


On the Idea of Industrial Policy

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This short essay is based on the text of the Industrial Development Association (IDRA) Commencement Day Lecture delivered by Professor Deepak Nayyar, at the Special ISID@40-IDRA Session held on October 29, 2025. It reflects on the critical role of industrial policy in countries that are latecomers to industrialization and development. In doing so, it draws upon what we can learn from economic history and economic analysis, to consider what makes for the difference between success and failure. In conclusion, it suggests that industrial policy will continue to matter even in the profoundly changed global context. 

Economic history suggests that, among countries, there is no latecomer to industrialization that has succeeded in catching up without an effective use of industrial policy. This is true for the earliest late industrializers such as the United States or Germany, who followed in the footsteps of Britain and France, as well as the last of the early industrializers such as Japan, beginning in the late 19th century. It is just as true for the latecomers to industrialization in Europe such as Finland, or in Asia, such as South Korea, Taiwan and Singapore, followed by China, during the second half of the 20th century.

Industrial policy, in some form or the other, is an integral part of starting, as also sustaining, the process of industrialization in countries that are latecomers to development. It is essential for creating some initial conditions. It is necessary for creating enabling institutions. It is the basic foundation for the supportive role of governments, whether as leaders or catalysts. Such intervention can and does come in different forms at different stages of development. But industrial policy always matters, because industrialization is about learning-by-doing. The counterfactual validates this proposition. For some countries, in the past, de-industrialization was about unlearning-by-

not-doing. For many countries, in the present, the absence of industrial policy is also industrial policy which has adverse consequences for industrialization. In retrospect, it is clear that success at industrialization was driven by sensible industrial policy that was implemented by effective governments.

It is possible to think of industrial policy at the macro-level, meso-level and micro-level. This blurs the distinction between general and selective interventions but it reflects observed realities in practice. At the macro-level, for the economy as a whole, governments may seek to foster industrialization through industrial protection and import substitution to manufacture for the domestic market or industrial promotion through export orientation to manufacture for the world market. The stress on the former in large countries is motivated by

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Industrial Development Research Association (IDRA)

IDRA has been conceived as a forum for debate on the issues concerning industrial development, to promote and facilitate networking of various stakeholders, including researchers, academicians, business associations, and government bodies, and to undertake, promote and facilitate research and teaching in the areas of industrial development and related subjects. Bringing together professionals working on industry from across the country, IDRA is anchored by the Institute for Studies in Industrial Development (ISID).

The vision of IDRA was floated at the First ISID Conference on Industrial Transformation held during 4-6 October 2023 by Prof K L Krishna and was enthusiastically supported by the young researchers who felt the need for such a platform for them to come together to present their work and network with their peers from across the country.

The Draft Memorandum of Association and the Rules were discussed at the Second ISID Conference held on 19-21 November 2024, when the participants also nominated the founding office bearers, including Professor K L Krishna as the Patron and Professor Deepak Nayyar as the first President of IDRA.

IDRA was launched at a Special ISID@40-IDRA Session organised at the Third ISID Conference held during 29-31 October 2025, while the IDRA registration is in process. Prof Deepak Nayyar, as the President-Elect, delivered the IDRA Commencement Lecture at the Special Session, which was also addressed by Prof K L Krishna, former Director, DSE & Patron, IDRA, Prof Dhananjay Singh, Member-Secretary, ICSSR, Prof S R Hashim, former Director, ISID and former Chairman UPSC, and Prof TCA Anant, ISID Board Member and former Chief Statistician, and Prof Nagesh Kumar, Director, ISID, among others.

the object of learning-to-industrialize, not only in consumer goods but also in intermediate goods and capital goods, so that exports are the end of the market expansion path for firms. The emphasis on the latter in small countries is also motivated by the object of learning-to-industrialize, but with a focus on labour-intensive manufactured consumer goods, so that exports are the beginning of the market expansion path for firms. At the meso-level, for particular industries, government intervention may seek to develop sunrise industries or retrench sunset industries. Strategic government support for industries to be developed is possible through a range of policy instruments. But the withdrawal of such support which is possible in principle requires effective governments in practice. At the micro-level, always for selected firms, government support in the domestic market, or in the world market, seeks to nurture their managerial or technological capabilities, or encourage their horizontal and vertical expansion, so that they are able to realize scale economies not only in production but also in marketing to develop global brand names and create large international firms. This is about picking winners and creating champions.

The complexity of government intervention necessary increases progressively in moving from the macro-level through the meso- to the micro-level.

Success or failure, in terms of outcomes, depends upon the nature and the quality of intervention. Thus, industrial policy is no panacea. There are benefits and there are costs. However, outcomes are not binary. More often than not, outcomes are a mix of success and failure. This mix changes over time. Moreover,

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Professor Deepak Nayyar

Deepak Nayyar is Emeritus Professor of Economics at Jawaharlal Nehru University, New Delhi, and an Honorary Fellow of Balliol College, Oxford. He was invited to the Kluge Chair in Countries and Cultures of the South at the United States Library of Congress, Washington DC, for the academic year 2022-23. He was Distinguished University Professor of Economics at the New School for Social Research, New York. He also served as Vice Chancellor, University of Delhi. Earlier, he taught at the University of Oxford, the University of Sussex, and the Indian Institute of Management, Calcutta.



Professor Nayyar is Chairman of the Board of the Institute of Development Studies, Sussex, in Britain, Vice-chairman of the Board of Governors of ISID, and was Chairman of the Board of the World Institute for Development Economics Research, UNU-WIDER, Helsinki. He has served as Director on the Board of the Social Science Research Council in the United States. He served as a member of the World Commission on the Social Dimension of Globalization, as Vice Chairman of the South Centre, Geneva, and as Vice President of the International Association of Universities. His professional life in academia has been interspersed with time in the world of public policy, as Chief Economic Adviser to the Government of India and Secretary in the Ministry of Finance.

He was educated at St Stephen's College and the Delhi School of Economics. Thereafter, as a Rhodes Scholar, he went on to study at Balliol College, University of Oxford, where he obtained a B Phil and a D Phil in Economics.

Professor Nayyar has published numerous articles in professional journals and several books. His books include the best-selling *Catch Up* and *The Intelligent Person's Guide to Liberalization*, both of which have been translated into many languages. His latest books, *Resurgent Asia*, also a best-seller, and *Asian Transformations*, published by Oxford University Press, Oxford, analyze the remarkable economic transformation, and rise, of Asia during the past half-century.

in the process of learning-to-industrialize, the costs surface earlier while the benefits accrue after a time lag. It follows that industrial policy must be assessed not at a point in time but over a period of time. The real question, then, is how to make industrial policy more effective for intended outcomes. It could slip into rents and patronage. Its success depends upon the nature of the state and the effectiveness of administrative systems. This, in turn, requires institutionalized control mechanisms. At the same time, the risks associated with industrial policy must be balanced against the risks associated with no industrial policy.

There are two other attributes of industrial policy that must be recognized. First, it is about the ability of governments to use carrot-and-stick – reward for performance and penalty for non-performance – to attain success, the litmus test for which is that domestic firms become competitive in world markets. Second, effective industrial policy requires a coordination of economic policies across the board, including not only of trade, investment and technology policies, but also of interest rate and exchange

rate policies, combined with the provision of industrial finance.

Just as important, industrial policy matters at every stage of development and every level of income. For example, late industrializers in their continuing quest for development, often face the challenge of the middle-income-trap. It describes a situation where a country makes a transition from low-income to middle-income status but gets stuck there, unable to move from middle-income to high-income status.

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The first stage in this transition is driven by abundant cheap labour and high investment rates. Growth slows down as these factors wane in their impact. And industrialization stops at labour-intensive goods as wages rise. The second stage in the transition requires higher productivity levels and a capacity to innovate. This, in turn, requires nurturing managerial and technological capabilities, fostering vertical diversification in production processes, encouraging technological-upgrading, inducing technological-learning, and creating R&D capacities. The attainment of these strategic long-term objectives depends on the quality of industrial policy and of human resources.

It is important to recognize that, during the second half of the 20th century, the use of industrial policy was not limited to developing Asia. It was also used, most effectively, by some latecomers to industrialization in Europe, particularly Finland and Ireland. Indeed, even Britain, France, Germany and Spain used industrial policy most effectively to develop Airbus as an aircraft manufacturer that could compete with Boeing which had dominated the world market. In fact, Brazil also used industrial policy to develop the Embraer as a smaller passenger aircraft, which became competitive in world markets.

Given the ideological dominance of the Washington Consensus after the collapse of communism, most countries in Latin America (except Brazil) and Asia (except the few success stories in East Asia) dumped industrial policy into the dustbin. The absence of industrial policy was, in effect, also industrial policy that led to de-industrialization in many countries. India is a perfect example. In the economic liberalization of 1991, the government almost dispensed with industrial policy, without

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creating the conditions or the ecosystem that might have enabled our manufacturing sector to become competitive in world markets. The outcome was a discernible de-industrialization as the share of manufacturing in output and employment witnessed a significant decline.

It is ironical that in this period when developing countries reduced industrial policy interventions, industrialized countries did exactly the opposite. Industrial policies comprise policies that change the relative prices across sectors or direct resources towards certain selectively targeted activities (e.g., exports, R&D), with the purpose of shifting the long-run composition of economic activity. Available evidence suggests that, during the decade 2009-2019, the share of such industrial policies in measures that discriminate against foreign commercial interests doubled from one-third to two-thirds in high income countries, whereas it rose from one-tenth to one-fifth in low-income and middle-income countries. Thus, there was a pronounced increase in the use of industrial policies in high-income countries and their incidence was far greater than in low- and middle-income countries.

Since then, there has been a dramatic change in the global context, which has intensified with Donald Trump assuming office as President of the United States. The unilateral imposition of high, as well as discriminatory, tariffs by the US, has led to a proliferation of bilateral trade deals and plurilateral trade groupings, which have, in effect, dismantled the twin principles of non-discrimination and most-favoured-nation treatment, that provided the foundations of the multilateral trading system. The politics of resurgent nationalisms could lead to an escalation of beggar-thy-neighbour policies.

These developments in the international trading system will probably mean that industrial policy is going to be a necessity even more than it was until now, perhaps driven by the objective of minimizing costs rather than maximizing benefits in a global context that is in the midst of dramatic changes where the ultimate outcome is uncertain. In this new world, I believe that it is essential to make a distinction between short-term industrial policy to protect national economic interest and long-term industrial policy to promote national economic interest.

For India, going forward, it might not be possible to replicate the experience of the countries that have been success stories in Asian industrialization owing to profound changes in the global economic landscape. Thus, industrial policy will need to be creative, recognizing the implications of technological changes on the horizon for labor-intensive manufactured exports, more explicit industrial policy in advanced economies, and the increasing interdependence between manufacturing and services.

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later. Industrial policy, especially through a system of experimentation and evaluation, can enable large manufacturers to leapfrog technologically, building on its foundations of higher education in science and engineering, a capital goods industrial base, and by creating institutionalized control mechanisms. India's unique success, among developing economies, as an exporter of range of professional, scientific, and technical services also presents an opportunity for industrial policy to facilitate technological leapfrogging. Last, but not least, there are synergies between manufacturing and services which could be exploited and must be captured. Industrial policy support can help manufacturers move up the value chain by diversifying into related but higher value-added services.

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