Industrial Country Policy and Adjustment to Imports from Developing Countries

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WORLD BANK

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INDUSTRIAL COUNTRY POLICY AND ADJUSTMENT TO IMPORTS FROM DEVELOPING COUNTRIES

A Background Study for World Development Report 1981

This essay reviews and interprets recent analyses of the policy of industrial countries in response to increasing imports from developing countries. Industrial country policy has been caught between the sometimes conflicting objectives of economic security for each individual and economic efficiency, or growth. Policies which have ignored this basic trade-off have not been successful in achieving either objective.

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I. INTRODUCTION AND SUMMARY

The literature on adjustment by industrial countries to imports from developing countries is extensive. By way of summary -- more of the literature than of this paper -- the following points are listed:

- Trade with the developing countries is not a threat to the existence of a manufacturing sector in the developed countries. Such trade, and particularly its growth in the 1960s and 1970s, has been a significant net addition to demand for manufactured goods produced in the developed countries.

- The shifts between industries required by adjustment to imports from developing countries are small in relation to the magnitude of the total structural change taking place in developed countries.

- No country has discovered a costless formula for adjustment; that is, a way to avoid having to choose, at least at the margin, between the economic security of individuals and the growth or efficiency of the aggregate economy.

- Full employment and rapid economic growth have contributed more to rapid redistribution of resources than has conscious policy to redeploy resources.

- Comparative advantage matters. Attempts by governments of developed countries to revitalize industries in which comparative advantage clearly lies with labor-rich countries have not been successful. Where revitalization programs have produced significant improvements in productivity, the new technology has been put in place in developing countries almost as rapidly as in the innovating developed country. Japanese industrial support has tended to emphasize scale of plant and quality control. In products which are "scale and quality intensive," they have become world leaders, but in other products they have done less well.

- The statement "Governments do not pick winners, they make winners" is very misleading. There are more instances in which long-term government support failed to produce a "world-class" domestic industry than instances in which it succeeded.

- Japan's postwar growth does not illustrate that government policy to identify and promote industries with high growth potential (at the expense of other industries) can make a major contribution to the rate of growth of aggregate output. Many high-growth industries (e.g., autos, radios, televisions) were not "chosen" industries; entrepreneurship and very high rates of saving and investment were much more important in determining their growth.

- Mere identification of industries in which the nation has comparative advantage and the nation's actually being a successful exporter are not the
same thing. A high school student might have college entrance examination scores higher than 90 percent of last year's university graduating class, but if he presents his score report to the university registrar, expecting to receive in exchange his diploma, he will be disappointed.

- Losers are easier to pick than winners. Identifiable exogeneous factors such as labor or technology intensity are significant determinants of relative costs, but not complete determinants. Thus, one can confidently forecast that a labor-intensive industry will not achieve world competitiveness if it is located in a high-wage country. But it is much more difficult to predict in which human-capital-rich economy a particular human-capital or technology-intensive industry will become a world leader.

- The success of a particular policy is often closely associated with social conditions unique to a country. There has been a marked shift of U.S. industrial capacity into poorer regions, the South and Southwest (or "Sun Belt"). Regional policy has been, in effect, competition among the states to attract industry, but the overall pattern of industry support has been consistent with the export pattern of the United States. A major factor in this shift has been the mobility of the U.S. population, which has made possible the transfer of significant amounts of human capital. The European population is less willing to move, and European regional policy has been less successful. The Japanese government's emphasis on large scale of plant as a key feature of the structure of export industries has been complemented by the discipline of the Japanese work force, and this discipline has allowed a high level of quality control to be maintained.

- Effective research of this subject will shy away from attempts to find a better way for developed countries to adjust; instead, it will attempt to identify the costs of protectionism or of the failure to adjust, and the means by which such information may be brought to bear on the relevant policy decisions.

Some of the foregoing items may appear as truisms; nevertheless, they define the intellectual framework from which the present analysis of the issues emerges.

The developing countries' interest in structural adjustment in the developed countries is obvious. If the developed countries are able to transfer resources quickly from one use to another, then their resistance to increased imports from the developing countries will be reduced. The developed countries' interest in their own adjustment is, of course, equally direct. The opportunity costs of not transferring resources to more efficient uses are large, and defensive policies put in place to protect groups and individuals from reductions of income tend to worsen the inflation-growth trade-off and to increase, in the long run, resistance to adjustment.

Again, the literature on the subject is extensive; because it has been recently reviewed by Martin Wolf (1979), this paper will not
attempt to repeat his exercise. The reader is referred to his excellent
survey for a listing and evaluation of the many policies and programs which
have been implemented in various countries. Likewise, the findings of the
various Organization for Economic Co-operation and Development (OECD)
committees on the subject have also been recently gathered together in one
document (OECD 1979).

This paper will take both a more superficial and a more selective
view of the subject than previous reviews have taken. At a level more
journalistic than scientific, it will examine several major hypotheses
which have an impact on public opinion, though not necessarily on informed
opinion. The following section attempts to identify the background
issues and policy questions that are concerns of the literature on adjust-
ment. Later sections discuss the following "hypotheses":

- That open trade with developing countries is a threat
to the existence of an industrial sector in developed
countries

- That the experience of Japan shows the way by which
adjustment and growth may be achieved through government
selection and nurture of particular industries with high
growth and trade potential

- That the key to successful adjustment policy is effective
technocratic planning.

II. THE LITERATURE ON ADJUSTMENT:
BACKGROUND ISSUES AND POLICY FOCUS

The size of the literature on the industrial countries' adjustment
problems and policies is impressive. The bibliography of Martin Wolf's
survey of this topic (1979) includes more than 160 items; since then at
least three sets of conference papers (Bhagwati 1980; Levenson and Wheeler
1980; McMullen 1980) and another survey paper (Krugman 1980) have appeared.

Were the number of lines written on a subject a reliable
indicator of how well the subject is understood, then the industrial
countries would know what to do to adjust to the expanding export
capacity of developing countries. There are, however, two reasons why
this is not the case.

First, this literature evaluates in terms of one objective
policies designed primarily to serve another. Most of the programs and
policies surveyed were not established with adjustment as their primary objective. They arose from the twentieth century liberal concern with "economic security" [see Nelson (1981) for a discussion of the emergence of this concern as a major element in public policy] or, more particularly, from concern at a policy level with the side effects of economic growth. The general objective of these policies was to minimize the dislocations (geographic and sectoral) and offset the (perhaps temporary) income losses embedded in the responses of economies to the changes of consumer tastes and of modes of production which add up to economic growth. But the discomfort of remaining in a declining sector and the potential gains from shifting to an advancing one are the incentives by which a market economy adjusts. Thus, these policies have -- as the literature points out -- often tended to compromise the capacity of the economies to adjust and grow.

The second reason why this literature does not present a clear "how-to-adjust" formula is that it reflects not so much a shift back to growth as the sole economic objective, but an emerging plurality of objectives. The literature emphasizes the conflict between growth of the aggregate level of income and the economic security of individual citizens, but it does not diagram an easy way to balance the political forces behind each objective or to tip that balance toward adjustment and growth. Had the literature reflected simply an exchange of one objective for another, the task of deciding how to accomplish that objective would have been much easier.

Policy Objectives

One or the other of two interdependent objectives underlies most of the work on adjustment. One of these is the obvious one: to reestablish economic growth and efficiency as a social objective coequal with economic security and to identify the costs (in terms of capacity to grow) of economic security policies and programs.

Perhaps the clearest example of this objective is the work of the OECD Secretariat. An OECD ministerial communique (1979, p. 19) recognizes that "governments are pursuing other social and political objectives concerning the social and physical environments, the distribution of income, and the fair sharing of the burden of adjustment to structural change." The communique goes on to add that "It is essential, however, that these goals should be sought through policies which minimize any resulting costs in terms of reduced economic efficiency."

A second objective of "adjustment policy" is, as stated by Martin Wolf (1979, p. 3), to "make possible the acceptance of, rather than resistance to, market penetration by the exports of developing countries in developed countries."
Operational Questions

With these policy objectives always in the background, the literature on adjustment has tended to concentrate sequentially on three policy questions:

- How to shift resources from lower-to-higher productivity uses
- How to choose and promote industries with high growth potential and a strong position in international trade
- How to identify the costs of industry support programs.

Policy analysts have tended first to look for policies which served the economic security and the growth-efficiency objective simultaneously; i.e., to try to find a way to avoid trading one constituency against another. This "golden path," however, has not been found. Reviewers have more or less unanimously agreed that public policy, to promote economic security, has often sought to delay the transfer of resources, or at least it has had that effect (see Ohlin 1975, p. 11). Recognizing this, OECD documents have tended to stress the welfare gains which positive adjustment will allow in the long run and the deterioration of the trade-off between the short-run individual security benefits and the long-run aggregate income-efficiency costs of defensive measures. But to those who might be displaced by technological change or developing countries' exports, this is a "bird-in-the-bush" argument; hence, in the relevant political context, economic security and growth efficiency are alternatives which cannot be achieved simultaneously.

Thus, answers to the first question did not produce a golden path to security -- a path which had no costs in terms of growth and efficiency. Indeed, it was generally found that "the greatest contribution to rapid reallocation has probably been the pursuit of full employment and a generally high level of demand" (Ohlin 1975, p. 11).

To promote adjustment through growth, one obviously has to promote growth, and this can be approached in either a macro or a micro context. In macro terms, growth involves the allocation of a larger share of GNP to investment and research. It obviously reduces short-run consumption possibilities. An alternative approach, which might be described as "economic growth on the cheap," is suggested by the second policy question listed above -- how to pick industries with high growth potential and promote them; i.e., to transfer resources to "winners" and away from "losers" without increasing the total amount of resources devoted to research and investment.

Industrial policy -- policy to choose and promote industries with high growth potential and a strong export position -- has not proven to be the golden path either. Winners are not so easy to pick, particularly
for industrial countries at the frontier of technological progress and changing patterns of consumption and possessing roughly similar factor endowments and management skills (OECD 1979, p. 38). Even historically, it is difficult to distinguish unambiguously losers from winners. Vaccara and MacAuley (1980) measured U.S. industrial performance by several alternative criteria (such as output growth, export performance, and wage and price performance) and found generally insignificant correlations between industries ranked by one criteria and those ranked by another.

Furthermore, losers have not proven easy to abandon. Economic distress seems to be a stronger political force than economic potential. For example, rates of assistance across industries in the Federal Republic of Germany are negatively correlated with the export position of these industries (Glismann and Weiss 1980, p. 14), and industrial policy in the United States has tended to be a sequence of rescue programs for firms in trouble.

Finally, Japan is frequently given as the prime example of the effectiveness of picking and promoting industrial winners. The attraction of the Japanese model apparently is that it offers a costless solution to the problem of lagging economic growth: by having government direct or induce the available amount of savings to the "right" industries, the growth rate of aggregate output which a given savings rate produces will be increased. On careful examination, however, this interpretation does not fit the Japanese case very well. Several major growth industries (e.g., autos, radio and television receivers) were not picked by the Japanese government (see below, section IV). Investment in Japan was no more "growth efficient" than elsewhere, in the sense that a percentage point of GNP devoted to investment did not buy more growth in Japan than it did in other countries. There were simply more percentage points of investment in Japan.

As these attempts to find a costless way to promote adjustment and economic growth have proven fruitless, attention has begun to turn toward the less glamorous tasks of identifying the costs of protection and of industry support programs. This involves both steps to promote the collection and publication of information relevant to the calculation of these costs and steps to bring this information to bear on the relevant decisions.

These tasks might initially seem trivial, but they are not. Anyone who has sought to identify at the product level those imports subject to quantitative restraint will know that this is a complex and time-consuming task. With more subtle forms of non-tariff protection or industry support programs, the task simply of measuring their coverage (apart from estimating their effects) is even more difficult. Examples of government actions which make such work less difficult are the U.S. Trade Action Monitoring System, which tabulates trade-restrictive measures put in place by the United States; the annual record of government industrial aids and trade protection provided by the Industries Assistance Commission in Australia (cited in Biggs 1981, p. 19); and the German "Subsidy Report,"
which records by sector all federal government subsidy expenditures and also forgone tax revenues that are a result of industry tax exemptions (Fels and Glismann 1975).

The existence of information on the costs of industry protection or subsidization does not mean that it will influence such decisions. The decision mechanisms through which protection and industry policy are administered usually focus on very narrowly defined criteria, which often do not include such costs. For example, under the General Agreement on Tariffs and Trade (GATT), "injury" in a safeguard case is determined with respect to the effects of imports on domestic producers of like or competitive products. Offsetting benefits to users of such products are not to be taken into account. (For a more general discussion of how countries define the focus of administered protection decisions, see Nelson 1981.) Although the calculation and publication of the costs of protection will surely influence the general political climate, for such information to affect the operative decisions that constitute trade and industry policy, legislative changes in these decision mechanisms will be necessary.

In summary, studies of adjustment experience have been less effective in finding an economically costless or politically acceptable way to adjust than in popularizing the idea that failure to adjust has significant costs. The OECD, for example, has popularized the term "positive adjustment" to stress the bright side of the issue. To be effective, further research should concentrate on the identification and quantification of the costs of protection or failure to adjust and on finding ways to apply these data in the decisive stages of fiscal and industrial policy.

III. THE DIMENSIONS AND NATURE OF THE ADJUSTMENT PROBLEM

At the most elementary level, the subject of adjustment to imports from developing countries raises concerns about the state of the manufacturing sector in the industrial countries.

Disappearance of the Manufacturing Sector in Developed Countries

As an indication of the virtual disappearance of the manufacturing sector in industrial countries, a labor union official, testifying before the U.S. Congress, suggested that, unless the growth of imports was controlled, the United States would eventually become "a nation of hamburger stands." Indeed, as Table 1 indicates, already through the 1960s the developed countries' manufactured imports from the developing world were growing more rapidly than was the developed countries' manufacturing production. From 1970 to 1978 manufactured exports from developing to developed countries grew three times as rapidly as developed countries' manufacturing output. Such figures, used in isolation, appear to give substance to the union
official's fears that trade with developing countries is causing the industrial sectors of the developed countries to disappear -- i.e., to become vast consumer depots, "nations of hamburger stands."

A more complete picture of the growth of industrial country trade with developing countries is presented in Table 2. Figures there indicate that in 1970 the industrial countries imported some $6 billion ($6,000 million) more of manufactured goods from developing countries than they did in 1960. But over the same period developing country purchases of manufactured goods from the industrial nations increased by almost three times as much -- by over $15 billion. Thus, during the 1960s the growth of manufactured goods trade between developed and developing countries added in net terms almost $10 billion to demand for developed countries' manufactured goods.

From 1970 to 1978 developed country sales of manufactured goods to the developing world increased by almost $32 billion (1970 dollars), whereas the counterflow grew by less than $12 billion.

In direct terms, growth of trade between developed and developing countries added $10 billion to demand for developed countries' manufactured goods over the 1960s, and $20 billion (1970 dollars) from 1970 to 1978. From the 1960s to the 1970s, the growth rate of developed countries' manufactured exports to other industrial countries was cut in half (11.4% to 5.8%), whereas the growth rate of developed countries' manufactured exports to developing countries picked up by nearly a half (6.2% to 9.2%). These figures suggest that, far from retarding the industrial sector of the developed countries, trade with the developing world made a significant contribution to the vitality of the industrial world's manufacturing sector.

As to the fear that trade with developing countries will limit job opportunities in the developed countries to the relatively unattractive service sector (i.e., hamburger stands), the opposite seems to be true. Compared with the developed countries, the developing countries are at stages of development at which demand for manufactured goods is high relative to demand for services. Because consumers in the industrial world demand more "services" than do consumers in the developing world, to isolate production in the developed countries from world commerce would mean a larger, not a smaller, share of developed countries' production in the service sector.

Employment Displacement Compared with "Revealed" Capacity to Adjust

Data in Table 2 make clear that the expansion of trade between developed and developing countries has provided a net addition to demand for developed countries' materials and manufactured goods, and therefore to employment in both these sectors of the developed countries' economies. Suppose now that developed countries' exports to and imports from developing countries consist of products from different industries. We can then
Table 1
Rates of Growth of Quantums of Output and of Trade, Developed and Developing Countries, 1960-70 and 1970-78
(annual percentage rates)

| Sector and Period | Developing Countries | | | Developed Countries | | |
|-------------------|----------------------|--|----------------------|--|------------------|
|                   | Output | Exports | | Output | Exports | |
|                   | To Developed | To Developing | To World | To Developed | To Developing | To World |
| Manufacturing     | (Manufacturing Sector) | (Manufactured Goods) | | (Manufacturing Sector) | (Manufactured Goods) | |
| 1960-70           | 7.5    | 10.5    | 11.1 | 10.5 | 6.2 | 11.4 | 6.2 | 10.0 |
| 1970-78           | 6.5    | 10.7    | 13.5 | 11.5 | 3.3 | 5.8  | 9.2 | 6.8  |
| Aggregate Economy | (GDP)   | (All Non-Fuel Merchandise) | | (GDP) | (All Non-Fuel Merchandise) | |
| 1970-70           | 5.6    | 5.1     | 5.8 | 5.0 | 5.1 | 9.6  | 6.0 | 8.2 |
| 1970-78           | 5.3    | 5.0     | 9.8 | 6.4 | 3.2 | 5.5  | 8.9 | 6.1 |

Sources: Growth rates of GDP and of manufactured output are from World Bank (1980, Annex Table 1). Growth rates of exports were computed from indices given in United Nations (July 1980). "Manufactured goods" is defined operationally as SITC 5-8, and all non-fuel merchandise as SITC 0-8, less 3. Indices for 1-digit categories were combined using 1970 trade values as weights.
Table 2
Increments in the Volume of Developing Country --
Developed Countries Non-Fuel Trade, 1960-70 and 1970-78
(billions of 1970 dollars)

<table>
<thead>
<tr>
<th>Time Period and Direction</th>
<th>Raw</th>
<th>Foods etc. (0+1)</th>
<th>Excl. Fuels (2+4)</th>
<th>Chemicals (5)</th>
<th>Machinery (7)</th>
<th>Other Manufactures (6+8)</th>
<th>Non-Fuel Materials (0+1+2+4)</th>
<th>All Manufactures (5-8)</th>
<th>All Non-Fuel Merchandise (0-8, less 3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960 to 1970</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Developed to Developing</td>
<td></td>
<td>1.45</td>
<td>1.03</td>
<td>2.72</td>
<td>8.28</td>
<td>4.22</td>
<td>2.48</td>
<td>15.22</td>
<td>17.70</td>
</tr>
<tr>
<td>Developing to Developed</td>
<td></td>
<td>2.56</td>
<td>1.90</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>4.46</td>
<td>5.78</td>
<td>10.24</td>
</tr>
<tr>
<td>1970 to 1978</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Developed to Developing</td>
<td></td>
<td>3.86</td>
<td>1.88</td>
<td>4.36</td>
<td>16.57</td>
<td>10.90</td>
<td>5.74</td>
<td>31.83</td>
<td>37.57</td>
</tr>
<tr>
<td>Developing to Developed</td>
<td></td>
<td>0.98</td>
<td>0.15</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td>1.13</td>
<td>11.48</td>
<td>12.61</td>
</tr>
</tbody>
</table>

n.a. Not available.
Source: Calculated from quantum indices and current dollar values from United Nations (July 1980).
interpret the growth of developing countries' exports to industrial nations as the gross amount of output displaced by the expansion of this trade, and the trade figure multiplied by the average labor-output ratio as an approximation of the number of workers it was necessary for the developed countries to transfer from one industry to another because of the expansion of trade with the developing world.

Figures on output per worker vary considerably from industry to industry, but $24,000 (in 1970 dollars) is most likely a lower-end estimate. (The actual 1978 figure for the United States over the entire manufacturing sector was approximately $36,000 in 1970 dollars.) This figure then implies a gross displacement, in all the developed countries combined, of about 62,500 workers per year, (or 500,000 over the eight years from 1970 to 1978).

Table 3 presents some rough indicators of the "revealed" capacity to adjust in the developed countries. The figures given indicate that in 1979 total employment in the United States, the European Economic Community (EEC), and Japan combined was approximately 250 million. The gross displacement estimate (62,500) is 2.5 one-hundredths of one percent of this total employment figure, or 1.4 percent of the annual change of employment in the EEC, the United States, and Japan combined.

In conclusion, the number of job shifts made necessary in the developed countries by growth of their trade with the developing world is small relative to the number of changes which occur for other normal reasons. And the total number of jobs created by the expansion of this trade (from 1970 to 1978) is approximately three times as large as the number displaced.

IV. THE EXPERIENCE OF JAPAN

Japan's postwar economic miracle is often cited as an example of skillful economic planning by which the energies and skills of private businessmen were closely controlled and coordinated by a paternalistic and technocratic government. "The ultimate responsibility for industrial planning, for deciding in which new directions Japan's burgeoning industrial effort should try to go, and for fostering and protecting business as it moves in those directions, lies with the government" (Macrae 1967; cited by Trezise and Suzuki, in Patrick and Rosovsky 1976, p. 755). Were this rather simple explanation for Japan's economic performance valid, then "all" that would be required to duplicate Japan's economic performance would be:

- To follow the Japanese blueprint in organizing a ministry for international trade and industry
- To copy the techniques that the Japanese ministry had used to determine which industries to promote
- To initiate the incentives which the leadership of "Japan, Inc." had used to rally the responsive cadres of businessmen and workers into action.
Table 3

Total Employment, 1979, and Average Annual Change of Employment, 1975-79, in Selected Developed Countries (thousands of workers)

<table>
<thead>
<tr>
<th>Area</th>
<th>Total Employment (1979)</th>
<th>Average Annual Change of Employment (1975-79)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Total Employment</td>
</tr>
<tr>
<td>EEC</td>
<td>103,389</td>
<td>+638</td>
</tr>
<tr>
<td>F. R. Germany</td>
<td>25,017</td>
<td>+47</td>
</tr>
<tr>
<td>Italy</td>
<td>20,287</td>
<td>+367</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>24,711</td>
<td>+21</td>
</tr>
<tr>
<td>United States</td>
<td>96,945</td>
<td>+3,041</td>
</tr>
<tr>
<td>Japan</td>
<td>54,790</td>
<td>+753</td>
</tr>
</tbody>
</table>

Source: EEC (1977-80, Table II-8).
More detailed study of the Japanese experience has, however, produced a more balanced view of the role of government in determining the structure of the Japanese economy. As Philip Trezise and Yukio Suzuki sum up their evaluation: "There is no question, of course, but that, as in all modern states, the political environment and the economic policies that were among its products have influenced economic events pervasively and in some respects crucially. To suppose, however, that politicians and officials in league with businessmen were able to plan and guide Japan's explosive economic growth in detail is neither credible in the abstract nor (as will be seen) supported by the realities" (Trezise and Suzuki, in Patrick and Rosovsky 1976, pp. 756-57).

The Political-Technocratic Order

Trezise and Suzuki point out (p. 785) that there was a "broad consensus that after occupation saw economic or industrial growth as the road to national revival and independence." As Richard Cooper (1972-73) has pointed out, a broad consensus focused on a singular objective creates an ideal environment for the establishment of a smoothly functioning "technocratic track," along which problems are worked out in accordance with established and accepted rules. The singularity of the objective allows the smooth functioning of the technocratic track, and the smooth functioning of the process then tends to validate the objective. But the dynamic of such a mechanism comes from the singularity of the objective it institutionalizes, not from its capacity to make decisions across a plurality of purposes. Such synergism between a broadly accepted purpose and technocratic mechanism has existed in instances other than postwar Japan. Indeed, Cooper describes the Western international economic system, as it existed in the 1950s and 1960s, in these terms. There are, however, limits to how much the functioning of the technocratic mechanism can prevent eventual disillusionment with a singular purpose.

In any case, this lesson from Japan's economic history provides no particular guidance for policy. Although singularity of purpose does allow a complementary and smoothly working technocratic mechanism to be created, the recent history of attempts to reform the international trading system suggests that the construction of a technocratic mechanism does little to generate a consensus regarding purpose. And without this consensus, the technocratic mechanism will not be able to resolve differences over the appropriate course of action. Such differences will jump the technocratic track and become political issues.

Planning and Economic Growth

The idea that economic growth in Japan largely took place through selective promotion of particular growth industries seems to be based on one example: steel. The Japanese government provided no particular support for other industries which have done very well in Japan (for example, cement, paper, bicycles, radio and television receivers,
optical goods, and motorcycles; Trezise and Suzuki, in Patrick and Rosovsky 1976, p. 794). In addition, Japanese government policy toward the automobile industry was at best ambivalent. The auto-producing firms successfully resisted government pressure to concentrate on a single car model, and two of the producers which have become the most successful, Honda and Mitsubishi, stayed out of the cartel guided and nurtured by the government (Etzioni 1980).

It is clear that the explosive growth of the Japanese economy did not result from Japan's having developed (either by government alone or in cooperation with business) a scientifically precise plan and then having stuck to it. There are too many instances in which firms and industries which were not government-picked "winners" did well. Their doing well not only shows that the selection of industries was not precise, it also shows that the maverick firms and industries were not cut off from the resources needed to expand and prosper, which rigid enforcement of a plan would have implied.

In the Brookings study of the Japanese economy (Patrick and Rosovsky 1976), both Caves-Useuka and Trezise-Suzuki emphasize the importance of entrepreneurship. The latter authors write (p. 800) that: "If the general environment was favorable for enterprise, it was, after all, the enterprisers who seized the opportunities. It is not credible that these talented men could have been closely directed by a cadre of civil servants, however well educated, or that their vision and skills could have been adequately exploited within a tightly managed, essentially bureaucratic system." Industrial policy, or the choice of which industries would expand, was apparently more an entrepreneurial decision than a governmental one.

The most striking feature of the Japanese economy is not its government-business relationship, but its very high savings-investment rate. (The personal savings rate in Japan runs at about 20 percent of disposable income as compared with 6 percent in the United States. The Japanese annually invest about 17 percent of their GNP in new plant and equipment, versus 8 percent in the United States.) Such a savings rate has made the determination of industrial policy in Japan relatively easy. In cases of conflict between the views of government and business over which of two firms or industries had the better growth prospects, the Japanese government could allow both to expand. Thus, an amicable business-government relationship was reinforced by the government's not having to make any hard choices regarding the allocation of capital. The usual response by the Japanese government to pressures generated by tax advantages or other incentives for particular industries was to extend those advantages to yet other industries (Trezise and Suzuki, p. 800).

In summary, growth came from the interaction of a very high savings rate, the dynamic of private entrepreneurship, and a very supportive business atmosphere -- not from the development or implementation of a scientifically precise plan.
International Competitiveness

The role of the Japanese government in several Japanese industries gaining leadership positions in world trade may have been more direct. Again, the contribution of government was not in the early identification of industries which would eventually become export winners. Government influence was more subtle and influenced less the industrial composition of the Japanese economy than the form and structure of the industries which did emerge. Through its multitude of avenues of contact with business, and particularly through its influence over the flow of capital, the Japanese government stressed three characteristics:

- Large plants, always expanding the limits of realized economies of scale
- Large firms, with an export orientation
- Quality control.

That some Japanese industries have not become dominant in world trade indicates that not all industries are capital and scale intensive; i.e., other factors or industrial characteristics contribute significantly to comparative advantage there. But in those industries in which these characteristics have proven to be dominant, the Japanese record has been excellent. Capital intensity, plant size, and quality control have acted in concert to produce a significant Japanese advantage in labor productivity and overall costs.

What are the lessons from this experience that other countries might apply? The stress on export orientation and quality control, perhaps. But it is possible that the outward orientation of Japanese businessmen and the adaptability of Japanese workers to rigorous standards of quality control are based on cultural characteristics which would be difficult to duplicate in other countries. Large plant size and capital intensity might be easier to duplicate. These are characteristics which may be influenced by the instruments available to economic policymakers. But two important qualifiers should be kept in mind. First of all, the productivity increases which the Japanese gained from capital-intensity and scale may not be possible without their rigorous standards of quality control. The worker discipline necessary to duplicate Japanese accomplishments in other countries might require changes in policy areas into which governments would be reluctant to move.

Perhaps the more significant qualifier is that the day in which scale intensity and high labor productivity are winning characteristics for industry in developed countries may have passed. Such industries may soon become very vulnerable to competition from the newly industrialized countries or labor-rich countries such as Indonesia and China. Wage differentials between these countries and the developed countries are sufficiently large
that as they develop capacity they can become competitive even without achieving productivity rates comparable to the Japanese. Indeed, Drucker (1980) argues that the Japanese, aware of this, have moved away from scale as the target industry characteristic and are now stressing automation.

Lessons for Adjustment Policy

With a very high savings-investment rate, a rate of economic growth, and a rate of growth of the capital stock that is notably larger than the growth rate of the labor supply, the transfer of labor between industries presented no policy problems. Expansion simply pulled things along. Indeed, Sekiguchi's description (1975) of adjustment in the Japanese coal-mining industry indicates that the industry contracted despite government programs to support it. When the 1967 production target was not met "because labor had moved out of the coal mines to other sectors" (p. 295), the government's response was to increase the rate of subsidization -- and to revise the production target downward (p. 297).

The disappearance of the Japanese sulfur-mining industry illustrates the same point. Funds were raised by the oil refiners' association to buy up the sulfur mines and take over their labor force. The only sulfur produced in Japan now is produced as a by-product of petroleum refining (Sekiguchi 1975, p. 298).

The textile industry in Japan is often cited as an example of positive adjustment policy -- policy designed to facilitate rather than to resist the contraction of an industry which has lost its comparative advantage. The policy mix which the Japanese government implemented was, however, not novel and included:

- The encouragement of mergers to enlarge firm size and the organization of a cartel to cut back production
- Subsidized loans to support innovation and capital deepening
- Restrictions on the number of spindles the industry was allowed to operate and, eventually, purchase by the government of facilities of firms which agreed to leave the industry (Sekiguchi 1975, pp. 298 ff.).

All of these policies have been employed in other countries, against a backdrop of much slower overall economic growth, where they have not proven to be particularly effective. (See Wolf 1979, particularly sections IV.C, IV.D.) Indeed, Trezise and Suzuki (in Patrick and Rosovsky 1976, p. 801) point out that:
• Creation of cartels did not work because the industry was too fragmented.

• The reduction of spindles was extended to synthetic fibers, which were competitive in world terms and the production of which had been promoted by the government.

• Protection against imports stayed very high, and less than 2 percent of the sales of overseas Japanese textile and fiber plants went to the home market. (The Japanese export base was moved offshore, but the domestic market was not noticeably opened to imports.)

Trezise and Suzuki conclude (pp. 801 ff.) that: "If it is possible to find in the textile experience a policy of 'progressively giving away industries to other countries', the search must be thorough going indeed."

Thus, the lesson for adjustment policy which the Japanese experience offers is that, if things are going generally well, transfers between industries will be relatively painless, and policy which would meet with limited success under more trying circumstances will be satisfactory.

V. INDICATIVE PLANNING IN AN OPEN POLITICAL SYSTEM

One frequently hears that the key to successful adjustment policy is for the government to develop a scientifically precise, long-run plan identifying which industries will expand and which will contract and then to implement that plan. The first objection that can be raised against this position is that it is not easy to predict which industries will (or should, on efficiency grounds) expand or contract. As pointed out above, the past record of governments' picking winners has been spotty; even after the fact, when measured by several alternative standards (such as output growth, export performance, wages paid, and price stability), the ranking of industries as good performers varies considerably, depending on which performance measure is used.

A proponent of indicative planning might in turn argue that this is an overblown version of his proposal, and insist that policy support be limited to a few extreme cases, the obvious winners and losers. A look at recent trade statistics would provide preliminary lists, and professional analytical studies of these industries would then produce the final determinations.

The major problem with plans such as these is not that such technical determinations are impossible: technical expertise is available in government staffs or can be hired. The problem is that in an open political system such determinations must be enforced and defended at a
political level, and technical evidence is not a secure basis for a political sorting of those industries which will receive public support and those which must fend for themselves.

Those who lose at a technical level are free to appeal that decision at a political level, beginning by publicizing their case so as to generate public support. This appeal might take the form of pressing for a legislative or administrative exception to the technical decision (as was the case recently when the U.S. International Trade Commission determined that imports were not a major cause of injury to the U.S. automobile industry) or of generally supporting the political opposition to the government in power.

In his public or political case, a potential loser (an industry which will be excluded from public support) will attempt to do two things:

- To expand the criteria by which qualification for public support is determined beyond the measures of economic potential on which the technical determination is made
- To put forward evidence which challenges the negative technical verdict; i.e., which indicates that the industry in question is at least a potential winner.

Even if the government has a solid technical case (in the sense that impartial, trained experts would agree that the government's decision is correct), it may not be able to make its case stick at the political level. At the level of public debate, where such decisions must be defended, the relevant audience will not be technically competent to evaluate the conflicting scientific cases.

Such a governmental decision, if it is to stick politically, must rely for its defense on the competence of the technical staff which furnished the data for the decision. In the United States particularly, there is a tradition of disrespect for public officials, and in the United States the last two presidents elected have run against the federal bureaucracy. It would thus be impossible for a president to defend an industrial plan by pointing out that it was developed by the same bureaucracy which he indicted during his recent election campaign as bloated and incompetent.

In a country such as the United States, the technical part of indicative planning would be the easy part. Confining the relevant decisions to the technical criteria only would be the hard part.
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