

Decline of the Virtual Financial World?

Balázs Botos

The Metamorphosis of Industrial Policy



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This book is about the new dimension of industrial policy, which was a depreciated sector at the onset of the subprime crisis. Hopefully this real sector will be in the focus again after the crisis. Balázs Botos's book offers help to the afterlife of the secondary mortgage market crisis. The author hopes that the role of industry will be more important again.

The author's book on industrial policy does not belong to the discipline of finance in the traditional sense. Nonetheless, it addresses one of the classic fields of asset accumulation, the industrial policy mechanisms reigning for many centuries on the creation of money and new value. It is about the institutional system of the economic policy and the quality oriented industry it shaped, that used to be determinant in the past and are somewhat effaced in the present; becoming a less and less primary indicator of the level of development of national

economies after the break-up of the Bretton Woods system and not the most profitable field of profit generation. In addition: it has become an area confined by the monetary policy. The task of the reviewer therefore is to bring the topic of the book closer to the reader in two aspects.

Ad 1. As a consequence of the financial crisis set out by the collapse of the American mortgage markets, new perspectives may open up again to the industrial policy that is embracing its renaissance and the underlying industrial activity. The mere raising of the topic implies a shift from the space dominated by the overwhelming mechanisms of virtual monetary economy, as referred to indirectly in the investigation report concluded recently by the American Congress¹. Financial markets have become more and more global over the past three decades. The development of technology has made it possible to create increasingly effi-

cient, faster and more complex financial instruments, which simultaneously have been spread in an ever widening circle. This means that the financial sector is increasingly dominant in determining the economy. At the same time, due to the financial sector, between 1978 and 2007 the amount of overdue debts in the United States climbed from 3 billion dollars to as high as 36 billion dollars. By 2005, the ten largest U.S. commercial banks held 55 percent of the industry's assets, more than double the level held in 1990. On the eve of the crisis in 2006, financial sector profits constituted 27 percent of all corporate profits in the United States, up from 15 percent in 1980. One of the implications of the exaggerated privilege of the financial sector is that as of 2007, the five major investment banks – Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch, and Morgan Stanley – were operating with extraordinarily thin capital. For every 40 dollars in assets, there was only 1 dollar in capital to cover losses. Much of their borrowing was short-term, in the overnight market. The kings of leverage were Fannie Mae and Freddie Mac, the two behemoth government-sponsored enterprises and their combined leverage ration stood 75 to 1. From 2001 to 2007, US national mortgage debt almost doubled, while wages were essentially stagnant. Anxiety rises – as the congress report puts it – because it is impossible to monitor the transactions of financial institutions and there is nowhere to check upon specific data. Therefore it is necessary to increase the positions of more 'tangible' real sectors, mainly those of industrial production against the virtual financial space. In such a milieu, determined by 21st century financial markets, it seems refreshing and at the same time useful to read about the system of industrial policy.

Ad 2. Society in Hungary and in many emerging countries, as well as former colonies has a mysterious notions about industrial poli-

cy and industry itself. Since the invention of the steam engine, industry has replaced agriculture as a sector of primary importance for the national economy and has transformed the structure and conditions of dependence within societies. However, outside of the regions of Western Europe and North America, this did not take place early, but rather with a delay or not achieving expected results. In Hungary, too, the political atmosphere of the reform era, the abolition of serfdom, the industry regulations of 1859 and the Compromise of 1867 made it possible to establish the industry according to the needs of the era, of course, within the limits of the interests of the Habsburg Empire. Our agricultural endowments gave rise to the establishment of a competitive food industry in the second half of the 19th century and the vertical system of the food industry achieved in this way was adequately supported by the development of the heavy industry, railway construction and coal mining. The development of the industrial sector in the 19th century and in the first half of the 20th century took place without the political independence of the country or in an environment of opposing great power interests, therefore it was destined from the onset not to be successful and comprehensive in the long term. What is more, in the end it meant that agriculture continued to have a determining role and, in our country, semi-feudal conditions were conserved. Without internal social modernisation it was impossible to catch up in spite of the fact that we had competitive industrial sectors and laws that gave preference to them (1881, 1890, 1899, 1907). Thus in Hungary, the development of industry that dynamises the national economy and society took place with a reduced impact. The forced and voluntarist attempts of the socialist planned economic system tried to make up for this deficiency. Vertical systems in the heavy industry, built on iron from Krivoy Rog, coal from the Donetsk

Basin and crude oil from Siberia, could not mean even at the beginning the sustainable development of Hungarian industry. While the growth of industrial production was 10.2 percent between 1950 and 1958, a mere 1.7 percent increase was realised by the period 1978 through 1987 after continuous decline. Though industrial activities had become a determinant sector of the national economy over four decades, by the end of the 1980s they destroyed the planned economic system and induced political changes in a determinant way as a consequence of the exhaustion of internal resources, the ongoing decline in performance and efficiency, as well as the loss of markets. From the end of the 1980s, heavy industrial vertical systems, mostly those in the field of machine building, were replaced by sectors from abroad that also belonged to the profile of machine building. No doubt they created a higher technical standard, though in terms of the product-service value chain they established industrial sectors requiring less knowledge and capital and relying more on live labour with average qualifications. They appeared in the form of international companies preferring high state subsidies and tax allowances, constituting the bulk of the new type of industry established in Hungary. One has to admit that they manufacture marketable products, using organised production management processes. Their industrial production culture, though with substantial delay and not completely, is seeping into small and medium sized Hungarian enterprises and all in all they increase the standard of the industrial production of the country, as well as its technical and work culture. It is also indisputable that they are able to provide a part of the local society with such an income as is higher and more secure than the Hungarian average.

These antecedents, historical and international aspects may raise with elementary force the need in the reader to become familiar with

the scientific taxonomy of the industrial policy of our time that may have an impact on the course of Hungarian industrial policy. The purpose of the book titled “The metamorphosis of industrial policy” was not to elaborate a specific proposal for industrial policy, but to summarise the theoretical and practical experiences on the topic. To simplify and integrate all this into a single question, the author was looking for the answer as to how industrial policy can be useful and adjustable to the needs of this era or remain an outdated, anachronistic effort. As the answer is basically positive, *Balázs Botos* holds that the industrial policy may be needed at a specific time and place subject to appropriate conditions. He has outlined a set of frames wherein a modern and functional industrial policy can be established. The book suggests the following theses conceived by Balázs Botos.

1 There is no straightforward definition of industrial policy, accepted by everyone. In a broad sense, each segment of economic policy has some kind of an impact on the industry, thus they can be regarded as components of the industrial policy. Consequently, each industry politician and each government defines the goals to be achieved, the set of tools to be used and the institutional background according to their priorities.

2 It also follows from the foregoing thesis that there is no industrial policy in general. There used to be a Hungarian industrial policy in the transitional period. It exists during the crisis and will exist after the crisis, too. There was Japanese industrial policy and Spanish industrial policy after World War II. There was and there is an EU industrial policy at the beginning of the integration and during the enlargement. What might be expedient at a particular time, in a particular country or in a particular international environment, may not

necessarily be usable under different conditions, in a different place and in a different structure.

3 The foregoing allows one to conclude: it is not possible to give a clear answer to the question whether industrial policy or something else was behind the success of successful examples (e.g. Japan or other East Asian countries)? However, it is possible to state that even if the successful recipes of industrial policy were the key issues of economic policy in these countries, it is not expedient to follow them step by step under the current conditions in other countries desiring to catch up.

4 However, the successful examples allow one to make the so far somewhat neglected conclusion whereas it is more expedient to focus on the proper selection of sub-fields and niches and to ensure that the information available will become part of the public domain than to strive to follow a global industrial policy on government level.

5 The last decade saw the resolution of the dispute abroad and in our country as well whether the appropriate approach to industrial policy is vertical (sectoral) or horizontal. The modern approach to industrial policy endeavours to ease the structural tension in an integrated manner, both sectorally and horizontally and often simultaneously. This involves that the primary targets of government subsidies are the activities and not enterprises or sectors.

6 The crises of recent years have shown that industry protection, protectionism and/or patriotism are not suitable for providing lasting help for those in trouble. Still, as a temporary step, they were applied in many countries, even perhaps on an integration level, with the use of increasingly diverse and sophisticated means. However, in the long run, efficient (functional)

industrial policy can only be established by actions that increase competitiveness and productivity, supporting innovation in the broader sense.

7 For industry, one of the positive “yields” of the crisis may be that the focus of attention has shifted from the financial, partly virtual world to real processes. If it all leads to the increase in the so far rather weak assertion of industrial interests against the monetary policy, there is a hope that the economic policy will put more emphasis on the handling of such problems.

8 Neither the setting of proper objectives nor the existence of an adequate set of tools and of an institutional system can alone guarantee the success of an industrial policy. What is needed everywhere and above all is mutual trust between the actors of the economy. Trust that makes it possible and indispensable for the parties to establish efficient cooperation and for the development ideas to be formed through ongoing dialogues in merit and for government and business to regard each other as partners. Obviously, governments primarily have a strategic and co-ordinating role while business is responsible for implementing the industrial policy. If the parties concerned can cooperate in the atmosphere of trust, they can mutually agree on the steps for the promotion of competitiveness and on the possibilities for generating the information required for decisions. One should not forget that neither governments nor businesses have perfect information. And once the atmosphere of trust has been established, one can forget the question whether industrial policy is needed; the partners will have to concentrate “only” on what kind of policy can help achieve the best results.

What should a new, modern industrial policy be like? This is the question one raises when reading the book of Balázs Botos. In the

author's opinion three fundamental, necessary and indispensable requirements have to be met.

► Strategic cooperation has to be established between the business sector and the government. Nothing but the atmosphere of mutual trust can ensure that the steps made after the joint preparation of decisions will orientate the development of industry in the direction of efficiency in spite of mistakes in the market and by the government. This also involves that it is time to forget the debates about the need for industrial policy and that attention should be turned to how to do it.

► The interest asserting influence of real economy and industry needs to be strengthened over monetary policy. The trend enforced for decades of the decrease of the role of industry in the national economy, that is, the trend of de-industrialisation leaves its mark on the efficiency of the activities of industrial lobbies. In addition, the weakness of statistical databases on industry – in spite of the apparent redundancy of data – makes it difficult to evidence on a statistical basis that most developed countries have reached such a level through industrial activities, the “pull effect” of industry, that helps them play a determinant role in the world economy. Industry plays a strategic role in facilitating economic growth even if 70 percent of jobs in the European Union can be assigned to service activities. To say nothing about the fact that many jobs in the services sector would not exist without a strong industrial base.

► It is time to put an end to the useless, decade long debates whether an industrial policy is needed and if so, which industrial policies are “right” and which are “wrong”. It is not industrial policy that should be pursued, rather such set of industrial policy tools have to be built as is suitable for improving the competitive positions of the enterprises. There is no need to choose between supports to vertical or horizontal, profitable or non-competitive firms because a modern, efficient industrial policy

can be of an integrating nature only, including the diversity of principles and tools.

These are the indispensable premises that, according to Balázs Botos, are required for the establishment of a modern and efficient industrial policy. It is about general premises, as he emphasises that a specific industrial policy can be outlined only by taking into consideration the circumstances prevailing in a particular place and at a particular time.

Where Balázs Botos has also achieved lasting scientific results is that he has attempted to review the common features of the Hungarian industrial policies of the last 15 years. The highlights of the following summarising thoughts reflect the comprehensive system of the author's scientific experience, governing the Hungarian industrial policy:

- none of the industrial policies were able to follow to the end their concepts and the path outlined because each of them ended up as an unfinished torso, due to the cyclic character of politics and the changes in economic policy,
- each industrial policy presented in the forefront of the hierarchy of objectives the need to catch up and to increase the competitiveness,
- each industrial policy, essentially, applied the tools of horizontal policies only,
- none of the industrial policies paid particular attention to the relationship of the services sector and the industry, which is handled by the community's industrial policy as of key importance.

In the opinion of the author this all has contributed to what happened to the Hungarian industry in the past decades. As far as the future is concerned, the book assumes a kind of intellectual legacy of the theories set out in the pamphlets of the civil economic workshop, published between 2008 and 2010². Moreover, reaching back as far as *Lajos Kossuth*: the country needs its own economic policy, including an

autonomous industry, having been the cornerstone for modernisation in that era. However, the economists of the civil workshop, including Balázs Botos, hold – aligned with the modernisation cornerstone of our era – that more comprehensive, more transparent rules have to be set for the economic processes, including industrial activities in Hungary so as to enhance the harmony with the interests of the national economy. Thus it is not about the actions against or the rejection of international corporations that determine our industrial activities – far from it – it means that the economic playing field of multinational companies needs to be specified more clearly. A new doctrine of state regulations has to be elaborated in the field of industry, too, at least on a level as done by the West European governments and

the United States, fighting against the current economic crisis and saving their industrial sectors between 2007 and 2010. This is much needed as Hungarian industrial production fell by 12.1 percent³ from 2007 by 2009, as calculated at current prices in Forints. Although the level of development of the financial sector is important, the key to economic growth will be the growth of real economy. Simultaneously with placing industrial policy on new grounds, the primary need today is to create the set of conditions of the economic policy for the expanded industrial reproduction. The book of Balázs Botos provides a facility of orientation in this respect. It is worth reading!

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NOTES

¹ The Financial Crisis Inquiry Report (2011). Official Government Edition. Washington D.C. p. 553 (The American Congress Report gives an itemised list of the circumstances that led to the financial crisis, supported by figures. It concluded as a major reason of the crisis that the supervision of financial markets and banks as well as their regulation by the State had been weakened and credit risks had been ignored.)

² Matolcsy György és társai (2008): Megújított szabadelvű és szociális piacgazdaság Magyarországon [*György Matolcsy et al. (2008): Renewed liberal and social market economy in Hungary*] Növekedéskutató Intézet [*Growth Research Institute*], 165 pages

Matolcsy György és társai (2009): Jövőkép [*György Matolcsy et al. (2009): Vision.*] Magyar Gazdaságfejlesztési Intézet [*Hungarian Institute for Economic Development*], 155 pages

Matolcsy György és társai (2010): Új Széchenyi Terv. [*György Matolcsy et al. (2010): New Széchenyi Plan*] A talpra állás és felemelkedés fejlesztéspolitikai programja. [*Development policy programme for recovery and rise.*] Nemzetgazdasági Minisztérium [*Ministry of National Economy of Hungary*], 200 pages

³ Statistical Yearbook of Hungary, 2009. Central Statistical Office, according to table on page 351