

# INDUSTRIAL POLICY: NEW DIRECTIONS?\*

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Interactive  
Session

**1C**

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## Introduction

Industrial policy has resurged as a central economic strategy globally, with interventions increasing manifold over the past decade. This brief examines critical challenges facing emerging markets in implementing effective industrial policies amid rising protectionism, Chinese trade diversion, and technological disruption. The urgency stems from emerging markets' dependence on exports for growth, with only 13 economies achieving sustained 7% growth for 25 years-all through strong global engagement. This analysis provides policymakers with evidence-based recommendations for navigating these contemporary challenges while maintaining export orientation and competitiveness.

figure 1), with effective US tariff rates reaching 18%-levels not seen since the 1930s



Figure:1 | Source: Graph from the session

- China's excess capacity is flooding emerging markets with cheap imports, creating a "China shock 2.0" that threatens domestic manufacturing bases.
- Successful industrial policy requires time limits on protection, competitive neutrality across all enterprises, and transparent governance to prevent rent-seeking.
- Export orientation remains crucial, with no historical example of sustained high growth without strong global engagement.
- The premium on competitiveness has never been higher, requiring comprehensive reforms rather than protectionist responses.

## Main Points

- Emerging markets face three mutually reinforcing shocks: increased protectionism through tariffs, trade diversion from Chinese excess capacity, and rapid technological automation.
- Global trade volumes have stagnated since the Global Financial Crisis (as shown in

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## Context

### Changing Global Manufacturing Landscape

Manufacturing-led transformation historically provided pathways to prosperity for countries like Germany, Japan, South Korea, and China through targeted industrial policies with performance monitoring and export orientation. However, the external context has changed dramatically since the hyper-globalization era of the 1990s and early 2000s.

### Current Global Challenges

The contemporary environment features near-flat growth in global trade and investments, rising protectionism, stalled multilateral agreements, and geopolitical tensions in Europe and the Middle East. Industrial Revolution 4.0, including AI, is automating industrial processes while manufacturing becomes increasingly capital and skill-intensive. Global supply chains are being restructured with advanced countries incentivizing production localization through aggressive industrial policies.

### Emerging Market Vulnerabilities

Emerging markets remain heavily dependent on exports, with global trade serving as their economic lifeline for almost 25 years. Since the pandemic, exports have been the primary driver of recovery in these markets, while domestic demand has struggled below pre-pandemic trajectories.

## Main Findings

### Industrial Policy: A Double-Edged Sword

Industrial policy demonstrates both positive and negative effects. Positive impacts include correcting market failures in infrastructure, education, and healthcare; supporting infant industries; ensuring national economic security; and guiding investment toward cutting-edge technology. However, negative consequences include market distortions, resource misallocation, over-protection leading to inefficiency, links to corruption, and potential global economic fragmentation.

### Three Critical Shocks to Emerging Markets

First, protectionism has increased with non-tariff barriers rising since 2019-20 and effective US tariff rates reaching 18%. Second, Chinese trade diversion creates excess capacity flooding Asian markets, with Chinese exports increasingly targeting emerging economies rather than G7 countries. Third, technological disruption through automation threatens job creation in countries with expanding demographic profiles.

### Successful Policy Principles

Effective industrial policy requires adherence to specific principles: time-limited protection except for strategic industries directly related to national security; competitive neutrality treating all enterprises equally regardless of ownership; and transparent, accountable decision-making processes to minimize rent-seeking.

## Export Market Reality

India's service exports have grown remarkably (as shown in figure 2), increasing global market share from 3% to 4.5%, while manufacturing remains below 2%.

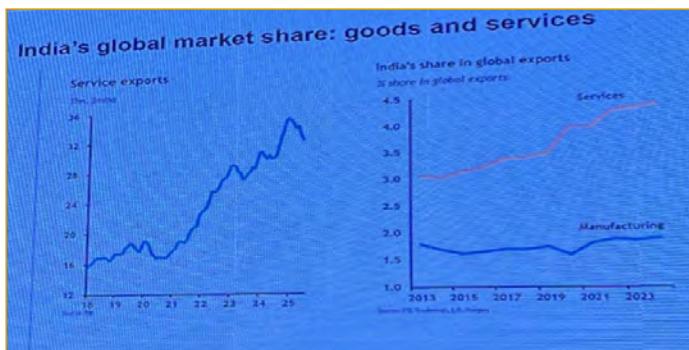


Figure: 2 | Source: Graph from the session

## Conclusions

Industrial policy effectiveness depends on correcting market failures rather than engaging in protectionism or excessive government meddling. The distinction between industrial policy and trade protection is crucial, as successful policies can operate without discriminating between domestic and foreign goods or firms.

Emerging markets cannot afford export pessimism despite current challenges. The fundamental equation remains unchanged: sustained high growth requires export orientation and global engagement. However, the premium on competitiveness has intensified, demanding comprehensive reforms rather than defensive tariff responses.

The capital-labour balance requires urgent attention. Economic systems must encourage creative destruction, enabling seamless

movement of capital and labour between sectors in an era of rapid technological change.

## Policy Recommendations

### Maintain Export Orientation

- Resist export pessimism and inward-turning policies despite increased global protectionism.
- Pursue trading arrangements outside the US, including multilateral and bilateral agreements like CPTPP.
- Focus on increasing market share within existing global trade volumes rather than relying on overall trade growth.

### Implement Competitive Reforms

- Prioritize comprehensive domestic reforms to enhance competitiveness both for export growth and defence against cheap imports.
- Avoid imposing tariffs on intermediate goods (particularly Chinese imports) as this reduces export competitiveness.
- Develop economic systems that facilitate creative destruction and factor mobility between sectors.

### Address Capital-Labour Imbalances

- Subsidize labour rather than capital in industrial policy interventions.
- Invest in health, education, skilling, and labour law reforms to make labour more attractive relative to capital.
- Focus on labour-augmenting rather than



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labour-substituting technological adoption.

### Ensure Policy Governance

- Implement time-limited protection measures with clear sunset clauses for non-strategic industries.
- Maintain competitive neutrality across all enterprises regardless of ownership structure.
- Establish transparent, accountable decision-making processes with robust supervision mechanisms.

### Build Resilience Through Multilateralism

- Support WTO reform and strengthening of international economic organizations.
- Enhance regional cooperation through ASEAN, Global South partnerships, and BRICS collaboration.
- Build domestic economic resilience through structural reforms and appropriate demand stimulus.



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