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The Quest for Growth: Competition and Industrial Policy, Complementary or Estranged Bedfellows

There is no doubt that very high on the agenda of most Jamaicans is the issue of economic growth. Economic growth means the expansion of the goods and services produced by an economy; simply put it means expanding the wealth of a country. As the economy grows more resources become available for the provision of public services, law and order, public health, education etc. It would normally mean that on average the Jamaican people would be getting richer and therefore able to provide more of the things which they want for themselves. The issue which we want to look at this afternoon is "what is the path to having the fastest rate of growth and therefore the likelihood of attaining all the good things which we associate with economic growth." Is it competition policy? Is it industrial policy? Are the two compatible or not?

Economic growth means that the overall economy grows; some sectors will grow and others might decline or even die.

As important as economic growth is, it is not the main objective of the policy makers. The ultimate objective of any society must be to maximize social welfare. We can think of social welfare as the well-being of people living in a society. The economist defines social welfare as consumer surplus plus profits. Consumer surplus is a proxy for consumer well-being; generally speaking consumers are better off with lower prices, consuming more and having a wider choice of goods and services. Profits are a measure of the well-being of firms. Economic growth is more closely associated with the growth of profits. One could of course make the case that as profits increase more money is available for investments which would likely result in more people being employed and prices falling. The general thinking therefore is that economic growth will benefit not only firms, but workers and consumers.

The natural impulses of competition policy and industrial policy tend to be in conflict. Competition policy starts with the assumption that the market is the best allocator of limited resources. If consumers demand more of a commodity, prices and profits rise signalling for more. If consumers no longer want as much of the product as before the opposite signal is sent.

Industrial policy is aimed at changing the signals sent by the market. A policy decision is taken that a particular sector is important and should be encouraged. It is felt that the market signals are either incorrect or not strong enough to shift resources to the preferred areas. One has to ask the question: on what basis do the policy makers decide which are the preferred sectors? Why is one sector more likely to grow than another? Can the policy makers see into the future and predict the growth areas? In order to implement industrial policy the Government must alter the incentive structure which individual firms face. The preferred sectors are given more favourable conditions; this tilting of the playing field will cause resources (capital and labour) to flow into the preferred areas and away from the non-preferred ones. The policy makers are convinced that the flow of resources to the preferred areas offer the best hope for growth. Industrial policy may take many forms: e.g. preferential access to capital; differential tax rates and government expenditure favouring the preferred sectors. Industrial policy usually has a trade policy component i.e. the conditions under which the preferred industries compete with imported commodities. High tariffs and quantitative restrictions on imports are among the instruments used to provide protection.

It is very important to realize that when there are preferred sectors those sectors which are not preferred are not unaffected; they are usually made worse off by the preference given to others, both in an absolute and a relative sense. The government might restrict the importation of a particular commodity using tariffs or quantitative restriction so as to facilitate the development of Jamaican competitors. One might be tempted to think that there are only Jamaican winners from such a policy stance and the only losers are the foreign firms which have had their access restricted. For example the government might decide that the milk industry needs to be protected against imports because local consumers are buying imported milk as a result of its lower prices. The government's action would ensure that the price of the foreign milk is increased so that it is no longer cheaper, thus leading Jamaican consumers to purchase the local milk. The Jamaican milk producers are therefore able to compete more favourably and sell their milk. Jamaican consumers are however made worse off because they are forced to pay higher prices. With higher prices, a given money income buys less i.e. the real incomes of Jamaican consumers fall. This policy does not result in a transfer of wealth from foreign milk providers to domestic milk providers; rather it engineers a transfer of resources from domestic consumers to the domestic dairy industry. Recall that the objective of the policy maker is to maximize social welfare, which we defined as consumer surplus plus profits. The domestic dairy industry benefits from protection: Farmers get higher prices, higher profits, they can expand their operations and hire more people. Consumers are however made worse off because of this policy. They would have to pay more for milk; in essence they would be made poorer. The beneficiaries of such a policy are easily identified; they are likely geographically concentrated and organized to advocate for such a policy. Consumers on the other hand are dispersed over the entire country; politically disorganized with no mechanism to advocate for their interest. The issue then rests on the question of whether the gains made by the dairy industry are sufficient to compensate for the losses suffered by consumers. Conventionally, economists assign a weight to consumers at least as big as the weight assigned to producers. At equal weights a unit of social welfare transferred from a consumer to a producer would result in no change in overall social welfare, simply a redistribution of this welfare between consumers and firms. However, it turns out that these sorts of protectionist policies result in the consumers losing more than the producers gain. The reason for this is that consumers faced with higher prices buy less than they do at lower prices. The local dairy farmer is only able to capture surplus from the consumers on the quantity of milk purchased, not on the milk not purchased. Whatever surplus the consumers had from the milk which they no longer purchase is lost to them but not recovered by the domestic dairy farmers. Economists refer to the excess loss which consumers suffer over the gains of the producers as a deadweight loss. Of course if producers are seen as more valuable than consumers i.e. they are assigned higher weights their gains might be valued more than the consumers losses even with the existence of deadweight losses. A political representative for a dairy producing area or a Minister of Agriculture is likely to assign a higher weight to the dairy industry than to consumers in proposing public policy.

Industrial policy seeks to identify which industries are likely to be able to grow fast and to encourage those industries. This is often done by some policy measures which protect the selected industries. A government is unable to protect all industries, since protection is a relative concept, in the same way that a mother cannot prefer all her children. Protection like preference means putting some ahead of others. Protecting some industries do not leave the non-protected one unaffected. Protection and harm are like two sides of the same coin. Some years ago there was a discussion on whether or not Jamaica should allow the importation of bananas from Central America. The reason why a public policy response was thought to be necessary was because the local agricultural sector argued that importation of bananas would put the local industry in peril because of the cheaper imported prices. This would cause economic distress to banana farmers and their workers. Protection of the banana industry would preserve the agriculture sector and allow it space to grow, the argument continued. Such a policy would no doubt be growth inducing for agriculture. We have already outlined the effects which that sort of protection would have on consumers, forcing them to pay higher prices. However, consumers are not the only ones who would be forced to buy bananas at higher prices. The banana chip industry uses bananas as a vital input. Forcing the banana chip manufactures to have higher input costs mean that their products would be more expensive and hence less competitive. Jamaican banana chips would find it more difficult to compete against foreign banana chips both at home and abroad. The policy of protecting bananas would therefore harm the banana chip industry, making it less profitable, restricting its growth and possibly even causing it to reduce its output and lay-off workers. Protecting the banana industry makes banana farmers richer at the same time it makes banana chips producers poorer. It would save jobs or even cause an expansion of jobs in the banana industry while preventing job growth or even forcing the reduction of employment in the banana chip industry. This protection helps agriculture while harming manufacturing. If we view agricultural jobs as more valuable than manufacturing jobs then this would be a very good policy. But why should we sacrifice manufacturing jobs to preserve agricultural ones?

The example I used just now had the output of one activity as an input into another. It was clear under these circumstances how industrial policy favouring one industry would hurt another. Does the picture change when the industries are not directly connected as in the case just discussed? The tourist industry in Jamaica has been the beneficiary of industrial policy over a very long period of time – very low tax rates and direct government expenditure. There is no doubt that these policies encouraged the tourist industry to expand rapidly. The foregone tax revenue from the tourist industry must be made up elsewhere. The tax rates applied in the rest of the economy are therefore higher because of the tourism concessions. Although the tourist industry has expanded rapidly it has not been able to pull the rest of the economy with it. The tax code makes other firms in the economy less competitive with imports and on foreign markets. Because of this it is privately optimal for a hotel operator to seek much of his inputs from imports: food, linen, towels and even furniture. It appears that competition policy which does not favour any particular sector could possibly have resulted in the entire economy growing at a faster rate since disadvantaged sectors under industrial policy would have been in a better position to participate in the global supply chain and therefore to contribute more to the growth of the Jamaican economy.

Some firms and or industries have argued for protection for a limited period. The basis of this argument is that the industry needs more profits than they would be able to garner in a competitive environment. These resources are needed to allow the appropriate level of investment to take place so that the industry might attain the level of efficiency required to compete. If the appropriate levels of investment are made, the argument goes, the industry will be efficient in the future. If a firm by making the appropriate level of investment will credibly become profitable in the future, then that firm should borrow from a financial institution and repay that loan when it becomes profitable. The firm could, through the financial institutions, transfer some of its profits, which it will make because of the investment, from the future to the present. Of course having protection would reduce the risk for making this investment, but the question arises why should the society pay the price for this investment through higher prices and all the consequences outlined before, when it will not share in the rewards of this investment.

Various tax incentives have been given to firms operating in preferred areas. These firms are given tax relief for a given period of time, as a way of helping them to acquire the resources needed, to make their investments efficient. Experience has shown that it is not uncommon for some of these firms to close at the time of the expiration of the tax benefits, just to reopen under a different name and thereby become beneficiaries of a further period of tax relief.

Alexander Hamilton in his Report on Manufacturing presented to the US Congress on December 5, 1791, was the first person to advocate for protection on the basis of the Infant Industry Argument. Temporary protection is given on the basis that the industry is not efficient, because it lacks the requisite skills. The local players are simply not good enough. The requisite level of skills can only be acquired through a process of learning by doing. When the industry has learnt it would be able to deliver its output at competitive prices compared to imports. The argument continues that it takes time to acquire the requisite skills, so the industry should be protected for a period long enough to allow it to acquire the skills needed. This really translates into "local consumers should pay the price for the firms' learning." The experience with the infant industry argument the world over, is that the infants tend not to grow up as the market discipline which forces efficiency has been suspended. Irrespective of the contract signed with the government, the industry will seek to extend the time of protection when it expires. Usually there is the threat of laying-off hundreds of workers which of course no politician wants to be identified with. It is almost impossible to have a contract that cannot be re-negotiated; the firms involved know that in spite of what is said at the time of the signing, the exit date is not an iron clad one. There is therefore no incentive for a firm enjoying this type of protection to strive towards efficiency. Even if the infants do grow up and the timing of the removal of the protection is honoured, a further question arises; why should the rest of the society bear the cost of preparing a select group of entrepreneurs and workers for the opportunity of making private gains?

Another argument in favour of protectionism which was proposed by Alexander Hamilton and which finds currency today is "free trade is fine, if everyone practiced it." Encrusted in this argument is some appeal to fairness. For a moment let us assume that no other country practiced free trade, what should Jamaica's response be? We should not be guided by a tit-for-tat strategy. We should figure out what is best for us and pursue that strategy. Since protection does not transfer resource from foreign businesses to local ones, but rather from one set of domestic players to another, it is very unlikely that protectionism will deliver a higher level of welfare for the Jamaican society. To disadvantage oneself simply because others have chosen to disadvantage themselves is not a particularly sensible thing to do.

Linked with the fairness approach is a call to have balanced trade with all our trading partners. Often Jamaica-Caricom trade is seen as disadvantageous to Jamaica and from time to time there are calls for protectionist measures to be implemented to reduce the trade deficit with Caricom. Countries are like individuals, they trade with several other entities. I run a deficit with all the people with whom I trade except one. I have a deficit with my gas station, with my supermarket, with my barber and with my telecommunications providers etc. The only trading partner with whom I run a surplus is my employer. It would be foolish for me to insist on balanced trade with my gas station, my grocer etc. What I need to ensure is that the surplus which I generate from trade with my employer is big enough to offset the deficits which I have with others. Similarly, a country does not have to have balanced trade with all its trading partners; it should only seek to ensure that its overall trade is balanced. Too often we view exports as good and imports as bad. If we attempted to make everything ourselves we would greatly reduce the chance of growing our economy and welfare levels would fall. The Jamaican economy is very small; production which is aimed at the domestic market is constrained by the small size of the market. Economies of scale will never be attained and consumers would have to endure relatively high prices and limited choices. If the country positions itself within the international supply chain then the local market would not be an impediment to growth; rather the global market now provides the envelope. Most individuals do not attempt to produce all the goods and services which they require for their lives; most of us do one thing and with the earning from that one thing we buy the other things which we need i.e. we trade, not necessarily on a balanced bilateral basis with each other. Similarly, a country does not have to attempt to make everything it needs. Competition policy rather than industrial policy is likely to best help the country in deciding which goods and services it would be best at providing.

If I asked how many of you would think that it was a good idea to erect a wall around August Town and have the people of August Town produce all of their wants, with protectionist policies to ward off competition from outside that wall, I suspect that not many of you would think that this was a very smart thing to do. Well what about erecting a wall around Kingston and having the people of Kingston produce all their needs, with protectionist policies to aid and abet that process? Maybe I am being too demanding; rather than have Kingstonians produce everything that they need, what about having Kingstonians produce one thing that is protected from producers anywhere else in Jamaica? Again I suspect that there aren't too many persons here who would support that policy. But somehow if I suggested that we should wall off Jamaica and protect some Jamaican products there might be persons who would not strongly object. The question is, if August Town or Kingston was not the optimal economic size to construct a protected economic space, why is Jamaica? Why are we imposing political boundaries on economic space?

Industrial policy when stripped to its core is really about picking winners (and losers). Who decides which are to be the preferred sectors and/or firms? This process is rife for political capture. Well organized, politically connected entities are more likely than others to capture the State or have the State serve their interests. But even if we were able to control political capture and use only technical know how we would still be guessing in the dark. Not too dissimilar from betting at Caymanas Park on a Saturday. Remember that what industrial policy does is to encourage resources to flow towards given areas and away from others. Suppose the incoming Government in Jamaica in 1980 had an industrial policy which made it very attractive to make typewriters in Jamaica. Some firms would have migrated from producing other things to making typewriters; people would have been trained to make these machines and much money would have been diverted from other uses so as to advance the production of typewriters. Typewriters were invented in 1860 and so in 1980 were around for 120 years. Every office had several; who could have foreseen in 1980 that before the end of the 1980s typewriters would have started to disappear at a rapid rate to be replaced by personal computers? Had we had a typewriter industry it would have died, not because of inefficiency of the production process, or a lack of a skilled work force or a lack of capital. It would have died because it was not a part of the future. Technology made it redundant. Nobody sitting in the Planning Institute of Jamaica (or the National Planning Agency as it was known then), the Ministry of Finance or the Ministry of Industry in 1980 could have predicted that typewriters had a very limited shelf life left. The Government had no more information than anyone else about what the future would look like. When a private business person decides to invest in a particular area she gambles on the future of the product which she is investing in; this is a part of standard commercial risk. If she guesses right, and does everything else right she is handsomely rewarded with huge profits. If she is wrong with her guess, even if she does a spectacular job with everything else she will lose her investment. When the country implements an industrial policy it changes the signals which are seen by business people; making some activities more attractive and others less attractive. When the Government guesses wrong, many persons lose their investments which is bad enough. But worse, it is possible that an area which the market will determine as a winner in the future, the government encouraged resources to flow away from; crippling the capacity of the country to take advantage of the developments to come.

Some governments do interfere with free trade by the imposition of tariffs, not because they seek to protect any particular economic activity, even if that is the end result. They do so as a means of collecting taxes. Their tax collecting capability might be underdeveloped, and collecting taxes at the borders is relatively easy. If the tariff rates are uniform across all products the distortionary effect is less than if there are a multiplicity of rates for different goods.

Governments sometime engage in protectionist activity for non-economic reasons. A military superpower might not want to outsource the manufacturing of its sophisticated weaponry even if these armaments could be more cheaply produced in another country. Such a country might think that steel is vital to its military machinery and therefore decide that it must have a steel industry and is prepared to protect its steel industry to ensure its sustainability. These are examples of protectionist policy for security reasons. Protectionist policies for non-economic reasons are not 'wrong'. They do however carry an economic price. A country must be prepared to trade-off greater economic wellbeing for the non-economic goals which it wishes to pursue. Obviously the richer a country is the more latitude it has to give up further economic gains for other causes.

I have outlined the inherent conflict between competition policy and industrial policy. There is a vast economic literature which shows conclusively that free and open trade results in faster economic growth and greater wealth creation. For every successful application of industrial policy we can find even more failures. The successes of industrial policy are not necessarily due to smarter people and greater efforts but more likely to luck, in the same way that every horserace has a winner. Yet in spite of all of this academic evidence we are living through a period where more and more people seem to be clamouring for a withdrawal from globalization, from free trade and the chorus for protectionism is growing. We see this in Brexit, in the revolt of the white working class in the recent US elections. There is a wind of right wing popularism that is blowing in Europe that has now reached the United States. Places to watch this year are France, Italy and Germany. Will the far right in the person of Marine Le Pen come to power in France? Will Angela Merkel be able to hold the line in Germany? While no doubt there are cultural and even racial factors at play, it is primarily the sense of economic dislocation which has resulted in the creation of the angry white worker in these countries and the push back against further integration. We are also seeing a divergence between people living in large cities and rural folks; a fault line has opened up between college educated people and people without this level of education. The city dweller and the college educated people have come down on the side of greater integration, more trade and more diversity, while the rural folks with less education have been responding positively to the call for disengagement, for building walls to keep people and goods out. Why has the responses of these different groups been so diametrically opposed and so visceral? It is not that college educated people are smarter and high school educated people are dumb why generally these groups have taken different positions on this matter. Rather, it is because in general, greater openness to trade, more competitive landscapes and globalization have affected these groups differently.

Economists have always known that with free trade there are winners and there are losers. We have waved our hands proclaiming that the winners gain more than the losers lose and so society can be made better off without anyone becoming worse off if only the winners would compensate the losers. But of course they never do. This leaves the losers very angry. We have been experiencing the phenomenon of jobless growth in some countries. We see a worsening of income distribution within countries. Whether the losers are angry because of the worsening income distribution or simply because they are made worse off in an absolute way or because they have not progressed as fast as they would like is an interesting question. The policy responses would be vastly different depending on the answer to this question.

Free and open trade, globalization and the international supply chain have resulted in different activities being located in different countries. Free trade is partly responsible for lifting 1 billion people out of poverty over the past 30 to 35 years. It has led to vastly improved incomes in India and China: measured in 2010 dollars India's per capita income grew from US$553 in 1991 to US$1,806 in 2015 while China's rose from US$783 in 1991 to US$6,416 in 2015. The huge populations of both these countries meant that these improvements in average incomes led to a significant reduction in income inequality among the world's population. This process has led to a reduction in income inequality between countries while increasing income inequality within countries. Jamaica has been the beneficiary of the global supply chain with an expanding Business Processing Outsourcing industry. Thousands of Jamaicans are employed to provide customer service and other sorts of services to foreigners who are customers of companies which are not located in Jamaica. These jobs were previously located in the countries of either the companies or the customers. Some manufacturing jobs have left Europe and the United States for the developing world. This results in a more efficient production process, which translates into cheaper prices. Apple currently sources material from and have operations in 28 countries. If the Trump Administration's pledge of putting a 45 percent tariffs on China is implemented the price of the basic i-phone 7 in the US which currently retails for approximately US$650 could increase by approximately US$100 (15 percent). Trump has proposed these high tariffs as a mechanism to encourage American companies to relocate their operations to the US. The reason why these companies moved abroad in the first place was to reduce cost. High tariffs are unlikely to succeed in returning these manufacturing operations to the US, but even if they were, the prices which consumers pay would increase significantly. Globalization has resulted in consumers receiving low prices at the expense of some jobs. What the popularist right-wing is promising in the US and Europe is a return of jobs, but with little attention to the commensurate increase in prices.

Persons, who despite their best efforts see their standard of living falling, do look for someone to blame. International trade, open markets and immigration are prime targets. The true situation is however that many of the jobs which have been lost will not return. These jobs are lost not to outsourcing facilitated by trade, but to increased productivity, mechanisation and artificial intelligence. Although the number of persons employed in manufacturing in US has declined the output of US manufacturing sector has more than doubled since 1980. Both the median income and the median wealth in the US have risen substantially since 1980. Of course the problem is that this increase in income and wealth is not evenly shared. Jobs which are traditionally done by people without college degrees are usually the easiest ones to outsource and the easiest ones to mechanize; these are the jobs which first disappear. Jobs which are performed by people with college degrees are the ones which are more difficult to replace by automation; they tend to be less repetitive and therefore not prime for outsourcing. People with college education therefore are affected differently than people without; which explains the different responses of these groups.

Erik Brynjolfsson and Andre McAfee[1] of the Massachusetts Institute of Technology argue that advances in computer technology from improved industrial robotics to automated translation services are behind the sluggish employment growth in the United States over the last 15 years. They anticipate that many different types of jobs will be lost as these powerful new technologies are increasingly adopted. Job losses will not be confined to manufacturing, clerical, and retail work but will include professions such as law, financial services, education and medicine. They argue that technology is destroying jobs at a faster rate than it creates new jobs. A 2013 study by economists Carl Frey and Michael Osborne[2], both of

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[1]Reported in Rotman, David "How Technology is destroying jobs" MIT Technology Review. June 12, 2013

[2]Frey, Carl and Michael Osborne "The Future of Employment: How Susceptible are Jobs to Computerisation?" 2013

Oxford University predicted that 47 percent of US jobs are likely to be destroyed by automation in the next 20 years.

Jamaica is not immune to these technological changes. There was a time when every office had many secretaries and a pool of typists. There were schools such as Duffs, Fitz-Henley and Alpha Commercial to train people for these jobs. These jobs have mostly disappeared due to the advent of the personal computer, and so too have the training institutions just mentioned. Without Automatic Teller Machines and internet banking employment in banking for rudimentary skills would be greater. No one would seriously argue however that the benefits of more conveniences and greater efficiency should have been sacrificed to preserve these jobs.

What happens when the technology of driverless vehicles is perfected? Bus drivers, truck drivers and taxi drivers will all become obsolete. The advancement of drone technology will replace people employed in courier services. This is not the first time that the world has been upended by technology. Manufacturing could not have evolved until agricultural productivity improved sufficiently to shed workers without fear of mass starvation. No doubt the transition process was messy and uncertain. In hindsight it is all logical, but at the time could the participants who were displaced know what was to become of them? There must have been not only great anxiety but also great misery for displaced people. What is happening now is that the job destruction led by technology seems to be on steroids. Never before has the world experienced technological changes happening so fast which has impacted employment and living standards so rapidly in so short a period of time.

What should be the appropriate policy response to these changes and anxieties? Should we seek to slow technological progress and wealth creation to give ourselves time to figure out how to make the process more inclusive? We see the destruction of jobs but we are not clear in which areas the new jobs will emerge. Furthermore, the skill sets for the new economy might be significantly different from that of the old economy. Younger folks are best suited for acquiring the knowledge for the new economy. Middle age persons are less likely to be able to make that transition even if they are willing to try. If Jamaica's sugar-cane industry should disappear at the same time that an equal number of jobs opened up in information technology, it is most unlikely that a sixty year old sugar-cane cutter could transition smoothly, or otherwise, into information technology.

The political reality is that displaced people in sufficient numbers can have devastating effects on a system capable of creating vast amounts of wealth. They have nothing to lose. The winners can compensate the losers, but what are the policy measures which would allow this without distorting people's incentive to study, work hard and make risky investments? Will we have to trade-off higher levels of wealth for more stability? Will some sort of industrial policy have to slow down growth in order to guarantee some amount of stability in the political economy? Will industrial policy have to become an estranged bedfellow with competition policy?

Thanks You.