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# NATIONAL INDUSTRIAL POLICY: AN OVERVIEW OF THE DEBATE

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## INTRODUCTION

Through the passage of a wide range of government initiatives, grouped under the rubric of "national industrial policy," a growing coalition of American political, labor, and business leaders is seeking to realign in a fundamental way public and private decision making in the economy. The proponents' objectives are laudable: to renew economic prosperity and growth in national wealth and to enhance social justice. The attendant rhetoric, however, echoes appeals of bygone generations of social reformers intent upon spurring social improvement through greater government control of the economy. Senator Gary Hart (D-CO) has summarized a now familiar political theme within the movement: "Today, more than at any other time since the Depression, traditional policies are producing unintended consequences. They are increasingly irrelevant to the unique economic realities of this decade."[1]

What Hart and many other industrial policy champions argue is that a new holistic approach to public policy can be forged by "melding" the "Jeffersonian principle of free competitive economy"

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1 Gary Hart, "Restoring Economic Growth," a policy statement presented to the National Committee Strategy Council, February 6, 1982, p. 1. These views are recited by Robert Reich, Professor of Business Policy at the Kennedy School of Public Policy, Harvard University, in his new book The Next American Frontier (New York: Times Books, 1983).

with the "Rooseveltian principle that economic success cannot be divorced from social conscience."[2] Senator Ernest Hollings (D-SC), for instance, stresses that we need a "unity of purpose" to economic policy.[3] A founding father of industrial policy is Harvard University Professor Robert Reich. In The Next American Frontier, he contends that "in the emerging era of productivity, social justice is not incompatible with economic growth, but essential to it. A social organization premised on equity, security, and participation will generate greater productivity than one premised on greed and fear."[4] Mirroring Hart's vision of the industrial world (or, perhaps, having originally articulated that vision for Hart), Reich writes, "America has a choice: It can adapt itself to the new economic realities by altering its organization, or it can fail to adapt and thereby continue its present decline....But failure to adapt will rend the social fabric irreparably. Adaptation is America's challenge. It is America's next frontier."[5]

The trouble with this new talk about industrial policy is that it is not new. It is at least as old as the 18th century's mercantilism and as familiar as this century's disastrous experiments with central planning, the corporate state, and five-year plans. From what industrial policy proponents have been saying so far, there is no reason to believe that their repackaged schemes will be any less catastrophic than the earlier models. To be sure, most industrial policy enthusiasts have noble concerns. But their arguments are replete with internal contradictions that draw into question the movement's intellectual foundation. While several specific policy proposals warrant examination by Congress, mainly because they attempt to correct problems with existing policies, much of what has been proposed as "national industrial policy" is a 1980s version of the social politics of the late 1960s and early 1970s. It calls for more federal money and more federal intervention in the activities of workers, businessmen, investors, and consumers. Strangely, the lessons painfully learned in the past decade seem to be willfully ignored. What is most alarming is that backers of these policies fail to acknowledge, or choose to ignore, a critically important and central point in such debates: government control of capital ultimately translates into control of people, whether the control is instituted by democratic or by authoritarian means.

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2 Ibid., p. 4.

3 Ernest Hollings, "Statement of Candidacy," remarks presented at Midlands Technical College, Columbia, South Carolina, April 18, 1983.

4 Reich, op. cit., p. 20.

5 Ibid., p. 21.

## MAJOR POLICY PROPOSALS[6]

As evidenced by the array of policy proposals, national industrial policy (NIP) means different things to different people, a point that may go far in explaining the political appeal of calls to join the movement. Consider several of the major proposals of frequently cited industrial policy advocates.

### The Hart Proposals

Senator Hart offers a reasonably complete, broad-based policy menu:

*To encourage investment in physical and human capital, the tax code should be changed to a progressive expenditure tax, exempting savings from taxes and thus stimulating investment.

*To encourage new investment and to reduce the tendency of the 1981 tax cut to favor existing firms over emerging firms that have limited capital bases and, therefore, have minimal depreciation allowance to deduct from taxable corporate profits, the tax code should allow capital expenditures to be treated as an expense. Further, a new form of common stock should be created. Called "new capacity stock," it would be used to finance new plant, equipment, and research and be exempt from capital gains taxes.

*To encourage "new entrepreneurial frontiers," federally financed "Venture Development Centers" should be established to provide technical assistance and seed money to small businesses. The corporate income tax rate would be reduced for small businesses, and small business shareholders would be allowed to deduct company losses from their taxable personal income.

*To stimulate research and development, federal support of science and engineering schools would be increased, the patent laws would be strengthened, and government procurement policies would "pull technological progress forward."

*To expand global markets for American goods, the federal government would free international trade of tariff and nontariff barriers and eliminate export subsidies provided to other countries' industries.

*To reduce the crowding out effect of government deficits, the 1983 tax cut was to have been postponed, while defense expenditures would be trimmed by $20 billion. To reduce inflationary pressures, a "Tax-Based Incomes Policy" would impose a tax penalty on price

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6 For a description of specific legislative proposals before Congress, see an accompanying paper by Gregory L. Klein, "Industrial Policy: A Summary of Bills before Congress," Heritage Foundation Issue Bulletin No. 96, July 12, 1983.

and wage increases exceeding a "pre-established target" and would focus on the 2,000 largest firms in the country.

Hart would also revise anti-trust laws to allow for more joint research and development projects among competing domestic companies, impose a "security fee" on imported oil that would reflect the now-hidden cost of our "energy vulnerability," and expand federal aid to education, incorporating a "GI Bill in Reverse," meaning a program under which students would pay back their federally subsidized loans by work in areas of "national need."[7] Generally speaking, Hart's NIP is designed to ease what he sees as the adjustment process of "old line basic industries," commonly called "sunset industries," and to facilitate the emergence of small high tech firms in what are described as "sunrise industries."

The Reich Proposals

Robert Reich believes that the key to revitalizing the American economy is "adaptation" to the new economic realities of production. These he defines as flexible production processes, highly skilled workers (the presumed source of America's comparative advantage in international commerce), and "precision, custom, and technology-driven products." Such adaptation, for Reich, requires a number of policies similar, but not identical, to those of Senator Hart:

*To reduce structural unemployment and to speed the "adjustment process," Congress would enact an unemployment voucher system by which the federal government would pay half of firms' costs for training people unemployed for longer than three months. Even larger subsidies would go to those firms training workers in areas of high unemployment. Retraining vouchers for those unemployed for more than two years would be redeemable at universities and technical colleges. In addition, companies could establish "human capital reserves"--funds set aside to reflect the depreciation of the skills of the company's employees. These reserves would lower corporate profits and would be used to upgrade worker job-related skills, just as similar reserves now are used to replace worn-out equipment.

*To reduce the "inequity" in the current disparity in tax treatment of human and physical capital and the inclination of physical capital to move, a "human capital tax credit," in connection with training costs, similar to the investment tax credit on physical capital, could be instituted, which would lower the after-tax training and retraining costs incurred by businesses.

*To reduce forms of "paper entrepreneurship" (specifically, mergers and acquisitions and tax avoidance), the tax code could

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7 Hart, op. cit., pp. 1-35.

allow an interest deduction only for purchasing new or modernizing old plants and equipment.

*To reduce cyclical unemployment, unemployment insurance taxes would be more directly related to the unemployment experience of firms.

*To ease the decline of decaying industries, such as textiles, steel, automobiles, and rubber, "regional development banks," along the lines of the Reconstruction Finance Corporation of the Great Depression era, would be organized to provide low interest rate, subsidized loans to companies promising to retool and retrain workers or, in Reich's words, "to restructure themselves to become more competitive."[8] With their federal subsidies, such banks could redistribute investment funds among regions, urban and rural areas, and industries with the intent of enhancing social justice and job security and facilitating the adjustment process.

*To reduce the adversarial relationships that now presumably exist among businesses, labor groups, and government, tripartite councils would be organized. Such councils would seek consensus (which Reich acknowledges may be difficult to achieve) on how capital investment would be allocated differently than it is in free capital markets.

*To relieve unemployment and other social problems, the federal government would offer grants to entice firms to hire the unemployed, handicapped, or other groups subject to discrimination and unfortunate circumstances. Washington also would fund, through firms, such social services as "health care, social security, day care, disability benefits,...and relocation assistance."[9] In short, "firms will become the agents of their employees, bargaining for different packages of government-supported social services."[10]

*To ensure that the programs negotiated by firms with government are run with the workers in mind, a form of "industrial democracy" would be imposed. The employees "will elect representatives who will select the combination of benefits and choose the providers. Through labor-management councils, also including worker representatives, workers will participate in company decisions about physical capital, helping to choose the direction and magnitude of new investment in research, plant and machinery."[11]

In summary, Reich starts with the propositions that the economy, as now organized, is insufficiently adaptive and that

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8 Reich, op. cit., p. 243.
9 Ibid., p. 248.
10 Ibid.
11 Ibid.

even now there is no "free market" due to extensive federal subsidies to businesses and government protection from domestic and international competitors. In Reich's view, the federal government already has an "industrial policy." Yet it lacks sufficient coordination to serve the broad general public. No expanded involvement in the economy by the federal government is necessary, says Reich. He maintains that Washington simply could use the subsidy and protection resources already at its command to extract public benefits from businesses.

The Mondale Proposals

Having acclaimed Reich's book as "one of the most important works of the decade," former Vice President Walter F. Mondale has not sketched in the details of his own brand of industrial policy. Instead he complains that the country's industrial policy is "destroying industry--not building it."[12] The broad outlines of his NIP include five strategies:

*First, he believes something must be done to reduce "wasteful mergers and acquisitions."

*Second, he suggests altering the anti-trust laws to allow more joint research and development ventures to "enhance international competitiveness without reducing domestic competition."[13]

*Third, "we've got to shape a policy to keep high technology here at home," because companies are shipping high technology production jobs abroad and "leaving the lower-end jobs here at home."[14]

*Fourth, he endorses the call of other liberals for the creation of an "Economic Cooperation Council" with functions similar to those of the old Reconstruction Finance Corporation.

*Fifth, he wants federal aid to "those communities and regions hit hardest by economic change," which for him means "targeting infrastructure programs and impact aid--automatically triggered by measures of distress" and adopting plant-closing restrictions.

Though insisting that he is a "profound believer in our free enterprise system," Mondale hastily adds that "government must work in partnership with the market."[15]

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12 Walter F. Mondale, address to the Twenty-First Constitutional Convention of the United Steel Workers of America, September 11, 1982, p. 5.

13 Walter F. Mondale, excerpts from a speech to the Industrial Union Department Legislative Conference, May 4, 1983, p. 2.

14 Ibid.

15 Ibid., p.4.

The Rohatyn Proposals

Felix Rohatyn is a New York investment banker, who wants to revitalize the national economy by applying principles he learned while heading the New York Municipal Assistance Corporation, the agency established to prevent New York City's bankruptcy. Like other NIP enthusiasts, he wants to expand the economic role of government. Examples:

*Along with Reich, Rohatyn advocates establishing a reinvigorated Reconstruction Finance Corporation (RFC) to allocate capital as directed by a council of labor, business, and government leaders. The bank's activities would be financed by a higher gasoline tax. The central task of the council would be to "allocate sacrifice."

*To reduce problems caused by unexpected inflation and to moderate competing claims on the national income realized in strikes, "Annual negotiations resulting from one year contracts with no cost-of-living escalators" should be institutionalized.

*To improve labor-management relations, a "larger share of the compensation package [would be] in the form of profit sharing."

*To better coordinate U.S. domestic policies with Western Europe and Japan, the U.S. should consider recreating "something like the Bretton Woods agreements," providing for central bank intervention within certain bands of exchange rates, like the European monetary system.

*To permit underdeveloped countries to develop, to "avoid enormous distress in those countries," to enable underdeveloped countries to repay their loans, and to avert protectionist measures, the International Monetary Fund should be "reliquified." This means increasing U.S. contributions to the IMF.[16]

Rohatyn admits that he tends to "look at money as a tool or a weapon...to leverage concessions from unions, suppliers, banks, management, legislatures."[17] He justifies this by arguing that "the basic issue to me is whether we have a government with a philosophy that will look upon intervention as a philosophical imperative when disparities in the country become too great, or whether government's philosophy is simply to take its hand off the steering wheel and let the market work its will."[18]

The Thurow Proposals

MIT economist Lester Thurow bases his prescriptions on his diagnosis "that our economy and our institutions will not provide

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16 These positions are discussed in Jeremy Bernstein, "Profiles: Allocating Sacrifice," The New Yorker, January 23, 1983, pp. 45-78.

17 Ibid., p.78.

18 Ibid.