A case for subsidies in developing countries like Kenya

By Auscar Wambiya

President William Ruto's plan to fully scrap fuel subsidies will face major headwinds after the world's top oil producing countries agreed to deeply cut exports to prevent erosion of revenues according to latest global financial reports. While this is not good news to the new government, it was expected. Developing economies need subsidies, particularly on import goods, to stabilize their markets before they take off to economic prosperity. History has shown us that not all countries have succeeded through protection and subsidies, but few without them. Cambridge economist, Ha – Joon Chang, lucidly makes this point in his book "*Bad Samaritans; The Guilty Secrets of Rich Nations and The Threat to Global Prosperity*"

Korea, one of the poorest places in the world in 1963, is currently one of the wealthiest countries in the world. Between 1963 and now, per capita income in Korea has grown something like 14 times, in purchasing power terms. It took the UK over two centuries (between the late 18th century and today) and the US around one and a half centuries (the 1860's to present day) to achieve the same result.

For some economists, Korea has succeeded because it has followed the dictates of the free market. That it has embraced the principles of sound money (low inflation), small government, private enterprise, free trade and friendliness towards foreign investment. The view is known as neo-liberal economics. Neo – liberal economics is an updated version of the liberal economics of the 18th century economist Adam Smith and his followers. Just like liberal economics, neo-liberals share the enthusiasm for the free market, deregulation, privatization and opening up of international trade and investment. In a world where countries are not at par in the levels of economic development, neo – liberalism is faulty.

This neo-liberal establishment would have us believe that, during its miracle years between the 1960's and the 1980's, Korea pursued a neo-liberal economic development strategy. The reality, however, was very different indeed. What Korea actually did during these decades was to nurture certain new industries, selected by the government in consultation with the private sector, through tariff protection, subsidies and other forms of government support e.g. overseas marketing information services provided by the state export agency, until they grew up enough to with stand international competition.

The Korean miracle was the result of clever and pragmatic mixture of market incentives and state direction. The Korean government did not vanquish the market as the communist did but it did not have blind faith in the free market either. While it took markets seriously, the Korean strategy recognized that they often need to be corrected through policy interventions like subsidies.

Korea is no exception. All of today's developed countries, including Britain and the US, the supposed homes of the free market and free trade, have become rich on the basis of policy recipes that go against neo-liberal economics. Today's rich countries used protection and subsidies. In 1841, a German economist, Friedrich List, criticized Britain for preaching free trade to other countries, while having achieved its economic supremacy through high tariffs and extensive subsidies. He accused the British of ‘kicking away the ladder’ that they had climbed to reach the world’s top economic position thus; it is 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.

President Ruto’s government need to understand that subsidizing the market, particularly for products that are not locally produced in a developing country, like fuel, in our case, is inspired by the need to nurture the infant industries e.g. the boda boda industry. The practice of protecting ‘infant industries’ had existed before but it was Alexander Hamilton, USA first treasury secretary, who first turned it into a theory and gave it a name. In his *Report on the Subject of Manufacturers* submitted to the US Congress in 1791, Hamilton proposed a series of measures to supporting infant industries and achieve the industrial development of his country, including protective tariffs and import bans; subsidies; export ban on key raw materials; import liberalization of and tariff rebates on industrial inputs; prizes and patents for inventions; regulation of product standards; and development of financial and transportation infrastructure.

Thus practically all of today’s rich countries used nationalistic policies like tariffs, subsidies and restrictions on foreign investments to promote their infant industries, though the exact mix of policies used, as well as their timing and duration, differed across countries.

Subsidies, loosely defined as incentives towards capabilities, should not be used to protect developing countries from competition in the free market forever, though. Even in real life, making an infant go to work in the free market economy at the tender age six is wrong but so is staying with him in the parent’s house and providing him/her with the basic needs (read subsidizing) at the age of forty. Eventually, he/she should develop capacities to go out into the big wide world, get a job and live an independent life. He/she only needs protection while he/she is accumulating the capabilities to take on a satisfying and well-paying job. But in infancy, we meet the basic needs of the child (read developing countries), postpone his/her employment to provide him/her with education while preparing him/her for the free market (employment).

Yet this line of argument is what neo-liberalists free-trade economists justify rapid, large-scale trade liberalization in developing countries while trashing subsidization. They claim that developing country producers need to be exposed to as much competition as possible right now, so that they have the incentive to raise their productivity in order to survive. Protection, according to them, only creates complacency and sloth. The earlier the exposure, the argument goes, the better it is for economic development. Nothing can be further from the truth. Kenya is yet to achieve the levels of development that warrant the complete withdrawal of subsidy. Thanks to the mismanagement of the past regimes, most of our industries still remain at infancy. Let President Ruto subsidize fuel within a set timeline to help stabilize the markets as we smart from the effects of the war between Russia and Ukraine and the COVID-19 pandemic that destabilized most of the economies of the developing countries and whose effects we continue experiencing. With the effects of fertilizer subsidy expected in the long term, something have to give in the short term if our infant industries depending on fuel are to survive in the long term.

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