

Green Industrial Policy: Saving the Planet Without a Trade War

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The urgency of addressing climate change now well recognized

- Immense risk of going beyond 1.5 to 2 degrees C.
- We are on target to do that
- Achieving this goal will be easier if firms and households are encouraged to invest and innovate in green technologies
- Market incentives without a high carbon price won't suffice
- Achieving the requisite carbon price through taxation (or “shadow” price through regulation) has proven politically difficult in most places, and especially in the US, the highest large per capita emitter

Industrial policy as a second best measure

- US has turned to industrial policy—in spite of a long history (especially among Republicans) of criticizing such policies, both at home and abroad (e.g. by China)
 - Subsidies to firms and households to become more green
 - Rather than the imposition of taxes
 - Distorts production
 - Protectionist measures (subsidies restricted to American production)
 - Reflection of business interests—always love subsidies (though they criticize subsidies when given to others)
 - Incoherence—great worry about budget; carbon taxes would have incentivized and generated revenue; regulations would have incentivized without revenue; subsidies incentivize, but impose costs, both financial and economic

Violation of the international economic rule of law

- Such subsidies, especially with protectionist provisions, seem to be a clear violation of WTO rules
- Little if any discussion within Administration of this—or the consequences
 - Consistent with other aspects of downplaying WTO—not allowing the appointment of Appellate judges, tariffs on China
- Europe, not surprisingly, objected
- Could have imposed countervailing duties
 - Would have had limited effects—illustrating limited scope of this instrument
- Could have retaliated—starting a new trade war

Europe's cautious policy

- A trade war would have been particularly problematic in the midst of the real war in Ukraine
- Besides, Europe wants US to go more green
 - Even if it would have preferred policies more WTO consistent
 - This may have been the only kind of policy that could have been passed in the US Congress
- But responding in-kind, through protectionist subsidies, is also problematic
 - Two wrongs don't make a right: still a violation of international economic rule of law
 - And puts developing countries at a disadvantage

Cross-border carbon adjustment may also create an unlevel playing field

- As well motivated as they might seem to be—preventing “leakage” to emission reductions in Europe are offset (or more than offset) by dirty production abroad
- But advanced countries own the green technologies—and requiring green production forces developing country producers to pay rents to advanced countries
 - Rio agreement provided for compulsory licenses, but advanced countries have resisted implementation (just as they have done everything to undermine compulsory licenses for medicine, even in a pandemic)
- Green technologies are often very capital intensive--again putting developing countries at a disadvantage
- And data required to avoid paying CBA duties is hard for developing countries to get

The charade of a rules based international economic system

- US action (especially if combined with Europe acting in a similar way) suggests that the powerful obey “rules” only when it is in their interests—and enforce rules on others *because* it is in their interests
- Especially questionable behavior, given the dominant role of the US in writing the rules in the first place.
- Undermines support for West in other arenas—including war in Ukraine and the new Cold war with China; and areas where global cooperation is required, like climate change and global public health
- Even more so because the West used WTO rules to prevent access to Covid 19 IPR (Europe not supporting vaccine waiver, US not supporting waivers for testing and treatment; even though vast majority around the world supported these waivers)
 - Vaccine apartheid

Back to basic principles: should government subsidies be allowed?

- R & D and advances in knowledge as a result of learning by doing provide a (global) public good
- Especially important when the knowledge facilitates achievement of another global public good—preventing climate change
- Private markets on their own will produce too little knowledge
- With IPR, there will not be efficient utilization of knowledge
- Important role for collective action—subsidizing knowledge production

First best solution

- Knowledge gets produced where it is most efficient to produce it
- Disseminated freely around the world
- Costs born collectively by all
- Any rents associated with knowledge are distributed fairly around the world

But this is not the world we live in

Standard trade (neoliberal doctrines embedded in WTO)

- Believed markets on their own were efficient
 - Allowed basic research
 - Line between basic and applied research ambiguous
 - With learning by doing no clear line
- Focus on creating a level playing field—so subsidies were forbidden
 - (Put aside agriculture)
 - Same principle in EU: no state aid
 - But that will result in too little innovation
 - And especially too little green innovation

Some of old doctrines still relevant-- sometimes

- Trade and trade policy (at least for advanced countries) is not about creating jobs (exports create jobs; imports destroy jobs; if trade is roughly balanced, then the two effects offset each other—with trade destruction slightly greater than trade creation)
- Employment is responsibility of fiscal and monetary authorities
- Trade is about comparative advantage—and hence about standards of living
- But with learning by doing and R & D, comparative advantages can change—dynamic comparative advantage
 - And there can be significant rents (amounts of which will depend on nature of competition/industrial structure and tax policy)
 - There may be a subsidies war to get those rents
 - In the case of green transition, the subsidy war might be even globally beneficial—but probably less so in other cases.

Squaring the circle

- Distinguishing between temporary and permanent subsidies
 - Permanent subsidies can't be predatory
 - Importers reap benefit of subsidies through lower prices
 - Lower prices especially important in green products (solar panels)
 - From this perspective, US policy of imposing tariffs on solar panels makes no sense
 - Justified in terms of jobs
 - But jobs responsibility of monetary and fiscal policy

Squaring the circle

- In second best world, we want (a) some knowledge subsidies; (b) global access to cheap green products; (c) level playing field
- We want international rules which reasonably achieve these objectives
- Current WTO rules don't—and are understandably being ignored
- One solution: **Advanced countries who provide subsidies or engage in distortionary industrial policies must contribute to Green Development Technology Fund for developing countries and emerging markets, devoted to improving technology (including transfer of technology and developing new “appropriate technologies”); and provided industrial policies are not predatory**
 - **Annual SDR green emissions could further help level playing field**
 - Difficult issue of required size of payments (related to magnitude of trade distorting activities), and who gets subsidies/compensation/new technologies and how administered

Concluding comments

- Current rules based international trading system is not up to the challenge of climate change and the end of the neoliberal order on which the current system was based
- Imperative to find an alternative
- As bad as the current regime may be, the “law of the jungle” which seems to be emerging is even worse
- There was a “false” simplicity of the neoliberal rules—which the new rules won’t have
- I’ve tried to highlight the problem, and tentatively suggest one 2nd best alternative that might work