

What Motivates Industrial Policy in a Globalized World?

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The Rise of Industrial Policy

Bloomberg US Edition

Newsletter

How US Industrial Policy Is Changing the World Economy

mint Premium | INDUSTRY

Industrial policies have returned. What's new?

The Economist

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Warnings from history for a new era of industrial policy

The Rise of Industrial Policy



- ▶ Origins lie in early industrial revolution
(Hamilton, 1791; List, 1841)
- ▶ Policies that aims to change the **composition** of national economic activity
 - ▶ E.g. tariffs, subsidies, tax breaks, and more

What Motivates Industrial Policy?

1. Domestic Political Economy Considerations

- ▶ Lobbying by special interests, job creation

(Rogowski, 1990; Alt and Gilligan, 1994)

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2. Breakdown in International Political Relationships

- ▶ War, technological rivalry, great power politics

(Meunier and Nicolaidis, 2019; Miller, 2022; Bauerle Danzman and Meunier, 2023)

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(Meunier and Nicolaidis, 2019; Miller, 2022; Bauerle Danzman and Meunier, 2023)

- ▶ Lack a theory of why domestic politics allows for industrial policy

My Argument

- ▶ Breakdown in international political relationships creates a coalition between:
 - ▶ Domestic special interests
 - ▶ Policymakers concerned about foreign dependence
- ▶ This empowers special interests to make a case for inward looking industrial policy

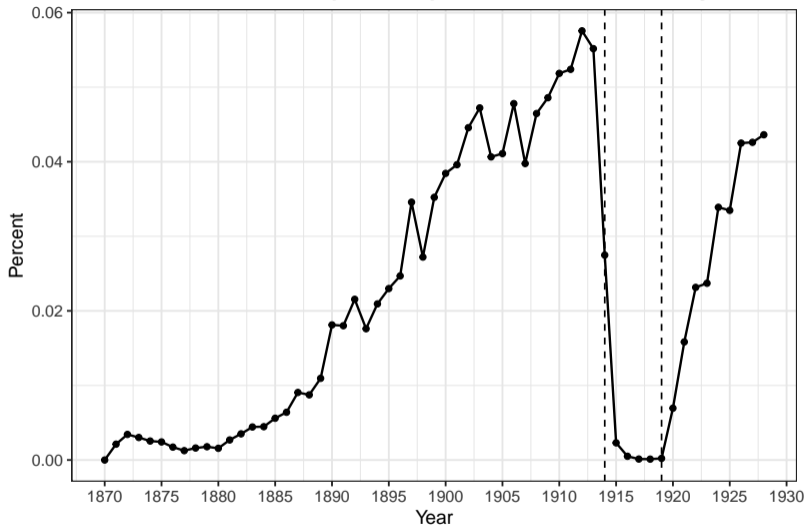
Setting: Trade Policy within the British Empire



Setting: Trade Policy within the British Empire

- ▶ British commitment to free-trade restricted tariff autonomy within the empire
(Findlay and O'rouke, 2009; Casler and Gaikwad, 2019; Bonfatti and Brey, 2020)
- ▶ Yet British dominance challenged by US, German and Japanese industrialization
- ▶ World War I resulted in a collapse of imports from Germany
- ▶ New import-substituting industries emerged in many non-belligerent countries

Share of Empire Imports from Germany



UK Share

US Share

Empirical Strategy

Hypothesis:

- ▶ Disruption of imports from Germany empowered new industries to obtain protection
(Hirschman, 1968)

Design:

- ▶ Measure import-substituting industrialization in the British Empire pre/post- WWI
 - ▶ Digitize archival data on tariff policy for 53 countries from 1910-1928

Findings:

- ▶ Interruption of German imports led to **increased protectionism** within the empire
- ▶ Early origins of imperial preferences

Treatment: Pre-War Reliance on German Imports

Import Dependence of i on product p

$$Exposure_{ip} = \frac{M_{ip,1912} / \text{Total Imports}_i}{\sum_{i'} M_{i'p,1912} / \text{Total World Imports}} \times \frac{\text{Imports from Germany}_i}{\text{Total Imports}_i}$$

German Import Share for country i in 1913

Measuring Trade Policy

The Board of Trade Journal

Vol. CXVIII (New Series) No. 1570.]

JANUARY 6TH, 1927.

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Measuring Trade Policy

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CUSTOMS REGULATIONS AND TARIFF CHANGES

SWEDEN.

Tariff Modifications.

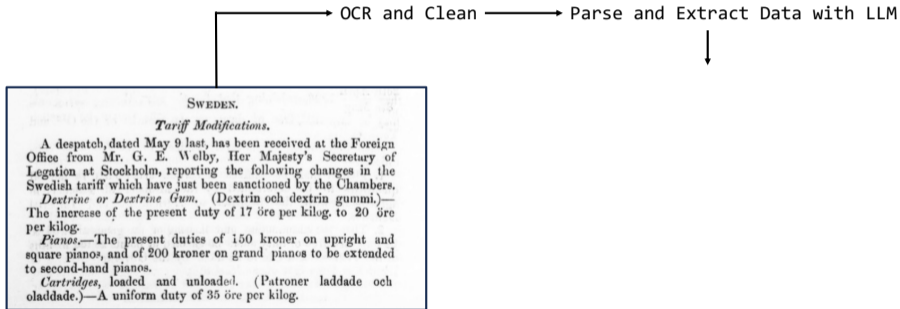
A despatch, dated May 9 last, has been received at the Foreign Office from Mr. G. E. Welby, Her Majesty's Secretary of Legation at Stockholm, reporting the following changes in the Swedish tariff which have just been sanctioned by the Chambers.

Dextrine or Dextrine Gum. (Dextrin och dextrin gummi).—The increase of the present duty of 17 öre per kilog. to 20 öre per kilog.

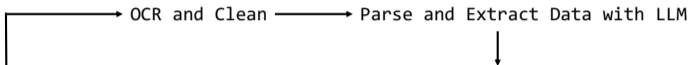
Pianos.—The present duties of 150 kronor on upright and square pianos, and of 200 kronor on grand pianos to be extended to second-hand pianos.

Cartridges, loaded and unloaded. (Patroner laddade och oladdade).—A uniform duty of 35 öre per kilog.

Measuring Trade Policy



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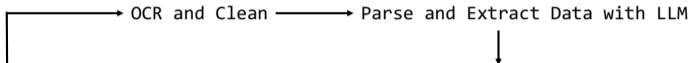
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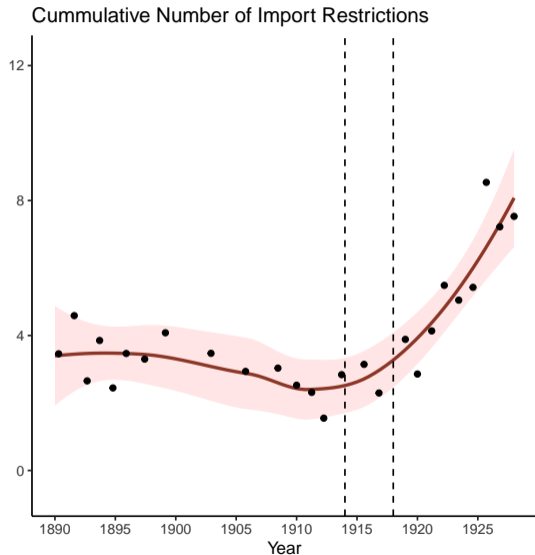
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Output: Parsed Table

Country	Product	Old Policy	New Policy	Direction of Trade Policy
Sweden	Dextrine or Dextrine Gum	17 Ore per kilog	20 Ore per kilog	↑
Sweden	Pianos	150 kroner on upright ...	Same duties extended to second-hand pianos	↑
Sweden	Cartridges, loaded and unloaded	NA	Uniform duty of 35 ore per kilog pianos	↑

Measuring Trade Policy

- ▶ $\approx 35,000$ trade policy changes from 1910-1928 at the SITC-2 two-digit level
- ▶ Measure import restrictions cumulatively over time
- ▶ Accords with our intuition for falling then rising trade barriers
- ▶ **Limitations:**
 - ▶ Only extensive margin of protection
 - ▶ Only tariffs



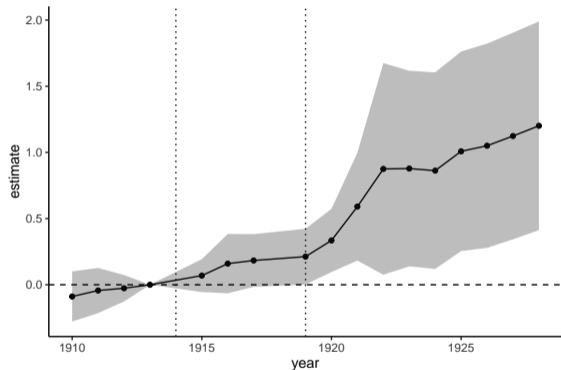
Empirical Strategy

$$T_{ipt} = \sum_{t=1910}^{1928} \left(\tau_t \text{Exposure}_{ip} + \gamma_t \mathbf{X}_i + \alpha_{c(p)} \right) \times \mathbb{1}\{\text{Year} = t\} + \phi_{ip} + \psi_t + \epsilon_{ipt}$$

- ▶ T_{ipt} is the cumulative number of import tariff restrictions by i on product p in year t
- ▶ Exposure_{ip} is the pre-war reliance on German imports for product p in country i
- ▶ $\alpha_{c(p)}$ are SITC-2 product fixed effects interacted with time dummies
- ▶ \mathbf{X}_i are country controls interacted with time dummies
- ▶ ϕ_{ip} and ψ_t are country-product and year fixed effects

Results: Wartime Import Disruption → Import-Substituting Tariffs

- ▶ Large effect on tariffs after the war
- ▶ Tariff restrictions $\frac{1}{2}$ s.d. higher for products with a unit higher exposure
- ▶ Effect largest after early 1920s



Mechanisms: How did Industries Get Empowered?

- ▶ **Mobilization of Special Interests:**

- ▶ Mobilization should be more difficult in British colonies and dominions
- ▶ Effect size much larger in British colonies and dominions
- ▶ Suggests more than just simple mobilization of special interests

- ▶ **Pure Dependency Concerns:**

- ▶ Effect no smaller in countries flooded with US and Japanese exports
- ▶ Suggests that post-war resumption of trade links did not mitigate dependency concerns

- ▶ What happened?

Piecing Together the Story

- ▶ International shocks can change policymakers' beliefs around the:
 1. Domestic viability of previously non-existent industries
 2. Degree to which industry can be trusted to provide rents in the future

Changing Beliefs About the Viability of Import-Substituting Industrialization

“...the war demonstrated the need for a local steel industry and this was a vital factor in the minds of the framers of the tariff. The fact that the industry obtained no adequate protection from the 1914 tariff shows the pre-war attitude of the legislators.”
(Forster, 1953)

Changing Relationship between Domestic Industry and the State

*“The Tata Company placed most of its output [during the war] at the disposal of the government at the controlled prices then prevailing in Britain. Though considerably higher prices were obtainable in the private market, the company chose to take a long-term view and to **build up a fund of governmental goodwill** upon which to draw in less prosperous times.”*

(Hardach, 1977)

Takeaways

- ▶ Wartime disruption behind origins of Imperial Preferences system
(Hirschman, 1968; Casler and Gaikwad, 2019)
- ▶ Industrial policy often the result of temporary shocks that empower new industries
- ▶ Empowerment occurs by creating an alliance between domestic special interests and policymakers concerned about dependence

Thank You!

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA.

TARIFF BOARD.

PIANOS AND PLAYER PIANOS.

1. That prior to 1914 the Wertheim Piano Factory was the only one of its kind in Victoria.

2. After the outbreak of war it became impossible for importing houses to continue obtaining their supplies from Germany as previously, and in consequence several of the larger houses decided to embark on local manufacture themselves or support firms who had taken up the construction of pianos.

3. The stoppage of imports during that particular period was, therefore, the direct cause of the birth of four new local piano factories in addition to the one represented by the witness.

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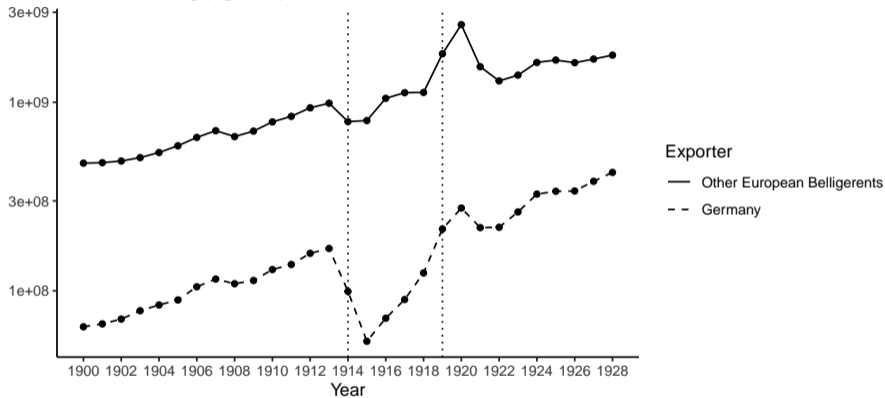
PIANOS AND PLAYER PIANOS.

Although one of the principal witnesses in favour of the request spoke most highly of U.S.A. and Canadian manufacturers and conditions, he did not ask for protection against them. The increased duties requested would operate, however, against both the countries named as against Germany, and even more severely in the case of the United States at the present time.

British Encouragement of Indigo Production

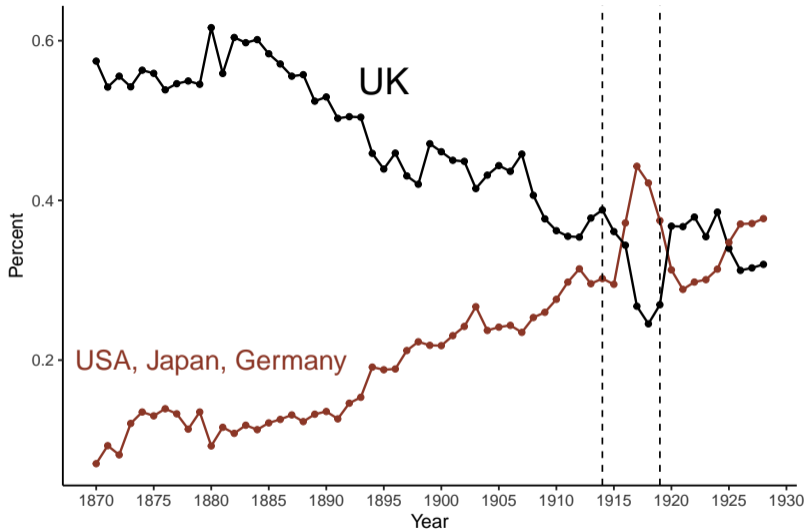


Total Exports from European WWI Belligerents
in Pounds Sterling (log scale)



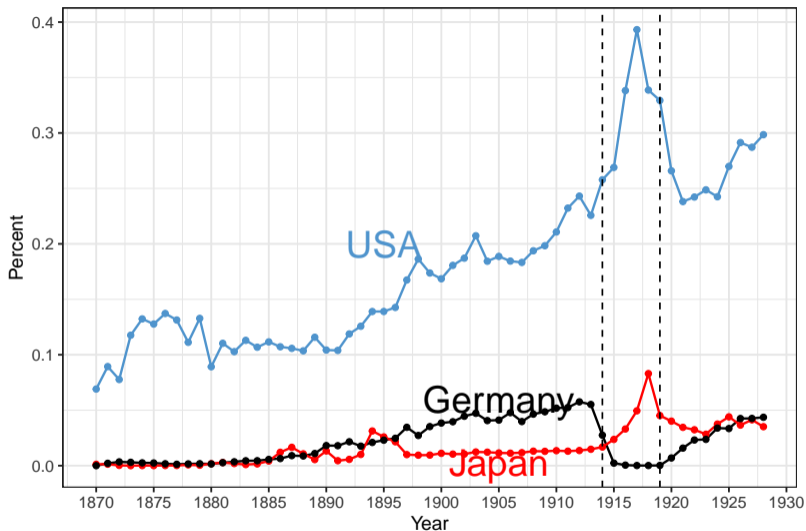
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Share of Empire Imports from UK vs Emerging Economies



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Share of Empire Imports from USA, Japan, and Germany



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