERICAN AND CARIBBEAN COMPETITION FORUM - Session III:
Industrial Policy and the Promotion of Domestic Industry**

– Contribution from Spain –

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Session III: Industrial Policy and the Promotion of Domestic Industry

– Contribution from Spain (CNMC)* –

1. Industrial policy is a fertile field for debate. Discussions revolve around the many different aspects of industrial policy, both theoretical and empirical, but perhaps, first and foremost, focus on the very definition of “industrial policy”. In the insightful analysis of industrial policy conducted by Warwick¹ in 2013 for the OECD’s Committee on Industry, Innovation and Entrepreneurship, the author, without claiming to be exhaustive, cites more than 20 different definitions by as many industrial policy makers. This is a good illustration of the constant debate that is in progress on this topic, the key element of which is the definition of the concept of “industrial policy” itself.

2. The origin of this debate about an elusive definition might be found in the changing nature of the rationale behind industrial policy over the course of history. This evolution of industrial policy is the combined result of theoretical advances and the analysis of experiences or case studies of industrial policies applied in different countries over time. Taking all this information into account, Warwick (2013) offers a sufficiently broad, inclusive definition of industrial policy, which can readily be adopted: “Industrial Policy is any type of intervention or government policy that attempts to improve the business environment or to alter the structure of economic activity toward sectors, technologies or tasks that are expected to offer better prospects for economic growth or societal welfare than would occur in the absence of such intervention.”

3. Within this broad definition of industrial policy, there is a place for competition policy as well. But, irrespective of whether competition policy is regarded as forming part of industrial policy or as a separate policy, competition authorities play a key role in industrial policy, with a dual function. On the one hand, the **control of private-sector activity** on the markets (enforcement) helps the markets to function more efficiently, not only benefiting consumers in those markets, but also contributing to the economic advancement of the country as a whole. On the other hand, the **promotion of effective competition** in the markets (advocacy) influences **public intervention in and on the markets** (regulation, public procurement, state aid and subsidies) towards efficiency and consistency with the general economic objectives. Last, but not least, competition authorities must perform the fundamental role of communicating the benefits deriving both from the control of the activities of companies or economic agents and from its efforts to promote competition.

4. In its work of promoting effective competition in the markets, the competition authority is required to foster the compliance of all economic policies with certain principles of efficient, competition-friendly economic regulation, specifically the principles of necessity

* CNMC = Comisión Nacional de los Mercados y la Competencia (National Commission on Markets and Competition).

¹ Warwick, Ken, 2013, *Beyond Industrial Policy: Emerging Issues and New Trends*, OECD Science, Technology and Industry Policy Papers, No. 2, OECD Publishing, Paris. <http://dx.doi.org/10.1787/5k4869clw0xp-en>.

and proportionality, minimal distortion of competition, effectiveness, transparency and predictability (CNC, 2008).² In this respect, the competition authority must be especially vigilant to ensure that industrial policy also observes these principles, since this policy, as far as its sectoral or selective policy aspect is concerned, tends to be aimed towards substantial modification of specific sectors of activity.

5. In applying these principles of efficient economic regulation, the first question that arises is about the rationale for (necessity of) sectoral or selective industrial policy, which has been evolving with the passage of time. Where are we now in the theoretical debate? As Warwick (2013), addressing the rationale for industrial policy, specifies, the phases of pure *laissez-faire*, the traditional approach (with state aids and public ownership), the neoclassical stage (market-failure correcting, using Pigovian engineering) and that of “new growth” (technological capabilities-based) are things of the past, and we are now in the “systems approach” phase, an eclectic category that includes elements of neo-Schumpeterian, evolutionist and institutionalist thinking. The systems approach places the emphasis on information and knowledge that is heterogeneous, context-specific, tacit and “sticky” (difficult to disseminate). The national system of production and innovation is made up of networks of formal and informal connections between relevant institutions, both public and private, through which this knowledge is disseminated. In this view, the role of industrial policy, hand in hand with innovation policy, is to create and develop institutions to promote networking and collaboration and to devise strategies to make best use of these institutions.

6. But this rationale is highly theoretical in nature, and in practice public-sector obstacles sometimes limit industrial policy. Public intervention is not without costs and difficulties, such as those involved in obtaining and processing information, decision-taking and the activities of rent-seeking and regulatory capture, which heighten the risk of inefficient industrial policy interventions. These problems are particularly pronounced in the case of certain sectoral or selective industrial policies, for two reasons:

- Firstly, because of the marked informational asymmetries between government and companies in the private sector, which make it easier for interest groups either to distort the information available to the public sector when designing this industrial policy, or to skew it in their favour. Indeed, the more specific the industrial policy is, such as when it comes to “picking winners” among sectors, companies or regions at national level, the more pronounced this informational asymmetry tends to be, and, accordingly, the greater the incentive is for rent-seeking.
- And secondly, in those cases where these measures are more or less certainly of potential benefit to specific industries, regions or groups, it is found that, on the one hand, their possible beneficiaries have greater incentives to join forces and dedicate resources to exert pressure in favour of the regulation concerned (reduced risk in this corporate “investment”), and, on the other, it may be easier for the politicians and officials involved to demand potential trade-offs in exchange for favourable regulation.

² CNC, 2008, Recomendaciones a las Administraciones Públicas para una regulación de los mercados más eficiente y favorecedora de la competencia (Recommendations to Public Administrations for more efficient and competition-friendly market regulation), <https://www.cnmc.es/expedientes/g-2008-01>.

7. In short, these regulatory and government failures have a negative effect on welfare, reducing the gains derived from the correction of market or systems failures which it was initially proposed to tackle. It is therefore essential to apply the principles of efficient economic regulation when the need for interventions is being assessed in terms of whether genuine public interest (as opposed to private interest) exists and to what degree such interventions are to be made, so as to avoid affecting welfare too adversely.

8. Given the experiences of industrial policy in many different countries and the risks and costs that it can entail, there is currently a trend in favour of the “new industrial policy”, which is far removed from distortionary instruments and centred around a “soft” industrial policy. This encourages a facilitative, co-ordinating role for the public sector, using a focus on systems to help increase productivity in mature and emerging sectors (Harrison and Rodríguez, 2010).³ Today there is a well-established consensus that government is not easily able to “pick winners” but is better placed to act as a facilitator to enable co-ordination between individual economic agents and to allow for experimentation in the economy through the design of better processes for search and “self-discovery” on the part of the private sector (Warwick, 2013). However, there remains the challenge of designing a form of governance and institutions with maximum autonomy from private interests (Rodrik, 2004).⁴

THE CONTRIBUTION OF THE CNMC TO THE DEBATE ON TRADE POLICY AS AN INSTRUMENT OF INDUSTRIAL POLICY

9. One of the traditional measures of industrial policy has been trade policy, in both defensive (tariffs and other import barriers) and offensive (subsidies and other export incentives) form, both having the objective of combating or offsetting international competition, seen as a threat to domestic production.

10. Promoting competition by applying the principles of efficient economic regulation can bring significant added value to the evaluation of industrial policy, and specifically trade policy used as an instrument of the former.

11. One of the unavoidable principles of any efficient economic regulation is the principle of necessity, that is to say the requirement for a policy rationale in consideration of the presence of market failures that reduce societal welfare. Accordingly, the economic rationale for trade policy as a tool of industrial policy needs clarification. Certain rationales that see industrial policy as a remedy for market failures are often cited (Warwick, 2013) and they tend to call for the application of trade policy measures, essentially in the scenario of the infant industry and the shifting of profits obtained by foreign firms with economies of scale, within what is known as strategic trade policy.

12. However, it is important to bear in mind the lack of information in the public sector for designing and implementing a trade policy as a tool of industrial policy, since these information issues may be exacerbated in these circumstances. It can prove extremely complex to design a trade policy which, by operating on trade flows, pursues internal

³ Harrison, Ann E., and Andrés Rodríguez-Clare, 2010, From hard to soft industrial policies in developing countries, VoxEU.org, <https://voxeu.org/article/hard-soft-industrial-policies-developing-countries>.

⁴ Rodrik, Dani, 2004, Industrial Policy for the Twenty-First Century, Faculty Research Working Papers Series, John F. Kennedy School of Government, Harvard University.

effects, such as the development of an infant industry, since this would give rise to serious complications in the cause and effect chain, leading to more potential undesired effects. As regards profit shifting, it must be taken into consideration that, as a beggar-thy-neighbour policy, it can prompt reprisals from the affected countries.

13. In many cases, trade policy in these contexts is an indirect solution to possible market failures, and it would be inefficient if used as the sole instrument of industrial policy (Carlton and Perloff, 2005).⁵ From the viewpoint of promotion of competition and efficient economic regulation, the best means of dealing with a market failure would be to tackle the root cause, at the source of the problem. When trade policy is used for industrial policy purposes, it is a symptom or effect of the problem that is being tackled (effects of the failure on the balance of payments), without the source (lack of competitiveness) being resolved, so that it must, of necessity, form part of a broader, more ambitious industrial policy programme. And it must be borne in mind that distortions possibly arising from a poorly designed trade policy (monopoly prices, disincentive to innovate, retaliatory trade measures, etc.) can diminish the improvements in welfare that were initially foreseen.

14. Indeed, applying the principles of efficient economic regulation can make trade policy more than a mere tool of industrial policy. Using these principles and in the light of the available theoretical and empirical developments, trade policy can be assessed as a whole, from the perspective of measures to promote competition.

15. In the context of an upsurge in protectionist tensions in various areas of the world, with the raising of tariff barriers to imports of various products with the declared aim of protecting employment, the CNMC thought it opportune to contribute to the debate on the benefits of international trade with the report: “*Análisis de los beneficios derivados del comercio internacional y sus implicaciones en materia de competencia*” (“Analysis of the benefits deriving from international trade and implications for competition”) (2017).⁶ The special feature of this analysis is that it approaches the issue from the stance of promoting competition, in other words encouraging the application of the principles of efficient economic regulation to trade policy.

16. In the aforementioned report, the CNMC outlines the beneficial effects of international trade, closely linked to increased levels of competition on the markets, which leads to lower prices, higher quality and a greater variety of goods and services. The report identifies both static and dynamic benefits. The former derive from the increased options for production (efficient reallocation of the factors of production, greater productivity arising from increased competitive tension, improved availability of intermediate goods, etc.) and aspects relating to consumption (greater choice in terms of the quantity, quality and variety of products). The dynamic benefits include, among other things, effects on innovation and long-term growth.

17. In the case of Spain, available empirical evidence primarily suggests a beneficial effect from trade liberalisation measures. Several empirical analyses have found that trade liberalisation in Spain resulting from its involvement in the European integration process has had spillover effects for Spain, both on trade flows and on GDP and welfare. Campos,

⁵ Carlton, Dennis W. and Jeffrey M. Perloff, 2005, *Modern industrial organization*, Addison-Wesley (New York).

⁶ CNMC, 2017, *Análisis de los beneficios derivados del comercio internacional y sus implicaciones en materia de competencia*, <https://www.cnmc.es/expedientes/procnmc00217-bis>.

Coricelli and Moretti (2014)⁷ quantify the actual gains from Spain's accession to the EU in 1986 as around 14% of current Spanish per capita income.

18. For broader empirical evidence, Costinot and Rodríguez-Clare (2014)⁸ use counterfactual exercises to compare the situation of trade openness that exists in a broad range of countries (including Mexico and Brazil) with different trade protectionism scenarios. They succeed in demonstrating that all the specified scenarios of increased protectionism (by means of tariff increases, whether imposed unilaterally by the EU or generally) entail net losses in terms of societal welfare.

19. Consequently, the CNMC highlights the interactions between industrial and competition policy and efficient economic regulation, in such a way that maximum trade openness leads to maximum gain in welfare. It may be inferred from this that trade liberalisation can also be an efficient tool of trade policy.

20. Indeed, it would be very difficult to characterise trade liberalisation or increased trade protection unequivocally and universally as beneficial or harmful in terms of welfare. They need to be evaluated within the context in which they occur, in other words with regard to the economic policies concurrent with the trade policy concerned. From the competition viewpoint, trade policy should be co-ordinated with an industrial policy that does not distort domestic markets, applying the principles of efficient economic regulation. Exploiting the beneficial effects of increased competitive tension on the markets would make it possible not only to maximise the impact of all the potential benefits offered by globalisation, but also to share these benefits as widely as possible.

⁷ Campos, N., F. Coricelli and L. Moretti (2014), Economic growth and political integration: Estimating the benefits from membership in the European Union using the synthetic counterfactuals method, IZA Discussion Paper No. 8162.

⁸ Costinot, A. and A. Rodríguez-Clare (2014), Trade theory with numbers: Quantifying the consequences of globalisation, in E. Helpman, K. Rogoff and G. Gopinath (editors), Handbook of International Economics, Elsevier, Vol. 4, pp. 197-261.