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ON THE DRY SIDE INDUSTRIAL POLICY John Hyde
In 1811 the Luddites tried to save their jobs by smashing stocking and lace frames, the new technology of their day. Had they and others like them succeeded, the lives of common Englishmen would have continued to be ill-clothed, poor and short. The essential Luddite position is opposition to new technology. There are modern examples. In the 1970's the Australian Telecom unions struck to prevent the installation of new equipment; in the 1980s shearers smash property rather than allow other shearers to use wide combs.

When governments get into the business of deciding which technology is most appropriate they prefer to call it an 'industrial policy', but 'policy' is a poor euphemism for the contradictory mess that just happens along when organised vested interests confront political weakness. A 'defensive industrial policy' supports yesterday's technology; a 'positive industrial policy' encourages tomorrow's. Both are wrong headed. Since only established vested interests can lobby, they have it all over up and coming technologies - there is no royal society or trade union representing tomorrow's industries. Most industrial policy is therefore defensive. It is the essence of Ludditism.

Yet, in spite of the political imbalance, the intellectual case against defensive industrial policies, that is against tariffs, import quotas, licences and other barriers to internal and foreign trade, is pretty well won. It was won by a new appreciation of old arguments. The increasing, and now obvious, weakness of our economy seems to have clarified our minds. Argument now is about the relative costs of abandoning protection too quickly, or too slowly. The Luddites still destroy innovation; but now they fight a rearguard action.

It is not so with positive industrial policies. it surprises me that we still entertain such expectations of them.

Positive and defensive industrial policies alike rely on the assumption that politicians know better than the market which industries will be wanted tomorrow. Brian Hindley of the Trade Policy Research Centre in London puts it this way: "...it is not unusual to discover in civil servants and politicians a deep seated but unresearched belief that most members of the private sector are incompetent (a belief which often boils down to the fact that the private sector does not always take those actions and produce those results which civil servants and politicians would find convenient.)"

It is easily established that private capital markets do not recognise all the winners. For instance they did not pick the oil boom and its winners, but then neither did the government. Our government's attempts to pick winners after the second oil shock to compensate for an energy crisis, which was thought certain to get worse, was almost all wrong. Although the market's record was better - except when subsidised it left most of the more outlandish projects alone - it too failed to pick an oil glut. Both government and market reacted to the available information of the time. With hindsight, both were less than perfectly right, but it is the public sector which has most egg on its face.

Participants in the market place are offered enormous personal incentives to invest in opportunities that no one has yet noticed - in tomorrow's technology. Every so often a bureaucrat identifies one of these areas; invariably he leaves public service to make his fortune. That is one reason why bureaucracies are not good at picking winners.

Another is that public sector incentives are all wrong. If an opportunity is known to the private sector but rejected by it, it may be taken up by a government. Since governments handle only other people's money and the punishments for wasting it are minimal, they are less risk averse than people with their own money. Further, there is a political bias toward short term spectaculars. The Government must be seen to be doing something! All too often the unsubsidised rate of return on politically chosen investments is negative. Who now will defend the decisions to subsidise the biomass generators, solar or wind energy generators, oil-from-coal plants, or most of those post oil shock spectaculars? In due time, will support be as hard to find for MICs and other hi-tec spectaculars?

Sensible businessmen do not gamble on new processes, plant or products when it is cheaper to induce the government to prop up what they do now. An explanation for the popularity of positive industrial policies may be that people do realise that defensive policies lock resources into yesterday's processes, dragging them away from tomorrow's. Despairing of changing this, they adopt a second best policy and try to subsidise the new processes they know are being taxed by defensive policies.

Or perhaps, people don't know why our technology is not keeping up with other nations, but realising that it is not, they subsidise heavy industry, value added, energy, hi-tec or whatever is yesterday's innovation and today's fad. If so, then their intentions are excellent, but once an idea is known to be good then they are too late to subsidise it. The political system cannot discover what the market system does not know.

Most nations have conclaves (with high sounding names but always known by initials) whose jobs are to pick winners. Their record is poor. Of the Netherlands, de Jong and Spierenburg say 'it cannot be said the NIB was a successful investor' and 'a disproportionate quantity of the funds went to large companies.' Of Belgium, de Grauwe and van de Veldt say 'through the NIM, capital provided by society is transformed into consumption by employees in lame duck industries.' Of Italy, Pontorollo says, 'fulfilling the demands of the political system became the standard by which to appraise managerial abilities.' Of Sweden, Eliasson and Ysander say, 'involvement became mostly defensive' and 'success [is] restricted to few activities.' Of Britain, Richardson and Hindley say, 'Companies which did receive IRC finance, have subsequently performed worse than the market as a whole.' Of Japan, the US Trade Commission says, 'industrial targeting has had comparatively little effect ... on the competitiveness of Japanese producers'.

Industrial policy is a not any sort of answer to poor productivity. Only a free market economy with strong positive and negative incentives can stimulate productivity. A dynamic world is always a little rough. At best a positive industry policy is a useless security blanket which wastes a few resouces; at worst it is captured by the sunset industries and becomes a tool of the Luddites.