Problem 1
On infant industry argument

Ha-Joon Chang, an economist at Cambridge University, in his 2002 book, "*Kicking Away the Ladders: Development Strategy in Historical Perspective"*, argued that just like yesterday's Britain, today's US' preaching free trade to less advanced countries was like someone trying to "kick away the ladder" with which he had climbed to the top. He concluded that since developed countries today almost all once adopted protectionist policies when they were developing countries, and they became rich, thus today's developing countries are justified to use the same protectionist industrial policies.

Assuming all the facts stated by Chang are right, do you agree with his reasoning and policy recommendation? Explain.

(A brief description of his book and main arguments is attached at the end)

Problem 2
Interest Parity Condition and Exchange Rate Determination

Do problem #9 of Chapter 13 (on page 345).

Attachment -

Kicking Away the Ladder:
How the Economic and Intellectual Histories of Capitalism Have Been Re-Written to Justify Neo-Liberal Capitalism

Ha-Joon Chang (Cambridge University, UK)

There is currently great pressure on developing countries to adopt a set of “good policies” and “good institutions” – such as liberalisation of trade and investment and strong patent law – to foster their economic development. When some developing countries show reluctance in adopting them, the proponents of this recipe often find it difficult to understand these countries’ stupidity in not accepting such a tried and tested recipe for development. After all, they argue, these are the policies and the institutions that the developed countries had used in the past in order to become rich. Their belief in their own recommendation is so absolute that in their view it has to be imposed on the developing countries through strong bilateral and multilateral external pressures, even when these countries don’t want them.

Naturally, there have been heated debates on whether these recommended policies and institutions are appropriate for developing countries. However, curiously, even many of those who are sceptical of the applicability of these policies and institutions to the developing countries take it for granted that these were the policies and the institutions that were used by the developed countries when they themselves were developing countries.

Contrary to the conventional wisdom, the historical fact is that the rich countries did not develop on the basis of the policies and the institutions that they now recommend to, and often force upon, the developing countries. Unfortunately, this fact is little known these days because the “official historians” of capitalism have been very successful in re-writing its history.

Almost all of today’s rich countries used tariff protection and subsidies to develop their industries. Interestingly, Britain and the USA, the two countries that are supposed to have reached the summit of the world economy through their free-market, free-trade policy, are actually the ones that had most aggressively used protection and subsidies.

Contrary to the popular myth, Britain had been an aggressive user, and in certain areas a pioneer, of activist policies intended to promote its industries. Such policies, although limited in scope, date back from the 14th century (Edward III) and the 15th century (Henry VII) in relation to woollen manufacturing, the leading industry of the time. England then was an exporter of raw wool to the Low Countries, and Henry VII for example tried to change this by taxing raw wool exports and poaching skilled workers from the Low Countries.

Particularly between the trade policy reform of its first Prime Minister Robert Walpole in 1721 and its adoption of free trade around 1860, Britain used very *dirigiste* trade and industrial policies, involving measures very similar to what countries like Japan and Korea later used in order to develop their industries. During this period, it protected its industries a lot more heavily than did France, the supposed *dirigiste* counterpoint to its free-trade, free-market system. Given this history, argued Friedrich List, the leading German economist of the mid-19th century, Britain preaching free trade to less advanced countries like Germany and the USA was like someone trying to "kick away the ladder" with which he had climbed to the top.

List was not alone in seeing the matter in this light. Many American thinkers shared this view. Indeed, it was American thinkers like Alexander Hamilton, the first Treasury Secretary of the USA, and the (now-forgotten) economist Daniel Raymond, who first systematically developed the infant industry argument. Indeed, List, who is commonly known as the father of the infant industry argument, in fact started out as a free-trader (he was an ardent supporter of German customs union – *Zollverein*) and learnt about this argument during his exile in the USA during the 1820s

Between the Civil War and the Second World War, the USA was literally the most heavily protected economy in the world. In this context, it is important to note that the American Civil War was fought on the issue of tariff as much as, if not more, on the issue of slavery. Of the two major issues that divided the North and the South, the South had actually more to fear on the tariff front than on the slavery front. Abraham Lincoln was a well-known protectionist who cut his political teeth under the charismatic politician Henry Clay in the Whig Party, which advocated the "American System" based on infrastructural development and protectionism (thus named on recognition that free trade is for the British interest). One of Lincoln's top economic advisors was the famous protectionist economist, Henry Carey, who once was described as "the only American economist of importance" by Marx and Engels in the early 1850s but has now been almost completely air-brushed out of the history of American economic thought. On the other hand, Lincoln thought that African Americans were racially inferior and that slave emancipation was an idealistic proposal with no prospect of immediate implementation – he is said to have emancipated the slaves in 1862 as a strategic move to win the War rather than out of some moral conviction.

In protecting their industries, the Americans were going against the advice of such prominent economists as Adam Smith and Jean Baptiste Say, who saw the country's future in agriculture. However, the Americans knew exactly what the game was. They knew that Britain reached the top through protection and subsidies and therefore that they needed to do the same if they were going to get anywhere. Criticising the British preaching of free trade to his country, Ulysses Grant, the Civil War hero and the US President between 1868-1876, retorted that "within 200 years, when America has gotten out of protection all that it can offer, it too will adopt free trade". When his country later reached the top after the Second World War, it too started "kicking away the ladder" by preaching and forcing free trade to the less developed countries.

The UK and the USA may be the more dramatic examples, but almost all the rest of the developed world today used tariffs, subsidies and other means to promote their industries in the earlier stages of their development. Cases like Germany, Japan, and Korea are well known in this respect. But even Sweden, which later came to represent the "small open economy" to many economists had also strategically used tariffs, subsidies, cartels, and state support for R&D to develop key industries, especially textile, steel, and engineering.

There were some exceptions like the Netherlands and Switzerland that have maintained free trade since the late 18th century. However, these were countries that were already on the frontier of technological development by the 18th centuries and therefore did not need much protection. Also, it should be noted that the Netherlands deployed an impressive range of interventionist measures up till the 17th century in order to build up its maritime and commercial supremacy. Moreover, Switzerland did not have a patent law until 1907, flying directly against the emphasis that today's orthodoxy puts on the protection of intellectual property rights (see below). More interestingly, the Netherlands abolished its 1817 patent law in 1869 on the ground that patents are politically-created monopolies inconsistent with its free-market principles – a position that seems to elude most of today's free-market economists – and did not introduce another patent law until 1912.