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Author(s): Paul W. McCracken
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Is Industrial Policy For The U.S.?

Paul W. McCracken*
The University of Michigan

ONE OF THE FEW ADVANTAGES of getting older (and the list is a short one) is personal observation of a growing span of historical experience. Thinking back over recent decades, one is struck by the extent to which discussions of economic developments and policy have been seized by a phrase. For some of us with a good many years already crowded into our professional careers, "the mature-economy" hypothesis early dominated the literature, and such books as Alvin Hansen's *Full Recovery or Stagnation?* would by the title itself convey the flavor of much thought in that era.

After the war concerns about a "dollar shortage" emerged. This did not have to do with the dollar shortage which bedevils most of us persistently, but whether, for structural reasons, there would be a persistent tendency for the United States to operate with an overly strong balance of payments. How, the rhetorical question was asked, can Europe and Japan ever expect to compete with that North American industrial behemoth? (The implied answer was, "Probably never.") And as late as 1957, for example, our merchandise trade surplus was equal to almost 1½ percent of GNP — equivalent to something like a $50 billion trade surplus in today's economy.

With the emergence of inflation in the industrial world in the mid-1960s, "income policies" encapsulated for many hopes for restabilization without tears. (The early American term for this was, of course, "guidelines".) A great deal of ingenuity was expended in the search for an approach, a program, that would leave the pricing system capable of performing its communications function for the economy, have no interim adverse effects on employment and output, and would somehow impose a discipline on the price level without having to make tough decisions about monetary and fiscal policies. Indeed, so sensitive were we to these matters that in 1969 the newly inaugurated Republican President assured the AFL-CIO that inflation would be countered with no adverse consequences for employment.

In the contemporary scene the new in phrase or concept is, of course, industrial policy. It did not spring full scale upon us in 1982 and 1983. Indeed, it has antecedents in at least two concerns about public policy. One emerged from international economic developments. As tariffs were progressively reduced after World War II, to generally quite low levels, it became clear that industries and markets in some countries were being adversely affected by programs in other countries to invigorate ailing industries or areas. However unexceptionable a government's concern might be for unemployment in its depressed areas, in an increasingly internationalized industrial world other companies in other countries found themselves competing against subsidized foreign sources, and the result was a trade argument. This argument, of course, escalated sharply as other nations have protested what has been perceived to be Japan's more overt and aggressive strategy — targeting industries presumed to represent the wave of the future, accelerating their progress with government support and early protection in the domestic market, and then focusing on external markets.

The other source of concern giving rise to the Great Debate about industrial policy is, of course, quite simply that the domestic economy has not performed well in recent years — and traces of this sub-

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See footnotes at end of text.

par performance extend back well into the 1970s. The dimensions of this sub-par performance are generally known, certainly to members of this Association, and need no belaboring here. Improvement in productivity for the whole economy became slower in the 1970s, with no further gains (until recently) after 1977. Unemployment in the decade of the 1970s averaged well over 6 percent, and close to 7 percent in the last half of the decade. And during the decade the price level rose at the average annual rate of over 7 percent, accelerating to a double-digit pace as we moved into the 1980s. This was a performance almost completely out of context with our history. If we look at the first two-thirds of this century, excluding pathological periods such as the two major wars and the Great Depression, for the remaining four to five decades of historical experience the average rate of inflation was about 2 percent per year, gains in productivity were 2 to 2½ percent annually, and unemployment averaged about 5 percent of the labor force. (The 4 percent which came into the lexicon of our profession as a full employment condition for the economy never had strong support from history. This is another illustration of economic policy's being off target because of our national disinclination to be aware of history.)

What, however, is "industrial policy"? Since these words are so much in current discussion, one might reasonably assume that the term has by now a clear and focused meaning. In fact, this is another one of those terms, like incomes policies, with a considerable measure of imprecision. For some, it represents little more than an essentially pragmatic set of suggestions to deal with some *ad hoc* problems.[1] For a variety of reasons some important industries (e.g. steel or automobiles) must respond to new market conditions with capital outlays extending beyond the boundaries of what capital markets could reasonably be expected to provide within the ambit of prudential rules. Government credit facilities should, therefore, be created to bridge this gap. Since we are in Detroit, the Chrysler loan would come to mind as an illustration of this *ad hoc*, pragmatic approach to industrial policy. A somewhat more general proposal, but still generally within this scope, is the suggestion by Felix Rohatyn to make these arrangements less *ad hoc* by the creation or re-creation of something like the old Reconstruction Finance Corporation.[2] A half century ago the RFC also was established to deal with a situation where companies and banks needed capital not then available from financial markets through the conventional avenues. It was created to deal with a situation, not to give expression to some new and ambitious theory about the social and economic scheme of things.

There is, however, a more ambitious view of industrial policy in the current Great Debate. It is this more Olympian concept that is beginning to dominate the Debate, and it is this concept with which my remarks here are largely concerned. Several names come to mind. While no author would ever agree that his theory and prescriptions are essentially similar to those of any other (and the closer they are the more violent the arguments often become), most of the elements of the new industrial policy have been articulated by Robert G. Reich, who has been referred to as its leading guru. And, indeed, his book[3] has tended to dominate the current debate.

There is an almost Hegelian ineluctability in this view about our arrival at the present condition requiring a new industrial policy. The very thing that ushered in the vigorous increase in American productivity and real income, beginning about a century ago, also has left us trapped out of position for the next chapter in the unfolding economic process. During this earlier period of about a half century American managements developed the systems for producing large volumes of relatively standardized products. The industries of Detroit epitomize the process. Through Ford and his assembly lines and Knudsen and his concepts of management, production costs were brought down to the point where nearly all Americans joined the carriage trade. The little businesses making buggies and wagons gave way to the huge factories spitting out cars and trucks. Parallel illustrations from the other great industries of the period, of course, also could be drawn.

There then emerged in the mid-1960s the increasingly internationalized character of the world market. Thus capital and technology could move to where labor rates were cheaper, and the great industries concentrating on a large output of standardized products began to fit the American facts of economic life less and less well. Such places as South Korea or Taiwan or Mexico became more hospitable locations for the kind of manufacturing that earlier was the basis for our economy's industrial strength. The United States has been left with facilities and management mind sets attuned to large scale production of standardized products in an era of rising affluence when we need managements and facilities that can identify and service the more diverse array of products for specialty and niche markets. Here is the Hegelian process at work. The high-volume, standardized-products industries brought with them high labor productivity, which meant high incomes, which induced customers to demand more diversified products. These products U.S. businesses were ill-prepared to produce.

Parenthetically, this is an epistemology which Schumpeter would readily have understood. For him also, you will recall, capitalism was in jeopardy not because it had failed, but because it had succeeded. It produced the economic development which brought into being the large corporations, which routinized the source of progress (innovation), which thereby rendered the entrepreneur and therefore capitalism obsolete, which opened the way for socialism.

Ad hoc developments have not, of course, been absent in discussions of industrial policy. Gasoline crises that caused the auto market to run to the small-car side of the deck, for example, exacerbated these problems. Management people and management principles, perhaps abetted by Schools of Business Administration, may have contributed to a hardening of the arteries. These things are, however, subsidiary. We have arrived at this juncture because of the on-going process of economic progress as it has unfolded through time.

There is also in some of this literature a theological fervor, a disdain for accuracy about facts, and a vagueness about corrective programs that enables it to perform an almost evangelical role. In this era when theological leaders have themselves vacated religion for such more exciting secular matters as running foreign policy, the field is admittedly wide open for new religions. (The awesome decline in church membership does suggest that theological leaders have apparently been failing the test of their market place.) Thus the response to writing that has intensity, certainty, and fervor could be expected to be dramatic, and that response is still in its crescendo phase. For example, the first sentence of Reich's book: "Since the late 1960s America's economy has been slowly unraveling." No qualifying phrases. No trouble with such prosaic details as that real per capita disposable personal income during the period rose by one-third, and 25 million new jobs were created. This stern refusal to be troubled by facts is the stuff of which theological fervor, intellectual queu lines, and certainly social and political movements are made. Admittedly the fever chart of Reich's first sentence does not quite reach: "A specter is haunting Europe . . ." It does, however, have some of that clarion intensity.

And what is the program? Here things begin to blur. For some, as already indicated, the program would consist of little more than selected government efforts, such as credit availability and tax incentives, that would put some ailing but important industries on the road to financial and economic vigor once again. One can agree with these proposals or disagree with them, but there would be a wide measure of agreement that they do not envision really fundamental changes in our system.

Those writers attracting the most attention, however, are not so reticent or modest. Again Professor Reich: "There must be a new organization of work that will rest on 'a new organization of society'."[4] Clearly it is government that must determine the industries and companies that are to be the wave of the future. Just precisely how government is to be organized to carry out this program is largely ignored, and this is not a trivial omission. If government is to identify and subsidize winners, *ipso facto* government will be penalizing the losers to be left behind. Major or even massive changes in the way government is structured and operated would then be required, and it would be helpful if apostles of this new order would be more specific here — though admittedly the scripturalistic intensity of the prose might then dull considerably.

Here one is reminded of the Brandt Commission Report's call for a new economic order. In spite of repeated calls for a new economic order, the Report was never able to make clear what the phrase really meant — an omission reflecting either sheer inability to spell it out, or reluctance to reveal that what they really had in mind would require or metamorphose into a highly totalitarian political order.

Second, the new flexible-system production that must replace the old high-volume, standardized-products era will require a quite different conception of the business entity. If a business is to qualify for restructuring assistance, it must agree to maintain its work force intact. This then will force companies to do the retraining and engage in other forms of human investment required of firms that are going to be participants in the more flexible-system new order. Since employees would then be attached securely to an employer, these firms could then receive the public funds for health and other social services — with employees, however, themselves running these human capital programs. Indeed, businesses would then tend to replace state and local governments as the entities for administering these programs, and managements would come to see themselves as really responsible to employees rather than as now *exclusively* (the word is Reich's) serving the interests of shareholders. Thus businesses would be forced to be more innovative and flexible and adaptable because, with labor as a fixed cost, such exits from unattractive markets or excessive costs as buying an oil company to get away from steel or chemicals or establishing semiconductor plants in Taiwan or Malaysia to end-run higher labor costs here would no longer be available.

Finally, if government is to play this larger role, a political revitalization will be needed. Reich points out that Mayor Lindsay's Administration was a well-designed managerial system (which itself is important new information), but it could not make the political choices. Carter promised efficient government management, but again had no way to rank priorities and deploy resources accordingly. Just how this political revitalization is to be brought about is not spelled out, except that we need more fearless and effective leaders in government, businesses, unions, and other organizations.

The problems with the industrial policy strategy are far more severe than one might assume from much of the current discussion. This discussion does reflect an uncomfortable resemblance to that of a decade ago about using incomes policies as a cure for inflation. It also was a benign, even euphonious, phrase that somehow would lead us without pain to the promised land of price-cost stability. Those urging it, however, were never able to agree on just what concretely the elements of a program would be that would thus stabilize the price level and leave the pricing system free to function — all without imposing the discipline, through disinflationary monetary and fiscal policies, of markets that would no longer accept out-sized price and wage increases. When occasionally advocates tried to be specific, the luminosity of the term faded. The phrase industrial policy is also in danger of becoming a grin without a cat — an intimation that behind the brand name is a powerful, painless, productive new approach to economic policy the details of which will be, but somehow never are, spelled out.

While this is not the place to criticize in detail, a comment about details is relevant, and this pertains particularly to the book by Reich. The cumulative effect of assertions in the book which would not stand the test of empirical evidence or analysis is to nudge the careful reader toward a feeling that the case is superficial — that the discussion as a whole has thus been cheapened. A few quick examples will suffice. "By the mid-1960s America's basic industries had lost the habit of competing."[5] Empirical evidence about concentration in markets has never supported this. ". . . the portion of the pie shared by workers has been declining as inflation has out-stripped wage hikes."[6] The share of the national income accounted for by compensation of employees in 1980 was 76 percent, compared with 75 percent in 1972 and 1976. "Wage and price increases in every other industrialized nation follow guidelines . . ."[7] The author is apparently unaware of the many careful studies about the limited and transient effectiveness at best of incomes policies in the industrial world.

The theory of government underpinning the more ambitious proposals for industrial policy also will not do.[8] It is not without significance that the organization structure required in government to implement such a program is given only the most fleeting attention. Reich, himself a Professor in Harvard's School of Government, is remarkably uninformative about how government would have to organize to implement his ideas. He alludes vaguely to the desirability of a public board within the Office of Management and the Budget to monitor these programs. Since he himself describes this as a small step, the reader might reasonably expect at least one succeeding chapter laying out the major steps, but no such chapter is forthcoming.

There are, I believe, some reasons for this omission. Fundamental to this strategy in its ambitious form is really a reincarnation of the concept of government by Plato's philosopher kings. If government would only quit acting like government, and go with super-leaders instead of those made out of the same common clay as the rest of us, things would somehow work out wonderfully with the economy thus managed. Unfortunately people in government will probably continue to resemble people in government (and the rest of us) rather than Plato's finest, and actions in the government arena will tend in the future as in the past to reflect the changing struggles of interest groups. Moreover, even a government agency occasionally here presumed to be blessed with near-omniscience (Japan's MITI) completely misjudged prospects for that nation's auto industry, and fortunately for Japan MITI lost the argument. (For that matter, how many Nobel prizes have been spawned by MITI-designated programs?) A government which built the Washington subway out to the airport, and then carefully located the station beyond walking distance to the terminal, would not seem to have the clairvoyance required to blueprint the whole economy.

Moreover, the strong tradition in this country for government programs to make for a more equal distribution would be a severe problem for a strategy of subsidizing winners and penalizing losers (or at least not helping them). How would a proposal fare, for example, for subsidies to IBM and Hewlett-Packard, with penalty taxes on textiles, basic steel, and domestic service? The probability that such a bill would emerge from the Congress exactly upside down would be close to 100 percent.

The industrial policy strategy is also fundamentally weak in its theory of progress. The liberal, basically market-organized economic order does, in fact, have underpinning it a well-developed process for generating economic progress — for making needed, continuing disestablishmentarianization actually operational. Economic progress (and progress in any area) requires a process that encourages the generation of new ideas and that can sort out the good ones and let the poor ones disappear — and all with an economy of resources used. This the liberal system can do. It is structured to take advantage of the aggregate of knowledge and creativity that does not exist in its totality any place and cannot be comprehended by any group. We then rely on open and competitive markets to sort out the good ones and to assure that today's new and better becomes tomorrow's standard.

Whatever the rhetoric, the more ambitious concept of industrial policy envisages a major further direct management of the specifics of the economy by government. This carries with it two problems. It shrinks the process of generating new ideas to the ones within the purview of those at the top. It also has tended to weaken the pressures for diffusing the new and better throughout the economy.

While no one would assert that those urging even a full-blown program of industrial policy are really proposing communism, in those state-managed economies we do see as through a magnifying glass that government management of economic life tends to slow down progress; because there is no way to use the creativity coming from unexpected places; and the bureaucracy frowns on displacing the old, and *for it* the comfortable, with the new and upsetting.

One more quick point (though it deserves a separate paper). There is a direct correlation between the extent of government management of the specifics of economic activity and the extent of corruption. When government diktats and permits are required to make a move in business life, those bureaucratic decisions have a cash value, the price will get paid, and the winners will be those willing to pay the price — not necessarily those who demonstrate performance in impersonal, competitive markets.

Finally, many of the problems this program is supposed to correct really derive from our political inability to follow sufficiently disciplined fiscal and monetary policies. This is not a glamorous point, but it is fundamental. Our current problem is illustrative. Whatever their indigenous problems, some of our industries losing ground to foreign competition are floundering because of the 25 percent rise in the real effective exchange rate of the dollar since 1980. While safe-haven money coming here is part of the problem, the major force has been money drawn here by our high real interest rates reflecting earlier inflation and the current impasse on the budget. This has imposed a heavy tax on exports, and it has created a subsidy for imports, and our trade balance in manufactured goods has shifted from a surplus of $19 billion in 1980 to a deficit at the annual rate of $28 billion so far in 1983 — a swing directly worth close to 1½ million jobs. No Hegelian process of ineluctability is required to explain the deterioration in American industry's general competitive performance in recent years. And there is no glamorous thing called industrial policy which will give us a steady and vigorous economic performance if we lack the will to manage properly disciplined budget and monetary policies.

We had, however, better take this Great Debate about industrial policy seriously. These are not just intellectual questions to be explored in the alleged serenity of academe. The London *Economist* reviewed Reich's book sympathetically. On the dust jacket of the book, Walter Mondale, who might be a future U.S. President, labels it one of the most important works of this decade.

There are, I believe, some messages in this admittedly amorphous and disparate literature that are fundamentally important. For one thing, these discussions might usefully remind us that there is more to economic policy than the Federal Reserve and the budget. In addition to macro-policies there are micro-policies, policies pertaining to specific parts of the economy, and these could be called industry policies. We do need to re-examine some issues that make for a more or less effective economic performance. Tax policy and the archaic conventions of the accounting profession, for example, have played their part in the under-investment that has afflicted capital intensive sectors of the economy. Before we are through with it, the A.T. & T. anti-trust settlement will probably bring U.S. telephone service down to prevailing world standards (suggesting once again that government gets nervous in the face of something in the private sector that works).

Problems on industrial policy thus delineated also extend beyond government policy. The matter is not much discussed in the literature, but a major requirement for businesses and unions, if employment is not to erode rapidly further in Smokestack, U.S.A., will be wage increases in these industries rising less rapidly than for the economy generally. There is no magic potion called industrial policy which can make out of excessively high wage rates times zero hours worked anything other than low incomes. That is a clear lesson from the last decade. Yet these tough and unpopular subjects are almost ostentatiously absent in the literature.

Another point. The American, perhaps the Anglo Saxon, milieu does not seem to have encouraged the same sense of loyalty and involvement on the part of employees that we see in some other societies. This is all the more remarkable since one might have assumed that these characteristics would be particularly evident in a society whose Weltanschauung has presumably reflected its Judaeo-Christian heritage. Whatever the moral and ethical issues here, a major source of ideas about how to do things better thus has been tapped inadequately. Moreover, people do have a right to feel some sense of belonging, and they will work more effectively when they do.

These discussions, and this is particularly true of Reich's book, also have a point that organizing for long runs of comparatively standardized products became almost a part of the American business creed or lore. It did make for enormous gains in productivity and real incomes, and perhaps no city has better epitomized the results of this strategy than Detroit itself. Again, however, the Hegelian process: with higher incomes a demand for diversity emerges. The same garage now may house a Fiero and a Caprice — instead of, as earlier, an old and a new Caprice. Managements, writers on management, and even Schools of Management, need to devote more attention to organizing efficiently for short runs, quick turn-around time, and the demands for more diversified products and services generally that ineluctably emerge with growing affluence.

There is also a legitimate national security dimension to industrial policy (through little is said about that in industrial policy literature). Economists do not find it easy to handle this problem because of the tendency for companies exposed to foreign competition to cry: "National defense." Yet we do live in an uncertain and dangerous world, and specific attention to the industrial capability needed for our external security is a legitimate — indeed, an essential — responsibility of national policy.

Taken literally, the more enthusiastic industrial policy programs would almost certainly lead us to a less rather than more progressive and vigorous economy, and they would have seriously adverse long-term consequences for the nation's social and political life.

This Great Debate is where it is, however, because we have some problems for which conventional widsom has been having difficulty providing useful answers. Consistent with our liberal intellectual tradition, some new boys have moved into the block. The policies that now emerge out of the homogenization process of ideas competing with each other may be the better even if the specifics proposed for an industrial policy program, literally implemented, would further erode the liberal system itself.

A note of caution in conclusion, however. Economics is a separate intellectual discipline because we want to do more than what we have to do with. This is why we so often seem to be dashing cold water on the poetry of life (and why poets dislike economists). The basic requirement for steady economic progress is a liberal, open, market-organized economic system operating within a disciplined management of basic fiscal and monetary policies. There is no poetry which will relieve us of this ineluctability.

FOOTNOTES

[1]Cf., for example, Lester C. Thurow, "America in a Competitive Economic World" in G. William Miller, editor, *Regrowing the American Economy* (The American Assembly, 1983), pp. 36-51. Thurow, however, would be classified by many among those taking a more ambitious view of industrial policy.

[2]Cf. Felix G. Rohatyn, "Alternatives to Reaganomics," *New York Times*, December 5, 1982.

[3]Robert B. Reich, *The Next American Frontier* (New York: Times Books, 1983).

[4]*Op. cit.*, p. 246.

[5]*Op. cit.*, p. 174.

[6]*Op. cit.*, p. 238.

[7]*Op. cit.*, p. 270.

[8]Amitai Etzioni, "The MITIzation of America?" *The Public Interest*, Summer 1983, pp. 44-51.