

What else has to be got right to make industrial policy effective?

Robert H. Wade

LSE

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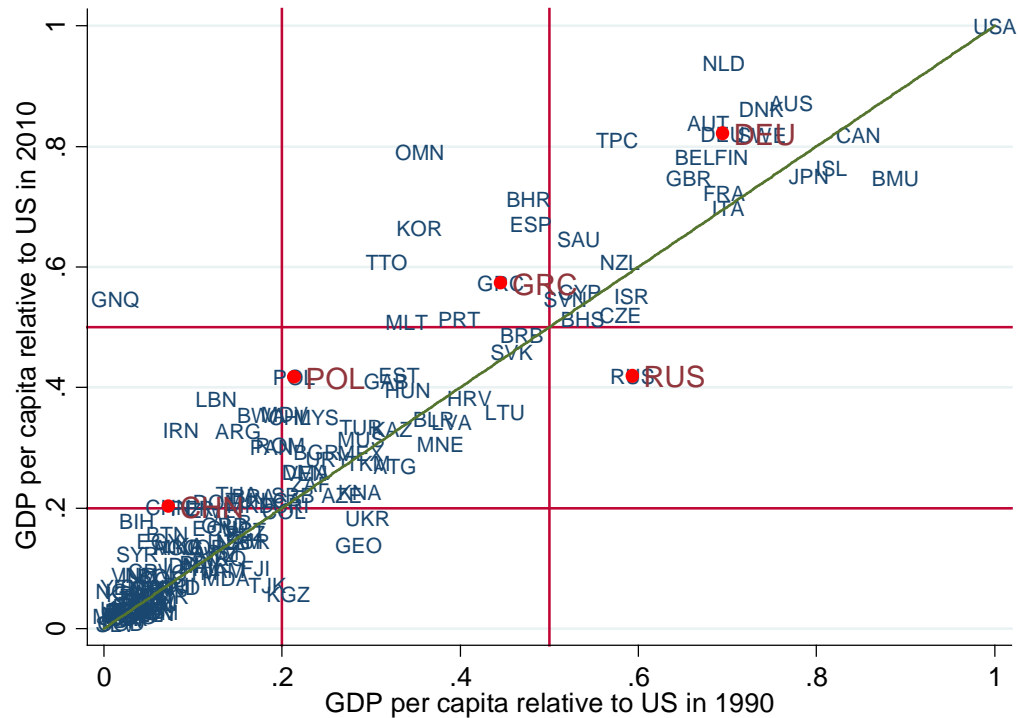
Background point (1): econ devt is difficult

- Economic development is difficult (cf neoclassical development economics)
- World Bank (2013). 1960: 101 MICs. By 2010, only 13 → HICs.
- Most were c'ies on periphery of W Europe or in E Asia

GDPPPC/ US, 1990-2010

: Poland, Russia, China, Germany, Greece, 2005

PPP \$ (Penn World Tables 8.1) Srce: Cherif & Hasanov 2015



Background point (2): share of mfg in employment & GDP

- ACs developed on back of mfg.
- For past few decades mfg has lost share of **employment** almost everywhere. Productivity growth in mfg >> consumer demand growth for mfd products.
- Hence pessimism reigns: eg Eduardo Porter, 2016, “The **mirage** of a return to mfg greatness”.
- US & West Europe, 2000-2013, lost share of global real MVA; but **share of real MVA in GDP held fairly constant** (Rodrik 2016)

	US	W Eur	China	Asia (exc China)	LAC
Share in global MVA (%)					
2000	24	16	6	24	7
2013	19	13	18	26	6
MVA in GDP (%)					
2000	13	18	29	19	19
2013	13	18	36	20	16

Industrial policy “debate” = endless repetition

- Standard economics hostile to IP; few “top” economists work on IP. Why?
- (1) Phrase “industrial policy” is toxic in standard economics. We shd replace with “productive sector policy”
- (2) **Theory** relating to IP is ambiguous
- (3) **Empirically**, causality difficult to determine, b/c difficult to find **source of exogenous variation** (eg RCTs, policy shift out of the blue eg imposition of sanctions on Russia). One can **correlate** IP with macro or micro variables, but cannot be confident of causality, b/c always alternative explanations

IP debate = endless repetition

- (4) “Top” econ journals will not publish **empirical** papers without clear source of exogenous variation. Therefore IP papers don’t get published in top journals.
- Therefore status quo prevails: standard economics remains hostile to IP, even as there is rising demand for IP expertise from policy-makers, especially since 2008

Faults in standard approach to IP

- Ignores macro variables, eg exchange rate; & international system which allows chronic trade surpluses & deficits (eg EZ)
- Focuses on supply side of national economy, underplays demand-income distribution side
- Focuses on role of state, underplays **combination** of state + more, or less, productive firms

Faults (ctd)

- IP literature not related to growth theory.
- Modern neoclassical growth theory focuses on: ideas, institutions, population, human capital. Relegates physical capital to margins, more effect than cause
- Growth models endogenize ideas, population, human capital; but not institutions (Jones and Romer 2009)

Non-IP institutions to make IP more effective: outline

- Boost companies' propensity to make productive investments: (1) dethrone "shareholder value"; (2) curb big funds' portfolio turnover.
- Make income/wealth distribution more equal without redistribution through state: spread ownership claims to the earnings of capital
- IP must target "greening GDP growth". How?

Boosting firms' productive investment:

(1) “shareholder value”

- Challenge ideology & practice of “shareholder value”
- In US & UK, “shareholder value” dominant; & influential in rest of West
- Justifies use of firm profits & borrowed funds to buy back the firm's stock → higher market valuation → higher bonuses
- Generates lower investment, higher Y inequality & permanent job displacement

Curbing “shareholder value”

- Ban stock repurchases (Lazonick 2011).
- Ban payment of bonuses by firms which do not pay dividends.
- Ban payment of bonuses & dividends out of **borrowed** funds.
- Index employee stock options to indicator of innovative performance (so executives cannot gain from speculation & manipulation of their companies' stock prices).
- Regulate employment contract to ensure that workers who contribute to innovation process share in gains to innovation.
- Impose taxes on private gains from innovation, to fund government agencies that need to invest in public knowledge base required for next round of innovation.

(2) Curb giant funds' portfolio turnover

- Standard theory: capital mkts “efficient”, asset prices “right”, therefore **time horizon of investors is irrelevant**
- Evidence that K mkts “inefficient”: higher risk goes with lower returns
- Problem lies in delegation contract b/w money fund trustees (Principals) & money managers (Agents). Contract incentivizes Agents to adopt **short time horizon**: (1) ride trends (momentum) or (2) shape portfolio so as to track market indexes (benchmarking).

Effects of asset mispricing

- Contract discourages money managers from investing to maximize **long term stream of earnings & dividends** (“fundamental value”).
- Resulting asset mispricing damages economy: (1) misallocates capital b/w sectors, (2) short-termism generates MACRO bubbles & crashes.
- Both effects curb R&D, deployment of innovations; & limit effectiveness of IP

What to do to improve K mkts?

- (1) Write **better contracts b/w trustees of giant funds (Principals) & money managers (Agents)**, so as to reduce the incentive for Agents to (a) follow trends or (b) follow benchmarks, both of which cause short-termism, discourage innovation, limit IP
- (2) **Curb portfolio turnover** (moving money w'out reference to fundamental value): eg a tax deterrent to turnover of $> 30\%$ per year.

(Vayanos and Woolley 2016)

Demand side: spreading income & wealth

- Profitable uses for capital **at home**, & therefore also employment, limited by highly unequal income & wealth distribution → limited consumption demand of small fraction of population receiving most income/wealth.

Solutions

- Solution (1): more redistribution thru the state?
- Solution (2): broaden claims on the earnings of capital
- (2) politically easier than (1)

Today, claims on earnings of capital very concentrated

- Today, 1% US population owns 40-50% of shares, 10% owns 90% (E. Wolff). **This small fraction earns income while it sleeps.**
- Most of population directly own few shares, because (1) limited savings (accrued from labor, not capital income), (2) limited collateral capacity to support borrowing to buy shares
- How to enable more people to acquire capital income (not just labor income)?

The principle of “inclusive, fuller employment capitalism”

- The more widely spread across the population are claims on the anticipated returns to capital (eg in form of shares), the stronger the incentive on investors and employers to employ capital and labor productively (Ashford 2007)

Trusts

- Company creates a tax-exempt, limited liability trust which operates as fiduciary agent for employees, customers, etc to buy shares in company.
- Trust borrows on capital mkts, & buys equity shares in the company.
- The company pays dividends to the trust.
- The trust repays the loans.
- The trust takes out capital credit insurance (Lloyds, AIG) in case equity returns insufficient to repay loans.
- Trust distributes net surplus to its members

Trusts (ctd)

- Trust idea is expansion of already-existing US scheme, employee stock ownership plan (ESOP)
- Trust could be established by the concerned company, or by mutual funds, business associations, trade unions
- Trust might cover several companies which would collectively benefit from more evenly spread consumption demand

Advantages of trusts to expand claims on capital income

- (1) Trust members **receive income while they sleep**; they have source of income without laboring
- (2) Lenders (capital mkts) want to lend to sophisticated borrowers (trusts), not millions of people with little financial expertise.
- (3) The trusts can take out capital credit insurance, so the individual trust members are not liable if the investment/ the company fails

Greening IP

- IP has to impart “directional thrust” towards decoupling of economic wellbeing from use of energy, water, minerals (& not just by shifting the burden to other economies).
- Implies innovation across all industries to reduce material & energy content of consumption & production methods → GDP growth with falling material/ energy content (European Commission 2016, Perez 2016)
- Eg 3D printing → improved inventory & maintenance, & bio-degradable composites

How to get GDP growth with falling energy/material content?

- Principle: rising long-run price of a resource induces resource-saving innovation, which raises the resource's productivity
- Question: How to give strong price signal in favor of higher resource productivity, without generating political resistance?

How to ...?

- First, measure resource productivity.
- Second, state must move resource prices *predictably* upwards (by taxes) in line with increases in productivity.
- State should announce “price corridors” rising with efficiency gains (different for fuels for vehicles, electricity, heating). Taxes and subsidies raised or lowered to keep market prices within the corridors. (UNEP 2014)

Expected results

- Predictably rising prices for energy & materials will stimulate investors, companies, research labs to make productivity-raising innovations
- Resource users don't pay more in total: they pay more for each unit, but they consume fewer units (because each unit now more productive).
- Political resistance to price rises muted

Qualifications

- For some resources (eg water, energy), “life-line” quantities must be available at low prices affordable by the poor.

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Economist magazine

- *'... governments can make use of a less risky tool: fiscal policy. Too many countries with room to borrow more, notably Germany, have held back. Such Swabian frugality is deeply harmful. Borrowing has never been cheaper. Yields on more than \$7 trillion of government bonds worldwide are now negative. Bond markets and ratings agencies will look more kindly on the increase in public debt if there are fresh and productive assets on the other side of the balance-sheet. Above all, such assets should involve infrastructure. The case for locking in long-term funding to finance a multi-year programme to rebuild and improve tatty public roads and buildings has never been more powerful.'*⁵⁰

CHINA'S SHARE OF WORLD EXPORTS OF LABOUR INTENSIVE PRODUCTS, 2010, 2014

