

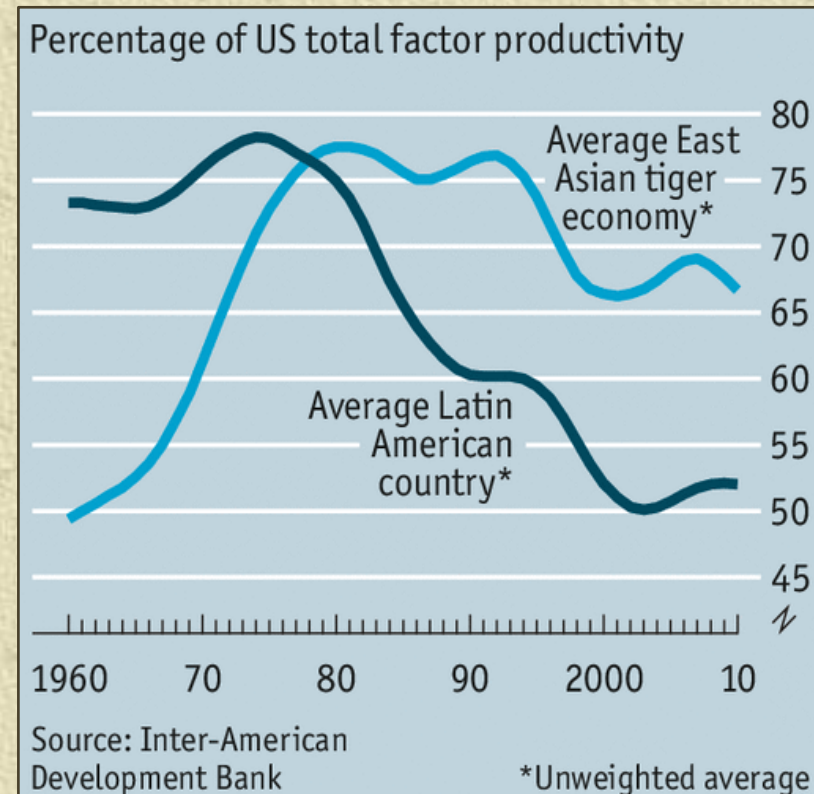
# Strategic Trade Policy Intervention

## ✦ Asian miracle vs Krugman's thesis

- ◆ Trade openness
- ◆ Capital accumulation
- ◆ Total factor productivity

## ✦ Asian financial crisis 1997: problem with the strategy

- ◆ Economic case against X-led growth at all cost
  - Macro imbalances
  - TOT implications
  - Over-investment

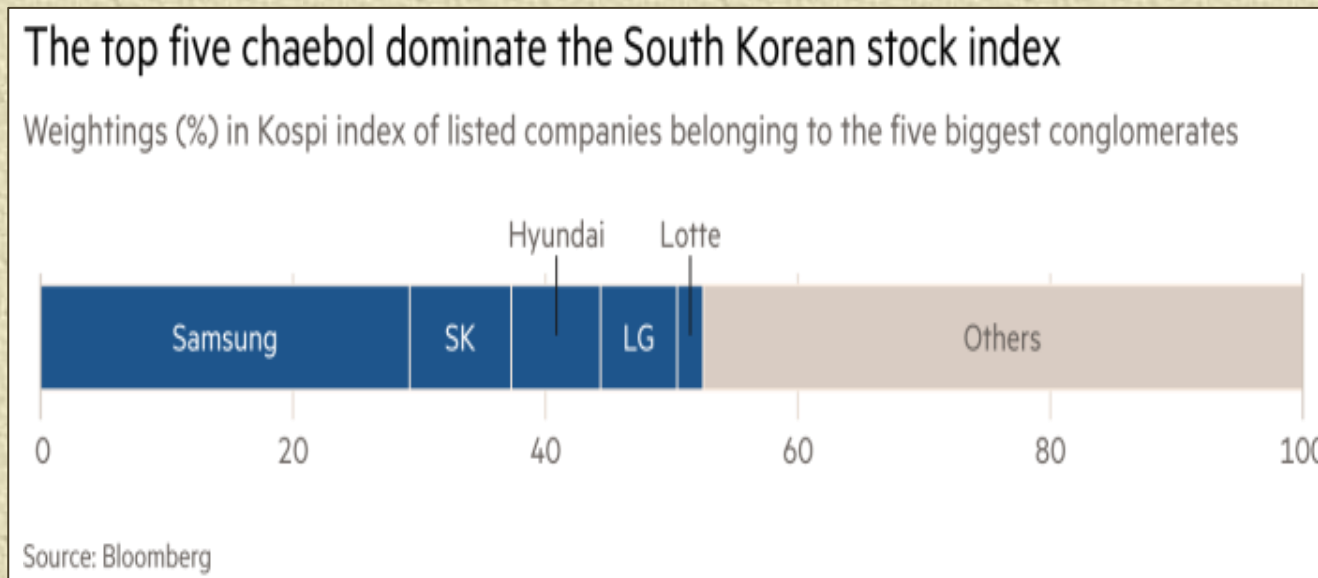


*Economist*, "Bello: Latin America's Korean dream", 20 Sep 2014

# Strategic Trade Policy Intervention

## ◆ Political argument: case of South Korea

- Chaebol (corporate conglomerates)
  - ◆ 10 main *chaebol* account for > 70% of profits of all listed firms
  - ◆ 4 *chaebol* acct for 47% of output; 50% of exports and 20% of employ
- Samsung's sales = 20% of GDP (shipbuilding, life insurance, smart phone)
- Second-tier chaebols survived 2007 financial crisis through state support



Samsung's rise mirrors S. Korea's. Its influence led to 2 bribery convictions, including of the president - and twice pardoned as the firm is seen as being in the national interest

*Economist*, "S. Korea's Economy: What do you do when you reach the top?", 12 Nov 2011; "Chaebol failures spark sharp rise in bad loans", *Fin Times*, 14 Oct 2013, p. 18; "Samsung: Losing its shine", *Economist*, 9 Feb 2008; *FT*, "In the shadow of a giant", B. Harris, 20 Aug 2018, p. 7.

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- Crony capitalism



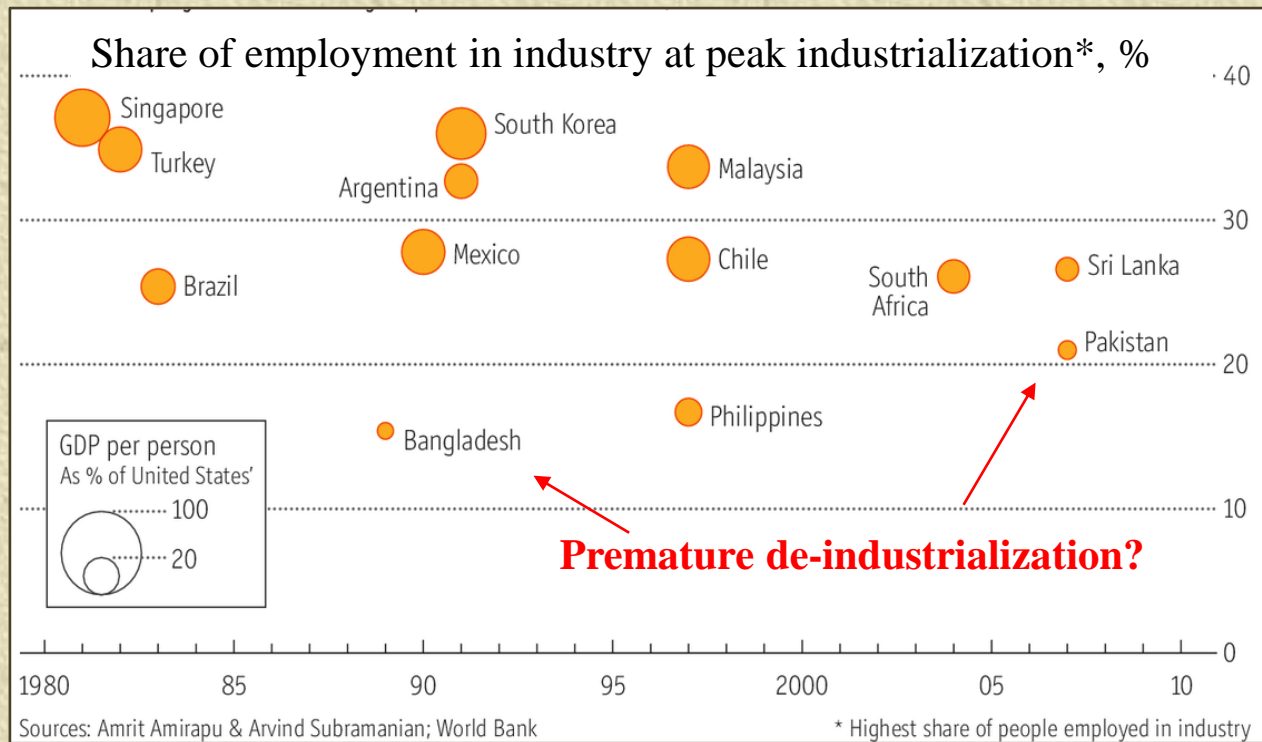
All of the BRICS (Brazil, Russia, India, China and S, Africa) emerging economies are ranked among the highest on the index. They are joined by mostly E. Asian economies.

The index considers billionaires whose wealth is deemed to be from “rent-heavy” sectors, but it does not measure actual relationships between agents and gov’t.

Source: *Economist*, “Our crony-capitalism index: The party winds down” 7 May 2016, p. 10-11.  
 see also limitations of the index: <https://globalanticorruptionblog.com/2014/03/31/the-economists-crony-capitalism-index-does-not-measure-crony-capitalism/>

# Strategic Trade Policy Intervention

## ✦ Middle-income trap / de-industrialization

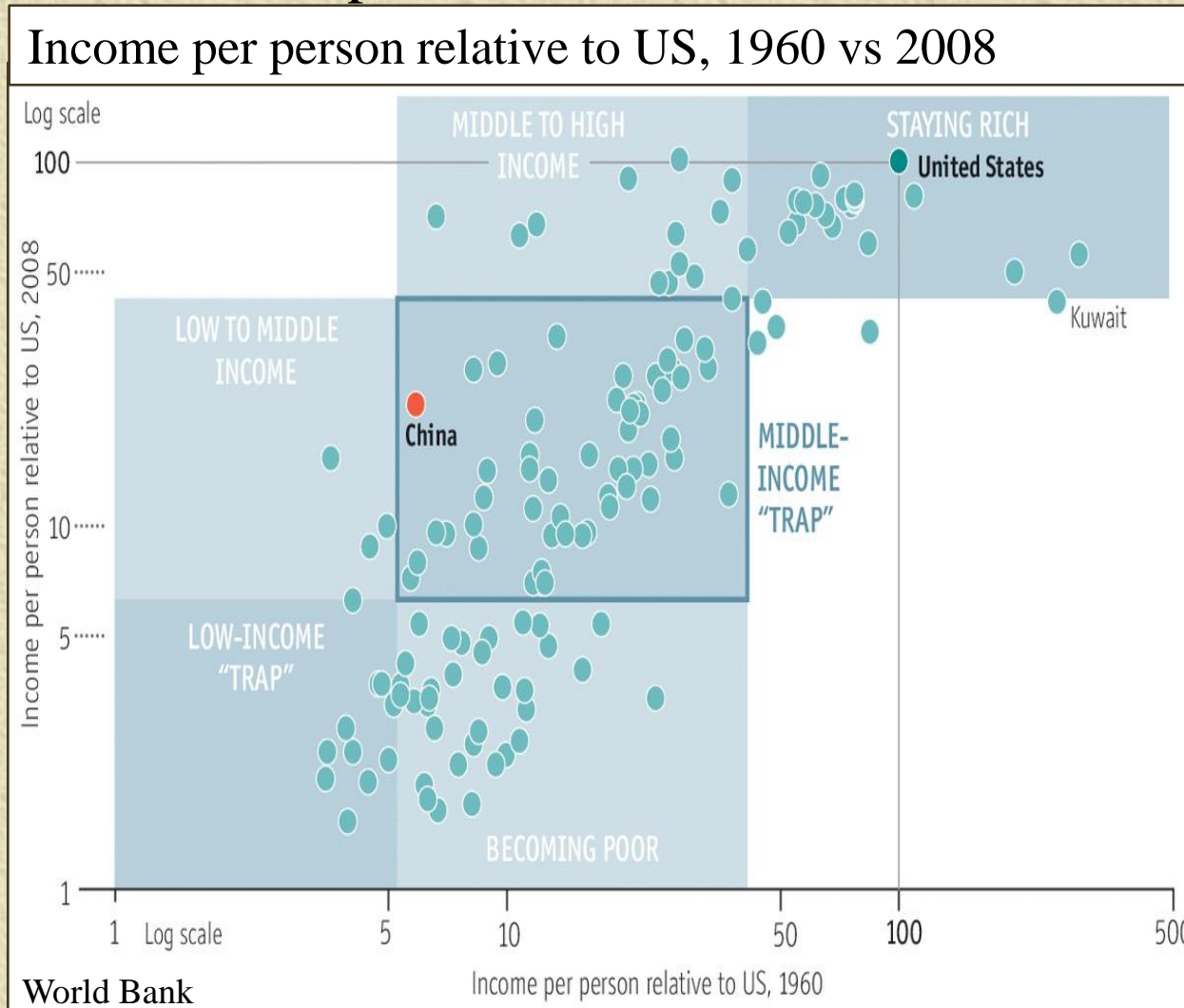


Industrialization is how North got rich. LDCs can grow fast by copying, importing K and learning rich world's know-how. Once cheap  $L_A$  shifts to M-sector, wages  $\uparrow$  and  $K/L$  ratio approaches rich countries. Growth slows and middle-Y trap is hit. Unless  $\uparrow$  TFP: use L, K more efficiently, new organ structures, supply chains or move to D-driven service sectors.

*Economist*, "Emerging economies: Arrested development", report, on world economy, 4 Oct 2014, p. 11-3

# Strategic Trade Policy Intervention

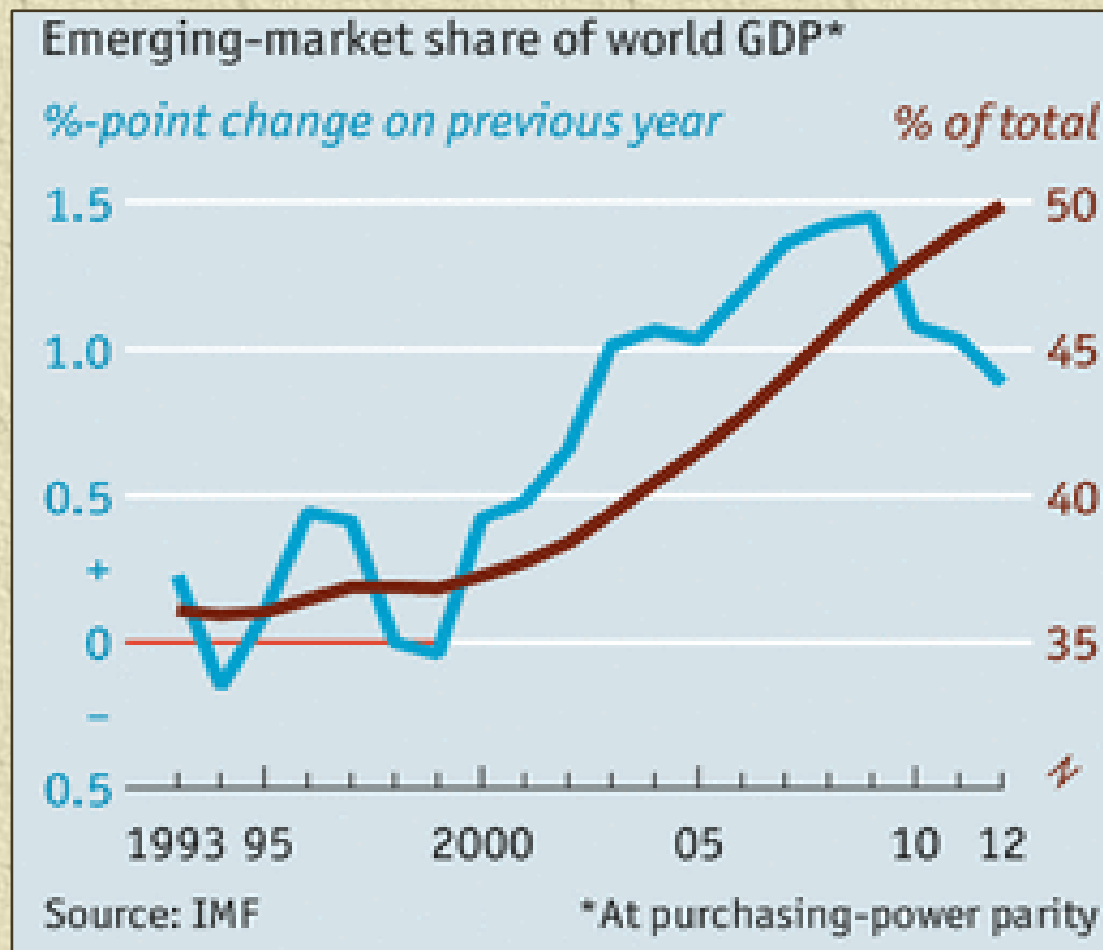
- ◆ Connection between slowing (productivity) growth and falling into the trap



Forces of convergence are powerful, but **middle-income countries squeezed by high-tech and low-wage rivals on either side. Poorer countries rely on low wages** to offset low tech and skills level. They grow faster largely because imitation is easier than invention. The **rich need advanced tech and skills to offset high wages**. Only 13 countries escaped the middle-income trap from 1960-2008. Averages mask huge variations though.

# Strategic Trade Policy Intervention

- ◆ Is there a slowing down of the “catch-up growth”?

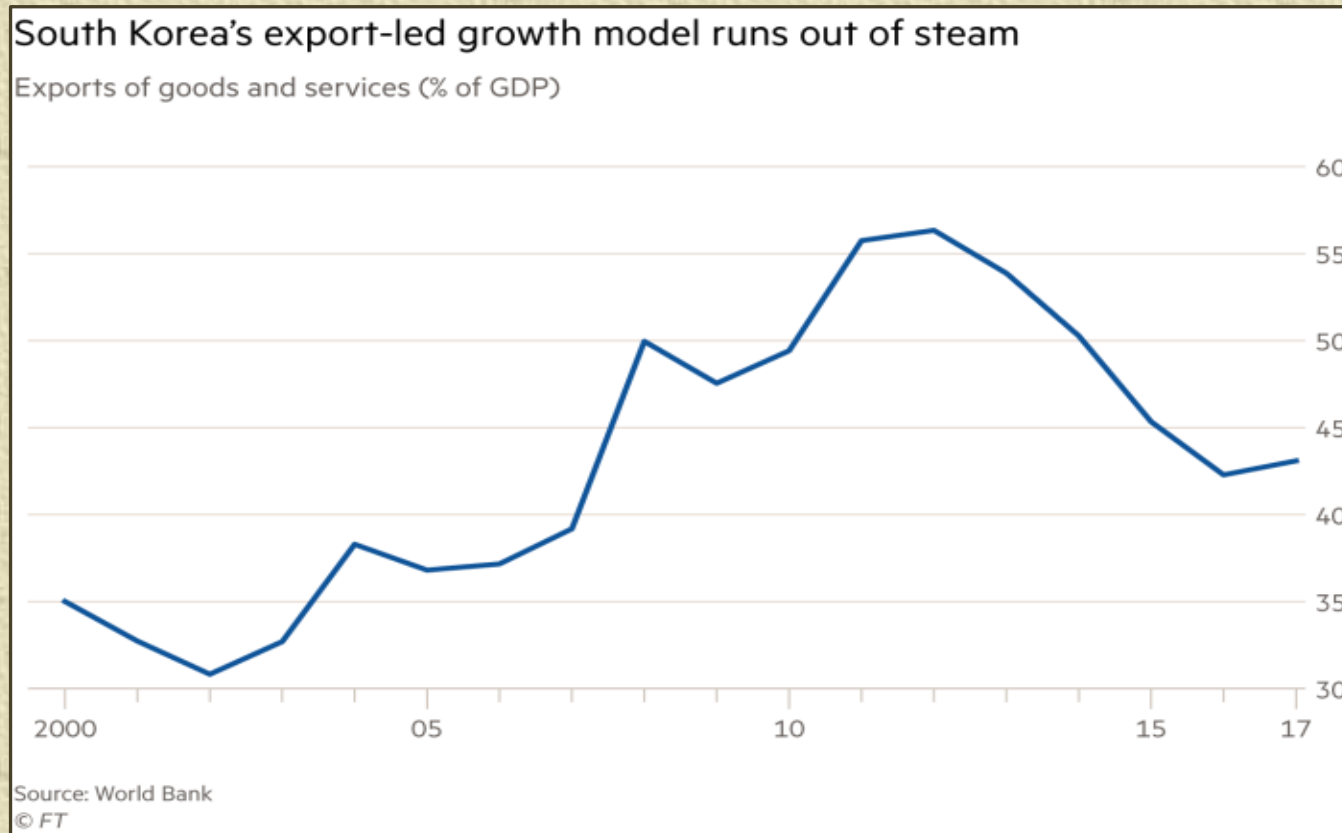


Since the 1990s, 73% of developing countries outgrew the US by 3.3% a year, on average. Brazil, Russia, India and China had most impressive growth rates, growing in different ways for different reasons.

Middle-income economies today employ fewer people in manufacturing than those economies in the 1960s or 1980s (Asian tigers).

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- ◆ Does export-led growth lead to export competition and commodification of manufactured goods?



# Strategic Trade Policy Intervention

## ✦ Long-term effect of Japan's model

- ◆ Founded on 3 elements for social cohesion and stability
  - Lifetime employment; workers promoted within
  - Seniority-based pay
  - Firm-specific unions: close L-mgmt cooperation
- ◆ Firms had a close relationship to a “main bank”
- ◆ “Keiretsu”: firms/subsidiaries bound thru web of reciprocal cross-shareholdings

1990s: Japan's real estate bubble burst - loaded with bad loans. Gov't thought to be the pillar supporting asset prices. 1997: System collapsed when Bank of Japan declared it could not back private debts. Corporate sector could not restore confidence.

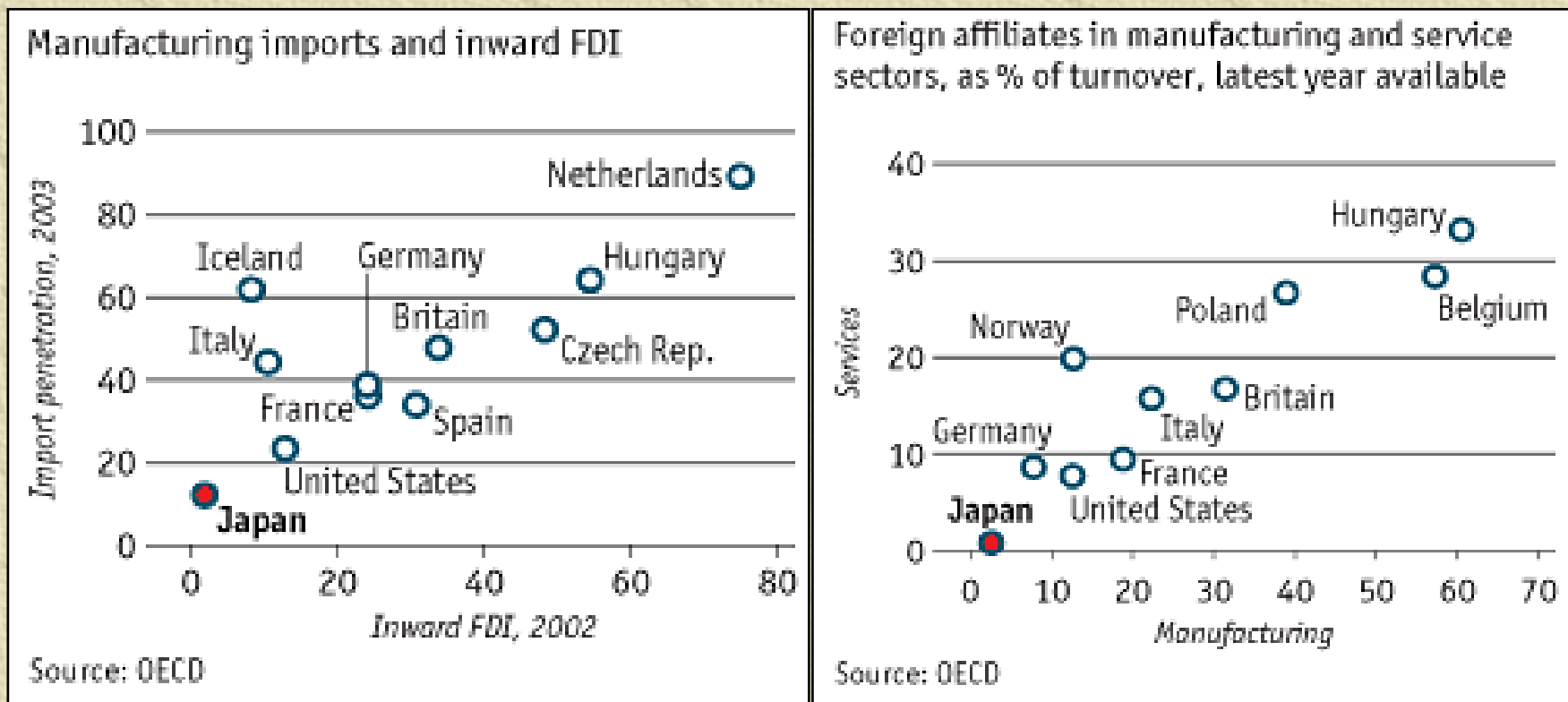
China's bank-centered, gov't-controlled financial system fostered rapid growth. As economy matured it outgrew the developmental model of finance, adding stock mkts and rating agencies. 2021: ↓ property prices exposed misallocated loans to gov't projects. Corporate debt at 160% of GDP and Bank of China seems unable to deal with bad debt.



# Strategic Trade Policy Intervention

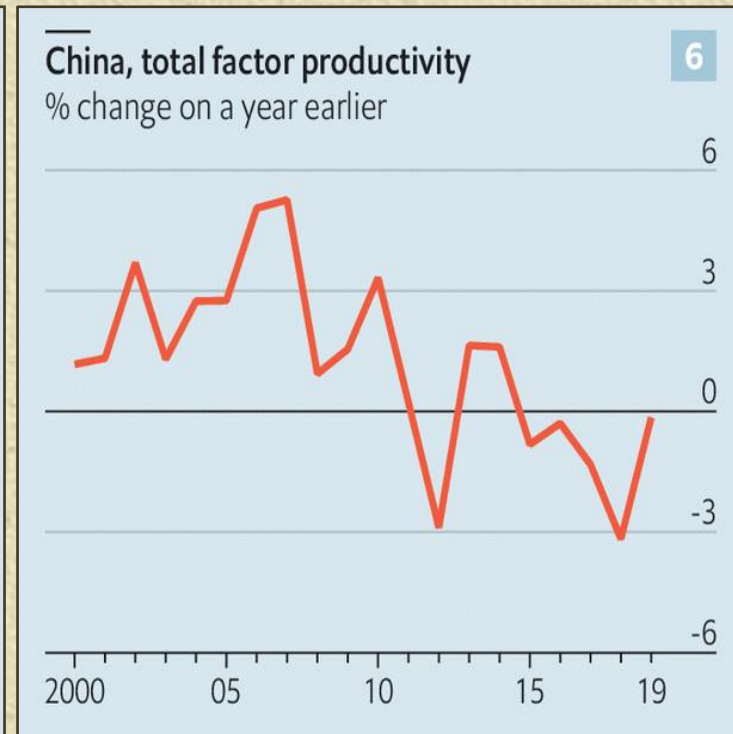
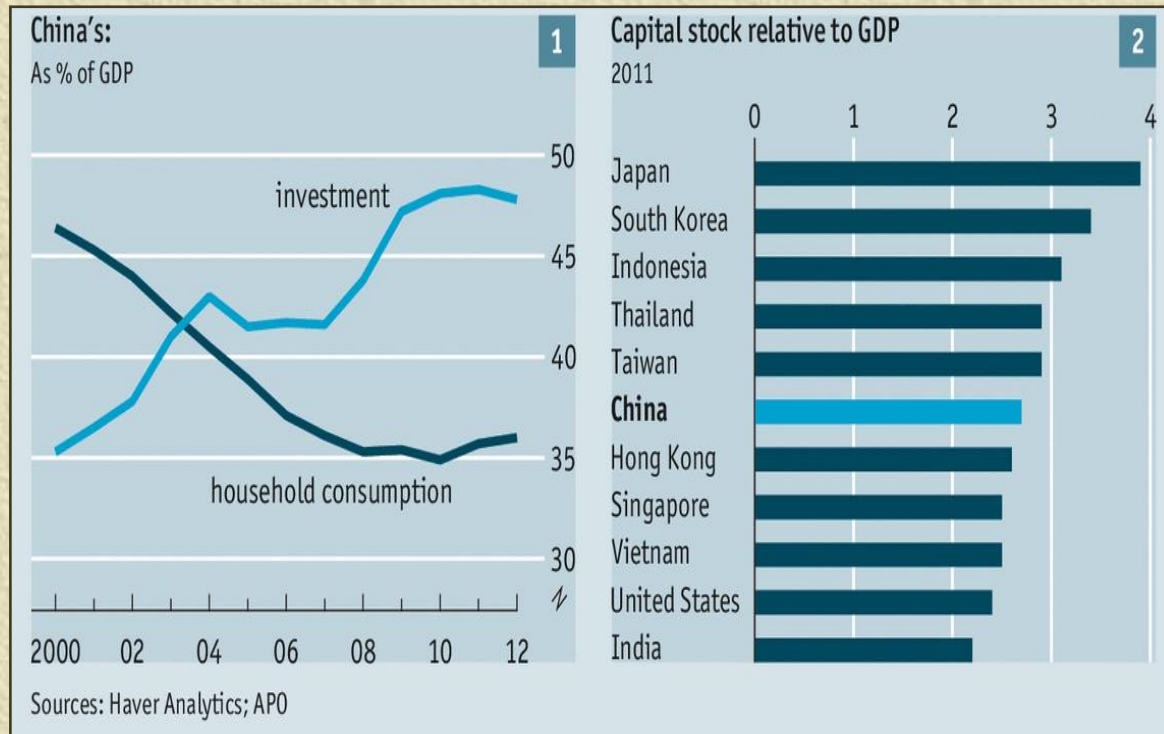
## ◆ Downside of the model

- Japan has lowest level of import penetration and inward FDI – foreigners play little role in its economy
- Japan has little participation in global wave of cross-border mergers and acquisitions – given so much mobility of goods, services, and K



# Strategic Trade Policy Intervention

- Consumption, saving and investment: case of China

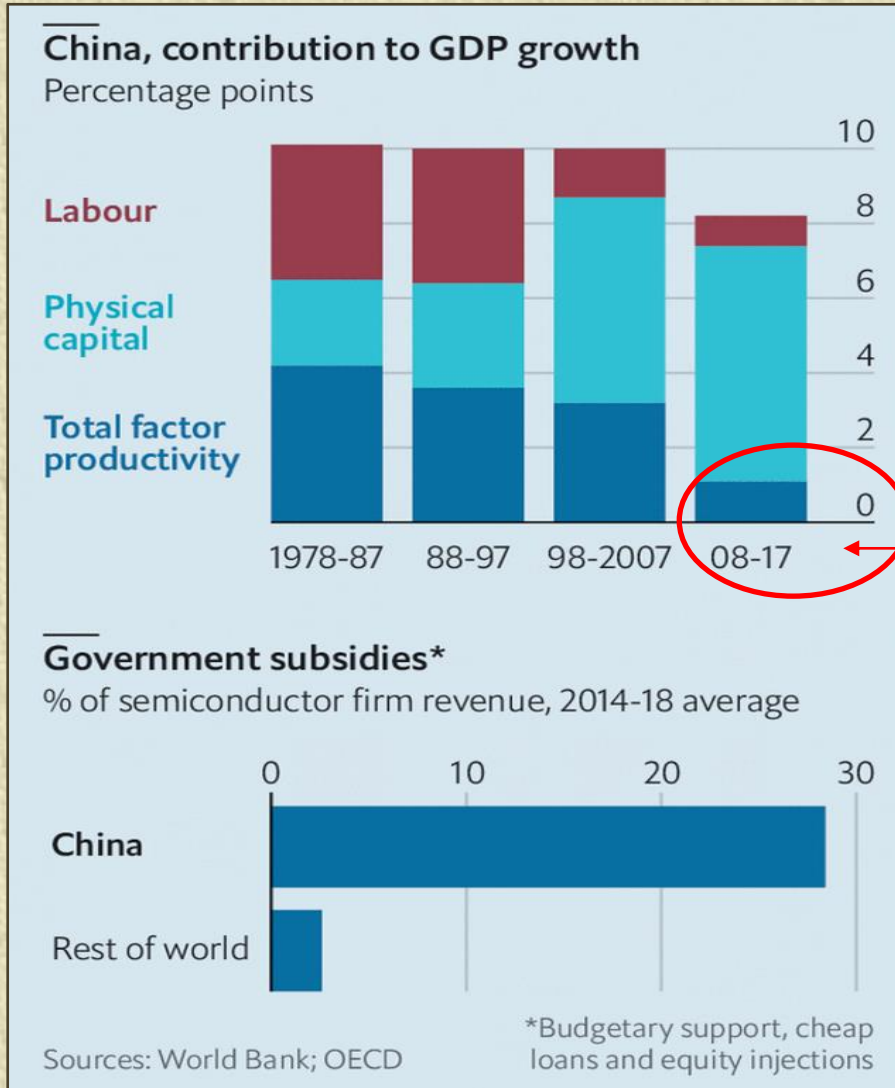


China's K-accumulation of imported physical K was financed by domestic savings. **↑K-intensity of the growth model in M-prodn and infrastructure investment meant high savings and low C/GDP.** Heavy reliance of export.

*Economist*, "Fortified but not enriched", Briefing on China's place in the world economy, 28 May 2022, p. 13-5.

# Strategic Trade Policy Intervention

- China: investment, subsidies and trade disputes



Does industrial policy work?

Gov't can use its muscle to stimulate activities not possible by private sector. S. Korea's policy targeting chemicals industry in 1970s led to tech advances and prodvty gains for macroeconomy.

Insights from China: (1) industrial policy works better when natural monopolies are involved (high-speed rail; power transmission); (2) continued heavy-handed intervention seems increasingly ineffective in TFP terms.

# Strategic Trade Policy Intervention

## ✦ Neo-developmental approach

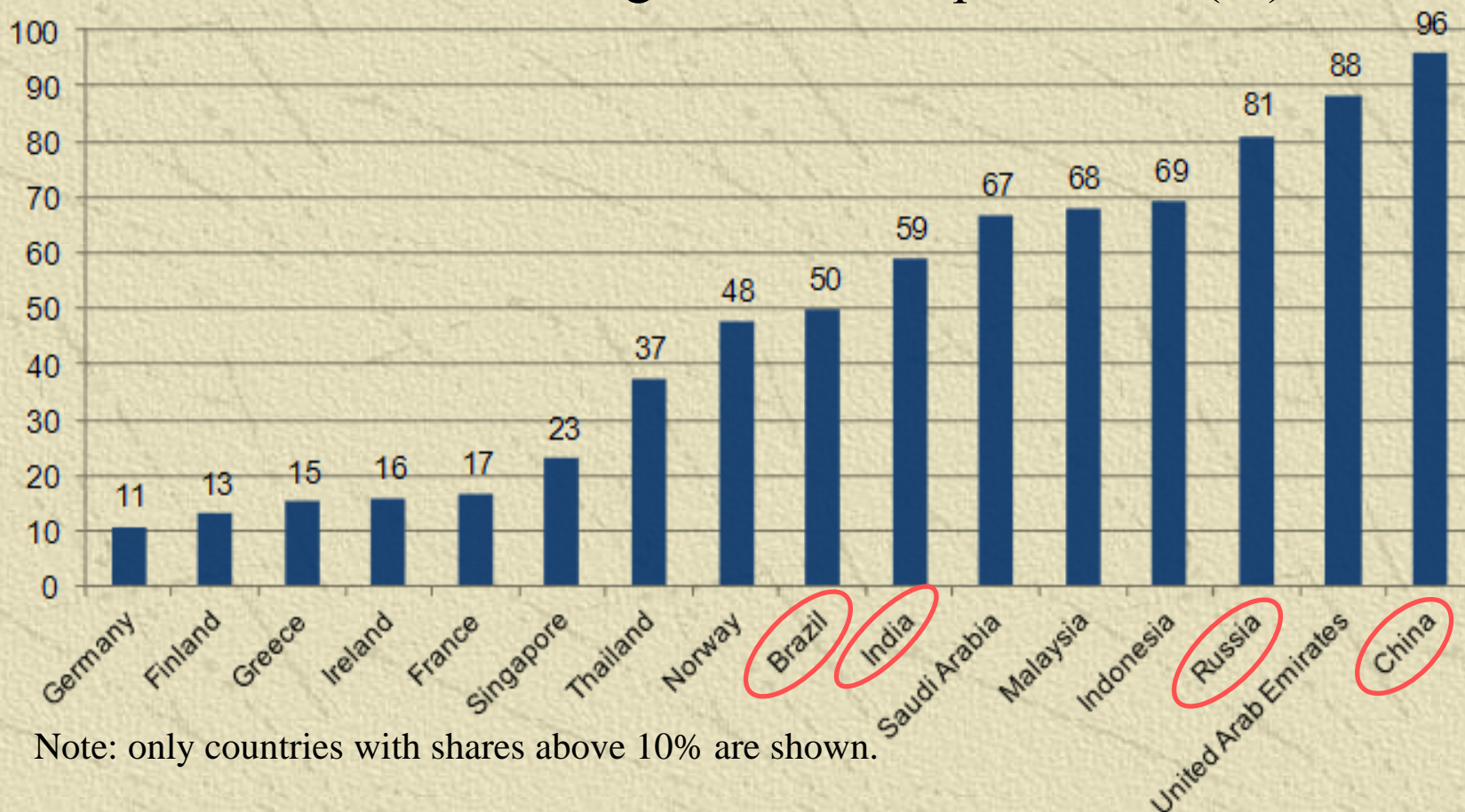
- ✦ IMF reverses position to allow K-controls and more nuanced on financial liberalization
- ✦ Since global financial crisis (2007)
  - National champions: ↑ investment thru SOEs
  - Internationalization of SOEs: trade and foreign investment
- ✦ Importance of “learning” and economies of scale (EOS)
  - “Mastering” new tech and prodn is a gradual process
  - Requires temporary measures, e.g., protection / subsidies-support
  - Where there are EOS, gov’t intervention is justified (even beyond mkt failure argument)

Source: OECD (2015), *State-owned Enterprises in the Development Process*, OECD publishing, Paris. ISBN978-92-64-22961-7 [www.OECD.org](http://www.OECD.org)

# Strategic Trade Policy Intervention

## ✦ Return to state ownership, 2013

◆ State's shares among countries' top 10 firms (%)\*



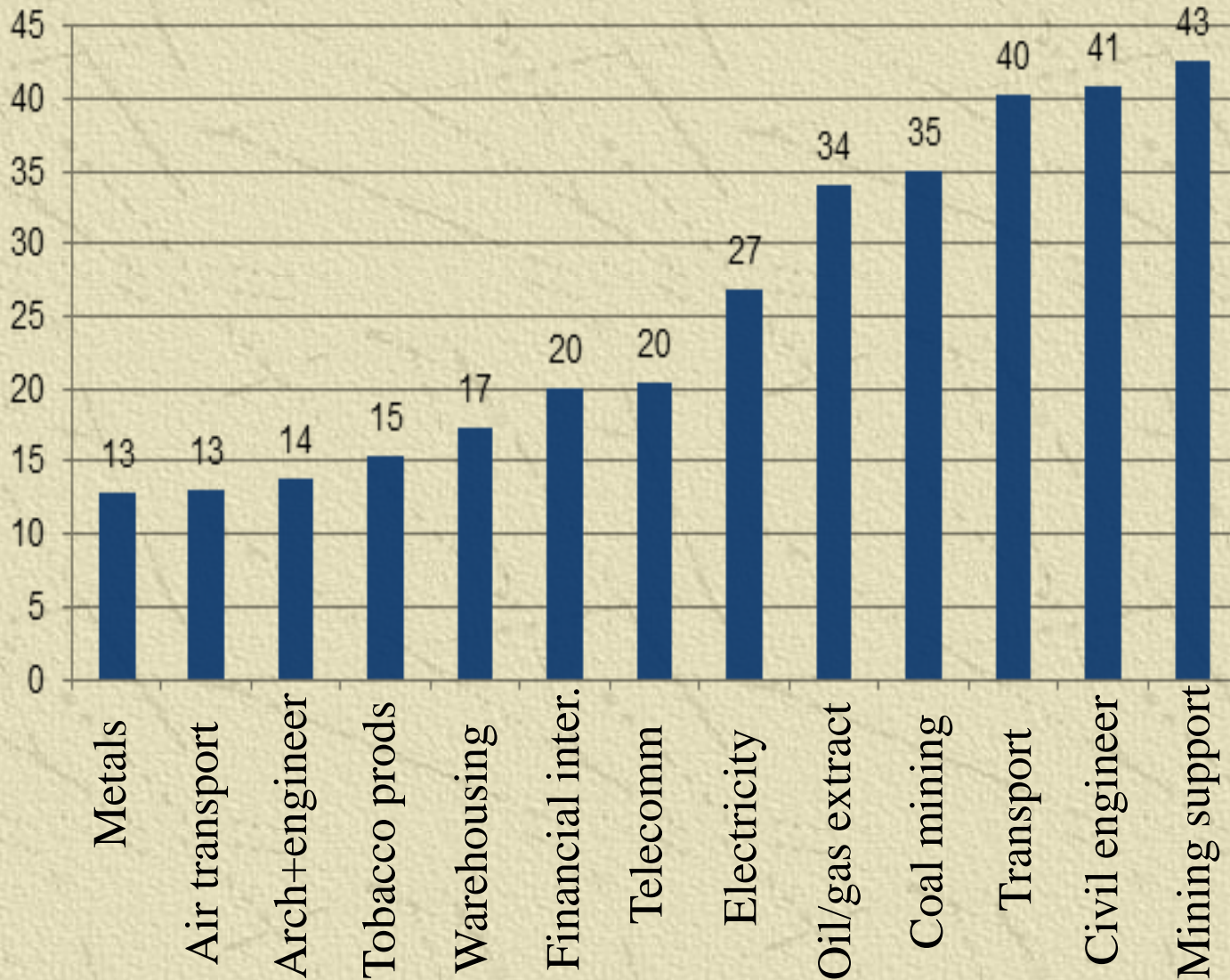
Note: only countries with shares above 10% are shown.

Source: Kowalski, P., M. Büge, M. Sztajerowska and M. Egeland (2013) "SOEs: Trade Effects and Policy Implications", OECD Trade Policy Paper, No. 147.

\* Excludes unlisted SOEs such as postal services or utilities, and firms with minority state shareholding.

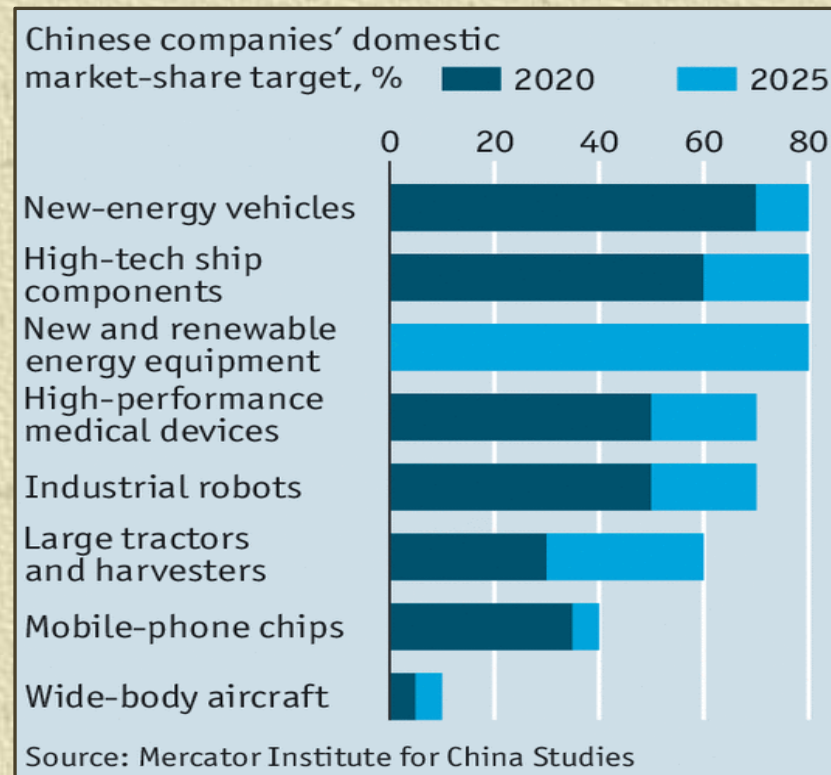
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- ◆ State ownership, share by sector (%)



# Strategic Trade Policy Intervention

- ◆ Industrial policy in China “Made in China, 2025”
  - 1,013 state-guided funds endowed with 5.3 trn yuan (\$807bn)
  - Manufacturing subsidies spread over 62 separate initiatives
  - Market share targets both at home and abroad
  - Local content rules – also illegal under WTO rules



# Strategic Trade Policy Intervention

- ✦ <https://mru.org/courses/international-trade/unbundling-supply-chain>



# Strategic Trade Policy Intervention

## 8.3 Policy intervention in developed countries

### ✦ WTO constrains use of trade policy and subsidies

- ◆ Tariff ceilings are low, on avg
- ◆ No industrial subsidy
  - Subsidy of 75% of research costs; 50% of new prod develop
  - Subsidy for infrastructure

### ✦ Cases for gov't intervention of North

- ◆ Infant industry argument applied to R+D-intensive sectors
- ◆ Externality: de-industrialization
- ◆ Imperfect competition

# Strategic Trade Policy Intervention

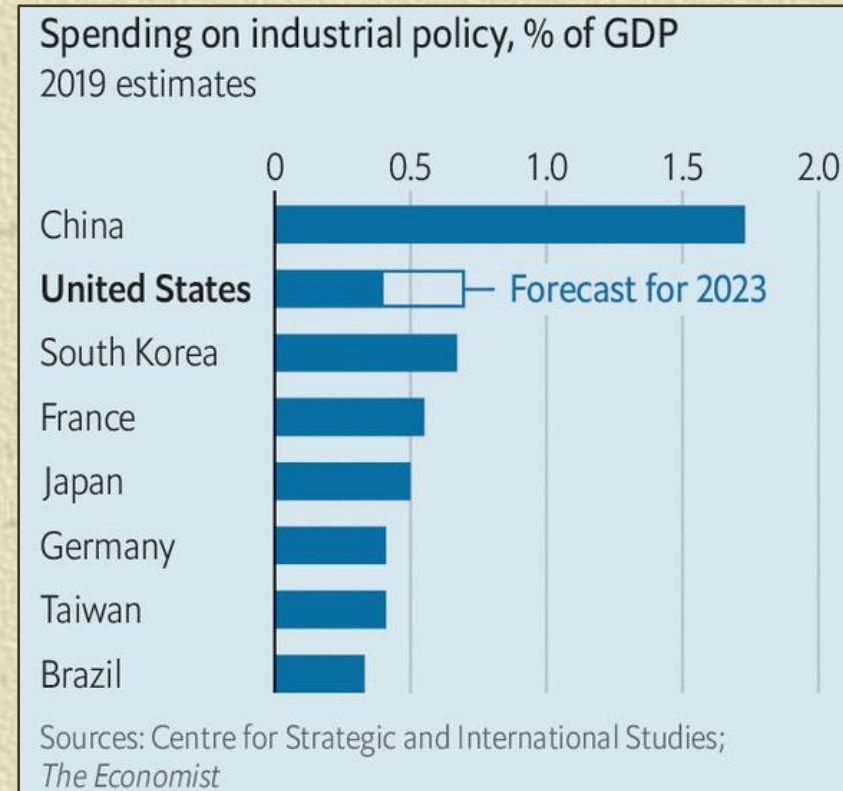
## ✦ Evolution of US-China trade war

- ✦ Tariffs were of limited use
- ✦ New US strategy: friend-shoring (“invest, align, compete”)
  - Subsidies in targeted sectors
  - Isolate rivals and recraft commercial ties with allies
  - Strengthen high tech supply chains, making them China proof



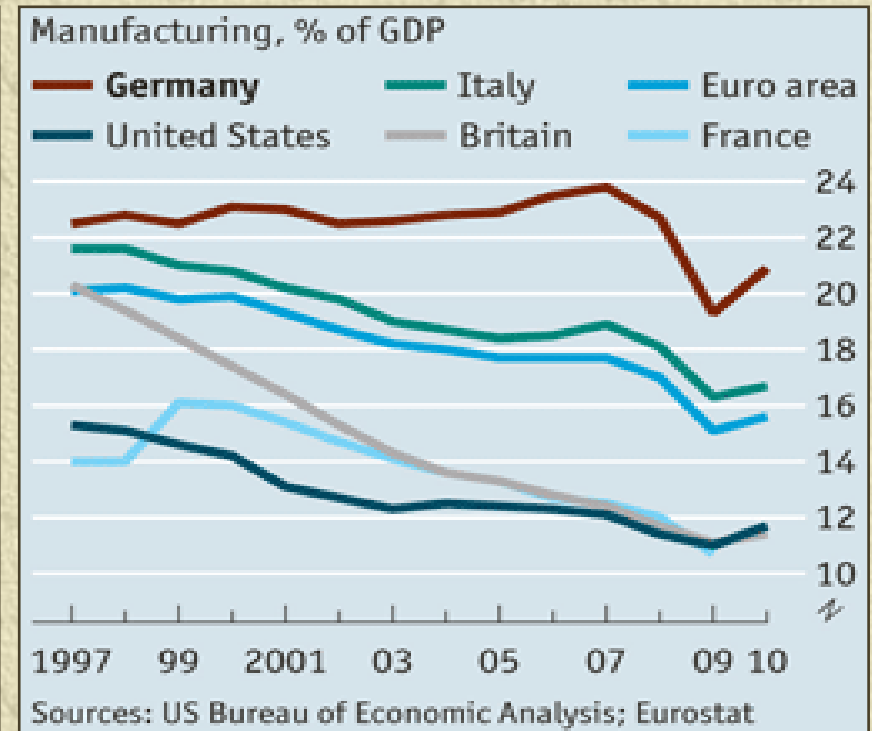
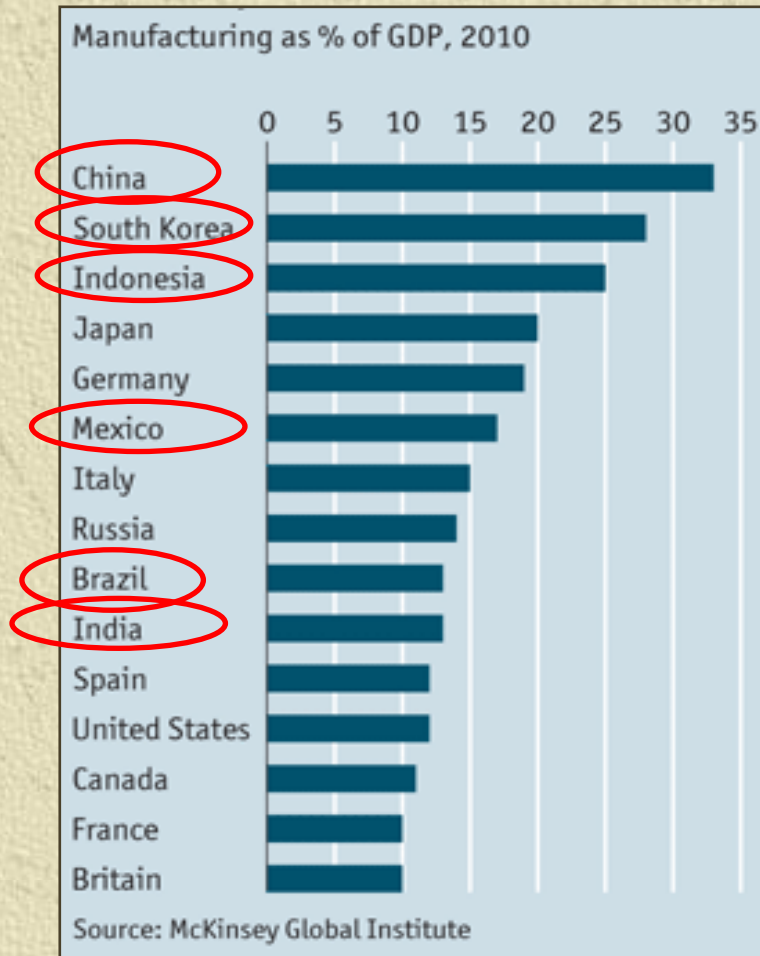
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- ◆ Subsidies
- ◆ Sanctions (nat'al security, 2019)
  - Block Huawei, Chinese 5G IT firm linked to gov't
  - Encourage allies to do same
- ◆ Export controls (2022)
  - US tech firms blocked from China
  - Export licenses for US firms
  - Much of IT runs on US software (Microsoft)
    - ◆ Western allies follow suit, or
    - ◆ 3<sup>rd</sup> country chip manufacturers affected as US software is blocked
  - Limit all US citizens/firms from aiding China's semi-conductor manu, supercomputing and AI



# Strategic Trade Policy Intervention

- ◆ Externality: De-industrialization from North-South trade
  - Manufacturing shares

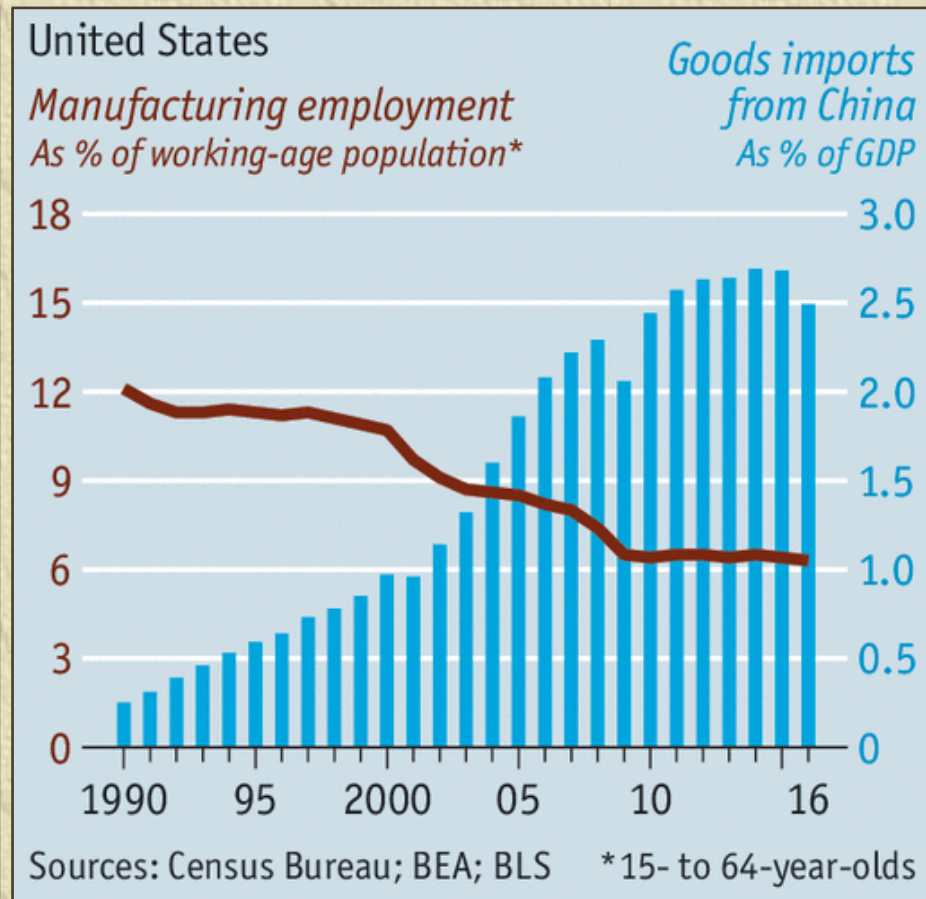
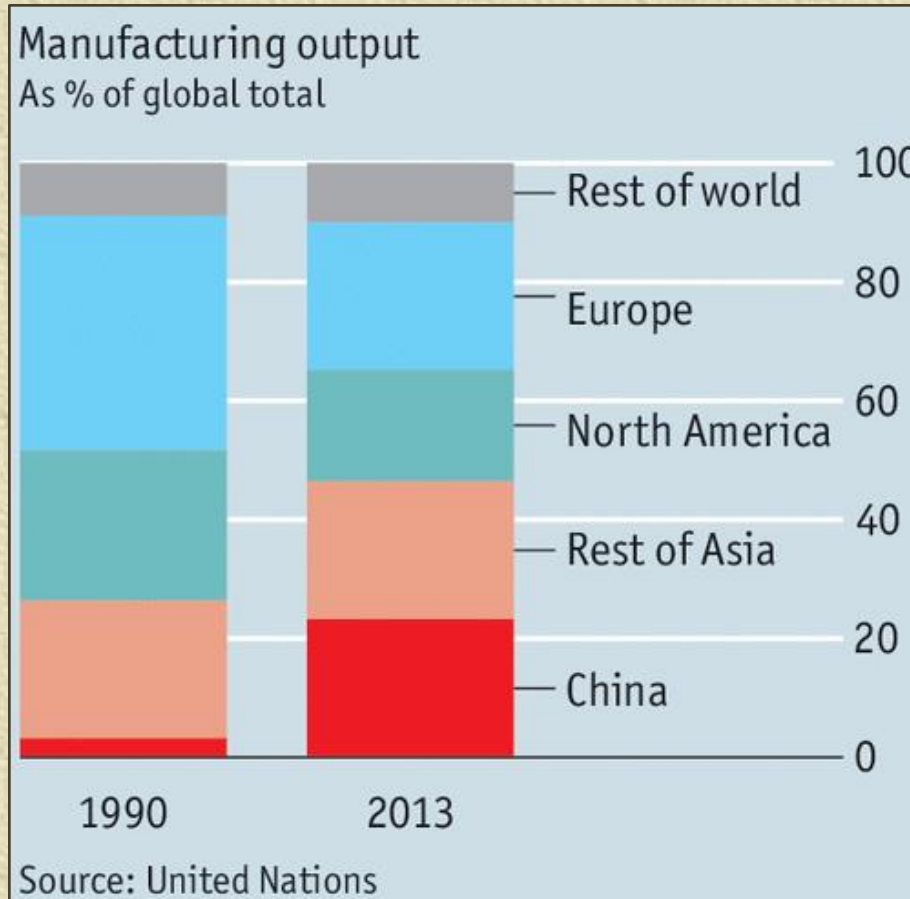


*Economist*, "What Germany Offers the World ", 14 Apr 2012, p. 56.

*Economist*, "Manufacturing: The new maker rules", 24 Nov 2012, p. 66-7.

# Strategic Trade Policy Intervention

- US-China trade and US employment in manufacturing

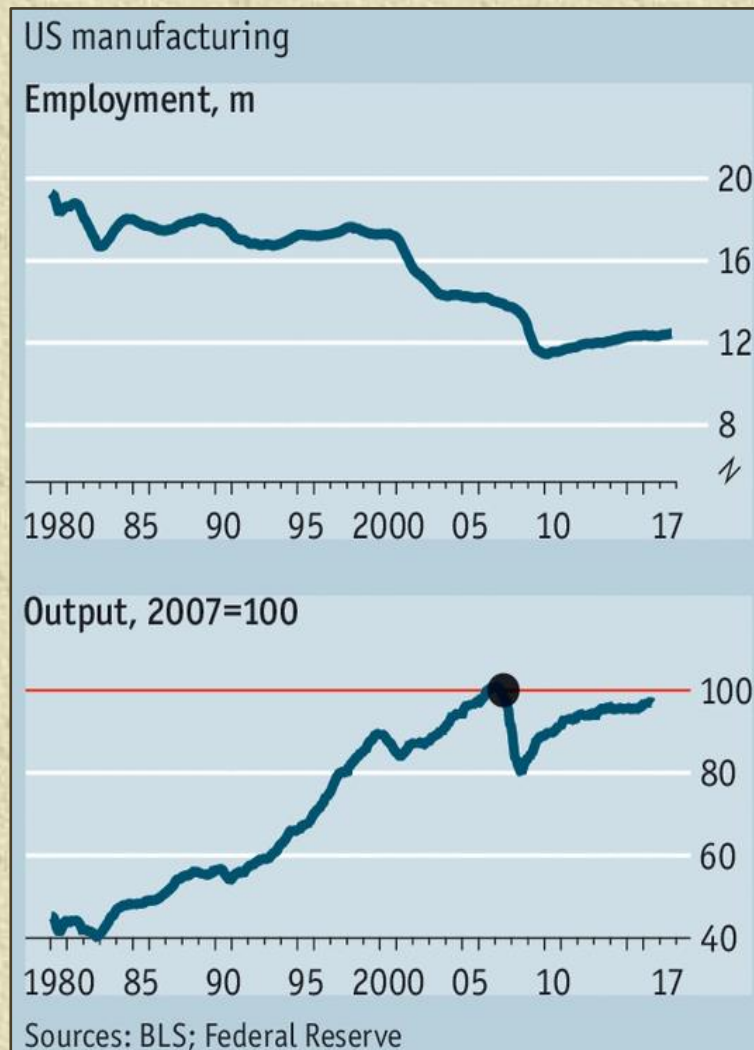


*Economist*, "The future of factory Asia: A tightening grip", 14 Mar 2015, p. 61-2.

Source: *Economist*, "Trade with China: Shock horror" 11 Mar 2017, p. 70

# Strategic Trade Policy Intervention

## ◆ Relative productivity: manufacturing



Source: *Economist*, "Manufacturing: Making it in America" 14 Oct 2017, p. 55.

Many reckon that global trade, especially with China, is to blame for the loss of manu employment. Studies show majority of past factory job losses were result of investment in automation (tech). Output more than doubled in real terms. Output per labor-hr rose 47% between 2002-15.

When Taiwan's **Foxxconn**, the world's largest contract manufacturer, which employs over 1m people in China, stated it would **build a factory in the US employing up to 13,000 people in return for \$3bn in tax breaks and state subsidies**, Mr. Trump called a press conference to celebrate (\$230,769/job).

# Strategic Trade Policy Intervention

- ◆ Relative productivity manufacturing and services



Substituting labor for capital is more difficult in services.

Some services sub-sectors are more labor intensive than others.

Thus, labor's share in the services sector is expected to increase relative to manufacturing.

*Economist*, "German Services: Protected and Inefficient",  
18 Feb 2012, p. 24;

# 9. Imperfectly Competitive Markets

## 9.1 Imperfectly competitive markets

- ✦ Use and abuse of market power

- ✦ Market situations

- ◆ Large country cases, e.g., factor endowment over strategic commodity
- ◆ Policy/regulations provides domestic market power
- ◆ Economies of scale (EOS) – increases firm size