

RIETI Policy Symposium

Industry-Related Government Policy and the Global Economic Crisis

December 16, 2009

Amid the current financial and economic crisis, many governments have implemented a variety of policies to assist industry and businesses. These policies include firstly, temporary assistance for businesses in financial difficulties resulting from considerable exogenous shock and secondly, forward-looking assistance for future growth areas such as low-carbon and health industries.

Under these circumstances, it is necessary to understand exactly how each of the major countries around the world have implemented industrial policies as well as deepening discussions on what industrial policies should be during and after a crisis.

With this goal in mind, RIETI held a symposium in collaboration with METI and had invited three specialists from the U.S., France, and Germany to share their experiences of how each of their countries approached policies aimed at assisting industry and businesses during the current crisis. The significance, issues, and future of such industrial-assistance policies were debated in a panel discussion.

Session 1

Industrial and Business Support Initiatives being Undertaken by Each Country around the World

Report 1



"Real Economy Support by the United States in Response to the Economic Crisis"

*Richard A. GITLIN
(Chairman,
Gitlin and Company, LLC)*

Four elements of an industrial strategy

Governments should implement industrial strategies for three reasons. First, there is currently more capacity than demand. Second, we will not solve unemployment without wisely positioning existing industries and supporting industries of the future. Third, other countries are implementing industrial strategies.

There are four elements of an industrial strategy: policy, decisions, execution, and the stage in which investments are managed and then exited. First, policy means that you should be able to explain the reason for executing the strategy to society in an understandable fashion. Second, once a policy is established, decisions must be made by the right people. Third, by execution I am referring to how decisions are carried out, and this is extremely important. Fourth, industrial strategy must be managed properly to consider any necessary adjustments, including how to exit.

Looking at the auto industry and battery industry as examples, we can see these four elements of the U.S. government's response to the current crisis.

Actual cases in the U.S.—auto industry and battery industry

For the auto industry, the policy was confusing. At best guess, it seemed to be decided that automobile manufacturing was critical to the U.S. manufacturing industry as a whole, and as a result, Chrysler and GM should be bailed out. But should Chrysler have been saved? Would the automobile industry be stronger

without Chrysler? The execution was brilliant, with top professionals brought into the government to efficiently restructure firms and make real changes. Exiting from these investments will be challenging as many of the experts brought into the government have since left, with the exception of Ron Bloom.

The other example is the battery industry. Batteries are an integral part of hybrid and electric cars. The battery market is projected to grow from \$7 billion currently to \$170 billion in the next 10 years. The U.S. has the capability to become a leader in R&D and manufacturing of high-tech batteries in the future. In order for this to happen, the U.S. government must put significant resources behind this industry.

Two companies, among many others, received money from the U.S. government to develop and produce batteries. The first, A123 Systems, was started by people from MIT and has good technology. It will likely receive almost \$500 million dollars in grants and loans to continue its work, even though the company had next to no earnings to show for itself. The second company, Ener1, was \$80 million in debt four years ago. With the help of angel investors, venture capital and public capital, the company was able to continue. This company, with a track record of losing money, was given over \$100 million dollars in grants through the government's stimulus program because of its excellent technology and its future promise. I think these examples say a lot about the U.S. approach to investing money. The U.S. does not put money into privileged or established companies, it looks for the companies with the best people; it invests for the future growth of society.

Let me finish with a few observations about what is necessary for the execution of successful industrial strategy. First, successful execution requires collaboration between the government, industry, and the academic community. Second, it requires a commitment at the highest level. Third, it requires oversight—there must be someone or some organization making sure that the

government does not chase after bad investments. Last, and this is the most important point I think, a successful industrial strategy is one in which the government enters to help the economy and then stops intervening once a recovery has been achieved to preserve competition in the economy.

Example of US support of a growth industry of the future —electric vehicles

Three key provisions of the American Recovery and Reinvestment Act of 2009 ("ARRA")

1 Battery development

- ◆ Two billion dollars of grants
- ◆ Ion batteries, hybrid electric systems, component manufactures and software designers

2 30% tax credit for manufacturing facilities for electric/hybrid batteries

3 Tax credit for vehicle purchase

- ◆ Hybrid plug in
Range from \$2,500 to \$7,500
First 200,000 vehicles
- ◆ Slow electric vehicles, 2 and 3 wheel electric vehicles
10% up to \$2,500

Report 2



"Governmental Assistance for Industries and Businesses: The French Response"

Jacques HENROT
(Partner and Head of the Restructuring and Dispute Resolution teams, De Parisieu Brocas Maffei)

State's intervention is being resuscitated in France

In the past, France was often criticized for the excessive part taken by the State in the economy. Major banks or industries were either in part or even fully under the control of the State. France was for instance the last post-war economy to have until recently a completely state-

RIETI Policy Symposium

Industry-Related Government Policy and the Global Economic Crisis

owned major car manufacturer, Renault; the employees of which could not go on strike without creating an immediate problem for the government, which did not help at improving its productivity at the time. Despite the criticism that this level of State intervention generated in the past, in the face of the current crisis, some of France's ancient support/intervention techniques are being resuscitated to help France weather the storm.

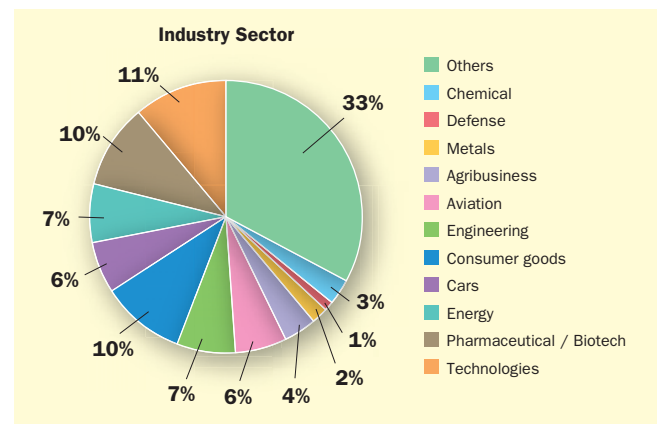
Let's focus on three of these techniques: (1) increased funding through the European Investment Bank (EIB); (2) the stimulus package, which the government put together in 2008 and 2009; and (3) the Fonds Strategique d'Investissement (FSI).

The EIB, of which the EU member states are automatically shareholders, is an institution set up in 1958 essentially to fund, through long term loans, projects in Europe. Before the crisis, the EIB was already providing around 60 billion euros/year of financing to SMEs' infrastructure and other projects, R&D ventures, green industries, etc.... When the crisis hit, channels were in place to offer otherwise unavailable funding to a larger number of beneficiaries. For 2009 and 2010, the EIB should increase its total lending capacity by some 30% (EUR 15bn. or JPY 1,963 bn.). Additional global investment value expected should reach around EUR 72 bn. or JPY 9,420 bn. Lending to SMEs should rise by 50% compared to 2008.

On the domestic side, of the two-year 26.5 bn. euro stimulus package announced in 2008, 75% was injected in the system in 2009. One of the techniques used was to accelerate refunds of provisional corporate tax installments and VAT credits. A so-called 1,000 new projects program was launched—a New Deal type program in which the government funded 1,000 essentially public works projects. Within the list of more day-to-day measures, standard terms of payment of invoices were shortened by decree to 60 days. The government moved to support insurers and increased its grant to OSEO (an existing state agency financing SMEs directly or through guarantees) by 5 bn. euros.

The FSI was established in December 2008 to act as an equity funding tool for the French State. Even though 100% controlled by the State directly, and through Caisse des Depots (a public institution that past governments also used for missions similar to that of the FSI), it is incorporated and set up to function as an ordinary commercial company. The FSI takes a minority stake in strategic businesses when their share capital structure needs to be reinforced. It has a budget of 20 bn. euros. So far it has invested in a wide variety of companies such as Accord and EuroTel Group, and in smaller companies facing difficulties, especially car parts manufacturers (through FSI's sub-fund FMEA).

The Strategic Investment Fund (FSI)



Effects and lessons of French policy responses

Did these policies work? It is probably too early to say; but, apparently they were not too bad if you look at credit ratings of European countries, since only France and Germany still have a triple A rating, and statistics show a growing number of new micro start-ups.

One of the main lessons to draw from the various responses to the crisis is that stimulus measures have to be transparent, temporary, and of an assessable cost. They must be evaluated in a reasonably short time, otherwise taxpayers will sooner or later refuse the efforts requested from them to fund such measures.

Report 3



"Germany's Response to the Financial Crisis—Governmental Assistance for Industries in Germany"

Josef BROICH
(Partner, Broich Bezenberger)

Germany's concern about policy responses

Germany in 2007/2008 was in a relatively good position to deal with the financial crisis. When it hit, Germany's answer was not as strong as those seen in France or the U.S.; it was reluctant. The German government did not want to engage in equity investments. The reason for this was that Germany had privatized many of its state-owned companies a few years earlier, and people were reluctant about possibly moving back to a time when there was too much state control.

In the end, there were two main features in Germany's response. First, Germany created Sonderfonds Finanzmarktstabilisierung (SoFFin), which is a special fund designed to prevent insolvencies in the financial sector. Second, Germany implemented two stimulus packages. Actually, the stimulus packages were implemented mainly by SoFFin and KfW Bankengruppe, a banking group. Both

packages were implemented with the strong belief that Germany wanted to maintain and strengthen its industrial backbone.

Achievements of stimulus measures—debt ceiling and employment maintenance

Package one offered 50 bn. euros for investments and orders and an additional 20 bn. euros to help maintain the financial resources and liquidity of enterprises.

Package two offered 14 bn. euros for infrastructure improvements and education, and then put 36 bn. euros into the financing program. Two important results of package two were the "debt brake" and the effect on unemployment.

The so-called "debt brake" is a policy that will come into effect in two years. It limits the ability of the government to take on more debt. German people want the government to do something, but not at the expense of greater future debt.

Package two was also implemented to minimize unemployment. Germany offered money to companies through the package in order to implement short hour work programs, in which employees work less hours per week, thereby allowing companies to avoid layoffs. It is estimated that Germany avoided approximately 600,000 cases of unemployment this way. Whether the package has prevented a rise in unemployment in a way that is sustainable in the long term or not is yet unclear.

SoFFin—Special Fund Financial Market Stabilization

SoFFin

- ▶ SoFFin was created on October 17, 2008 in connection with the financial crisis by the German Parliament and enacted on October 20, 2008.
- ▶ It is established as an agency at the German Federal Bank (Deutsche Bundesbank) and is supervised by the Federal Ministry of Finance.
- ▶ SoFFin is limited in time until December 31, 2010.

Tasks

- ▶ Guarantees: Guarantee newly issued debt securities and (founded) other liabilities of financial sector enterprises. All liabilities may have a maximum term of 60 months.
- ▶ Recapitalization: Investing in equity (recapitalization) of financial institutions in the amount of up to EUR 10bn. This may be achieved by the issuance of shares, silent participations or the acquisition of other elements of the financial institution's own funds.
- ▶ Assumption of risk positions: The Fund may assume risk positions (e.g. receivables, securities) in the amount of up to EUR 5bn from financial sector enterprises that were acquired by financial sector enterprises prior to October 13, 2008.

Financing

- ▶ The Fund may grant guarantees in an amount up to 400 bn. Euros. In the case a guarantee is enforced, the Federal Ministry of Finance can take out credits in an amount up to 20 bn. Euros as coverage.
- ▶ The Federal Ministry of Finance can take out credits in an amount of up to 70 bn. Euros to provide recapitalization measures and to assume risk positions. With consent of the budget committee of the German Parliament, this credit amount can be extended by up to another 10 bn. Euros.

RIETI Policy Symposium

Industry-Related Government Policy and the Global Economic Crisis

Two scenarios Germany would like to avoid

SoFFin is a special fund designed to prevent insolvencies in systematically relevant companies in the financial sector. The most prominent applicant to it has been Commerzbank, which received close to 20 bn. euros.

SoFFin is interesting in the context of the German discussion on the financial crisis. Most Germans regard the crisis as the fault of a highly distorted financial market in which risk, excessive leverage, and dubious risk management theories combined with greed for power and money to create toxic assets and bubbles. So there is not much support for programs perceived to only be helping the German equivalent of Wall Street. Germany wants to avoid two scenarios: (1) going back to having huge nationalized companies, and (2) having financial institutions so large that they cannot be allowed to fail

and having an organization like SoFFin come in and bail them out. These have led to two developments.

First, Germans are now discussing a proposal which provides for the dissolution of banks or companies considered to be getting too large to fail.

Second, Germany's Finance Minister is now working on a new roadmap for industrial policy. This roadmap seems to focus especially on new technologies, green industries, and industries which are open to international investors.

To conclude, it is not yet clear whether Germany's policies have been successful or not. Over the next year we will have to come to a conclusion as to whether we have solved our problems or just papered over them. However, no matter what happens, the government will probably stick to its principles, avoiding overexposure and restricting public debt.

Stimulus policies for industries and companies in each country after the global economic crisis

	Policies	Targets (examples)
United States	Assistance for next-generation electric vehicles based on the American Recovery and Reinvestment Act	Lithium-ion batteries, Hybrid electric systems, Electric motors
	Cash for clunkers	Fuel-efficient cars
France	Investment from the Strategic Investment Fund (FSI)	Automotive components, Energy, LED illumination, Drugs and medicines
Germany	Loan and credit guarantee from Special Fund Financial Market Stabilization (SoFFin)	Marine Transportation, Automobiles, Electric appliances
	Subsidies for new-car buyers	Automobiles
England	The Strategic Investment Fund (SIF)	Space aeronautics, Wind-power generation on the ocean
	The UK Innovation Investment Fund (IIF)	Biological science, IT technology, Low carbon manufacturing sector

Q&A

Q

For Dr. Richard GITLIN, what is the valid reason to support, for example, the battery industry rather than other industries?

● **Dr. Gitlin:**

You have to select which industries you believe in. President Obama made a statement that he wanted one million electric cars on the road by 2015. So, in effect, the examples I gave are part of comprehensive programs to make that happen. I emphasized the battery industry because I found the nature of the companies being supported interesting, but in fact, there is a comprehensive program for electric vehicles.

Q

For Mr. Jacques HENROT, are there any lessons on what kind of policy may be suitable for certain solutions? I would be interested in any merits or demerits of the various policies or the coordination among those policies.

● **Mr. Henrot:**

The good thing about the stimulus packages is that they are so big that people have realized that money has to go where it is supposed to go or the taxpayer will not vote for a third or fourth stimulus package. There was a total lack of coordination in the past. Now priorities are set. The FSI as well is saying to the government and companies, "Restructure first, restore the confidence of your bankers, and if you do, we will see."

Q

To Mr. Joseph BROICH, I would like to know what the asset strategy is for Germany. Also, in this kind of crisis, do you not follow the Maastricht criteria temporarily?

● **Mr. Broich:**

Regarding your first question, for the time being, I tend to believe that we will not see huge growth initiatives. We may see another stimulus package that will focus on environmental technology, but I think there will be a lot of resistance within the government to engage in new industrial policies. Germany recently introduced a bad bank act, enabling commercial banks, and in particular state banks, to get rid of toxic assets.

It is almost certain that Germany will not meet the Maastricht criteria next year. Will this lead to the abolishment of the criteria? Probably not. The German approach is "Let us stick to the Maastricht criteria. Once the worst is behind us, let us reduce debt again and go back to the principles of sound financial circumstances."

Panel Discussion

Significance, Issues, and Future of Industrial Policies

Presentation 1

"There can be No Future without Growth"

*Naohiro NISHIGUCHI
(Executive Managing Director, Innovation Network Corporation of Japan)*

Japanese corporations possess a high market share in the material and electronic component fields. While Japan is superior in terms of component technology and parts, architecting across corporations by combining these into

RIETI Policy Symposium

Industry-Related Government Policy and the Global Economic Crisis

products or services is something Japan has trouble with. The Innovation Network Corporation of Japan aims to achieve high level growth and productivity in Japan by taking individual pieces of domestic technology and combining and transforming them through innovative projects. In other words, the Innovation Network Corporation of Japan forwards open innovation by joining up technology and projects from different industries in new ways. The organization acts as a hub for information/ industrial capital and management development and helps businesses by providing risk money.

In relation to the development of human resources, people often bring up the issues of the falling birth rate and aging society, but actually personnel strength is a multiple of the number of people you have times the quality of people you have. If your personnel numbers are falling, you can still sustain or grow your personnel strength by increasing the quality of the personnel you have. Additionally, an aging society means that the number of highly proficient adults in society is increasing, and this sort of personnel especially ought to be good at management and be able to come up with new business enterprises. Accordingly, it is extremely important to raise the quality of management in Japan in light of the aging society and falling birth rate. Proficiency at global personnel management is vital for prevailing over global competitors.

It is said that the only resources Japan has are people and technology, but actually the coming together of people and technology is extremely important for the creation of further innovation. Innovation occurs when tacit and formalized knowledge come together. Tacit knowledge can only be spread through communication between people. The vertical innovation structure creates barriers to communication inside and outside of organizations, and blocks innovation from happening.

Even if you have superior products and development processes, if they are not accepted by clients, if they do not sell, it is not innovation. It is important that the start of innovation is based on an understanding of what is

important to clients. It is not necessary to think only from the perspective of the Japanese way—innovation based on knowledge of the world at large will support growth in Japan in the future.

In order to climb out of the current structure in which Japan continues to win the component technology battle but lose the overall concept and innovation war, Japan must improve its ability to come up with new business enterprises and there must be public-private cooperation on the grand design of the Japanese economy and business itself.

Presentation 2

"Perspectives on Industrial Policy"

Noriyuki YANAGAWA
 (Associate Professor, Graduate School of Economics,
 the University of Tokyo)

The necessity of government intervention is a major point of contention when talking about industrial policy. In Japan, opinion tends to be split between leaving things to the market and leaving things to the government, but what is really needed is an appropriate level of government intervention. If appropriate criteria for government intervention can be established we may arrive at a new perspective on industrial policy.

Government intervention is required when the market fails. Concretely, this is when there is:

- (1) a coordination failure among stakeholders;
- (2) a temporary breakdown of the market;
- (3) a need for the implementation of macro-policies;
- (4) a need for some sort of external strategy.

Private sector mechanisms, even informal ones, should be utilized to the maximum extent possible for industrial policy. Policies regarding coordination failure between the public and private sector are likely to become more and more important in the future. In relation to external strategy, support for the creation of standards and format competition is going to become an important point.

Another important point for industrial policy is going to be how it handles coordination failure among government agencies.

The role of the government is to come out with ideas on how to prevent coordination failures—the provision of funding is only a secondary role. Private sector funding should be encouraged as much as possible. In order to do this, there must be a reduction in the amount of political risks faced by the government on this issue.

There are three important points we need to stick to when considering industrial policy. First, financial support should not be given out lightly. Second, the decision to give financial support should not be made by a civil servant but by someone who can be held accountable for the outcome of the support. Finally, Japanese people have become quite comfortable with government intervention. We need to examine the limits of intervention.

Presentation 3

"The World after the Lehman Shock"

Yoichi TAKITA
(Deputy Chief Editorial Writer, Nikkei Inc.)

The economic downturn that has occurred following the immense financial crisis will have an unexpectedly long-term effect on the world. This is the first large-scale financial crisis since the Japanese economy entered into a long-term slump in 1997. The GDP of Japan has fallen from 520 trillion yen before the Lehman Shock to 480 trillion yen afterward.

One reason that we have not seen a recovery in GDP is because of the strengthening of the Japanese economy's export-oriented nature during the process of economic recovery under the Koizumi reforms. It is due to these reforms that the electronics and automobile industries are such a large part of Japanese industry.

At the start of this week the Bank of Japan announced in the Tankan that business confidence in major

manufacturing industries seemed to be improving. That said, equipment investment is down approximately 30% on what it was at this time last year. And within that figure, in the electronics and automobile industries, equipment investments are down more than 40% of what they were last year.

In light of all of this, what does the future hold? First, we can expect demand in Asia to grow. The IMF's World Economic Outlook predicts that the GDP of BRIC countries will be US\$10 trillion in 2011. Given that the United State's GDP is US\$15 trillion and the Euro area's GDP is US\$13 trillion, one can see that the balance of the global economy is shifting toward emerging economies.

How to support business activity in the midst of this change in the world economy is going to be a topic of conversation in the coming years. How the policies of the Democratic Party of Japan are implemented will be very important for the stimulation of domestic demand. Particular attention should be paid to what sort of concrete industry image is drawn up by the government in the fields of the environment, primary education, and elderly care.

The size of individual financial assets in Japan is said to be 1.4 quadrillion yen, and much of that is tied up in savings. This is because households and individual investors do not have faith that the Japanese economy will grow. With this being the case, the growth rate of Japan will not increase, and neither will we see the creation of growth industries. The importance of strategies which connect financial institutions with new growth industries is increasing.

Presentation 4

"Financial Crisis and Policy Intervention"

Keiichiro KOBAYASHI
(Senior Fellow, RIETI)

If we look at the phenomena that have occurred in the market since the Lehman Shock from the perspective

RIETI Policy Symposium

Industry-Related Government Policy and the Global Economic Crisis

of market failure, we can see that the incredible chaos caused was due to there being a market for lemons. The manifestation of a market for lemons is thought to bring about great structural changes, not only in financial markets but in other markets as well.

The financial crisis has led to a global mismatch between supply and demand. The acceleration of structural change in the economy means that we can expect an increase in informational asymmetry regarding the future direction of corporations.

If that is the case, a market for lemons will occur in many industries, and informational asymmetry will cause markets to break down and stagnation to occur. This is why we need government intervention.

There is public will to resolve informational asymmetry when carrying out the restructuring of corporations with uncertain futures. In light of this, the activities of organizations such as the Innovation Network Corporation of Japan are as significant as public policy. The investment of government funds into such organizations can be looked at economically as being public policy.

Infrastructure needs to be created for the development of new industries, such as the environmental industry, and new products, such as electric vehicles. However, this infrastructure is difficult to realize under normal competitive market conditions given the externalities present in the market and Increasing-Returns-to-Scale. Accordingly, I believe that the government must play a certain role in creating infrastructures for new industries and products at the development stage.

Discussion

— Prof. Yoshino

In the discussion so far, nine topics have emerged:

- (1) the creation of fair standards in each country;
- (2) the effective utilization of the retired;

- (3) supply-side development;
- (4) human resource development/education;
- (5) the strengthening of fields such as the agriculture; services, and financial industries, which are weak in Japan;
- (6) the creation of effective exchange policy;
- (7) the way government support should be;
- (8) initiatives for growth in Asia; and
- (9) support for eco-technology from the government.

— Dr. Gitlin

I have three things to say. One, the new party in power is now fighting with the bureaucracy in the belief that they have to change things, and maybe that is right, but it is absolutely the wrong time for the elected government and the bureaucracy not to be cooperating on what the right policy should be. Two, the U.S. will be restored because we are entrepreneurial and accept failure. In these transition times, people must be encouraged to take risks, not the opposite. Third, financial distress is an opportunity to reform companies.

— Mr. Takita

There exist industries which need government intervention. The government, the administration, and businesses need to tell each other what they each need. We also need to think about how to follow-up on entrepreneurs who fail or make a mistake. I think that industrial policy will be put to good use when we start thinking of pinches like the financial crisis as opportunities for change.

— Mr. Nishiguchi

The creation of new business enterprises and the mental state of entrepreneurs are two sides of the same coin. However, Japan is decidedly lacking in its ability to create new business enterprises. Rather than killing things before they begin, we need a social environment and structure and government policies that can foster new enterprises.



— **Prof. Yanagawa**

The government should exercise greater leadership on industrial policy. The government and administration need to present a direction for the country as a whole. We need a framework through which the unemployed, those who have failed at business and those looking to change jobs can look for new work with peace of mind. We are in an era in which there is competition to become the international standard. Industrial policy should work to encourage Japanese businesses to aggressively enter into potential markets in Asia and set product standards.

— **Dr. Kobayashi**

Wouldn't things be better if the entire government was responsible for industrial structure rather than it just being under the jurisdiction of individual agencies? Japanese financial techniques lag far behind the rest of the world, but there is still time to work to catch up. The walls between manufacturing and finance, and scientific and academic industries, create barriers to entry for superior human resources into high-added-value fields. Lenders need to create more friendly bankruptcy laws. We need to create an adequate safety net for those whose businesses fail.

— **Dr. Gitlin**

When you maintain a nonviable company with government support, directly or indirectly, there are two

consequences. One, it makes it more difficult for a viable company to compete because they must lower prices to survive. Two, you trap valuable assets in a company that cannot invest enough.

If you have an industrial policy that broadly allocates money on the theory that you are preserving employment, you are supporting an uneconomic situation, and you should be encouraging just the opposite, reducing it to an economic situation where, again, people can get to a point where they can invest in their future.

— **Mr. Henrot**

If you are too debtor-friendly in your legislation, you will have problems as we have. It is a bad choice in the long run to say that banks can wait to be repaid and that companies should be bailed out. The companies who have benefited from these protections very often fall sick again. It is fine to support debtors to a certain limit, but after that you are going to have a credit crunch.

— **Mr. Broich**

In the years to come, while economies like Japan and Germany will have to learn to adopt the culture of failure from the United States, the United States on the other hand will have to learn a different approach in which policymakers talk to industry and bankers and work in a more coordinated way to bring the economy forward.