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A New Industrial Policy for the United States?

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A NEW INDUSTRIAL POLICY FOR THE UNITED STATES?

by Murray L. Weidenbaum

It is fascinating to see how Washington decision makers and the coterie of private analysts surrounding them have finally discovered that American industry is in trouble. Seeing one car maker on the ropes, the entire steel industry beset with sluggish markets and high costs, productivity stagnant and innovation slowing down, even the trendy set in economic policy has sensed that something is wrong in the American economy.

Of course, many economists and business executives have been warning the nation for years that saving and investment—the keys to economic growth and rising living standards—are woefully low. Rather than simply acknowledging these basic but undramatic facts, it seems easier for all concerned to adopt some new buzz words and "in" concepts. We cynics who have an optimistic nature nevertheless welcome this attention to basic economic factors.

Thus, we must acknowledge that "industrial policy" and "reindustrialization" are new and vague terms which have rapidly become fashionable in the United States. Many in business applaud this new concern with business problems, expecting—or at least hoping—that the result will be more incentives for saving, investment, and capital formation generally.

But industrial policy, or reindustrialization, has also attracted another set of supporters with rather different viewpoints. One recent union publication, for example, lumps "rebuilding our industrial base" with labor's desire to "stop plant closings." Overall, however, the situation

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today is not a simple matter of business versus labor. It is much larger in scale. A prominent investment banker has been urging, as a major part of a reindustrialization effort, bringing back the Reconstruction Finance Corporation. For those who don't recall or are too young, the Reconstruction Finance Corporation was an ambitious corporate bail-out agency established in 1932 as a gigantic, government-sponsored and government-guaranteed investment bank.

Thus, a highly simplified but basically accurate distinction among the supporters of industrial policy can be made between (a) those who want to encourage greater reliance on private initiative and risk-bearing, and (b) those who want to expand further the role of government in the American economy. It is sad to note, along these lines, the recent special issue of *Business Week* on "The Reindustrialization of America," which urged that "the leaders of the various economic and social groups that compose U.S. society should agree on a program for reindustrialization and present that program to Washington." Shades of the recent, unsuccessful effort to foist centralized economic planning on the United States!

Whatever our personal viewpoint on the subject may be, it seems clear that we will be hearing a good deal more about industrial policy in the months ahead. Hence, some perspective may be useful.

Where We Stand

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. Examples include policies to provide a more equitable tax structure, to reduce the inequality in the distribution of income, to strengthen the role of the trade unions, 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, social goals. But, in the main, the result of these policies has tended to be in one direction—to weaken the basic condition of the manufacturing sector of the economy. This negative impact is most noticeable in the automobile and steel industries, which have been beset by lagging sales, rising foreign competition, declining profits, and numerous plant closings.

This surely unintentional weakening of the basic 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.

Moreover, this change is compounded by the metamorphosis of the traditional functions, such as that which can be seen in the size of "defensive" research as a major mission of industrial laboratories—which refers to reorienting business research efforts to please the regulators. Similarly, "reverse distribution" has become a new marketing function—which refers to gearing for, and on occasion carrying out, product recalls. As I have pointed out in my new book, *The Future of Business Regulation,* the ultimate costs of these responses to government dictates go far beyond the immediate compliance expenses and extend to attenuation of the entrepreneurial nature of the American business firm. Hence, many of the problems which spur the current calls for reindustrialization.

By overlooking these structural responses to *existing* government 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 burdens imposed by government 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 government intervention in the private economy.

Still another example of this pattern is the Energy Mobilization Board proposed by President Carter. Although Congress recently delayed any decision to authorize its formation, this new government agency was expected to cut through the worst of the red tape to enable several selected energy projects to proceed. Yet, as some of us have been pointing out repeatedly, the growing thicket of regulatory barriers makes it difficult to proceed with new industrial developments in almost any sector or region of the economy, and not just in the energy area. Given our national unwillingness to meet this problem head on, the preference for a "second best" strategy is not surprising. But merely legislating a few exceptions to a bad policy is surely second best.

We must realize, in the meantime, however, that government policy towards industry has not always been negative. In the 1950s and 1960s, we did in fact have a positive, albeit unintentional, type of industrial policy. Massive contracts from the Department of Defense, NASA, and the Atomic Energy Commission helped to foster growth industries in the aerospace, electronics, and nuclear fields, and in many supporting industries. In a more general way, the institution of the investment tax credit and liberalized depreciation was a part of that generally positive approach. In sharp contrast, during the decade of the 1970s, we have witnessed a burst of government regulation of business which has been documented in detail by our Center for the Study of American Business—regulation which, in the main, has had seriously negative impacts on the performance of the American business system.

Alternative Approaches to Industrial Policy

There is no shortage of proposals for change in government policy toward American industry. I find it useful, however, to distinguish between the negative policy of bailing out losers and a more positive approach, geared to creating more winners.

Along the lines of bailing out losers, we must acknowledge that there is growing interest in developing a comprehensive policy for identifying and aiding such companies. The concern here is to develop a "tidier" approach than the existing one of "quick fixes." As I pointed out earlier, some would like to bring back the old Reconstruction Finance Corporation, forgetting the scandals and many charges of favoritism that led to its demise. But, in retrospect, it should not surprise us that arbitrary power to disperse federal largesse to selected companies was, in fact, used arbitrarily. If we are determined to develop a more orderly way of providing government assistance to companies and to specific sectors of the economy, we have to realize that someone must decide which sectors "deserve" the assistance from government. There is no doubt in my mind that this path, albeit unwittingly, leads to a major expansion of government power over the private sector of the economy. Those who are fond of citing the Japanese example might do well to consider the sadder experiences of Great Britain.

Variations on this negative theme of focusing on the "losers" include restricting economic change, such as specifically dealing with the so-called "runaway plant problem" by making it extremely difficult and costly to move or close down an industrial facility. This 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. A milder variation is to beef up the existing program of adjustment assistance for employees and companies "adversely" affected by imports. By providing more benefits generously to these "victims" than to the unemployed generally, such well-meaning responses exacerbate the underlying economic conditions that generate the lay-offs because such action increases deficit spending and reduces the incentive for private initiative.

This approach of propping up losers also discourages business firms from making tough survival decisions. Compare the recent actions of Chrysler in focusing on obtaining government aid with the earlier painful steps taken by the management of American Motors, which instead cut back its product line in a successful effort to make it on its own. From the viewpoint of society as a whole, the negative approach locks resources into low productivity industries and areas of the economy. But perhaps we should not be too critical of the Chrysler management. After all, the company responded to a different set of public policy incentives than did American Motors Corporation. Any impartial observer of the automobile industry in recent years would conclude that there was little chance of government providing a general bail-out to American Motors. But because of its greater size and strategic location, the odds for such aid were much higher in the case of Chrysler.

The basic alternative—the positive approach that I am advocating—is to create more positive conditions for expansion in the economy generally. Thus, capital and labor would be encouraged to shift to more productive uses. My basic theme here is to foster the economic activities that lead to more job formation and also enhance new international competitiveness. There are many ways of doing that, and many of them are mutually reinforcing.

One positive alternative is to encourage companies to perform more research and development, which is the seedcorn for product and process innovation. Personally, I do not favor more government grants and contracts which pinpoint the specific areas to be worked on. Rather, I urge liberal tax credits for R&D which could yield a two-fold benefit. First, private enterprise would determine the research projects to be undertaken and, second, private enterprise likewise would continue to bear the bulk of the risk, depending on the precise percentage of the tax credit. Also, this approach avoids the great question that arises so often in government-performed and even government-sponsored R&D—how to commercialize the results?

Often, however, the main problem is not to develop a new business idea, but to raise the capital to develop it. There is a family of proposals to do that effectively, but indirectly, by increasing the availability of capital. One basic way of doing this is to reduce government competition for the limited amount of investment funds generated by the private sector. I mean reducing the budget deficit—especially by cutting back those transfer payments that reduce the incentive to work and to save. I surely would not increase the government's demand for funds by setting up new, off-budget credit agencies *a la* the Reconstruction Finance Corporation proposal.

Cutting income tax rates generally would increase private saving and private consumption as well. The tax cuts, alternatively, could be targeted at increasing saving by reducing the tax burden on the portion of income that is saved—that is, in practice, by shifting the tax burden to current consumption. Also, tax cuts could promote investment. Examples include the 10-5-3 capital recovery approach which would liberalize and simplify depreciation policies by enabling all buildings to be written off for tax purposes in ten years, all equipment in five, and cars and trucks in three.

Simultaneously, an industrial policy geared to creating more winners must reduce the numerous government obstacles to private capital formation, especially in the regulatory field. Along these lines, it is important to reduce the uncertainty about future changes in regulations and about getting final approval by a host of regulatory authorities for any new project. As we saw so dramatically in the now cancelled SOHIO pipeline case, such uncertainty discourages investment and also increases the cost of capital. In this regard, it is ironic to contemplate the large government subsidies which are being made in the synthetic fuel area to overcome these hurdles. This phenomenon is akin to the government simultaneously having one foot on the brake and the other on the

accelerator. This may also explain why my favorite advice to congressional committees that are considering the adoption of yet another government program is, "Don't just stand there, undo something."

All of the second category of responses to industrial policy that I have advanced boil down to encouraging more winners. Unfortunately, this approach is not a 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 than they would under the negative approaches. 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 important 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.

As I mentioned at the start, much of the current talk of a comprehensive industrial policy smacks of national economic planning. The rekindled interest in such an approach is due in part to the widespread use of 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. Its influence is externally oriented, extending its sway over the entire society.

When we look at the operation of national economic planning adopted by the primarily market-oriented, non-Communist nations, we find that these planning systems have tended to shift the focus of private enterprise even further away from dealing with market forces and consumer demands, toward reaching an accommodation 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. The Chrysler loan case furnishes a cogent example, since the management of Chrysler will have to negotiate with the federal government not only the models to be offered, but also the options included on those models with their federal benefactors.

Boiled down to its essence, business planning is part of a decentralized decision making process in which individual consumers make the ultimate choices. National planning is a centralized process in which the key economic decisions are made in the form of government edicts. The greatest danger of adopting a form of centralized economic planning under the guise of a comprehensive industrial policy is that it will—perhaps unintentionally at first, but inevitably as its initial results prove disappointing—propel the society away from market freedoms and toward greater governmental controls over individual behavior.

A cynic might well conclude that the optimum amount of change in industrial policy is zero. That is, the positive approaches that I have advocated are not very likely to be adopted; the negative approaches that involve further government planning of and intervention in the direction of the economy will turn out to be more popular. But, given the alternatives, I remain a patient optimist, hoping that some modest contribution to capital formation, productivity, and innovation will result from the renewed interest in facing the nation's economic problems.