

History of Economic Thought I

6: **III**. New Science and Its Enemies (1)

Protectionists and Literary People

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Nov. 19, 2024

The Return of Industrial Policy?

The screenshot shows the IMF's Finance & Development website. At the top, there's a navigation bar with the IMF logo and various menu items like 'ABOUT', 'RESEARCH', 'COUNTRIES', etc. Below this is a large blue banner with the article title 'THE RETURN OF INDUSTRIAL POLICY' by Douglas Irwin, dated June 2023. The background of the banner is an aerial view of an industrial port with several large offshore oil rigs being assembled. Below the banner, there's a section for the article titled 'Should developing economies follow the United States and China by building national champions?'. The article text discusses the changing landscape of world trade and the debate on industrial policy. On the right side, there's a 'YOU MIGHT ALSO LIKE' section with links to related articles. At the bottom right, there's a search bar.

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THE RETURN OF INDUSTRIAL POLICY

DOUGLAS IRWIN

JUNE 2023

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ENGLISH

6 MIN READ

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Should developing economies follow the United States and China by building national champions?

Geopolitics is rapidly changing the landscape of world trade. The policy environment of just a few decades ago seems like a distant memory. During the reform period of the 1990s and 2000s, developing and transition economies opened up their markets and embraced globalization. That period saw the creation of the World Trade Organization, establishing a rules-based system of nondiscriminatory trade. It was also marked by an absence of geopolitical tensions as China focused on growth and Russia struggled with stabilization.

Now policymakers debate the future of globalization. They worry about the fragmentation of the world economy and the flouting of global trade rules. Trade interventions are on the rise, in the form of industrial policies and subsidies, import restrictions based on national security and environmental concerns, and export controls to punish geopolitical rivals and ensure domestic supply.

What should developing economies do to navigate this new environment? Should they adopt similar policies, turning inward to protect key sectors with subsidies and trade controls?

The debate about whether developing economies should step into or back from the world economy is recurrent. In the 1960s,

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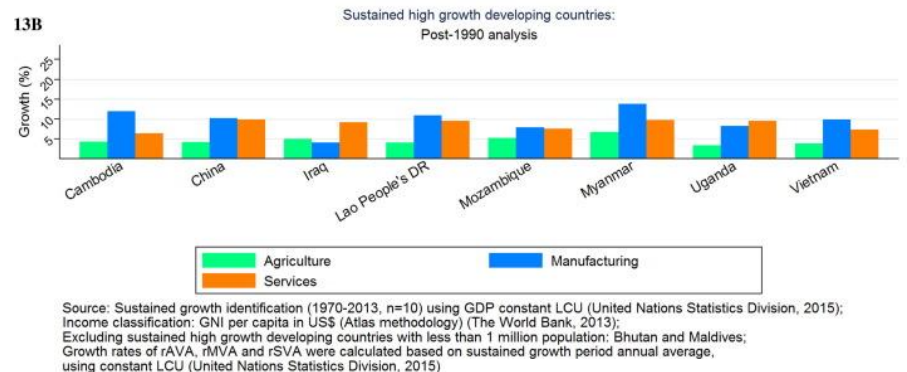
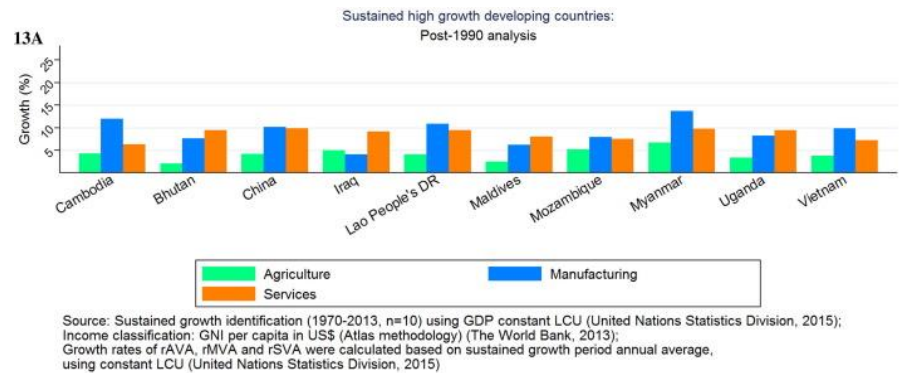
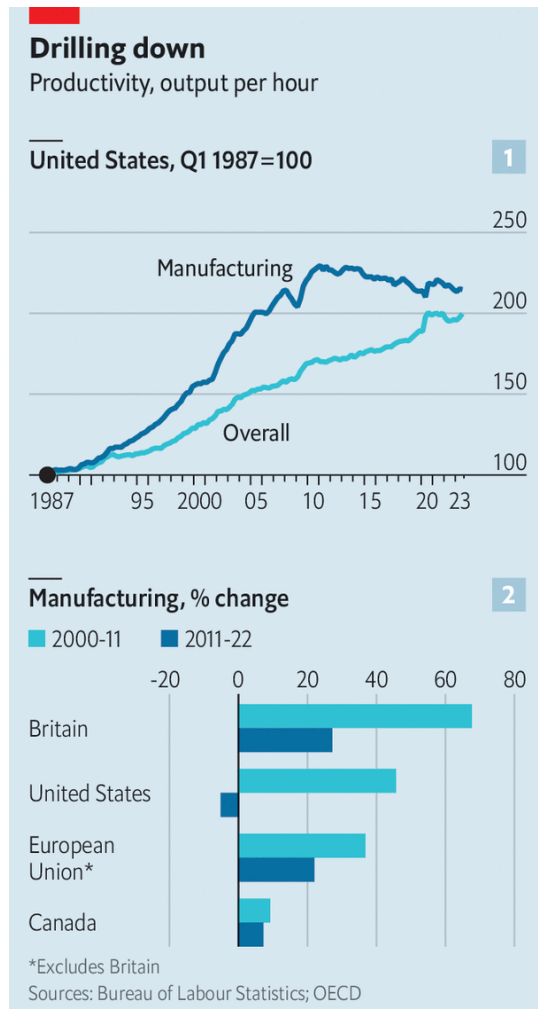
- Industrial Policy and the Growth Strategy Trilemma
- In Defense of Globalization
- Ruchir Agarwal on the Return of Industrial Policy

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Is Manufacturing Special?

https://www.economist.com/finance-and-economics/2023/11/09/why-american-manufacturing-is-increasingly-inefficient?utm_content=article-link-5&etear=nl_today_5&utm_campaign=r.the-economist-today&utm_medium=email.internal-newsletter.np&utm_source=salesforce-marketing-cloud&utm_term=11/9/2023&utm_id=1807228
<https://www.sciencedirect.com/science/article/pii/S0305750X16302613>



Key Messages for Today's and Next Week's Lectures

- Criticisms against newly emerged “New Science”: The “first heterodoxies”
- ① Protectionists: Hamilton and List
- ② Literary People: Carlyle
- ③ Karl Marx as the greatest heterodox and enemy → Next Week
- Classical responses and replies

Historical Background

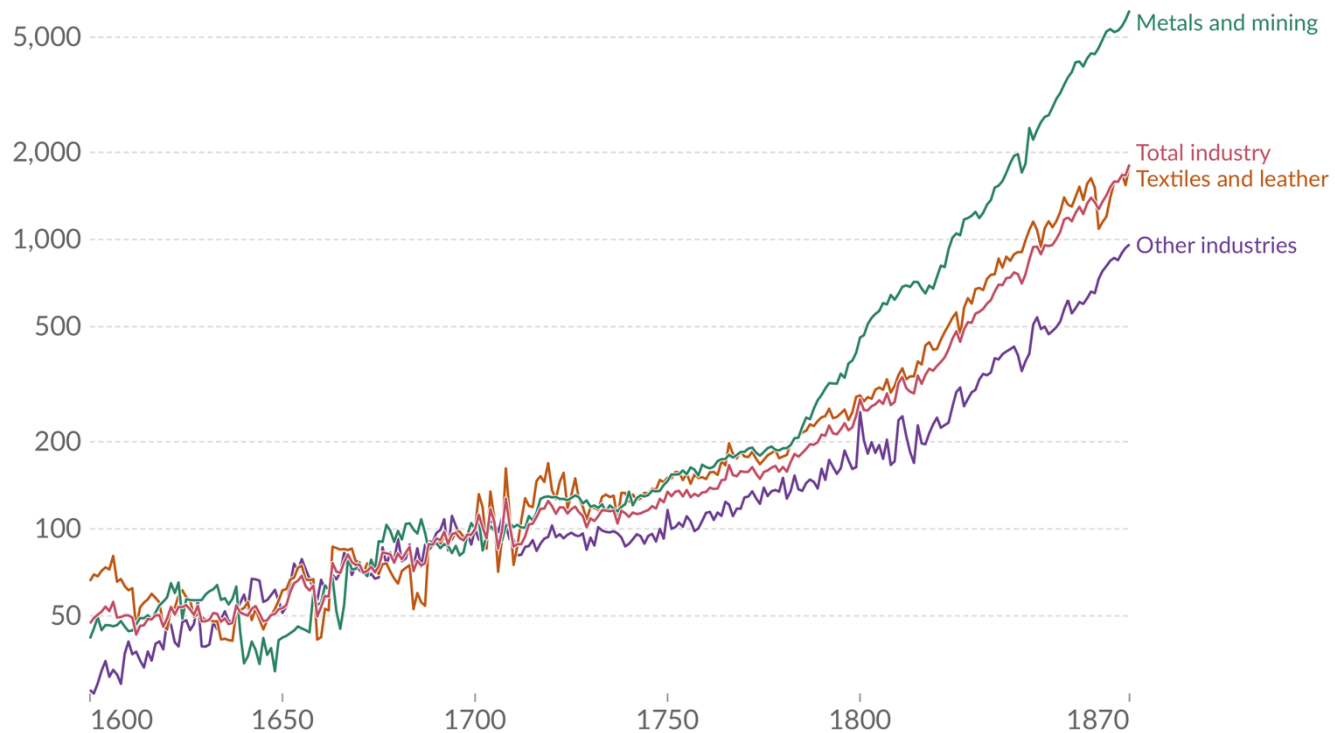
- The Emergence of Britain as the First Industrial Nation
 - Industrial revolution, modern economic growth
 - Democratization, Extension of franchise, 1832
- Catch-up by “late industrial countries”
 - USA
 - Germany
- How to understand social change due to industrialization?
 - Factory
 - Urbanization
 - Poverty
 - “The Conditions of England”

Industrial Revolution

Output of key industrial sectors in the United Kingdom, 1600 to 1870

Our World
in Data

This data is indexed to the year 1700, and shows how much industrial output was produced relative to that year.



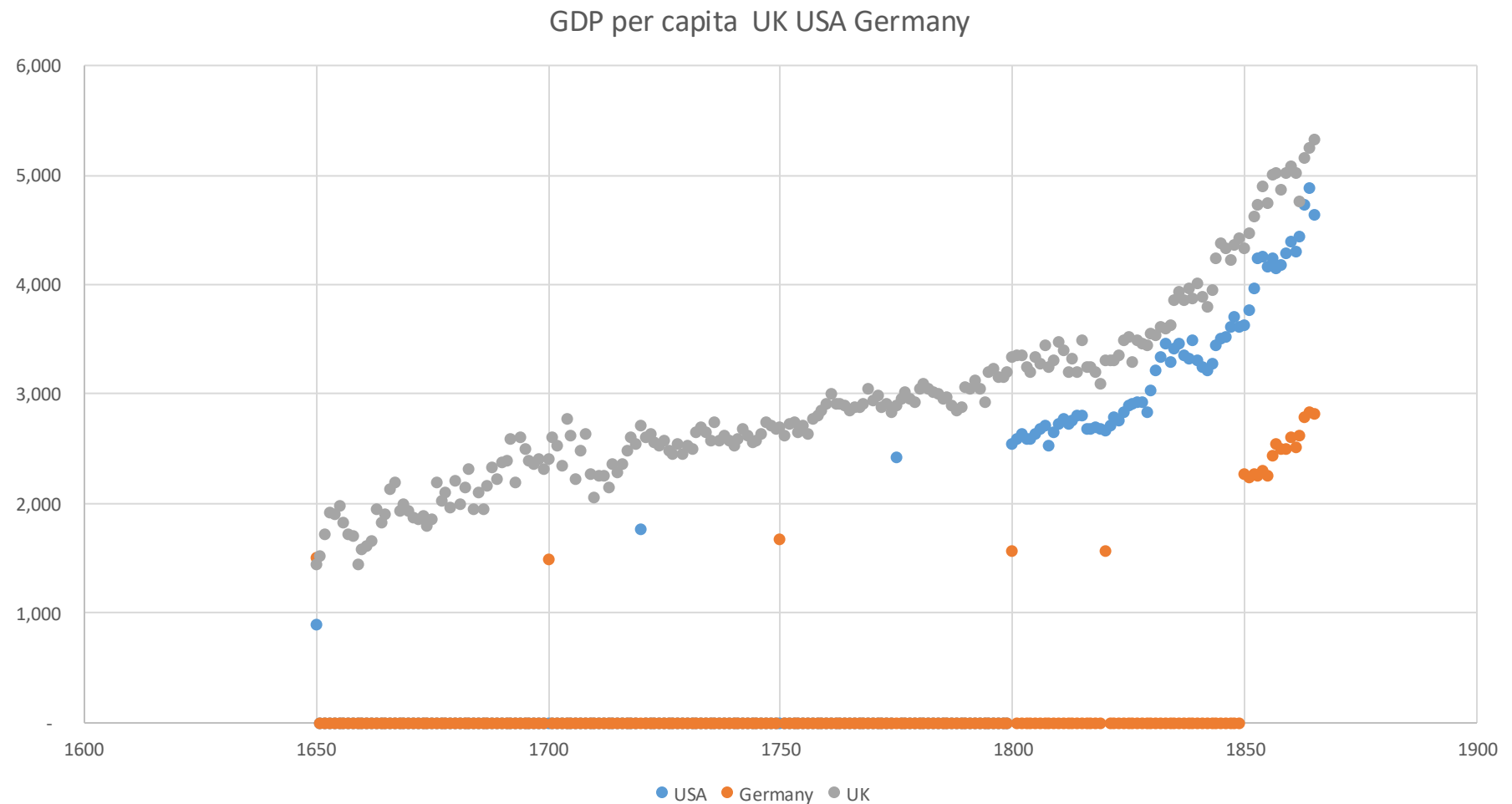
Data source: Output of key industrial sectors in England - Bank of England (2017)

Note: Data before 1700 refers to England, later data refers to United Kingdom.

OurWorldInData.org/economic-growth | CC BY

Catch-up by USA and Germany

<https://www.rug.nl/ggdc/historicaldevelopment/maddison/releases/maddison-project-database-2020?lang=en>



Fruits of Industrial Revolution: Real wages increase but diverge from real GDP per capita growth

Broadberry et al. 2015, 258

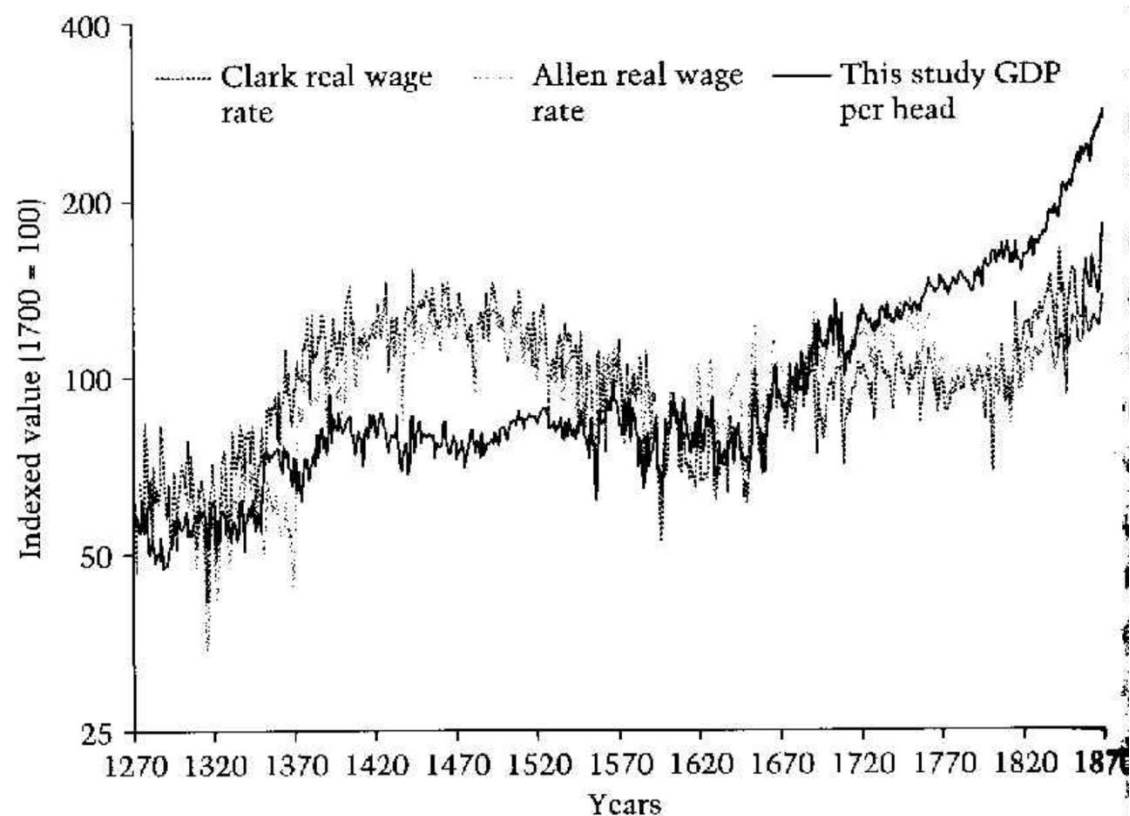


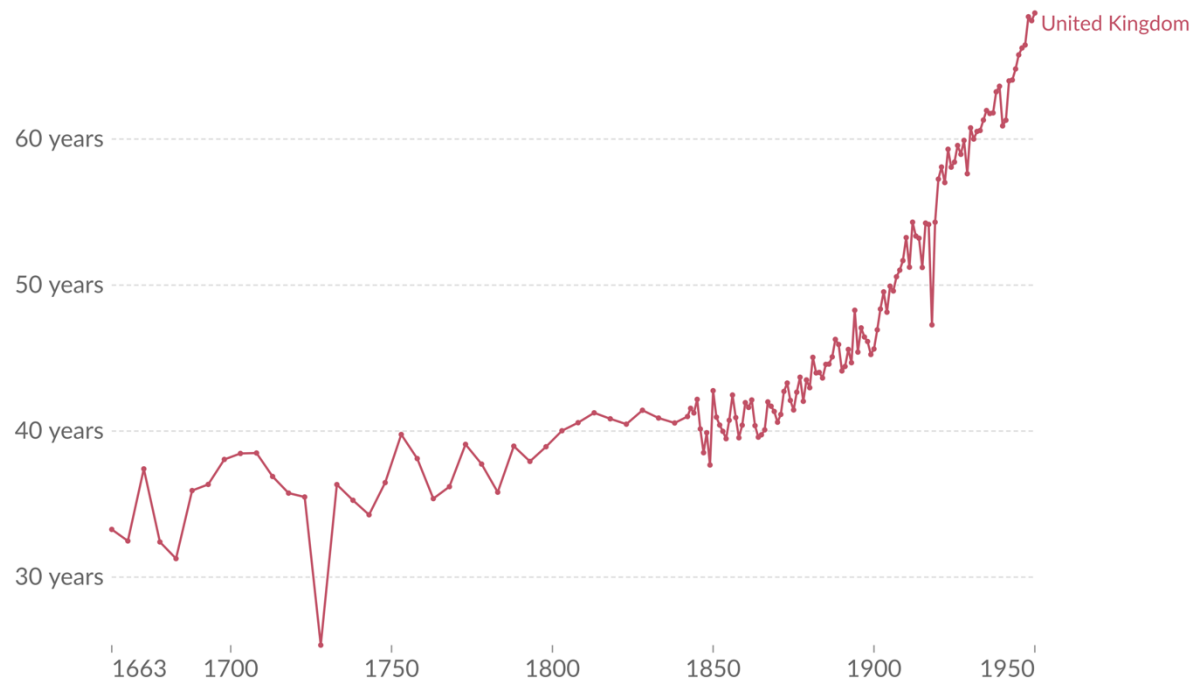
FIGURE 6.07 Daily real wage rates of unskilled building workers and GDP per head, 1270–1870 (log scale, mean of 1270–1870 = 100). Sources: Clark (2005); Allen (2001); Appendix 5.3.

But life expectancy stagnated

Life expectancy, 1663 to 1950

The period life expectancy¹ of the population in a given year.

Our World
in Data



Data source: UN WPP (2022); HMD (2023); Zijdemann et al. (2015); Riley (2005)
OurWorldInData.org/life-expectancy | CC BY

1. Period life expectancy: Period life expectancy is a metric that summarizes death rates across all age groups in one particular year. For a given year, it represents the average lifespan for a hypothetical group of people, if they experienced the same age-specific death rates throughout their whole lives as the age-specific death rates seen in that particular year. Learn more in our article: "Life expectancy" – What does this actually mean?

On free trade

- Free trade as a symbol: benefits of exchange=internal trade=external trade; importance of market as the place of trade; futility of regulation, protection and interference
- Theoretical basis
 - ① Hume, Smith: absolute advantage, “18th century rule”
 - ② Ricardo: comparative advantage
- Further developments
 - ① 3 goods model⇒Robert Torrens
 - ② Determining trade exchange ratio⇒J. S. Mill
 - ③ What determines comparative advantage: factor endowments, wages⇒Heckscher, Ohlin, Stolper, Samuelson
 - ④ Technology: Constant returns to scale⇒Increasing returns to scale: New trade theory in the 1970s (Paul Krugman)
 - ⑤ What if productivity changes depending on sectors?

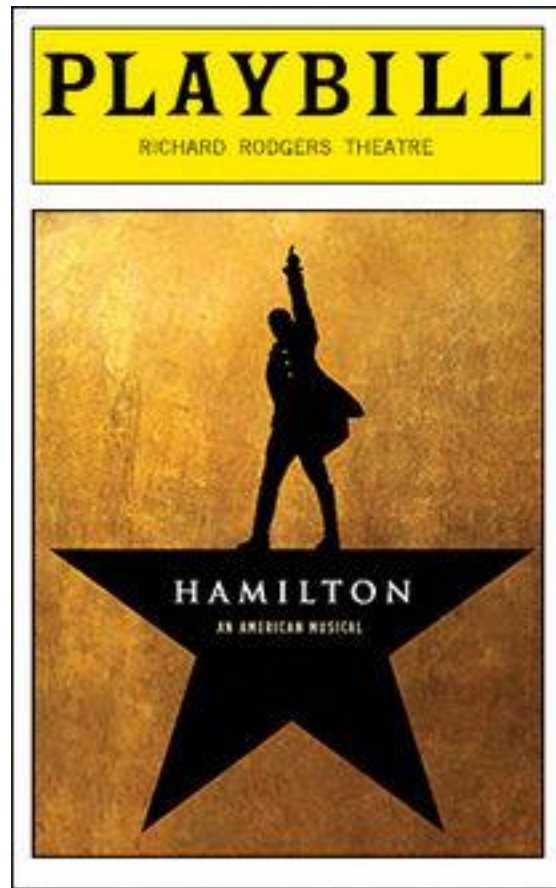
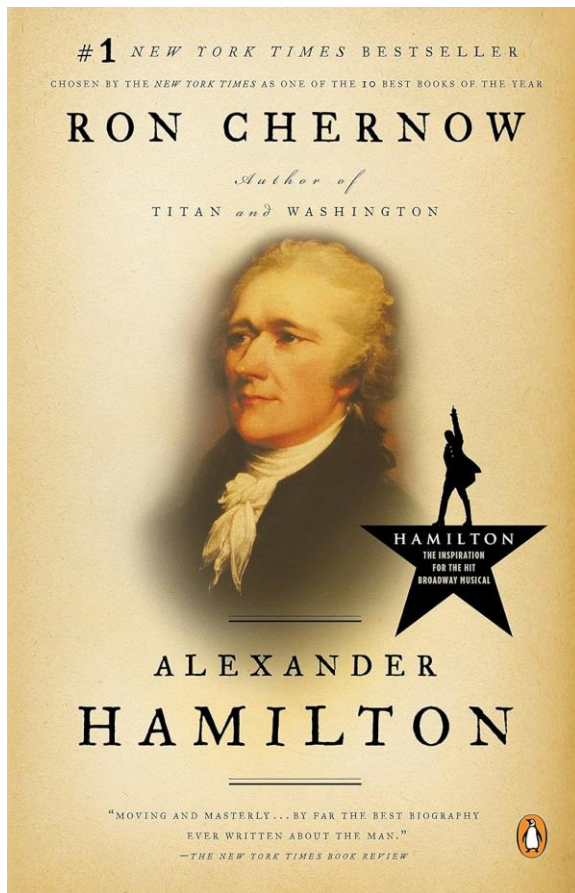
Criticism ①: Alexander Hamilton (1755?-1804)

- From illegitimate son to the first US Treasury secretary
- *The Federalist Papers* (1787)
 - With John Jay and James Madison
- *Report on Manufactures* (1791)
- Hamilton as the “First American” : Federal constitution → federal government → federal economic policy (Hamilton system)



Broadway musical, Hamilton

<https://www.youtube.com/watch?v=r1izVfVpBwE>



Hamilton System

In the economy

- 1 War time debt
- 2 Excise Tax
- 3 National Bank
- 4 Currency and Credit System
 - Mint
- 5 Manufacturing —
Revenues→Standing Army

Tariffs and Subsidies

Hamilton's Protectionism

- Inspired by Hume and Smith
 - ① Benefits of manufacturing : Smith's division of labor
 - ② Market failure : Assuming Humean human nature: people avoid new things and innovation
 - ③ Government should encourage innovation, and it will succeed
- In reality
 - Proposals for tariff adopted, but proposals for manufacturing not adopted
 - Hamilton's tariff policy was not so protectionist (Irwin 2004)

Another Hamilton System

- Rise and Fall of a Central Bank
 - First Bank of the United States (1791-1811)
 - Second Bank of the United States (1816-1836)
 - American animosity toward centralization
 - Finance and corruption
- Throughout the 19th century, frequent banking panics
 - The Panic of 1907 (Bruner and Carr 2007)
 - Dec.24, 1913: Federal reserve system established; but too decentralized

Criticism①: Friedrich List, 1789-1846

- American connection
- Success in railway
- *Outline of American Political Economy* (1827)
- *The National System of Political Economy* (1841年)
- Wide influence in Germany
⇒ Historical school
- Recently as a forerunner of European Union



List's System of "national productive power"

(1) Criticizing and Using Smith

- NO understanding of theory of comparative advantage; common to protectionist
- "stage theory of development" : Like Smith
- Nation state \Rightarrow Federation of nation states \Rightarrow World Union
- Philosophy : Free trade desirable in world union stage, but protectionism is needed in nation state stage
- History : to judge where a country stands in stages of economic development
- Policy : Free trade or protectionism? From protectionism to free trade depending on stages of development

List's System of “productive power”

(1) Theory of National productive power

- Located in temperate zone is prerequisite to economic development
 - What about the tropics?
- National productive power = Power to create wealth : more important than wealth
- Encouragement of manufacturing based on the division of labor
 - “increasing returns”
- Important to unify body (material production) and mind (knowledge production)
- Should NOT protect agriculture: imports cheap materials for manufacturing from abroad
- Even protection for manufacturing should be temporary : Needs an agile policy depending on stages of development
 - Free trade for Federation stage e.g.EU?

Assessment: Significance and Limitations

- Significance

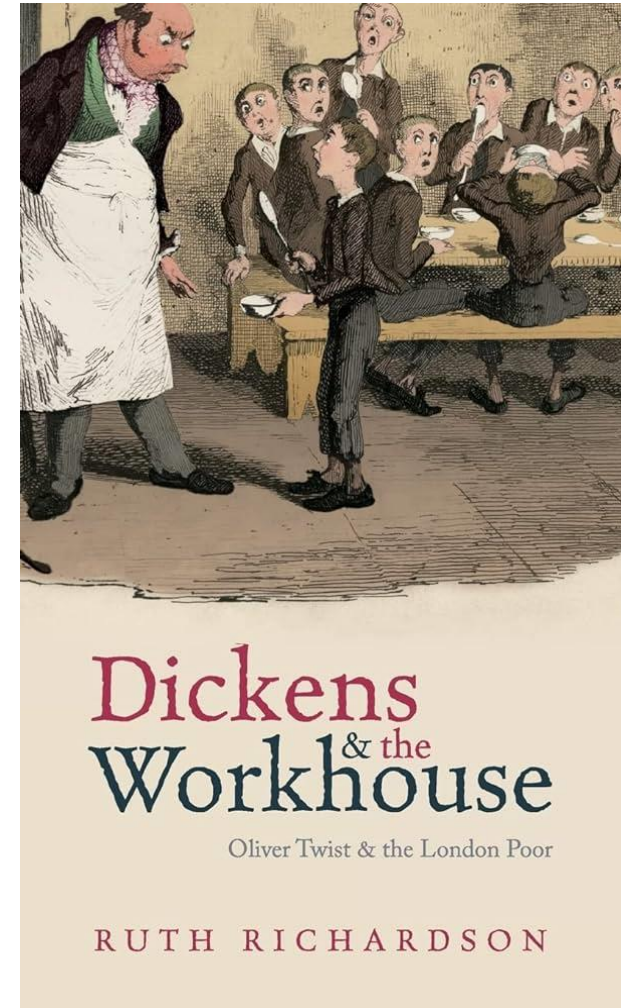
- 1 Importance of Nation state
- 2 Science and knowledge production
- 3 Manufacturing
- 4 Limited protectionism : “infant industry argument”
- 5 Importance of history and economics being history and context dependent

- Limitations

- 1 Nationalism→Hyper nationalism?
- 2 No understanding of Ricardo’s theory * Reference to Ricardo, but did not understand?
- 3 Neglecting flaws in protectionism : extremely difficult to abolish tariffs and subsidies
- 4 Imperialism : not all countries can develop→what happens to those countries which cannot develop?

Back to the UK: The Age of Reform

- Industrialization
- Poor Laws
 - 1834 : New Poor Laws
 - 3 Principles : no relief for able-bodied, less-eligibility, in-house (workhouse)
 - Benthamites, Economists
 - Charles Dickens
 - Clark and Page (2019)
- Democratization
 - 1832 Reform Act:
 - Extension of franchise (those paying house tax worth more than £10), reallocating seats (more to urban areas)
 - Others?
- Triumph of Free Traders
 - 1838: Anti-Corn Law League
 - Manchester
 - John Bright
 - 1846: Repeal of Corn Law

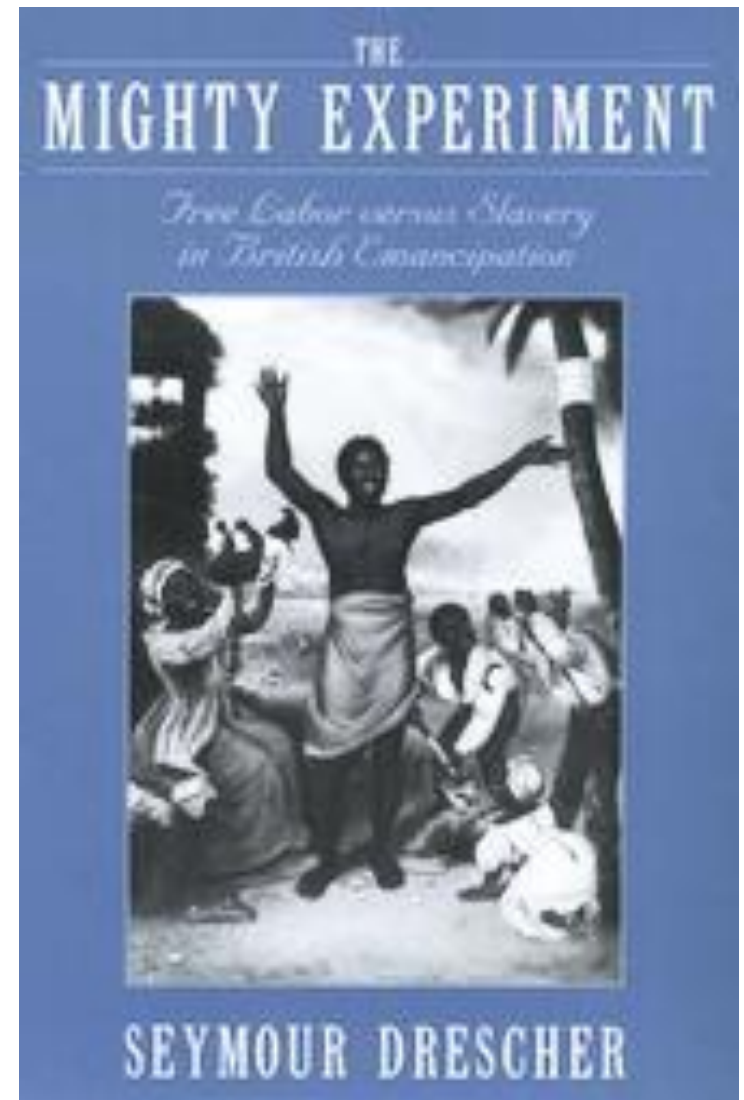


The Rise of Labor Movement and Socialism

- **1833 : Factory Act**
 - Children under 9 were not allowed to be employed in factories in textile industry, Appointment of Factory doctor, Factory inspector
- **1834** : Grand National Consolidated Trades Union short-lived
- **1838 — 48 : Chartist Movement**
 - 1838 People's Charter : voting rights for adult men, a secret ballot, annual and regular Parliamentary meetings, the removal of property qualifications, the introduction of payment for MPs
- **1848: Revolutions**
 - February : France
 - February 21 : Marx and Engels, *Manifesto of the Communist Party*
 - March : Germany
 - April : Petition by Chartists failed

Abolition of Slavery in UK

- 1788 : Shipping of slaves in British vassals regulated
- 1792 : Parliament adopted gradual abolition of slave trade
- 1807 : Britain abolished slave trade
- 1815 : Congress of Vienna adopted resolution to condemn slave trade
- 1823 : Parliament adopted motion to gradual liberation free slaves in colonies
- 1833 : UK freed slaves



Criticism②: Literary People: the Case of Thomas Carlyle, 1795—1881

- Scottish
- *Sartor Resartus: The Life and Opinions of Herr Teufelsdröckh in Three Books* (1831)
- *The French Revolution: A History* (1837)
- *On Heroes, Hero-Worship, and the Heroic in History* (1841)
- *Past and Present* (1843)
- *History of Friedrich II. of Prussia, Called Frederick the Great* (1858—1865)



The Past and the Present

- “The condition of England” (Preface, Book 1)
 - Poverty among affluence
 - Poor, unsanitary, and unhealthy poor
- Retrospectives on the past (Book 2, The Ancient Monk)
 - Samson of Bury St. Edmunds
- Solutions for the Present
 - Aristocracy by the Wise with high ethical standard
 - Organizing Labor by Captains of Industry

Its characteristics

- Contrast between the Past and the Present, Nostalgia for the Past
 - Antagonism toward progress, longing for order
 - Industrialization destroyed the order of the past
 - E.g. working condition
- Against democracy and inherited aristocracy ⇒ Aristocracy by the wise
 - An industrial society needs to recover order: “captains of industry”
- Human hierarchy : Leaders and followers
 - Sympathy and Prejudice
 - Sympathy toward laborers
 - Racism toward the Irish, native Americans, and the Negro
 - Proto-fascist? (Steinweis 1995)

Critique on Economics : How the Dismal Science Got Its Name

- Critique on Population principle?
- “The controversies on Malthus and the ‘Population Principle’, ‘Preventative Check’ and so forth, with which the public ear has been deafened for a long while, are indeed sufficiently mournful. Dreary, stolid, dismal, without hope for this world or the next, is all that of the preventative check and the denial of the preventative check” (*Chartism*, 1839).
- Human relations become supply and demand, “cash payment”
- Economics = dismal science
- “Not a ‘gay science,’ I should say, like some we have heard of; no, a dreary, desolate and, indeed, quite abject and distressing one; what we might call, by way of eminence, the *dismal science*” (“Occasional Discourse on the Negro Question,” 1849).

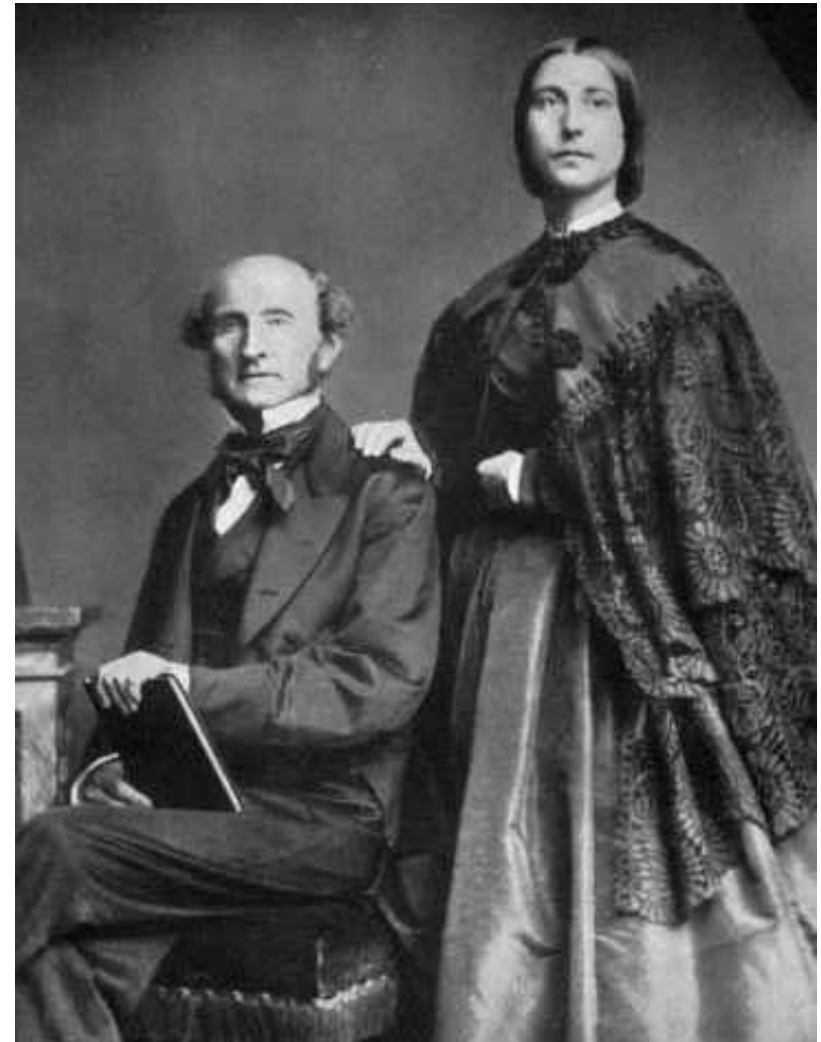
How the Dismal Science Got Its Name

- <https://www.youtube.com/watch?v=KBC2Lza7Yck&t=18s>



Classical Responses to Criticism①

- John Stuart Mill (1806-1873)
 - Philosopher, executive at East India company, economist and MP
- *Principles of Political Economy* (1848)
- To protectionists : infant industry argument; but an exception to free trade principle
 - Reason : can we abolish protection and regulation quickly?

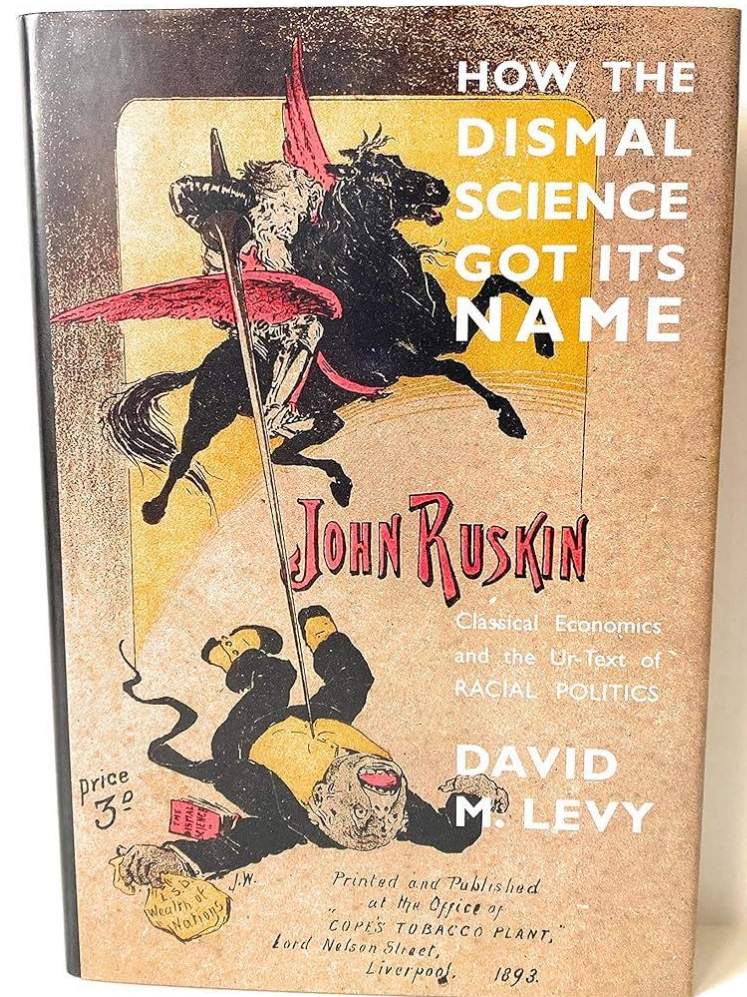


Mill' *Principles of Political Economy*

- Nature and purpose: summarizing and integrating all economic knowledge of his time
- Methodological ecclctism
 - Law of production is different from law of distribution
- Economics: Ricardian
 - Say's Law
 - Wages-fund theory
 - Diminishing returns to agriculture
- Economic policy : Laissez faire as principle, but a lot of exceptions

Response to Criticism ②

- To literary people: denies human hierarchy
- Equal gender rights
 - *The Subjection of Women* (1869)
- Abolition of slavery: Essential to secure property rights
- Real case:
 - Jamaica affair



Mill's response to Carlyle

<https://www.hetwebsite.net/het/texts/carlyle/mill1850negroquestion.htm>

- The author issues his opinions, or rather ordinances, under imposing auspices no less than those of the “immortal gods.” “The Powers,” “the Destinies,” announce, through him, not only what will be, but what shall be done; what they “have decided upon, passed their eternal act of parliament for.” This is speaking “as one having authority;” but authority from whom? If by the quality of the message we may judge of those who sent it, not from any powers to whom just or good men acknowledge allegiance. This so-called “eternal act of parliament” is no new law, but the old law of the strongest — a law against which the great teachers of mankind have in all ages protested — it is the law of force and cunning; the law that whoever is more powerful than an other, is “born lord” of that other, the other being born his “servant,” who must be “compelled to work” for him by “beneficent whip,” if “other methods avail not.” I see nothing divine in this injunction. **If “the gods” will this, it is the first duty of human beings to resist such gods.** Omnipotent these “gods” are not, for powers which demand human tyranny and injustice cannot accomplish their purpose unless human beings coöperate. The history of human improvement is the record of a struggle by which inch after inch of ground has been wrung from these maleficent powers, and more and more of human life rescued from the iniquitous dominion of the law of might. Much, very much of this work still remains to do; but the progress made in it is the best and greatest achievement yet performed by mankind, and it was hardly to be expected at this period of the world that we should be enjoined, by way of a great reform in human affair, to begin undoing it. (Mill, “The Negro Question,” 1850)

Jamaica affair

The Carlyle-Mill “Negro Question” Debate:

<https://cruel.org/econthought/texts/carlyle/negroquest.html>

- 1860s : racial tensions mounted in the Caribbean countries
- Oct. 1865 : Skirmishes at Morant Bay exaggerated as “Black Rebellion”
 - Governor Edward John Eyre declared marshal law
 - 439 blacks executed, 600 flogged
 - Execution of George William Gordon without trial
- 1866 : Eyre summoned back
- “Jamaica Committee” : Put Eyre to trial
 - Mill, Charles Darwin, John Bright, Thomas Huxley, Herbert Spencer
- "Eyre Testimonial and Defence Fund"
 - Thomas Carlyle, John Ruskin, Alfred Tenyson, Charles Dickens
- Governor Eyre acquitted



Summary

- ① Theory of Protectionism and Its Problems:
 - Theoretical possibilities: “infant industry” argument
 - Realities :
 - 1) Which industry to pick up?
 - 2) from political economy perspective, how to restrain rent-seeking behavior
 - core economic view remains free trade
 - E.g. Paul Krugman
 - But, debate goes on with globalization
 - E.g. Dani Rodrik
- ② What economics stood for: differences on property rights: Literary people on the right, socialists on the left
 - How to deal with poverty and the poor generated in a market economy?

Think Further

Usually this is for a paper topic, not suitable for feedback

- What are the economic reasons to justify the “infant industry” argument?
- Is the role of manufacturing in economic growth still large?
- Why did the contemporary literary people defend Governor Eyre?

Next Week

- Read the following:
 - Marx and Engels, *Manifesto of the Communist Party*
 - <https://www.marxists.org/archive/marx/works/1848/communist-manifesto/>
 - Marx, Preface to *A Contribution to the Critique of Political Economy*
 - <https://www.marxists.org/archive/marx/works/1859/critique-pol-economy/preface.htm>
 - Marx, *Critique of the Gotha Programme*
 - <https://www.marxists.org/archive/marx/works/1875/gotha/ch01.htm>

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