Industrial Policy: From Ideology to Pragmatism

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Ideological oppositions to industrial policy I

• “There are no theoretical justifications for industrial policy”. (‘Getting the prices right’).

• But myriad justifications
  • the infant industry argument (can be strengthened with Arrow’s learning-by-doing argument)
  • various Neoclassical theories of market failure, especially those related to knowledge generation and the capital market
  • ‘Interdependence’ arguments: Big Push, Linkages
  • Theories of collective productivity and innovation: industrial districts, National Systems of Innovation, industrial commons
  • Oliver Williamson’s theory of asset specificity can be developed to justify investment cartels or ‘defensive’ industrial policy (e.g., coordinated capacity cuts)
  • even the Austrian theory of tacit knowledge may be re-formulated to justify industrial policy
Ideological oppositions to industrial policy II-1

• Industrial policy is a uniquely East Asian. (“Industrial policy: It can’t happen here”, Badaracco & Yoffie, Harvard Business Review, 1983)

• Successful industrial policy experiences not confined to East Asia
  – national industrial policies in France, Finland, Norway, and Austria
  – regional industrial policies in Italy and Germany
  – industrial policy under another name in the US through government R&D funding
    • between the 1950s and the 1980s, the US federal government financed anywhere between 47% and 65% of national R&D spending, as against around 20% in Japan and Korea and around 30% in Europe.
In the 19th and the early 20th centuries, all of today’s rich countries, except for the Netherlands pre-WWI Switzerland, practised protectionism and other forms of industrial policy (subsidies, state-owned enterprises, regulation on FDI, investment in infrastructure).

– Interestingly, Britain and the US – the supposed homes of free trade – had the world’s highest levels of tariff protection during their respective catch-up periods.
BAD SAMARITANS
THE GUILTY SECRETS OF RICH NATIONS & THE THREAT TO GLOBAL PROSPERITY

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Ideological oppositions to industrial policy III

• Industrial policy should be horizontal, non-targeted.

• This is a false distinction
  – *In a world with scarce resources, targeting is inevitable.*
  – In such a world, every policy choice you make, however “general” it may look, has discriminatory effects that amount to targeting (no such thing as “general” engineer or infrastructure).
  – Moreover, it is **not true that less targeted policies are necessarily better** (leakages, monitoring costs; this is exactly the argument used against universal welfare state)
  – The debate should not be on whether we should target, but how to target well.
Ideological oppositions to industrial policy IV-1

• Industrial policy is uniquely exposed to government failure, so you need an exceptional government capacity for it to work (World Bank, *East Asian Miracle*).

• Political conditions (leadership, state coherence, and state-society relations) matter, but we should not let the best be the enemy of the good.
  – In the real world, successful countries are the ones that have managed to find “good enough” solutions to their political economy problems and went on to implement policies, rather than sitting around bemoaning the imperfect nature of their political system.
Ideological oppositions to industrial policy IV-2

- Especially in relation to the ‘bureaucratic capabilities’ argument, **not true that industrial policy is uniquely difficult** (e.g., Japanese macroeconomic policy)
- Industrial policy does *not* require sophisticated knowledge of economics, as often believed (non-economists with ‘wrong’ economics ran industrial policy in East Asia)
- High-quality bureaucracies are not as difficult to build as people think (e.g., France, Korea, Taiwan after WWII).
- “**learning-by-doing**” in policy, so without trying out “difficult” policies, like industrial policy, capabilities cannot be improved
- The fact that something is “difficult” cannot be a reason not to recommend it (after all, we encourage individuals to aspire to the most difficult goals!).
Ideological oppositions to industrial policy V

- Industrial policy has become impossible due to changes in global rules (The WTO the best friend of lazy government officials?)

- WTO rules not as restrictive as believed.
  - Tariffs allowed, including emergency tariffs
  - Subsidies for environment, agriculture, R&D, regional policies, and (for LDCs) export allowed de jure or de facto
  - TRIPS constraining but not for older technologies
  - TRIMS constraining but performance requirements for local labour, technology transfer, R&D, etc. allowed.

- Bigger constraints are aid/loan conditionalities and bilateral/regional trade/investment agreements

- All these rules are ‘man-made’ and can be changed if deemed necessary.
The Pragmatic Turn I

• Once we accept that industrial policy will always exist at least implicitly and that it can work well, we can start looking for ways to make it work better from a pragmatic point of view.
  
  – In doing so, it is very important to learn lessons from real life examples ("Life is stranger than fiction").

• Pragmatic lessons that have emerged from the debate on industrial policy in the last three decades:
  
  – The importance of vision (Why are the Japanese good at making cars?)
  
  – The choice of targets important (not too far but not too close)
The Pragmatic Turn II

• Pragmatic lessons (continued):
  – The design of performance measures matter (especially the need to use export performance)
  – “Boring things” are often important (e.g., scale economy, export marketing, ‘extension services’)
  – Diverse institutional vehicles exist (‘industrial districts’, deliberation councils, development banking, socially-productive cartels, the welfare state, cooperatives, government credit guarantees)
  – Political economy problems can be reduced (e.g., avoiding capture, building consensus, building design and implementation capabilities in and outside government)