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Industrial Policy Rears Its Ugly Head

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HIGHLIGHTS

- "The willingness of government to bail out a Lockheed or Chrysler is not surprising. That is the price that Congress is willing to pay to avoid dealing with the underlying industrial problems that arise from the existing pattern of governmental intervention in the private economy." (p. 3)

- "Some would attempt to stop economic change by dealing with the so-called 'runaway plant problem'....This 'King Canute approach' ignores the reasons why companies are forced to take such actions in the first place. So frequently those plants have lost their competitiveness due in large part to the government policies advocated by the same groups that now support legislation against runaway plants."

- "There is a growth strategy that involves no expansion in either government power or federal spending. Its elements are basic -- tax simplification, regulatory relief, lower deficit financing, and curtailed government lending." (p. 5)

- "The worst thing that we could do . . . is to shift from the much maligned, ad hoc approach to a tidier and better planned system of business bailouts. Say's Law -- supply creates its own demand -- would work with a vengeance. The assured supply of assistance would create more demands for aid." (p. 6)

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As predictable as Spring crocuses, the high level of unemployment has led to pleas for an "industrial policy" to restore the health of the American economy. By guiding investment into growth areas and out of declining markets, a new federal industrial policy supposedly will restore the competitiveness of American business at home and abroad. But, as I tell my students regularly, you often have to preserve the private enterprise system from the contrary actions of individual entrepreneurs.

What is especially disconcerting is the number of business executives who are joining in this chorus for more governmental intervention. These are men and women who normally champion private enterprise and oppose a bigger role for Uncle Sam in business decision-making.

Shortcomings of Existing Industrial Policy

To begin with, it is important to realize that we already have many government policies which affect industry in important ways -- and which have in large measure contributed to the difficulties now being faced by the American economy. In the main, of course, these impacts are side-effects of laws designed for other purposes. There are many examples -- policies to provide a more equitable tax structure, to reduce the inequality of the

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distribution of income, to enhance the quality of life, to improve the physical environment, and so forth.

Most of these policies ignore or at least take for granted the needs and operations of the private enterprise system by focusing on non-economic and social goals. Intentionally or not, the result of these policies, in the main, has tended to be in one direction -- to weaken the basic condition of the manufacturing sector of the economy.

This influence on the fundamental structure of American industry, as a result of government policy, can readily be seen in the larger manufacturing companies as they shift increasing portions of their work force away from the creative and productive areas of business such as research and development, manufacturing, and marketing. This shift has resulted in an increase in the overhead functions -- legal activities, accounting and finance, public affairs, and government relations. For the individual firm, this change may be an essential way of responding to pressures from government agencies and self-styled public interest groups with noneconomic orientations. But the impact on national productivity can only be negative.

Moreover, this change is compounded by the metamorphosis of the traditional functions, such as the growing size of "defensive" research as a major mission of industrial laboratories. That refers to reorienting business research efforts to please the regulators. Similarly, "reverse distribution" has become a new marketing function. That refers to gearing for and, on occasion, carrying out product recalls. The ultimate effects of these responses to government dictates go far beyond the immediate compliance expenses. Often, they contribute to the problems which spur the current calls for reindustrialization.

By overlooking these structural responses to existing governmental policy, all that is visible in the short run are the pleas for bailouts, subsidies, and other special assistance from the companies that are most severely affected by the governmental burdens imposed on American industry. But, on reflection, the willingness of government to bail out a Lockheed or a Chrysler is not surprising. That is the price that Congress is willing to pay to avoid dealing with the underlying industrial problems that arise from the existing pattern of governmental intervention in the private economy.

Why Bring Back the RFC?

A focal point for the current advocates of industrial policy is the proposed reestablishment of the Reconstruction Finance Corporation. Let us take a detailed look at that idea. As we may recall, that federal agency was a creature of the Depression of the 1930s which grew rapidly during and following World War II. Those with short memories may think well of that government enterprise. But a review of its activities is instructive for today's situation.

Under the original act passed in 1932, Congress granted the RFC very modest lending powers limited to railroads and financial institutions. During the next six years, however, the agency's authority was steadily broadened. By 1938, it had the power to buy the securities of any business enterprise. The RFC had become an extensive corporate bail-out agency in the form of a government-sponsored investment bank. Attention is usually focused on the contributions that the RFC made during the Depression and World War II. Nevertheless, most of its loans to business were made in the postwar boom period of the late 1940s and early 1950s.

The statutory criteria for loan approvals were extremely vague. As we would expect, Congress stipulated that the RFC should extend loans only for purposes that would serve the public interest. By 1949, rumors circulated that connections with influential people in Washington were often the real basis for gaining loan approvals from the RFC. Subsequently, Congressional hearings disclosed numerous examples of favoritism and corruption in the granting of RFC loans. Finally, in 1953, Congress ended the life of what was by then a discredited agency.

There is indeed much to learn from the operations of the RFC. Its history shows that government subsidy of business encourages and perpetuates a misallocation of resources. The agency's loans included such "high priority" ventures as distillers, brewers, drive-in theaters, hotels, motels, and bars. The RFC experience also demonstrates once again that government programs develop a life of their own and persist long after the problems for which they were created have been solved.

Variations on the negative theme of focusing on the "losers" are not limited to the notion of bringing back the RFC. Some would attempt to stop economic change by dealing with the so-called "runaway plant problem." Their response is to make it extremely difficult and costly to move or close down an industrial facility. This "King Canute approach" ignores the reasons why companies are forced to take such actions in the first place. So frequently those plants have lost their competitiveness due in large part to the government policies advocated by the same groups that now support legislation against runaway plants. Such proposals also overlook the negative signals that this policy would send out to any company considering building a new plant in a region that has adopted restrictive legislation (and a few states already have done so).

Close cousins of this negative approach are proposals to "protect" various industries and markets from foreign competition and to inhibit American investments overseas. None of these approaches would lead to a more productive or more competitive economy. They often would shelter companies and localities from their own mistakes.

A Positive Approach

All this, however, need not lead to a "do nothing" approach to the serious economic questions that face the United States. There is a growth strategy that involves no expansion in either government power or federal spending. Its elements are basic -- tax simplification, regulatory relief, lower deficit financing, and curtailed government lending. In each of these areas, much needs to and can be done.

The 1981 tax reductions were surely welcome. But the sad fact of the matter is that the tax code is far more complicated today than it was just a few years ago. To any one who has ever tried to fill out the tax forms for a small company, it is clear that simplification is not just a pleasant thought, but a vitally important need.

Similarly, the regulatory relief effort has accomplished much in reducing the burden of new rules. But fundamental improvement can come only from revising existing statutes that mandate unreasonable burdens of compliance, such as the "zero discharge" goal of the Clean Water Act and the "zero risk" provision of the Delaney Amendment to the Food, Drug and Cosmetic Act.

Furthermore, it is ironic to contemplate the numerous industrial-policy proposals for funneling federal funds to "worthy" private investment areas at a time when the federal government is running budget deficits of $200 billion a year. The most effective way to increase private capital formation is just the reverse of the RFC approach; it is to reduce the federal drain on private saving represented by massive deficit financing.

Finally, federal lending programs are a classic example of robbing Peter to pay -- or lend to -- Paul. They do nothing to increase the pool of private saving. But they do reduce the amount available in the private market.

The most effective strategy for encouraging economic growth is no secret. It is to reduce government barriers and achieve a better functioning market economy. However, the approach I am advocating is not accompanied by any guarantee. In a truly dynamic, competitive economy, we do not know in advance where the new product breakthroughs will occur. And the benefits will not be evenly distributed. But we do know that society as a whole will be better off, since it is likely that most -- but not all -- industrial workers and employers will enjoy higher real incomes and living standards. Surely the positive types of industrial policy are designed to enhance productivity, capital formation, and international competitiveness. The negative approaches are all adverse to these key economic goals.

Conclusion

The current discussion of industrial policy ignores the fundamental contradictions that now abound in government policies affecting private industry. The worst thing that we could do, however, is to shift from the much maligned, ad hoc approach to a tidier and better planned system of business bailouts. Say's Law -- supply creates its own demand -- would work with a vengeance. The assured supply of assistance would create more demands for aid. Companies would be more reluctant to make those difficult choices needed to avoid pleas for government aid. Unions would be reluctant to settle for less if the government ultimately validates pay increases beyond the capacity of companies to pay.

Much of the current talk of a comprehensive industrial policy smacks of national economic planning. The rekindled interest in such an approach is due to a simpleminded analogy with planning techniques in private business. But to talk about "corporate planning" and "government planning" in the same breath disregards the fundamental distinction between members of a society forecasting and reacting to the future, and the government of that society trying to regulate or control it. Corporate planning is necessarily based on attempting to persuade consumers to buy a firm's goods or services. In striking contrast, the government is sovereign, and its planning ultimately involves the use of its power to achieve the results it desires.

When we look at the operation of centralized economic planning adopted by market-oriented, non-Communist nations, we find that these planning systems have shifted the focus of private enterprise even further away from dealing with market forces and consumer demands, toward reaching an accomodation with an ever more powerful government bureaucracy.

Under an American version of centralized economic planning, a company might find it desirable to shift resources from conventional marketing activities to convincing the government to adopt more generous production targets for its industry. Thus, there might be less payoff from traditional consumer market research than from new efforts to persuade the government to treat the industry more favorably. Such public sector "marketing" activities would be a low priority use of business resources from the viewpoint of society as a whole. Yet, given the incentive of any organization to grow and prosper in the environment it faces, this result would not be surprising under a system of strong national economic planning and centralized decision making.

A cynic might conclude that the optimum amount of change in industrial policy is zero. That is, the positive approaches that I have advocated may not be adopted and the negative approaches that involve further government intervention may turn out to be more popular. But I remain a patient optimist, hoping that some modest contribution to a more productive and competitive industrial structure will result from the renewed interest in facing the nation's economic problems.