real-world economics review, issue no. 84
subscribe for free

Industrial policy, then and now

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Abstract
After 40 years of neoliberalism, even governments believe that they are inefficient when compared to the private sector. And economics, in its swing to the right, reinforces this view. The philosophy behind public expenditure for social purposes and the criteria for judging such projects has not been a subject for public debate until recently. In particular, industrial policy was very simple: leave it to the private sector to allocate resources as the market prompts. In Keynes's time this was not the case. This article reviews some of the issues concerning industrial policy that were aired in the interwar period. The debate needs to be revived, revisited and, where appropriate, revised to suit the present day, but on basic principles there is much to learn from the interwar discussions. The contrast between the recent (2018) UK government's White Paper on Industrial Strategy and the Liberal Industrial Inquiry's *Britain's Industrial Future* (1928) is quite instructive.

Keywords
industrial strategy, industrial policy, The Yellow Book, Keynes, public purpose, profit.

Economists tend to see industry and government as two entirely separate sectors – indeed it is quite standard to treat government as outside "the Economy" altogether: *G* is an exogenous variable. This practice is, of course, nonsense. Government is a major producer of goods and services: schools, hospitals, the police, the armed forces, infrastructure and so on. What keeps those goods "outside" the economy, in economists' minds if not in the minds those who consume the products, is that the decision to produce them is taken politically and those who consume them are not the same group as those who pay for them. "Economics" has traditionally concerned itself only with production for market sale. As June Sekera (in conversation) has pointed out, that leaves economics analysing probably less than half of actual economic activity, when both the State's non-market production and household production – equally outside "the market" – are taken into account.

This paper is concerned with the element of government policy that blurs the line between private enterprise for market sale and the provision of public goods, namely industrial policy, where "the line of demarcation between [public and private enterprise] is constantly changing... [N]o great question of principle is involved" (Keynes, 1927: 695). A little over a year ago, interest in industrial policy would have been thought wildly eccentric: it was understood to be a non-topic after years of being rubbished as "picking winners", an activity which, as "everybody understood" after some pretty obvious failures in the 1960s, government was very bad at. The prevailing prescription was that government should not meddle in private enterprise; they should deregulate and leave it to competition to solve all problems. Government would only make matters worse. Economists have been dripping this poison into the ears of politicians and the electorate for about 40 years now, until it is very widely believed, even within government itself. (It is based on a theory that assumes market participants have perfect knowledge, so of course government cannot improve matters. Naturally, this assumption is never mentioned.)

Astonishingly, despite the weight of this opinion in public life, in July 2016, Theresa May, on her appointment as Prime Minister, created the Department for Business, Energy and

Industrial Strategy (BEIS) from the former Department for Business, Innovation and Skills; and early the next year, the Department published a Green Paper, *Building our Industrial Strategy.* Industrial policy, the Cinderella of government activities, for so long kept well out of sight, had exchanged her rags for decent clothes and strode into the daylight.

Later in 2017 the Fabian Women's Network invited me to give a short talk on the Green Paper. I contrasted some of its values with those expressed in various places by Keynes in the interwar period. It occurred to me then, though there wasn't time either to do the work or to talk about it, that it would be interesting to compare the Green Paper with the book produced by the Liberal Industrial Inquiry in 1928: *Britain's Industrial Future*, known, for its cover, as the Yellow Book. And now there is a White Paper, *Building a Britain Fit for the Future* (BEIS, 2018) for the comparison.

The Yellow Book is a report of a committee known as the Liberal Industrial Inquiry (LII), on behalf of the Liberal Party. The Party was not only not in power, but their prospects for power were dim: they were in the process of being squeezed out by the Labour Party. But the Inquiry could command some of the best brains: its Chairman was Walter Layton, at the time editor of *The Economist*; its Executive Committee included Lloyd George, H. D. Henderson and J.M. Keynes. Among those who served on one or more of its special committees were D.H. Robertson and Sir Josiah Stamp.

If I were to summarise the way each strikes me, the Yellow Book explains what it sees as the public purpose in the industrial field; the White Paper reads like a shopping list.

Public purpose

Liberal philosophy

The Yellow Book opens with an Introduction in which the Liberal vision of public purpose is explained. Democracy, it says, exists to remedy grievances and to create the conditions in which all have the opportunity to live a full and free life. There is a balance to be struck between social justice and efficiency, to those ends. The main grievances at the time they identify as economic, pointing to a wide disparity of incomes, widespread un- and under-employment, and poor housing for some while others do very well, often for no apparent reason. These factors cause further inefficiency, as they lead to industrial strife. (The few of you old enough to have seen the film "I'm alright, Jack" will know what they are talking about.) Yet their ambitions are not radical: such were the perceived merits of the system in harnessing energy and resourcefulness that they wished only to identify and cure the ills, leaving the basic structure intact.

How far should the State go?

Keynes's view of the scope of government action, a few years before the Yellow Book was published, was quite conservative: "... not to do what individuals are doing already, and to do them a little better or a little worse; but to do those things which at present are not done at all" (1926: 291).

The Inquiry took a somewhat broader view. They disclaimed any interest in state intervention *per se,* but they recognised that the scope for beneficial action is larger than what was normally (for the time) assumed, because the structure of production had changed. The small sole proprietorship or partnership with unlimited liability is a system in which the inefficient or otherwise inadequate are quickly eliminated at comparatively little social cost. This form of business organisation had been in decline for some time, and the larger joint-stock company, with its separation of ownership and control, had taken the commanding heights. Some had near-monopoly power. Most could influence the market by advertising and the like. This institutional change meant that, if competition ever did solve most economic problems, it certainly would not do so in 1928:

> "The theory that private competition, unregulated and unaided, will work out, with certainty, to the greatest advantage of the community is found by experience to be far from the truth" (LII: xix).

The economic theory that concludes that perfect competition will lead to Pareto optimality is based on the small firm of the type that was disappearing.

The introduction goes on to state briefly the Liberal political philosophy: that the state can enhance individual liberty, but its interventions can go too far. The Inquiry regards the debate between individualism and socialism as not worth their time, for in their view it pertained to the economy of some 50 years earlier: it was declared obsolete. (It is amazing how long hoary old theories hang about; this one is, of course, still with us.)

The Introduction ends on its opening theme:

> "We believe with a passionate faith that the end of all political and economic action is not the perfecting or the perpetuation of this or that piece or mechanism or organisation, but that individual men and women may have life, and that they may have it more abundantly" (LII: xxiv).

A preliminary idea of what this meant in practical terms is indicated by the structure of the main body of the volume. There are five sections or Books. The first is an analysis of the state of British industry, in which they identify unemployment, low productivity and wages, and decline in specific industries as the central problems. The search for solutions is far-reaching: Book 2 deals with the organisation and governance of business, Book 3 industrial relations, Book 4 a sectoral analysis of business, and Book 5 national finance and taxation. Their scope is not purely national, for the collapse of International trade, still continuing from the First World War, is held responsible for the high concentration of unemployment in the export industries.

Is public purpose unmentionable?

> "To suggest social action for the public good to the City of London is like discussing *The Origin of Species* with a bishop 60 years ago ... An orthodoxy is in question, and the more persuasive the argument, the greater the offence" (Keynes, 1926: 287).

Today it is not only the City but almost the whole of society that refuses to discuss – perhaps even to acknowledge the existence of – public purpose. Although letting Cinderella out into the daylight may encourage you to think that the present Government understands public purpose or the public good in the industrial sector, I do not think the words appear once in either the Green or the White Paper. Perhaps they were considered unmentionable, would frighten the horses, that sort of thing. They still frighten the City of London, a place where campaign donations regularly find their way to the Tory Party and lobbyists are very active. There is certainly no discussion of what public action is for at the level of the Yellow Book's Introduction. But there are little snippets, and some elements of the Government's view can be inferred.

The Prime Minister, in her Foreword, speaks of her "belief in a strong and strategic state that intervenes decisively whenever it can make a difference" (though what sort of difference is left open) and her aim to create a Britain that "works for everyone" (BEIS, 2018: 4). The latter objective is most clearly manifest in the proposals in both Papers to strengthen economic activity outside the south-east.

The nearest thing to a discussion of purpose in the White Paper is the "vision statement". It is entirely in economic terms (p 13):

> "Our vision is for:
> The world's most innovative economy
> Good jobs and greater earning power for all
> A major upgrade to the UK's infrastructure
> The best place to start and grow a business
> Prosperous communities across the UK."

Apart from the words "for all" and "communities" there is no sense of the social dimension, let alone social purpose, in this vision. And the prospect of "good jobs" is the only concession to social justice – quite an omission in this era of zero-hours contracts and MacJobs. All the rest assumes that if the economy is booming, everybody will be happy and the Government's purpose, if not the public purpose, is fulfilled.

The vision statement reads as if people are here to serve the economy, not the other way round. A booming economy serves the state, too, as it can boast "best in the world" about its business environment.

Social purpose is thus assimilated to the purpose of private enterprise. So it is not surprising that they

> "believe in the power of the competitive market – competition, open financial markets, and the profit motive … But governments have to work through the factors responsible for higher productivity and earning power[,] coordinate and convene efforts to develop and disseminate new technologies and industries[,] … make long-term investment[s] … and … [pool] risk" (pp. 21-2).

This goes some way towards Keynes's view that government should mitigate risk, uncertainty and ignorance (1926: 291) and has the advantage of being able to take the long view:

> "I expect to see the State, which is in a position to calculate the marginal efficiency of capital-goods on long views and on the basis of the general social advantage" (1936: 164).

But it is still a far cry from the vision of 90 years ago:

> “The task is one of… harmonizing individual liberty with the general good and personal initiative with a common plan—of constructing a society where action is individual and knowledge and opportunity are general, and each is able to make his contribution to the efficiency and diversity of the whole in an atmosphere of publicity [transparency], mutual trust and economic justice” (LII: 63).

You would search in vain for anything this high-minded in the White Paper. The Government’s purpose – their only purpose – is industrial success. Let us examine the three elements that they consider the keys to that success.

Competition, open financial markets and the profit motive

Competition

You have already seen the scepticism with which the Inquiry greeted unregulated and unaided competition. Many, perhaps most, of the members were men with some experience of real-world business and knew how it operated. Economic theory portrays competition as acting only through price. But there are many other ways, not all of them socially desirable or even legal, by which to compete: advertising, creative accounting, industrial espionage, and so on. Many business firms today prey on their customers instead of serving them. Think of Payment Protection Insurance, energy tariffs and bank deposit rates that disadvantage loyal customers, RBS’s treatment of small and medium-sized businesses, fixing LIBOR and so on. The Government itself has been ripped off by G4S, Carillion and I’m sure many others. Some of this kind of thing has always gone on, but now it is rife. Surely it should be a government priority to stamp out these practices, but such action forms no part of the Industrial strategy. They are an aspect of competition that is not mentioned.

The Yellow Book’s authors started by looking at industry: how it was organised and governed and how it worked. Three chapters each in Books 2 and 3 analyse these matters thoroughly. Comparisons were made with pre-war industry and conclusions drawn about the significance of those changes. Considerable emphasis – a chapter in fact - is given to the operation of what they term public concerns, that is, enterprises operating mainly or wholly in the public interest and not driven to maximise profit.

Interest in this type of concern is foreshadowed in Keynes’s *The End of Laissez-faire* (1926), in which he praises the form of governance developed by corporations (in the UK semi-autonomous bodies, usually within the State, not ordinary business firms as in the US). Their “criterion of action within their field is solely the public good as they understand it” (p. 288). Examples are the Bank of England (then technically privately owned), the universities, the Port of London Authority, “even perhaps the railway companies”; surely also the BBC.

“But more interesting than these is the trend of joint stock institutions, when they have reached a certain age and size, to approximate to the status of public corporations...” At a certain size, the shareholders become dissociated from management’s personal interest in making great profits. The stability and reputation of the institution become its primary concerns. Examples given are a big railway or utility company, bank or insurance company (p. 289).

The behaviour of business firms has almost completely gone into reverse now. I blame ideology, economic theory and competition. The White Paper has nothing to say about this, naturally: their only criterion for evaluation of a business is its productivity.

There is, incidentally, a quite fine-grained map of average productivity throughout the country (BEIS, 2018: 218; from ONS, 2017). As you would predict, it is highest (coloured blue) in London and the south-east and also in Grampian (Aberdeen and North Sea oil, not even at its peak), and lowest (dark red – interesting choice of colours) in mid-Wales and the Shetland Islands. If you look closely you can just discern the darkest blue in – you guessed it – the City of London. Banking and finance are the most productive industries. They are not mentioned in the Paper; with that productivity, they need no Strategy. But what do they produce? Money. So did Midas.

In Book 4 the Inquiry looks at specific industries and their problems: oversupply and fragmentation of ownership in the coal industry, inadequacy of roads and housing, necessary improvements to electricity supply, waterways and docks, the needs of agriculture (including tenure issues) and forestry – industries chosen because there were serious problems for which solutions were posed.

No analysis of that kind appears in the White Paper. Its authors seem to have taken their starting-point not from looking at the range of business institutions, their governance, behaviours (they are not all scumbags) and industry-wide problems but from mainstream economic theory, which is more concerned with how the economy ought to work in some kind of ideal world than how it actually does so. It usually assumes the industrial form prevalent in the nineteenth century: businesses too small to affect prices by their own actions.

Open financial markets

Nowhere has competition been more misguided than in financial markets.

In Britain the rot set in well before neoliberalism took hold, beginning with the policy of Competition and Credit Control (1971). This set the banks up to compete with building societies, and now mortgages, formerly understood to be too long-term for institutions funded by sight deposits, dominate their loan books. The larger firms turned to internal finance and the capital markets for finance, leaving smaller businesses struggling. The Big Bang allowed retail banks to engage in investment banking, and Basel I reinforced the trend to mortgages by favouring collateralised lending. Banks kept down their Basel capital requirements by adopting mortgage-backed securities and other “structured products” (see Chick, 2008; 2013).

These events and the Acts which further deregulated the banks (for a thorough list see Siniscalchi, 2016) were amongst the factors that led to the financial crash. The banking regulator, then the Financial Services Authority, thought of competition in microeconomic terms: it would keep lending rates down and deposit rates up. They did not see the macro-disaster that competition was brewing up. Has this lesson not been learned? Competition can be good, and it can be bad. We must learn to discriminate. I’m with Keynes: “... let finance be primarily national” (1933), and, I would add, compartmentalised into non-competing groups.

Profit

On no topic was Keynes consistently more scathing than the use of profitability to assess the desirability of undertaking a project for its social benefit. Everybody knows the passage in *The General Theory* about burying bottles full of cash and digging them up again. Po-faced people took this as a genuine recommendation; they forgot the paragraph just before (and the one just after, but that is another story):

> "It is curious how common sense, wriggling for an escape from absurd conclusions, has been apt to reach a preference for *wholly* 'wasteful' forms of loan expenditure rather than for *partly* wasteful forms, which, because they are not wholly wasteful, tend to be judged on strict 'business' principles" (Keynes, 1936: 129).

This had been a preoccupation for at least ten years:

> "It is *not* a correct deduction from the principles of economics that enlightened self-interest always operates in the public interest. Nor is it true that self-interest generally *is* enlightened" (1926: 288).
>
> "The nineteenth century carried to extravagant lengths the criterion of ... 'the financial results', as a test of the advisability of any course of action sponsored by private or by collective action. The whole conduct of life was made into a sort of parody of an accountant's nightmare. Instead of using their vastly increased material and technical resources to build a wonder city, [they] built slums ... because slums, on the test of private enterprise, 'paid' ... We have to remain poor because it does not 'pay' to be rich. We have to live in hovels not because we cannot build palaces but because we cannot 'afford' them. We destroy the beauty of the countryside because the unappropriated splendors of nature have no economic value. We are capable of shutting off the sun and the stars because they do not pay a dividend" (Keynes 1933).
>
> "It is the State ... which needs to change its criterion. It is the conception of the Secretary of the Treasury as the chairman of a sort of joint-stock company which has to be discarded" (*ibid*.).

Although there is no discussion of the difference between private and social return in the Yellow Book, it is clear that the Inquiry knew they are not at all the same – not least from their discussion of the "public concern". Years of conservative Governments (small "c", for I count the Blair years in) have eroded this knowledge.

The shopping list

If the White Paper is marked by an absence of analysis, it makes up for it in its proliferation of proposals. A quick perusal of the body of the White Paper reveals a bewildering list of commitments to a wide range of different projects, usually with a new organisation to deliver the policy. A more-or-less random dip produced the following examples:

- Total public expenditure on R&D to rise to £12.5bn in 2021-22, p. 67.

- Invest £725m in an Industrial Strategy Challenge Fund pp. 74-5.
- School Improvement Fund £280m p. 87.
- Cyber Discovery programme £20m, p. 109.
- Productivity Investment Fund £31bn p. 132.
- Transforming Cities Fund £1.7bn, p. 133.
- £2.5bn investment in low carbon technology by 2021, p. 144

I have not made a full list: it would be boring to compile and type and even more boring to read. I counted 80 examples in just over half the text before even I gave up. This is an approximate figure, for there are duplicates which I have tried to eliminate but almost certainly imperfectly, and I will have missed many examples. At the very least there should have been an appendix which brought all financial commitments together and lists all the new organisations which will be tasked to implement the Strategy.

The list is ordered, to give this mess some coherence, by categories described as five "foundations of productivity", each of which "aligns" with one of the elements of their "vision", in the same order. The categories are "ideas, people, infrastructure, business environment, places". *Ideas* includes the focus on R&D and innovation, *people* captures their intention to invest in education in science, technology, engineering and mathematics (STEM) and re-skilling, *infrastructure* includes transport, housing and digital infrastructure, *business environment* refers to their extensive list of initiatives to foster innovative new industries and other "high potential" businesses; promote cooperation between business, government (including local authorities) and universities; and address productivity problems in small and medium-sized businesses (SMEs), and *places* refer in various ways to the attempt to establish and nurture industry in a less-centralised way.

Already when this scheme of thinking is introduced (p. 11), the shopping list makes an abbreviated appearance. After that, in the body of the text, it becomes unreadable to any but the most dogged or those with special interests. But you can see that they are proposing to take various initiatives to achieve low carbon output and other green objectives somewhat seriously, for example, and it is interesting what industries have attracted their support, either because they are already highly successful or because they are "cutting edge": aerospace and the (mostly foreign-owned) motor car industry are examples of the first, driverless vehicles and battery technology are examples of the second.

Reading their objectives I am particularly worried about the fate of SMEs. Why does the report seem to associate high productivity with large firms? Have they looked at Carillion? – big, but actually they did nothing but bid for government and other large contracts; smaller firms, subcontracted, did all the work. In any case, productivity is important but it is not everything. To run a small business, making your own decisions, enjoying what you are doing and turning an adequate profit is to many people a satisfying life. SMEs are also said to be the source of many innovations – nothing on the scale of quantum computers or driverless vehicles perhaps but still a contribution. Big may be productive, but small can be beautiful. Will SMEs survive in Mrs May's white heat of productivity?

A sample paragraph reads

> "For the economy to realise the benefits of AI, the sector and the government will coordinate action on solutions to shared challenges and opportunities through an AI Council, a new government Office for Artificial Intelligence, an expansion of TechCity UK to become TechNation and a new GovTech Fund" (p. 200).

It must have taken an army of advertising copywriters to dream up these names. My favourite is the network of Catapults for different industries, to help commercialise new technologies.

As well as being presented under each category of contribution to productivity, proposals are grouped under four Grand Challenges. They pledge to:

> "put the UK at the forefront of the artificial intelligence and data revolution maximise the advantages for UK industry from the global shift to clean growth become a world leader in shaping the future of mobility and harness the power of innovation to help meet the needs of an ageing society" (p. 34).

Now we can see clearly what I suspected when talking about the vision statement: that the purpose of the whole project is to aggrandise the State, not to help us live better, more fulfilling lives. They advocate AI, for example, not because robots can relieve us of some drudge jobs but to be *first*; clean growth not for the sake of clean air to breathe and water to drink, never mind saving the planet, but to capture gains for UK businesses investing in clean technology; to foster mobility not to make it easier for people to get about (and, incidentally, make them more productive), but to be a world leader in the future trajectory of its technology. Finally, in the fourth Challenge, we see a twinge of humanity – or do we? Is the ageing population (not society!) really just a testbed for new technology? Are we oldies not just a growing market being used for the good, first, of British industry and, through industry, the State? We might as well be put to some use, since it's illegal to kill us off. After all, we're not *productive*.

By contrast, the recommendations of the Inquiry are summarised in a chapter of 30 pages at the end of the book: "to press on with housing, road construction, electricity and the regeneration of agriculture", to reform the governance of Public Boards (such as the Metropolitan Water Board, now defunct), to force large companies to publish their accounts and other information, to collect business statistics more frequently, to ensure that workers receive a just wage and a share of profits.

> "The primary purpose of such a system [of profit-sharing] should be neither to encourage greater output nor to increase the earnings of the workers, though these results should incidentally follow; but to define the principles upon which the wealth created by a concern is divided and to give assurance that these principles are observed" (p. 199).

And so it goes. If the reader is interested in detailed recommendations, he or she will find quite a lot in "Can Lloyd George do it?", a more accessible source (Keynes and Henderson 1929). Throughout the book, pragmatic policies are based on principles.

Conclusion

It is a pleasure to see Cinderella out and about and open for debate after so many years in seclusion. It is also a pleasure to find that the Government is last eager to spend some money. Some of the projects are imaginative and commendable, others, in my view, are not (HS2, fracking), but that is normal where preferences differ. There are important areas left out: health technology more generally - not just for the ageing population, for example. If, as they emphasise, education is important for productivity, so too is health.

However, one of the few principles in economics that I think holds good is opportunity cost. While this Government proposes spending serious sums of money on glamorous, cutting-edge technology, the NHS is in deep financial trouble, public libraries are closing, high streets have become uniform because only the big chains can afford the rates, set high for businesses because local authority budgets have been slashed. I have nothing against a successful economy: I wish we had one. But where are the tools of conviviality; the public spaces where children can safely go independently, what of subsidies to the arts – the things we need if we are to live "wisely, agreeably and well".

Actually, "we", the people, do not count in the thinking behind the White Paper at all.

I have not done justice to the richness and complexity of either document, but I hope I have done enough to illustrate the vast gulf between them in both style and substance. It doesn't take long quotations from of the White Paper to expose its style as a mixture of puerility, bombast and adspeak, after which the Yellow Book's writing style is a delight.

The two documents differ dramatically in what is considered appropriate to include in a document on industrial policy. Of course today's problems are different from those in1928: the coal industry has disappeared, the issue of the planet's limited resources is now prominent, and so on. Some of the difference is explained by the fact that one is a government policy paper and the other similar to a manifesto (within a limited field) of a political party: the recommendations of the Yellow Book are not "priced" (for that, see Keynes and Henderson, 1929). And the Inquiry gave itself more space: 488 pages, excluding the index; the White Paper is half that length: 242 pages, excluding references and credits (there is a picture on almost every page). There is no (much needed) index. The Yellow Book was two years in the researching and writing; the White paper was knocked out in less than a year.

But it is the strong emphasis on underlying philosophy that recommends the Yellow Book as a review of industrial policy. At that level, the White Paper cannot even begin to compete.

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SUGGESTED CITATION:
Victoria Chick, “Industrial policy, then and now”, *real-world economics review*, issue no. 84, 19 June 2018, pp. 178-188, http://www.paecon.net/PAEReview/issue84/Chick84.pdf

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