

## **COMMON INDUSTRIAL POLICY AND COMPETITIVENESS\***

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**Abstract:** This article focuses on the theory in the field of industrial policy and government intervention in economy, presenting personal approaches and considerations related to this subject. Also, it presents worthy aspects to be considered when adapting industrial policy instruments to the modern day socio-political realities and especially to Romanian economy.

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### **Introduction**

Traditionally, industrial policies are based on the observation that free-market economy does not always lead to a fair and socially acceptable distribution of resources within society.

Disputes among supporters and opponents of industrial policies often make use of arguments and demonstrations accumulated empirically over time, based on the practical experience of certain countries that either had or had not reached a successful outcome.

The only economically undisputed arguments in favor of an industrial policy are those given by market failures. In addition, new economic theories come to support and develop the pro - industrial policy – arguments like: the new theory of economic growth, the theory of strategic commerce, the theory of the competitive advantage of nations and the theory of technological competence.

The distinction of the European Union industrial policy comes firstly from its above state and above national nature, which means on the one hand a yielding and delegation of power and sovereignty in favor of the other members of the EU, and on the other it implies a new level of granted access and influence in the national territories of these members.

Like other community approaches, the industrial policy respects the governing principals of all activities carried out at the Union level, and these are: co-decision, solidarity and subsidiary. This means of course that the decision making process takes into account the social effects of any new measure before anything else, it being, in essence a social system based process that must uphold, maintain or enhance the social

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structures that make up the European Union and in this it follows a few specific guidelines: the creation of new jobs, equal opportunities, justice and social coherence.

The common industrial policy proposes a positive approach to structural adjustments, which it views as a necessary, permanent and inevitable consequence of progress. It is basically a reflection of those processes of adaptation imposed by the market which signals and determines a continuous funneling of resources into the most productive of activities. Given the fact that it looks about creating a dynamic framework of structural adjustment and sustaining it, the EU common industrial policy displays the characteristics of an active policy that manifests an acceleration effect on top-edge technological development.

### **Main concepts in the field of CIP**

#### *Industrial policy definition*

Industrial policy comprises all government interventions, which are directed towards the supply side of the economy (enterprises, industries, sectors), and aim to influence the industrial structure of the economy and/or its industrial change. Industrial policy purposefully affects incentives to produce specific goods or incentives to enter/exit specific goods markets. (Budzinski, 2004)

In another approach, the industrial policy represents a government-sponsored economic program in which the public and private sectors coordinate their efforts to develop new technologies and industries. Government provides the financial support and capital to the private sector by direct subsidies, tax credits, or government-run developmental banks. Industrial policy emphasizes cooperation between government, banks, private enterprise, and employees to strengthen the national economy. (R. Reich, 1991)

An industrial policy is a set of actions executed by interventionist or mixed-economy countries in order to affect the way in which factors of production are being distributed across national industries. By the former definition, it is logical that industrial policies contain common elements with other types of interventionist practices such as trade policy and fiscal policy.

At the EU level the industrial policy is perceived as: interventions on the market with the clear purpose of influencing the utilization of resources by entrepreneurs based of an objective, by means of fiscal measures, financial aid or public works.

In our opinion, the industrial policy is a correlated, structured assembly of measures with a well defined, public purpose that focuses and acts primarily on the industry.

#### *Market failures*

A market failure exists when the production or use of goods and services by the market is not efficient. That is, there exists another outcome where market participants' overall gains from the new outcome outweigh their losses (even if some participants lose under the new arrangement). Market failures can be viewed as scenarios where individuals' pursuit of pure self-interest leads to results that are not efficient – that can be improved upon from the societal point-of-view. (Medema, Mill, Sidgwick 2004). Market failure occurs when markets do not bring about economic efficiency.

Government intervention occurs when markets are not working optimally. For example, there is a Pareto sub-optimal allocation of resources in a market/industry. In

simple terms, the market may not always allocate scarce resources efficiently in a way that achieves the highest total social welfare.

Market failures can also be defined as situations in which resources cannot be efficiently allocated due to the breakdown of price mechanism caused by factors such as establishment of monopolies or situations, usually discussed in a model not in the real world, in which the behavior of optimizing agents in a market would not produce a Pareto optimal allocation.

Mainly in heavily industrialized nations, there has been a heated debate about the sustained encouragement by the state of such industries that display a high level of the added value/worker indicator, industries that function as a bridge between activities allowing for the creation of large industrial build-ups and conglomerates, of industries that offer a great prospect of growth in the future or simply of those industries that have been selected by other states in their respective industrial strategies.

In any economy, the level of added value/worker varies greatly from one industry to another. This fact has led some to believe that if a country manages to create an “industrial mix” in which high added value industries are found to be predominant, that country could create for itself, in this way, the means to sustained economic growth.

The mistake comes from the fact that those who accept such presumptions do not stop to ask themselves why some industries display an indicator level greater than others and write it off as being based on high salaries and even higher profits. But, if that was true, the market would itself regulate explicitly the flow of production factors towards these industries, stimulated by the above mentioned factors and any government intervention would no longer be necessary.

As for encouraging industries that work as a bridge in creating build-ups, and that by added inputs in these specific industries, multiplication effects could be triggered within the economy that could “spark” an economic boom, the popularity of such arguments are drawn and based more upon personal, subjective beliefs than anything else, and as such economics theory does not endorse them.

It is better said that in the case of economies with working free-market mechanisms, where no deficit or functionality of these mechanisms is observed, there is no reason for suspicion that production of intermediary goods is not already at an optimum.

Another popular motive that is often used is that industrial policy should be brought to bare on promoting those industries that have great future prospects (example “sunrise” industries, so called embryonic industries, etc). It is, in other words, meant to chose the “winners” and stimulates the migration of workforce and capital towards these activities. It must again be said that, if the market is working properly, this matter would self resolute, that is – the workforce and capital would choose the winners with the bigger profits and of course, the bigger salaries.

Governments can only launch themselves into such initiatives with great difficulty and by accepting a very high risk factor and practical experience has shown that in few cases (most notably France) and only sometimes the selection of winners by the state has proven to be the correct choice and has brought about success.

Market failures consist of an inefficient or mistaken allocation of resources, which has the result of bringing about a relative loss of value for society. These represent, until the present day, the strongest argument for interventionism in general and industrial policy in particular, and are accepted by current economics, especially in

its dominant neo-classical perspective. We can also admit that in some marginal situations, of rare occurrence the state may intervene to apply corrections to market mechanisms, but granted that these interventions do not distort the market even further, creating greater failures.

Market failures, which motivate state run intervention by means of industrial policy, can best be categorized as:

- failures of dimensions
- failures of functionality

Failures of dimensions are represented as an incapacity of some businesses, industries, activities, markets or streams/fluxes to achieve the dimensional optimum, that is they failed to reach an ideal size (of production, commerce, etc), with repercussions on level of performance. Here can be included such failures as: the failure to create scale economies, insufficient production of universal/societal necessary goods, incomplete markets, incomplete information.

Failures of functionality manifest themselves as the inability to maintain a perfect - or close to perfect – competition, the inability to assure the easy transfer of production factors, the inability to assure the complete assimilation of all useful externalities resulted from production and the expansion of society's production capabilities in an socially acceptable rhythm and time-frame. Here can be included: imperfect competition, externalities, asymmetric information, difficulties in the transfer of production factors, dynamic failures (creative failures).

*The new theory of economic growth*

One of a series of relatively recent developments in the theory of economics that bring an added line of arguments in favor of, and promoting industrial policy is the new theory of economic growth. It can be noted that it brings an authentic justification towards a stronger state presence in stimulating industrial innovation and the formation of human resources.

The essence of this new theory consists of including knowledge in the production factors category, next to capital and workforce. Because of this fact, technological progress can be integrated; economic growth itself can be explained as an endogenous phenomenon.

*The theory of strategic commerce*

It is based on the observation that, at present times, international commerce has very different characteristics than it had even in the near past. An ever growing share of the markets, especially those of high technology/advanced products (such as: computers, telecommunications, flight/aircraft equipment, microprocessors) are becoming the scene of a spectacle with only a few actors, meaning a few, very large companies who by means of their dominant position influence the market and the nature of the competition greatly. The result is that these companies achieve very high efficiency / rated capacity, their profits rise well above what could possibly be earned from equally risky endeavors in other sectors of the economy. Such profits initiate a strong international rivalry between the few large companies capable of generating them.

*The theory of the competitive advantage of nations*

One of the ideas that had enjoyed wide scale acceptance over time is that the roots of economic welfare and progress are represented by labor productivity.

Adding to this, from early in the industrial revolution, there has formed an understanding belief that in industry labor productivity enjoys better development

conditions than for example in agriculture, given the fact that industry allows for a deeper specialization of work. Later developments have only confirmed this truth, especially in the organization of large scale industrial production, where the production process is broken down and separated into homogeneous activities that permit not only automation, but also superior performance of labor.

The theory of competitive advantage, proposed by professor Michael E. Porter, begins from the principle that at a national level the only important concept is that of national productivity and that the ability to export goods of high productivity which allows the nation to import goods of lower productivity is a desirable objective since it translates into a higher national productivity.

Highlighting the importance of the national environment in generating advantages for the domestic manufacturers engaged in international competition, the theory of national competitive advantage opens up an entirely new perspective in the science of economics and its modern sense.

Differentiating itself from the traditional approach where national advantages were based solely on production and its afferent, underlining costs, the theory of the competitive advantages of nations proposes the national advantages as being the product of an entire chain of activities that contribute to a products success of the market.

#### *Theory of technological competence*

Belonging to the structuralism approach, the theory of technological competence disputes the largely simplified view of the neo-liberal approach according to which technology is perfectly accessible, selected and assimilated passively and with additional costs for the developing countries. The theory of technological competence affirms that most industrial technologies are generally found to be used at a low technical performance level in these countries further stating that in such cases technical inefficiency tends to be a more significant cause of low productivity than inefficient allocation of production factors.

The process of selection, assimilation and mastery of technology is neither passive, nor cost free and the difference of efficiency in achieving a complete understanding of the imported technologies is in itself a major source of inequality between countries, in industrial performance.

By neglecting such aspects one can wrongly assume that no industrial policy is required. The creation of technological competence requires the development of new abilities, assimilation of knowledge (especially the so-called know-how), the drawing up of new forms of organization for businesses and new interconnections between them.

By technological competence one should perceive not only the ability to innovate, creating new technologies but also, at least initially, the ability to utilize more efficiently imported technology. This is because technology is not perfectly transferable, as opposed to physical goods and requires numerous side elements such as the investment of the buyer in the development of new abilities and information of the technical and organizational nature.

#### *Competitiveness*

Competitiveness is a comparative concept of the ability and performance of a firm, sub-sector or country to sell and supply goods and/or services in a given market. Although widely used in economics and business management, the usefulness of the

concept, particularly in the context of national competitiveness, is vigorously disputed by economists, such as Paul Krugman.

The term may also be applied to markets, where it is used to refer to the extent to which the market structure may be regarded as perfectly competitive.

Competitiveness can also be defined as the ability of a firm or a nation to offer products and services that meet the quality standards of the local and world markets at prices that are competitive and provide adequate returns on the resources employed or consumed in producing them or the ability of an economy to supply increasing aggregate demand and maintain exports. A loss of competitiveness is usually signaled by increasing imports and falling exports.

Competitiveness is often measured in a narrower sense by comparing relative inflation rates. For instance, if the sterling–dollar exchange rate remains constant, but prices rise faster in the UK than in the US, UK goods will become relatively more expensive, reflecting a loss in competitiveness; this in turn may lead to a falling demand for exports.

Competitiveness usually refers to characteristics that permit a firm to compete effectively with other firms due to low cost or superior technology, perhaps internationally. This is the condition of being competitive. When applied to nations, instead of firms, the word has a mercantilist connotation. (Deardorff, 2006)

As it is universally understood and accepted in the theory of economics and applied on practical matters, with a strong backing by empirical related proof, competition is the basis of a functioning free-market economy with the vital role of assuring an efficient allocation and usage of resources, increased productivity of work, economic progress and of course ultimately determining the welfare of nations.

### **Adapting industrial policy instruments to reality – Romania’s case**

#### *The “trauma” of planning*

Countries that have a history of communism must approach the delicate process of transition from a planned, centralized economy specific to this doctrine to a free-market economy with great care, as the great experiment as it has come to be called in present-day literature should not be allowed to take place without some form of planning, general directives and national-to-local coordination including that which must exist between manufactures. Still, in most cases the tools of industrial policy based action are not employed as there has been found that a great “trauma” seems to exist at the collective conscience level, manifesting in a general all-out disinterest and even hostility against any undertaking that might require the use of principals such as planning and centralization on a national scale.

This is an essential element of differentiation between the attitudes that exist in other less developed countries which tend to embrace such initiative, resulting in a faster reduction of the differences in economic structure and flux in comparison to economically developed countries, and those found in countries that have a history of communism. This is unfortunate as the latter displays considerable industrial production capabilities, which ultimately could ensure an advantage towards the development and growth of powerful economical structures and markets. Such an advantage, that could potentially bypass decades of hard work and sacrifice, is wasted, since the industrial facilities (and afferent start-up businesses since industrial facilities have passed from state property to private initiative) are not modernized and much of what could be done

to increase their profitableness and capacity for competition on the global market is lost generating an even greater loss to society on a social scale.

*Economic "illnesses"*

The relocation of production, de-industrialization, which have become a common aspect of especially the Nordic countries in Europe leads to a drop in the importance of industry and production in the formation of national income. Such trends are not however to be found in the case of Romania. Such tendencies arise from the need to reduce overall costs and increase profitability by relocating the production facilities to regions (manly but not limited to South-East Asia) which display a great advantage in labor costs coupled with low-union demands (if a union even exists, in many cases no such structure exists). This has the added benefit of lowering the level of local pollutants output for the Europe and the specialization of modern European economies in the service sector, an already common place trend. This does however present a problem of a strategic nature for the European Union, and it has been addressed at a European Commission level by such documents as: Industrial Policy in an Open and Competitive Environment: Guidelines for a Community Approach, October 1990, where a clear underlining of the importance of industrial policy in correcting these situations has been made.

From the information available, one can conclude that a clear demarcation exists between the Romanian economy and the structures found at the EU level. This "deficit of synchronization", noticeable still, has a strong tendency to subside, as the integration of the Romanian economic activities in the greater union level structures are an inevitable consequence of the adhesion as an EU member. An acceleration of these changes can take place in an optimum time-frame (a time-frame that is acceptable in both a social and historic context) by the use of industrial policy type tool-set.

### **Conclusions**

The Common Industrial Policy of the European Union aims at a positive approach to structural adjustment which it treats as a necessary, permanent and inevitable phenomenon, it ultimately being a reflection of the processes of adaptation imposed by market signals which determine and maintain a constant flow of resources towards the most productive activities. Given the fact that its underling directives are to accelerate and sustain structural adjustment, the common industrial policy displays the characteristics of an active policy that manifests an acceleration effect on top-edge technological progress.

Fundamental-theoretical research is especially insufficiently approached by means of free-market mechanisms, given the high costs and uncertain and far-in-the-future possibility of making a profit. As such it is mandatory that an industrial policy type approach take place, by means of a selective horizontal intervention to countermand this effect. Also, it is possible to intervene by means of public institutions to obtain a concentration of most research related activities (in this case Germany would make an excellent example since it strongly promotes research and development, public financing of fundamental-theoretical research and a vast network of research institutes with the given mission of "spreading" new technologies and finding practical applications) in subtle and indirect ways such as public financing of technology exhibitions. Since the externalities of such activities tend to attract entrepreneurial spirit, firms tend to become free-riders, utilizing the new found knowledge and technological expertise to develop their own activities. Even here it is necessary to

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construct a wide network of facilities dedicated to collecting the new data resulted from scientific advances and in cooperation with the businesses to develop practical applications, that can be used directly in economic activities (like in the case of Germany).

Its a worth mentioning aspect that the first form of industrial policy to manifest itself at a EU level was the policy of cooperation in research and development by means of the SIP frame-work. This remains one of the major components of the industrial policy tool-set at Union level that allows rapid accumulation and channeling of resources towards a few main fields of activity, considered at some stage to be of strategic importance.

It is as such noticeable that the dominant attitude within EU organizations is that at Union level science and technology must and are being put in the service of industrial competition as the demand must be met with ever greater efficiency. In this regard, industrial policy serves to support the progress of society by stimulating research and innovation.

Another area of interest is industrial cooperation, an initiative that from the very beginnings of what eventually become the EU represented a promise for progress and prosperity. The history of the rivalry between Germany and France over the regions of Saar and Ruhr, argument for war on a number of occasions (including the period of the “demilitarized zone“) and the source of much national humiliation and bitter hatred between the though nations, was finally resolved by the initiative of the major world powers of the time to introduce a regime of cooperation and peaceful sharing of resources, resulting in the formation of the European Community of Coal and Steel, an early precursor to the EU.

The European Union encourages industrial cooperation, a fact which is relevant not only in the area of the industrial businesses, but also in the area of national public institutions and of course, those of the Union. Even though the EU is not held responsible for the actual implementation of cooperation plans, it still must promote it as a means towards pushing the European presence on the international markets, including those markets that are primarily directed towards high technology.

In support of this great efforts have been undertaken to modernize the role of the public authorities by means of deregulation of the economic activities, the state taking up the role of player on the market, becoming an agent of economics, for the purpose of consolidating the free-market mechanism to promote “economic health” in relation to the so called “economic illnesses” like relocation, de-industrialization.

Efforts have also been undertaken towards consolidation of common internal market by providing on a competitive basis products and services for industrial users (for example: electricity, telecommunications), a measure which has been deemed necessary in order to lower total costs and thus, create competitiveness.

One final measure should be mentioned and that is the opening up of the EU market towards free trade. This too is achieved by planned action based on cooperation in developing international rules of competition and the mechanisms that will effectively and efficiently assure their implementation.

On a closing note it is worth adding that the EU pacts for advantages commerce, the evolution of protectionism, the efforts for selecting winners from the European economy to be developed into “European champions” for the global trade level, the investments in information society, in the knowledge based economy and their reflections in similar measures adopted in Asia ( protectionism and investment in

information society especially in the case of Japan) only goes to confirm and strengthen the attention given to industrial policy in economic progress on a global scale.

Based upon the given time-frame, on the dosage in which measures of vertical and horizontal intervention will be mixed in a continuous re-adaptation to the larger context and the wide variety of instruments and levers used, an industrial policy may or may not lead to the desired effect.

To conceive and apply an industrial policy on either a national or international scale is a difficult task to undertake for it implies great complexity and responsibility. It requires detailed analyses, competence, severity, flexible attitude and creativity. It also requires a mobilization of all resources on a long term basis, functional institutions and a powerful state.

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