

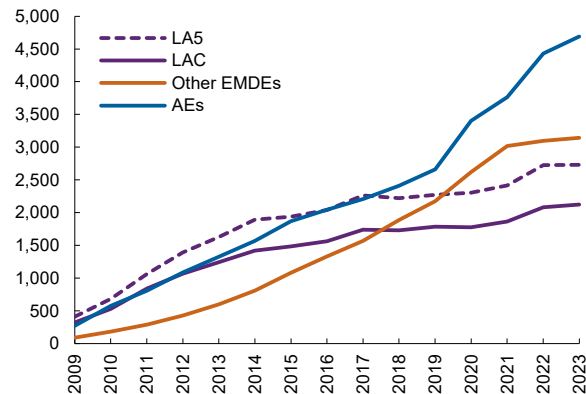
Online Annex 3. Industrial Policy in Latin America¹

Industrial policy (IP) has made a comeback in governments' policy toolkits in recent years. Faced with geopolitical tensions and the aftermath of the COVID crisis, governments around the world are intervening to steer their economies through IP. What is industrial policy? To what extent are governments in Latin America resorting to these policies? When is there a case for such policies, and how should they be implemented? This Annex sheds light on these key questions.

IP can be defined as government interventions aimed at supporting specific domestic firms, industries, or narrowly defined economic activities to achieve certain national economic or non-economic objectives. While measuring IP across sectors and countries is a notoriously difficult task, recent papers (Evenett and others 2024; Juhasz and others 2023) have leveraged information from the Global Trade Alert (GTA), which collects policy interventions that discriminate against foreign firms. During 2009–23, the average LAC country introduced around 2,000 trade-distortive policies; the average across LA5 countries (Brazil, Chile, Colombia, Mexico, and Peru) has been [somewhat] higher.² The number of these policies in the region, while larger than in other developing economies (EMDEs) and advanced economies (AEs) until 2015, has grown less rapidly since then and is lower than in other countries as of 2023 (Online Annex Figure 3.1).

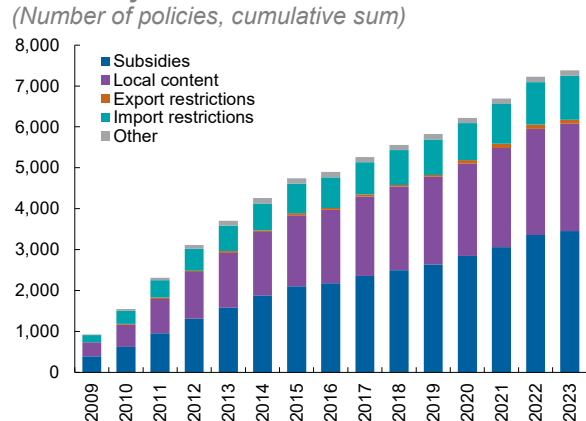
Around half of the trade-distortive policies in force in LAC as of 2023 are import restrictions and local content requirements and the other half are subsidies (Online Annex Figure 3.2). The significant role of local content requirements in the region (one third of all trade-distortive policies over time) stands in stark contrast with the experience of other emerging market economies—especially China (Rotunno and Ruta 2024), where subsidies are the most common policy tool.

Online Annex Figure 3.1. Trade-distortive Policies
(Average number, cumulative sum)



Sources: Global Trade Alert (GTA) database; and IMF staff calculations. Note: GDP-weighted average of counts of policies classified as trade distortive in the GTA database introduced since 2009 and enforced in a given year. AEs = advanced economies; EMDEs = emerging market and developing economies; LAC = Latin America and the Caribbean; LA5 = Latin America 5 (Brazil, Chile, Colombia, Mexico, Peru).

Online Annex Figure 3.2. LAC: Trade-distortive Policies by Instruments
(Number of policies, cumulative sum)



Sources: Global Trade Alert (GTA) database; and IMF staff calculations. Note: Counts of policies classified as trade distortive in the GTA database introduced since 2009 and enforced in a given year. Export subsidies are included in the “subsidies” category. LAC = Latin America and the Caribbean.

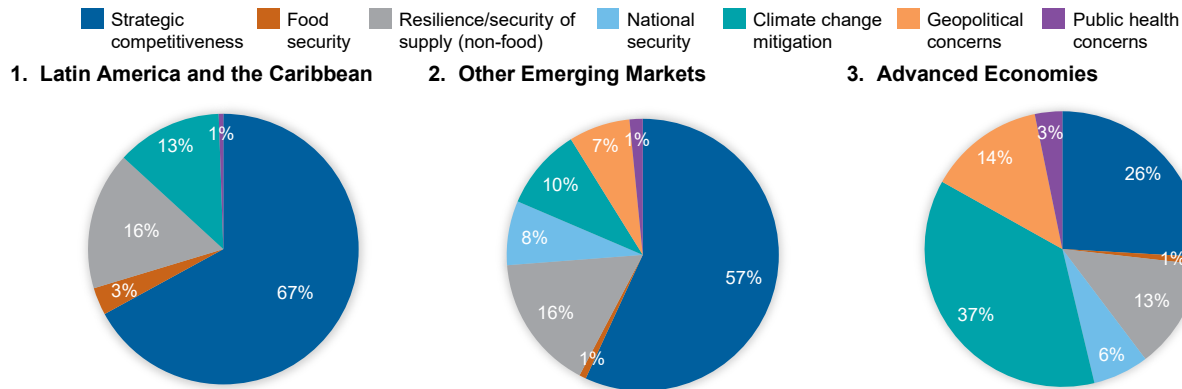
¹ Prepared by Oliver Exton, Adam Jakubik, Sergio L. Rodriguez, and Lorenzo Rotunno.

² This annex describes trade distortive measures as defined by the Global Trade Alert. These numbers may overestimate the role of industrial policies as defined by recent studies of industrial policy. Evenett and others (2024) measure industrial policy since 2023 by taking a subset of all GTA policies with specific stated motives and/or targeting certain strategic product groups. Juhasz and others (2023) apply a natural language processing approach to the text description of GTA policies to identify industrial policies.

The popularity of traditional inward-looking policy instruments in the region is reflected also in the stated motive of these IPs. Data from the New Industrial Policy Observatory (NIPO) reveal that 67 percent of IPs in LAC implemented in 2023 are motivated by strategic competitiveness (57 percent for other EMs), while more recent non-economic policy objectives such as national security and geopolitical concerns are absent in the region—in other countries, significant shares of IPs are motivated by these reasons (Online Annex Figure 3.3).

Online Annex Figure 3.3. New Industrial Policies by Motives

(Implemented in 2023; percent share)



Sources: New Industrial Policy Observatory database; and IMF staff calculations.

Latin America has a controversial history of government policies aimed at shifting comparative advantage and fostering economic growth. State-led industrialization amidst macroeconomic instability, especially in the 1970s and 1980s, brought about poor productivity growth and little diversification away from volatile primary sectors (Ocampo and Porcile 2020). After a retreat of industrial policy in the region during the 1990s, governments have returned to milder forms of interventions with mixed results.³

The Dos and Don'ts

Governments in the LAC region considering IP should tread carefully to avoid the shortcomings of the past. While IP can help address market failures, it could also lead to inefficiencies due to resource misallocation or rent seeking. Discriminatory IP measures can distort the allocation of domestic resources and encourage retaliatory policies from trading partners, damaging international trade and investment flows. IP support—if needed—should be time-bound, cost-effective, transparent, and consistent with preserving domestic macroeconomic stability, fiscal and external sustainability, and avoiding negative cross-border spillovers. IMF (2024) contains a set of broad considerations to help policy makers assess IP, including:

- *The case for targeted government intervention should be clearly established.* IP measures should aim at addressing well-identified market failures that cannot be addressed through alternative policies, including less-distortionary horizontal policies such as investments in infrastructure, R&D, and human capital.
- *IP should be well designed.* The choice of policy instruments should be consistent with the country's institutional framework and implementation capacity. Effective implementation of IP should be complemented by economy-wide policies, for instance, IP targeting the high-tech sector may benefit from appropriate education, labor market, and possibly immigration policies.

³ A report by IDB (2014) for instance discusses some examples of successful and less effective policies while highlighting the fundamental role of solid and healthy institutions to minimize the risk of political capture. Cornick and others (2018) expands on the list of case studies and confirm the importance of institutional capabilities in explaining the success (or failure) of government interventions.

- Also, IP should be underpinned by a governance framework that reduces risks of rent-seeking and corruption, including by calling for transparent mechanisms for allocating resources, regular monitoring and assessment of the support provided, and by setting clearly defined sunset clauses to ensure that IP support is temporary and gradually phased out.
- The benefits of addressing market failure through IP should outweigh the costs. Cost-benefit analysis should capture direct and indirect benefits and costs for the domestic economy, including fiscal and administrative costs, contingent liabilities, as well as indirect costs due to resource misallocation. The analysis should also include the effects of cross-border spillovers and spillbacks.
- Implementing IP should be compatible with fiscal sustainability as well as with external and domestic stability. The country should have adequate capacity to implement such measures, which should be consistent with the country's legal obligations, including WTO commitments.

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