Strategic Sectors: Conceptual Imprecision and Debates on the Role of the State in the Economy

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Summary

Defining what Strategic Planning (SP) is in political debates is not easy; on the contrary, it is ambiguous. However, the word suggests that it is of great importance to the nation for economic or security reasons. In this sense, security policies aim to prevent or confront war to guarantee the existence of the nation. Linking the debate on the existence of strategic sectors or resources with this security perspective seeks to provide a sense of urgency and justify the use of costly and extraordinary means. Another question arises from the need to know whether the State should intervene with public funds to prevent the bankruptcy of private companies, due to their supposed “strategic” nature. Likewise, it is key to analyze state ownership and the participation of foreign capital in strategic sectors. Finally, it is imperative to evaluate the idea that a country should promote and protect its strategic sectors, applying protectionist trade policies without producing armed conflicts.

Keywords: Strategic Planning, Strategic Sectors, Debate, Security Policies, Economic Efficiency, War, State Ownership, Industrial Policies.

Introduction

Strategic Planning (SP) is a crucial phrase in the field of business management that, according to some experts in the field, it would be better not to pronounce when talking about the State. A key author in this stream of business literature was the Chinese general Sun Tzu. The implicit paradox becomes evident when we evoke his work called The Art of War, a state activity par excellence. However, unlike game theory, where the word “strategic” has a precise meaning,¹ the use of the term in political debates is often ambiguous. In this context, the word suggests that the area of activity is of great importance to the nation for economic or security reasons.

It also becomes a substitute for the realistic perspective in international

relations on state security, which is based on the conception of war, contained in the aforementioned text of Tsun Tzu, stating that “the art of war is of vital importance to the nation. It is a matter of life and death, a path that leads to safety or ruin”. In this way, security policies are intended to prevent or confront war. In case of having to face it, its objective is to obtain the achievement of the established ends. These, in descending order of importance, guarantee a country’s existence, territorial integrity and ability to take autonomous action.

Therefore, from this perspective, linking debates on the existence of strategic sectors or resources is intended to provide a sense of urgency and justify the use of costly and extraordinary means. For example, during the COVID-19 pandemic, Donald Trump, the former president of the United States (US), called himself a “wartime president” to validate the measures he implemented.

Likewise, he invoked the Defense Production Act, adopted in the 50s, during the Korean War, to force the General Motors (GM) company to provide clinical ventilators to the US federal government. That is, it coerced a private company to manufacture goods that it did not produce, in a term, quantity and price established by the government of that time, which would become the sole buyer. Such a situation was incompatible with a market economy under normal conditions. However, negotiations continued. Trump said, “negotiations with GM about its ability to provide ventilators were productive, but the fight against the virus was too urgent to allow the hiring process to run its normal course”.

Although there is no agreement on what defines a sector of the economy as strategic, as suggested in the example above, it is also not true that

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this concept is completely arbitrary. Even someone who does not accept the existence of strategic sectors could, at least in principle, agree that a pandemic implies a serious risk to the economy and public health, since it would be the sustenance regarding the use of a large amount of economic resources, as well as the implementation of various measures to combat it.

Another example was the explanation offered by another Republican administration in the US for endorsing state intervention in the economy, in order to bail out – with public funds – private lenders during the 2008 financial crisis. In the words of then-Treasury Secretary Henry Paulson about the rescue of two mortgage lenders, Fannie Mae, and Freddie Mac, these “are so large and so intertwined with our financial system that the bankruptcy of any of them would cause a great shock in the financial markets here at home and around the world. This shock would directly and adversely impact household wealth (...). And bankruptcy would be detrimental to economic growth and job creation; That’s why we’re taking these actions today”.

That is, Paulson justified this action by claiming that the failure of these entities would have a systemic effect on the global economy; however, this argument ignored the problem of moral hazard. In this context, the financial services company, Lehman Brothers Holdings Inc., was bankrupted, arguing that its rescue would amount to rewarding an investment bank, whose conduct incurred reckless risks, and punishing – as a consequence – the banking entities that acted within the law.

Even if it were accepted that state intervention is necessary to prevent the systemic effect of a bankruptcy, it is necessary to reflect on the moral hazard it would cause. In the nineties of the last century, for example, Sweden bailed out private banks with public funds, but inflicting a cost on shareholders and executives, a provision that led to their bankruptcy. In these circumstances, the Swedish government acquired ownership of the

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banks at their market value, which, due to their insolvency situation, was quite low. It then assumed the cost of the unpaid loans and recapitalized the financial institutions with public funds and, once their finances were cleaned up, privatized them, in order to recover most of the state funds used for the rescue.

Although it could be argued that the bailout of publicly funded private companies in the US did not adequately address the moral hazard problem, the argument that the state should try to avoid danger to the system remains valid. Therefore, it could be argued that those companies, whose bankruptcy could pose a systemic risk, constitute a strategic sector of the economy. However, the controversy surrounding the existence of strategic sectors is not only due to the conceptual imprecision with which they are defined, but also to how it relates to debates on the role of the state in the economy.

**First Debate: State Intervention in Private Companies**

The first discussion addresses the premise regarding whether the State should intervene, with public funds, to prevent the bankruptcy of private companies, due to their supposed strategic nature. For example, unlike other Western economies, Iceland’s government allowed its three major banks, Kaupthing, Glitnir and Landsbankinn, to fail and then went after irresponsible bankers. Many high-ranking executives were jailed and the country’s former prime minister, Geir Haarde, was also tried, becoming the first world leader to face criminal trial stemming from the financial crisis.

**Second Debate: State Ownership and Foreign Capital Participation in Strategic Sectors**

A common assumption is that if a sector is important to a country’s economy or security, the state should have ownership over it. It is no coincidence,
for example, that in 2005 the three largest companies in the hydrocarbon sector, worldwide, belong to developing or post-communist nations, such as Aramco of Saudi Arabia, Gasprom of Russia, and the National Oil Company of Iran. However, Margaret Thatcher’s Conservative government in the UK changed the nature of this debate by arguing that a sector of the economy could be strategic without being owned by the state. In addition, it allowed the participation of foreign capital in privatized companies; even in sensitive sectors for national security, creating the so-called “Golden Shares” as a special regulatory mechanism. These transactions gave the United Kingdom the right of veto over certain corporate decisions related to ownership, such as capital increase, acquisition, or merger with other companies. In certain situations, the aim was to prevent advanced technology corporations in the military field from being bought by nations perceived as hostile or by foreign companies rivaling British industry.

Third debate: Role of the State and Industrial Policies

Should the State have public policies that benefit a sector because of its importance for the economy or security of a country? These guidelines may include credits on preferential terms, such as: subsidies, tax or tariff exemptions, or export and investment controls. For example, South Korea decided that its country’s economic development should be based on the export of industrial products with high added value, which is why it implemented industrial guidelines designed to achieve this end.

Moreover, as in other countries, similar objectives were pursued through the expropriation of private companies or the allocation of resources to market forces. In Peru, for example, a supporter of the market economy such as Carlos Boloña Behr, former Minister of Economy in the government of former President Alberto Fujimori Fujimori, had no problem allocating public resources to prevent the failure of private banks and explained his behavior based on systemic risk. In this sense, it is a question of great topicality, following the recent decisions of some of the main economies of the world. Verbigracia, in the supply chain of an iPhone participate firms
from different parts of the world. From those that provide inputs to those that design the product, through the assemblers. Until a few years ago, the chain was established mainly based on a criterion of economic efficiency; That is, whoever was able to offer a better product, or a lower price managed to become a link in the process. However, supply chain disruptions as a result of the pandemic and the war in Ukraine forced governments of the world’s major economies to increasingly subordinate efficiency as a criterion in favor of more resilient supply chains less dependent on political rivals.

Another case is Taiwan, which concentrates around 90% of the world’s production of advanced microprocessors, which shows a political vulnerability if these inputs are paralyzed, due to the conflict between China and the US. There is also concern that, according to a report by the International Energy Agency, China has a large proportion of the international capacity to process and refine the so-called “rare earths”, a crucial resource for the development of renewable energies.

On the other hand, China, the US, and EU countries are adopting industrial policies that seek three objectives: to produce at the national level part of what was previously imported, to diversify the sources of supply of those components that are not feasible to produce domestically and to reduce dependence on their rivals. This implies the adoption of industrial policies in favor of local companies or nations that are not considered as a source of economic or political risk. For example, the main beneficiary in Latin America of these measures would be Mexico, which has a free trade agreement with the US and is integrated into a supply chain that supplies the Aztec nation and is not considered a political rival. These policies deliberately introduce distortions into international markets in order to have supply chains that are more resilient and less dependent on political rivals, but at the cost of being less efficient in economic terms.

Judging by past experiences, these types of strategies involve certain risks. By applying them, large economies simultaneously fail to achieve their initial purpose, or the economic cost is exorbitant. For example, during the Great Depression in 1929, most major economies tried to compensate for weak domestic demand by exporting to their trading partners. To do this, they resorted to strategies such as devaluing their currency or adopting protectionist measures. However, since they all adopted the same measures, they neutralized each other and did not achieve the desired effect, worsening the international recession. This experience explains the Bretton Woods agreements after the Second World War, with the aim of promoting cooperation in times of crisis.

US President Joe Biden signed the Inflation Reduction Act on August 16, 2022. This law aims to lessen the environmental impact of economic growth by providing incentives for U.S. industry to implement sustainable energy sources and cleaner technologies. However, nations allied to the North American country see these incentives, which include subsidies and tax breaks, as a form of unfair competition. It is worth mentioning that only companies that carry out part of their production in the US or in territories with trade agreements can access these benefits, excluding the European Union (EU), the United Kingdom and China.

The proof that these benefits are perceived as a source of unfair competition in the EU is the joint pronouncement of the governments of Germany and France entitled “For a European Green Industrial Policy, a Franco-German contribution”. It argues that existing state aid rules could be made more agile in the area of transformational technologies; that is, those that would allow the transition towards environmentally sustainable growth. Targeted

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11 Ibid.
subsidies and tax exemptions are also added, as well as the implementation of EU trade policy to preserve the common market from distortions that come from countries that are not market economies, in order to ensure a level playing field. Although the emphasis is on China, this proposal also targets the US, as evidenced by the fact that the finance ministers of Germany and France were in Washington to discuss the implications of the Inflation Reduction Act. In this regard, the German news agency DW titled its report on the subject: “France and Germany travel to the United States to avoid a trade war”.

In order to avoid a commercial conflict with its own allies, it is also prohibited from exporting advanced microprocessors to China, as well as the means and technology to produce them if they have intellectual property or components from US companies. In other words, in addition to implementing policies that give U.S. companies a competitive advantage over those of their allies, the latter are required to stop doing business with a country whose imports account for about 50% of world trade in certain types of microprocessors. Although in the short-term companies with headquarters in these countries can only apply these sanctions, it is assumed that, in the long term, they will try to produce the same goods without US technology or components to avoid the effect of the sanctions and continue trading with China. In fact, there is a precedent in the satellite industry: after the US introduced export controls to the Asian giant in 1999, European companies began to design satellites free of US components to evade the effect of the aforementioned penalties and continue trading with the eastern country.

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12 Ibid.
13 Ibid.
14 DW, “Francia y Alemania Viajan a Estados Unidos para evitar una guerra comercial”, Deutsche Welle (February 6, 2023), https://www.youtube.com/watch?v=iRAdiCROStw
Fourth debate: The role of the State in the economy and the risks of protectionist trade policies

The idea that the state should promote or protect these sectors can lead to the adoption of protectionist trade policies. Historically, it was considered to achieve self-sufficiency in “strategic” resources from a geopolitical perspective and, in this way, avoid relying on potential rivals as sources of supply. However, this can increase the likelihood of armed conflicts between nations. Eugene Staley warned in 1939 of the dangers of protectionist trade policies, arguing that if the countries that control most of the world’s resources did not maintain economic relations with the rest they would be “sowing the seeds of unrest and war”.16

That is, in an international economy where significant restrictions on trade prevail, nations whose growth depends on access to natural resources, could seek them through military means. In contrast, in an open international economy, it could be accessed through trade. The contrast between Japan’s expansionist behavior, before World War II, and its peaceful management, at the end of this war, can serve as an example of this. However, when the COVID-19 pandemic hit, most international powers banned or restricted the export of medical or medicinal equipment and then hoarded, in their initial stage, the supply of vaccines.

In addition, the vast majority of developed countries opposed, in the World Trade Organization (WTO), the proposal of India and South Africa to temporarily exempt developing countries from patent rights given the health emergency, which is under the protection of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement) or, TRIPS, signed in 1994.17

Finally, when the war in Ukraine began, the world’s supply of food and fertilizer was temporarily restricted. In this context, in anticipation of a possible international shortage, India decided to limit its own exports, which meant a supply restriction. This fact shows that the States that take this type of action consider that the goods are of a strategic nature.

Conclusions

Although the term “strategic” may have an imprecise meaning in political debates, its understanding is crucial for the nation for economic and security reasons. In the case of security, the main objective is to prevent or confront war in order to guarantee the existence, territorial integrity and autonomy of a country. There are various debates about the role of the State in the field of economics, such as its intervention with public funds to prevent the bankruptcy of private companies and the control it may have over certain important sectors such as energy, transport, communication, and others, which have advantages and disadvantages. On the one hand, it can be guaranteed that these items are managed efficiently by optimizing the use of resources; However, among the main shortcomings are the lack of innovation and competition in the market. There is also discussion about the convenience of maintaining dominance over a strategic sector without it constituting state property. However, these well-intentioned actions can lead the government to implement protectionist trade policies that promote the risk of triggering armed conflicts. Consequently, an open economy is proposed where trade is self-regulating and international rights and agreements are respected.

About the author:

Farid Kahhat Kahatt holds a Ph.D. in Government from the University of Texas at Austin. Currently, he is a professor of International Relations at the Diplomatic Academy of Peru and the Pontificia Universidad Católica del Peru, as well as a columnist on international issues for the newspaper El Comercio and the website of the magazine América Economía. He has been
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