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Jagdish Bhagwati

Protectionism









Forever 007--SEAN CONNERY

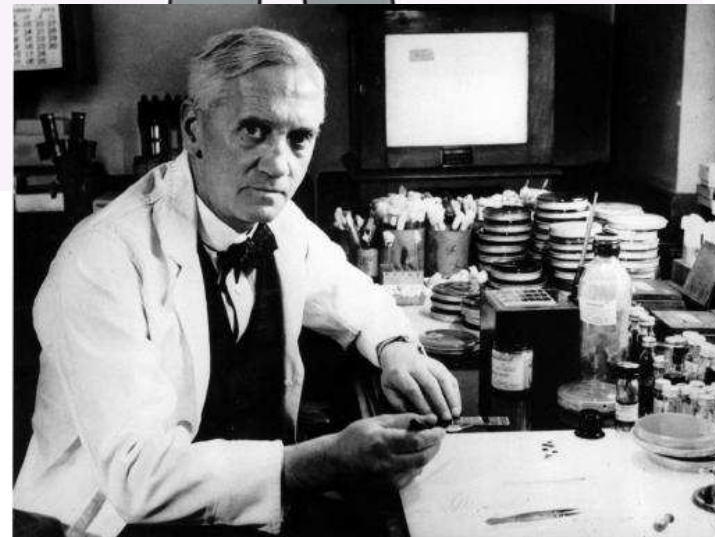




Table 1. Average Tariff Rates on Manufactured Products for Selected Developed Countries in Their Early Stages of Development
(weighted average; in percentages of value)¹

	1820 ²	1875 ²	1913	1925	1931	1950
Austria ³	R	15-20	18	16	24	18
Belgium ⁴	6-8	9-10	9	15	14	11
Canada ⁵	5	15	n.a.	23	28	17
Denmark	25-35	15-20	14	10	n.a.	3
France	R	12-15	20	21	30	18
Germany ⁶	8-12	4-6	13	20	21	26
Italy	n.a.	8-10	18	22	46	25
Japan ⁷	R	5	30	n.a.	n.a.	n.a.
Netherlands ⁴	6-8	3-5	4	6	n.a.	11
Russia	R	15-20	84	R	R	R
Spain	R	15-20	41	41	63	n.a.
Sweden	R	3-5	20	16	21	9
Switzerland	8-12	4-6	9	14	19	n.a.
United Kingdom	45-55	0	0	5	n.a.	23
United States	35-45	40-50	44	37	48	14

“The factory system would, in all probability, not have taken place in America and Germany. It most certainly could not have flourished, as it has done, both in these states, and in France, Belgium, and Switzerland, through the fostering bounties which the high-priced food of the British artisan has offered to the cheaper fed manufacturer of those countries”

(Richard Cobden, *The Political Writings of Richard Cobden*, 1868, William Ridgeway, London, vol. 1, p. 150; as cited in Reinert, 1998, p. 292).

“It is a very common clever device that when anyone has attained the summit of greatness, he *kicks away the ladder* by which he has climbed up, in order to deprive others of the means of climbing up after him. In this lies the secret of the cosmopolitical doctrine of Adam Smith, and of the cosmopolitical tendencies of his great contemporary William Pitt, and of all his successors in the British Government administrations.

Any nation which by means of protective duties and restrictions on navigation has raised her manufacturing power and her navigation to such a degree of development that no other nation can sustain free competition with her, can do nothing wiser than *to throw away these ladders* of her greatness, to preach to other nations the benefits of free trade, and to declare in penitent tones that she has hitherto wandered in the paths of error, and has now for the first time succeeded in discovering the truth [italics added]”

(Friedrich List, *The National Systems of Political Economy*, 1841 [1885 translation], pp. 295-6)

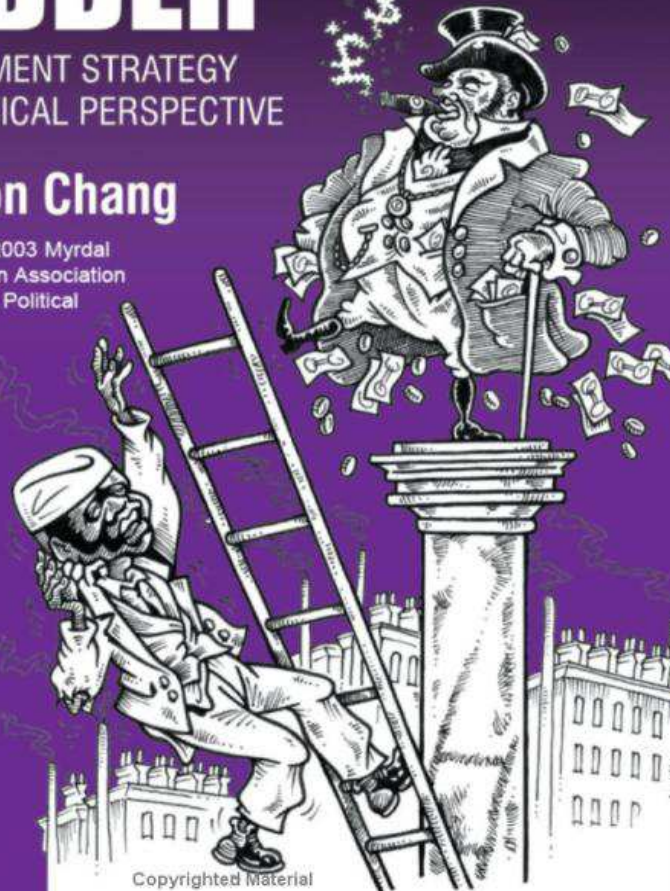
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KICKING AWAY THE LADDER

DEVELOPMENT STRATEGY
IN HISTORICAL PERSPECTIVE

Ha-Joon Chang

Winner of the 2003 Myrdal
Prize, European Association
of Evolutionary Political
Economy



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John W. Snow Secretary of the Treasury

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'Probably the world's most
effective critic of globalization'
MARTIN WOLF, *FINANCIAL TIMES*

'Lucid, deeply informed'
NOAM CHOMSKY



BAD SAMARITANS

**THE GUILTY SECRETS
OF RICH NATIONS
& THE THREAT TO
GLOBAL PROSPERITY**

HA-JOON CHANG

“Were the Americans, either by combination or by any other sort of violence, to stop the importation of European manufactures, and, by thus giving a monopoly to such of their own countrymen as could manufacture the like goods, divert any considerable part of their capital into this employment, they would retard instead of accelerating the further increase in the value of their annual produce, and would obstruct instead of promoting the progress of their country towards real wealth and greatness.”

(Adam Smith, *The Wealth of Nations*, 1776, the 1937 Random House edition, pp. 347-8).

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Trade Policy

- All of today's rich countries, except for the Netherlands and (pre-WWI) Switzerland used protectionism for substantial periods.
- Britain and USA were the most protectionist economies in the world in their catch-up periods.
- Germany, France, and Japan – the supposed homes of protectionism – were much less protectionist than Britain or the USA.
- Even in the post-WWII period, protection was quite high until the 1960s.

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Table 2 . Protectionism in Britain and France, 1821-1913
(measured by net customs revenue as a percentage of net import values)

Years	Britain	France
1821-1825	53.1	20.3
1826-1830	47.2	22.6
1831-1835	40.5	21.5
1836-1840	30.9	18.0
1841-1845	32.2	17.9
1846-1850	25.3	17.2
1851-1855	19.5	13.2
1856-1860	15.0	10.0
1861-1865	11.5	5.9
1866-1870	8.9	3.8
1871-1875	6.7	5.3
1876-1880	6.1	6.6
1881-1885	5.9	7.5
1886-1890	6.1	8.3
1891-1895	5.5	10.6
1896-1900	5.3	10.2
1901-1905	7.0	8.8
1906-1910	5.9	8.0
1911-1913	5.4	8.8

Source: Nye (1991), p. 26, Table 1.

Table 3. Average Tariff Rates (%) on Manufactured Products for Selected Developed Countries in the early post-Second-World-War Period

	1950	1959	1962	1973	1979
Europe					
Belgium	11	14			
France	18	30			
W. Germany	26	7			
Italy	25	18			
Netherlands	11	7			
E.E.C. Average ¹		15	13	8	6
Austria	18		20 ²	11	8
Denmark	3				
Finland			20+ ³	13	11
Sweden	9		8	6	5
Japan	n.a.		18	10	6
United Kingdom	23		16		
United States	14		13	12	7

Regulation of FDI

- US (19th century)
 - regulated FDI in finance, shipping, mining and logging.
 - especially in banking; only American citizens could become directors in a national (as opposed to state) bank and foreign shareholders could not vote in AGMs
- Japan (Korea and Taiwan to a lesser extent)
 - virtually banned foreign direct investment until the 1980s
- Finland
 - classified all firms with more than 20% foreign ownership as “dangerous enterprises”

State Ownership

- Important in Germany (textile, steel) and Japan (steel, shipbuilding) in the early days
- Extensively used in France, Finland, Austria, Norway, Taiwan, and Singapore in the post-WWII period
 - Singapore: 22% of GDP (Singapore Airlines and others)
 - Taiwan: 16% of GDP
 - France: Renault, Alcatel, St. Gobain, Usinor, Thomson, Thales, Elf Aquitaine, Rhone-Poulenc
 - Other examples: POSCO (Korea)

Intellectual Property Rights

- Many countries explicitly allowed patenting of foreigners' inventions.
(Britain, the Netherlands, USA, France, Austria)
- In the 19th century, the Germans mass-produced fake 'Made in England' products.
- Switzerland (1907) and the Netherlands (1912) refused to protect patents until the early 20th century (Swiss pharmaceutical, Philips).
- The US refused to protect foreigners' copyrights until 1891 (refused to protect copyrights for materials printed abroad until 1988).

Kamenev

Lenin

Trotsky



Lenin



Regulation

Market

Protection



Market



Changing Historical Tides

- Until the 20th century, some important limits to the ability of the state to intervene.
 - Small government budget (no income tax), no central bank, poor industrial and financial regulations
- Historical shifts since the 1930s.
 - Great Depression discrediting the free market
 - Success of early Soviet planning
 - Success of wartime planning in the US and the UK
 - Emergence of new institutions (income tax, central bank, industrial and financial regulations)
 - New economic theories (Keynesian economics, welfare economics)

Rise of the state in the Third World

- Latin America
 - Independent from the 1810s/20s
 - However, no tariff autonomy until the 1870s/80s due to unequal treaties
 - After the 1870s, rapid growth under protectionism (together with North America, the fastest growing region in the world between 1870 and 1913)
 - Critical boost by the ‘forced’ import-substituting industrialisation following the Great Depression and the subsequent collapse of world trade
- Asia and Africa
 - Pursued the import-substitution strategy since independence between the 1940s and the 1960s, in pursuit of economic, as well as political, independence.

New economic theories justifying state-led development

- Big Push argument (Paul Rosenstein-Rodan, Ragnar Nurkse, Tibor Scitovsky)
 - Given demand complementarity between different industries, there is a need for an ex ante investment coordination by the state, if you are to develop industries in an economy where they don't exist.
 - Critical assumption is that inputs cannot be imported and outputs cannot be exported (not an unreasonable assumption given the state of world trade then)
- Late Development thesis (Alexander Gerschenkron)
 - The minimum efficient scale of production grows over time with technological progress, so the later a country starts development, it needs to invest a higher share of its national income (self-financing in Britain, credit societies in France, banks in Germany, the state in Russia, and an even more active state in late-20th century Third World)

State-led industrialisation (SLI) a.k.a. Import-substitution industrialisation (ISI)

- The combination of these political, practical, and intellectual changes resulted in the implementation of state-led industrialisation (SLI) or import-substitution industrialisation (ISI) in most developing countries by the 1960s and the 1970s.
- The package typically consisted of:
 - economic planning (of various details and effectiveness)
 - state-ownership of key industries (especially but not exclusively heavy industries, utilities, infrastructure) and banking
 - import protection (tariffs, quotas, bans)
 - restrictions on foreign investment (usually portfolio investments were banned, while conditions were attached to direct investments, such as local contents, technology transfer, export)
 - state control over foreign exchanges
 - industrial licensing
 - control over technology imports

Attacks on state-led development

- “Get the prices right”
 - State intervention creates price distortions, producing allocative inefficiencies (Jagdish Bhagwati, Bela Balassa, Ann Krueger, Ian Little)
 - Higher distortion leads to slower growth (World Bank).
- Political Economy
 - Wrong policies are adopted because they serve the interests of the powerful (the state is not Plato’s Philosopher King)
 - Dependency theory
 - States in developing countries are controlled by those classes that are not really interested in national development
 - Neoclassical Political Economy
 - Predatory State Approach (North); Self-seeking Bureaucrats Approach (Niskanen); Interest-group Approaches (urban bias by Lipton and Bates, macroeconomics of populism by Dornbusch, Sachs, and Edwards)

Theoretical criticisms of the ‘Get the prices right’ Argument I

- A less distorted economy is not necessarily a more efficient economy, unless it is a complete free market economy (the Second Best Theorem)
- Neoclassical theory does not say that a less distorted economy will grow faster.
 - All it says is that a less distorted economy is more efficient.
 - From Schumpeter’s point of view, a dynamic economy has to have a lot of distortions (due to monopolies created by innovation), so an economy that always stays on the production possibility frontier may be efficient but not dynamic.

Theoretical criticisms of the ‘Get the prices right’ Argument II

- Impossible to define the ‘right prices’
 - Free market prices are not right prices (What you see as the right prices depends on your economic theory; welfare economics, Keynes, Schumpeter)
 - Amsden’s recommendation to ‘Get the prices wrong’)
 - Not actually possible to define a free market, as it is ultimately a political construct (“freedom of the market is in the eyes of the beholder”)
 - Child labour, environmental regulation examples
 - “The American system of free enterprise rests on the conviction that the federal government should interfere in the market only when necessary” (George W. Bush, announcing the \$700 billion TARP, or Troubled Asset Relief Program, in September 2008).

Theoretical criticisms of the ‘Get the prices right’ Argument III

- All markets are based on politically-determined institutions that regulate:
 - Who can participate (e.g., stock market listing rules; professional qualifications for lawyers and medical doctors, immigration control, social conventions; immigration control)
 - What can be traded (e.g., firearms, addictive drugs, human organs, human beings, child labour)
 - The rights and obligations of different agents in the exercise of property rights (e.g., zoning laws, environmental regulations)
 - The process of exchange itself (e.g., return of faulty products, fraud)

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THINGS
THEY
DON'T
TELL
YOU
ABOUT
CAPITALISM



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Ha-Joon Chang



Theoretical criticisms of Neoclassical Political Economy I

- Flawed assumption about human motivation
 - Ignores multiplicity and complexity of human motivation (non-selfish motives are important)
 - If we are all as selfish as assumed in neoclassical models, the world will collapse under the costs of monitoring and enforcements.
 - Not just a theoretical quibble
 - Bureaucratic reforms based on the theory of self-seeking bureaucrats (known as the New Public Management) have often produced negative results.

Theoretical criticisms of Neoclassical Political Economy II

- The solution, de-politicisation of the economy, is:
 - unachievable (i.e., markets cannot really become free of politics).
 - The establishment and the distribution of ‘endowments’ is a highly political exercise (e.g., the Great Plunder, the Enclosure, looting through privatisation in the former socialist countries, environmental campaign).
 - All prices have some political elements
 - anti-democratic
 - Transfer of power to unelected technocrats.