

Steering Structural Change

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- Economic historians talk about cases.
- So I will talk about a case.
- Predictably, perhaps...

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- So I will talk about a case.
- Predictably, perhaps, this one



Why structural change was needed

- Europe had fallen behind the United States in the sectors that defined the technological frontier after WWII (steel, motor vehicles, machinery).
- It had fallen two generations behind the U.S. in terms of high-school graduation rates.
- Products such as nylon and Teflon common in the U.S. had not been introduced in Europe.
- Electrification was less pervasive (contrast the Tennessee Valley Authority).
- Europe had fallen behind in the adoption of modern mass-production methods.
- Labor productivity in industry was barely half U.S. levels after World War II.

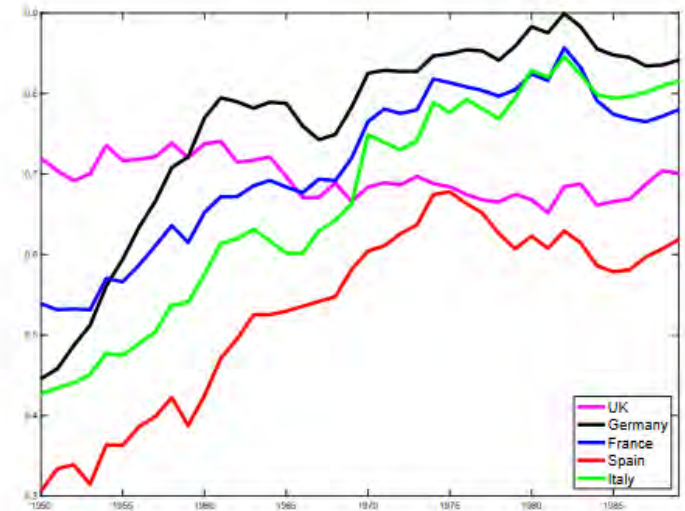


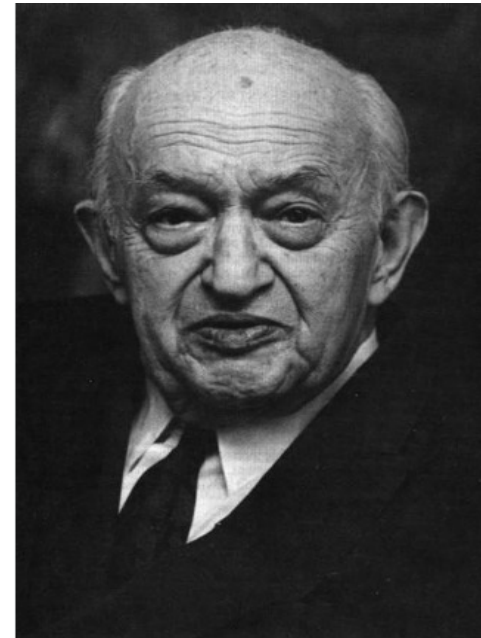
Figure 4: GDP per capita relative to the U.S.: 1950-1989

What Europe did

- It focused on raising investment rates, in the aggregate and in key industries.
- To this end, it created “planning” ministries to guide investments toward interdependent sectors (each of whose profitability depended on the others).
- State holding companies such as INI and ENI in Italy similarly coordinated investments in steel, energy and related industries.
- Created institutional arrangements (works councils, social and economic committees, codetermination) to coordinate capital and labor – to give labor assurance that profits made possible by its wage moderation would be plowed into investment (returning national security and higher future incomes), while using tax policy etc. to insure that management did its part. In effect, it sought to ensure that the returns to these initiatives would be shared.

Europe took this approach because:

- It had failed to close the productivity gap after an earlier war (when following a more laissez faire approach to structural change and economic growth).
 - In particular, investment rates had been depressed.
 - Labor relations had been conflictual.
 - This period saw Europe fall behind the US both in products (motor vehicles, communications) and processes (assembly-line production).
- But now, with the dawn of the Cold War, building up heavy industry and closing the technology gap were seen as national security imperatives.
- And on the theoretical side, this was the era of Big Push industrialization.



A primer: the case of French planning

- Investment plans were formulated by the *Commissariat du Plan* (with a staff of roughly 150 by the time of the 4th Plan, 1962-65).
- Plan was vetted by “horizontal” and “vertical” committees of industry representatives, submitted for scrutiny by consultative bodies (the Chamber of Commerce, Employers Federation, Trade Union groups), and subject to Parliamentary ratification.
- But plans were only “indicative” – that is, they indicated (in effect, they signaled) where investment was needed, and how much.
- At the time of the 4th Plan, 35 percent of investment economywide was undertaken by public enterprises, and another 15 percent was financed by government subsidies/transfers to private enterprise. Thus, fully half was private. Commercial banks and retained earnings provided finance for this other half, hopefully in a manner consistent with the plan.
- Government used taxes, subsidies and price controls to encourage private enterprise to invest in the desired directions.

How Europe avoided capture

- Did it? Good question. To the extent that it did, this reflected:
- Independent agencies.
 - *Commissariat général du Plan* was independent of ministerial departments.
 - It is said that this “insulated the planning function from the vagaries of French politics” (Yergin & Stanislaw 1998).
 - I think of the vetting, consultation, and Parliamentary ratification just described as ways of providing the accountability that makes institutional independence politically viable.
- In addition, the bureaucrats in charge had considerable personal authority.
 - Jan Tinbergen, Jean Monnet. (It wasn't called the Monnet Plan for nothing.)

In terms of outcomes, it helped that there was a leader to look to

- Planners could just look to the United States and the new industries and techniques already implemented there.
- Same can be said of post-WWII Japan.
- Does the U.S. have technological leader to look to today?
- One might ask: Is steering the economy *in the right direction* harder when you are a leader rather than a follower?
- I would suggest that this, indeed, is the case.



In addition, restructuring plans were coordinated internationally

- Through OEEC/OECD.
- In addition, European Coal & Steel Community was created to avoid over-investment in redundant excess capacity in key industries.
- A process that encouraged European integration more generally.
- One might ask: are governments seeking to promote investment in semiconductors and EVs coordinating their plans sufficiently today?



How Europe avoided getting locked into an outdated strategy

- Answer: it didn't.
- That being the message of this book.
- In order to produce results, policymakers installed institutions and implemented policies that complemented one another.
- But that complementarity / interdependence also constituted a barrier to change.
- Try changing out a transmission while the car's engine is running...



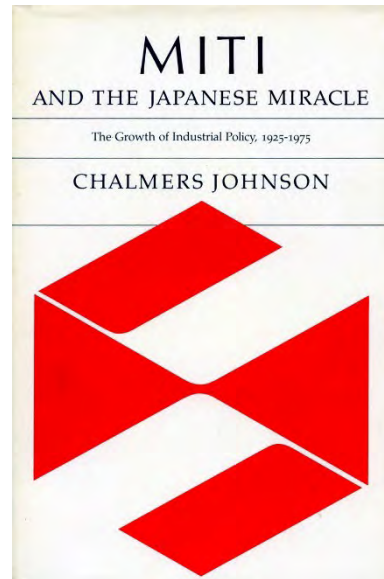
So Europe ended up with a set of institutions that:

- Prioritized the quantity rather than the quality of investment.
- Depended on government direction for resource allocation.
- Imposed heavy taxation to fund public investment and social programs to subdue conflictual labor relations.
- Utilized banks rather than capital markets for external finance.
- Adopted restrictive rules that limited scope for labor reallocation.
 - These institutions were appropriate so long as the European economy remained far from the technological frontier.
 - But no longer when it approached that frontier, where a different set of institutions (more suitable for an environment of elevated technological uncertainty) was appropriate.



Such is the cautionary tale from Europe in 20th century H2

- Of course, I might have made the same point about Japanese structural/industrial policy and MITI.
- Or about the successes and failures of import-substituting industrialization in Latin America.



So even if the early returns to the New Industrial Policy in the US are positive

- Even if U.S. is outperforming Europe in terms of labor productivity growth at the moment...
- Does it face a danger of getting locked in to an outdated strategy?
- It is worth recalling that the United States became the industrial and technological leader in the first half of the 20th century not by government targeting of specific industries but by investing in primary and secondary education, creating land-grant colleges, and becoming the leader of the “high school movement.”
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- TSMC woes in Arizona spring to mind...



- Thank you.