Pathfinder

CENTER FOR EDUCATION AND RESEARCH IN FREE ENTERPRISE
TEXAS A&M UNIVERSITY COLLEGE STATION, TEXAS 77843

August 1985 Volume 7 Number 4

INDUSTRIAL POLICY: REINDUSTRIALIZATION THROUGH COMPETITION OR COORDINATED ACTION

In the past three issues of the Pathfinder, *we have been running a series of essays on the functioning of the Soviet economy. As we announced, we plan to run additional essays on other types of planned economies. We are interrupting this series, however, to present a paper on Industrial Policy by Thomas F. Walton, director of economic policy analysis, General Motors Corp. This paper, presented at the Liberty Fund Industrial Policy Conference, Key Biscayne, Fla., March 1985, will be done in two parts: Part 1 in this issue and Part 2 in the next. This paper represents the view of the author and not necessarily that of General Motors. We will continue our series on planned economies in the December issue of the* Pathfinder.

The so-called New Industrial Policy—a brainchild of the "neoliberals," who were looking for ways to make interventionist programs appeal to an increasingly conservative public—has important implications for the competitive environment in which American firms must compete. I want to examine what "industrial policy" is and what it means for competition and the competitiveness of our domestic industries.

Following Robert Reich, the philosophical "guru" of the industrial policy movement, we can define industrial policy as the sum of the country's microeconomic policies—including tax and regulatory rules, loan grants, import restrictions, antitrust policies, and so on. There are, then, two types of industrial policy: that which relies more on business, government, and labor planning and cooperation; and that which relies more on decentralized market forces. Under Reich's preferred version, there should be, "a political forum capable of generating large-scale compromise and adaptation"—a forum that "will enable government, business, and labor to fashion explicit agreements to restructure American industry." In other words, the objective of industrial policy is to foster tripartite cooperation to develop a strategic plan for creating the growth industries of tomorrow.

A number of specific proposals have been suggested by prominent business and labor leaders, along with academicians. One proposal is a National Industrial Policy Board, consisting of leaders from business, government and labor, under the supervision of Congress. Another proposal is a series of social contracts or planning agreements that require firms to modernize and reinvest in exchange for tax incentives, roads, sewers, and other assistance they now receive from the public.

Several bills have been introduced to establish tripartite coordination mechanisms. These include a recent proposal to create a Council on Industrial Competitiveness, a Bank for Industrial Development, and an Advanced Technology Foundation. These agencies would remedy American industry's alleged deficiencies, remedy a lack of "patient capital" and provide the support American business needs for high-tech research and development. Another is the Automobile Strategy and Stability Act, which would provide nine more months of restraint on auto imports from Japan while "management and labor . . . would sit down with government and consumer representatives to formulate a long-term strategy for the U.S. auto industry." And the President's Commission on Industrial Competitiveness recently recommended the creation of a Cabinet-level Department of Science and Technology to coordinate government and private research, the restructure of the tax system to encourage saving, partly by increasing taxes on consumption, and the encouragement of labor, management, and government to work toward a consensus on industrial issues.

So, even though the term is no longer in vogue, any idea that industrial policy is dead seems a bit like the premature news of Mr. Twain's demise. It lives on in each proposal to "help" a troubled U.S. industry.

Let me suggest five basic predicates for the activist position: (1) In the long run, at least, the industrial base and the economy are in deep

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trouble; (2) activist industrial strategies are working for other nations; (3) our own historical experience shows how such programs can work; (4) we should rationalize our present hodgepodge of inconsistent policies—make them work in this second best world; and (5) an activist policy provides the public with a needed role in shaping our industrial policy. I will touch briefly on each assertion.

Proposals for tripartite strategic plans receive their most favorable hearing during times of national stress. Such was certainly the case when "industrial policy" proposals were introduced during the last recession.

By 1980 the rate of inflation had reached 13.5 percent, its highest since 1947. By 1982 the rate of unemployment had reached 10 percent, its highest since 1941. In the six years following the OPEC embargo, our nation's view of its economic future had changed from great optimism to great concern. The new mood was perhaps best captured in President Carter's famous 1979 address on "malaise" in America. Everyone realized that something was wrong with the American economy and that we needed some very different economic policies.

But the economic problems of the 1970s were anything but a return to economic liberalism. Increasing inflation, escalating taxes and the intrusion of governmental regulation into every nook and cranny of the economy can scarcely be called a policy of laissez-faire; add to that two protracted periods of wage/price restraints and unstable, excessive monetary growth!

Probably the best example of an activist industrial policy was the nation's energy program: Project Independence. We were told that the market for energy was too complex for consumers and business people. A 1977 CIA report predicted that by 1983 OPEC production would exceed 40 million barrels and that by 1985, total free world demand would equal 70 million barrels per day.

But look at the record. Today, daily OPEC production is less than 17 million barrels per day, and daily free world demand is roughly 45 million barrels. Under the alternative open market policy, prices have fallen substantially and our dependence on OPEC has declined from 34 percent of domestic consumption in 1977 to just 13 percent today.

Yet such doomsday forecasts were the basis for preempting market forces. As Jim Miller [then Chairman of the Federal Trade Commission] observed, "At a time when what was most needed was greater reliance on a free market, we went barreling ahead, imposing price controls and excise taxes, providing special subsidies to develop new, exotic energy sources and enacting a potpourri of specific measures to restrict industrial and consumer use of energy supplied."

A recent study pointed out that consumers did not ignore the energy crisis; they were not inherently wasteful in their use of energy; they were not psychologically unable to give up large automobiles; and such policies as mandatory efficiency standards were not the only way to prevent excessive dependence on imported fuel.

This points out the basic marketing problem for the advocates of activist policies—that now, after four years of experience with a more market-oriented approach, the industrial outlook is vastly improved. To be sure, we have just emerged from a most difficult recession. But, contrary to the assertion of Industrial Policy Advocates, productivity growth improved dramatically. Inflation is at its lowest rate since 1967. Investment is growing at its fastest rate since 1967. And since 1980, over six million new jobs have been created for the American economy.

Nonetheless, Mr. Reich asserts that other nations have weathered the recession better than we because they "understood the value, during the period of global change, of an explicitly strategic industrial policy." But, I say that we cannot discover any greater effectiveness of any other nation's industrial policies.

During the 1970s, total employment in Western Europe grew by just 3 percent, while U.S. employment grew by nearly 33 percent—20 million new jobs. Only three out of 10 new job seekers in Western Europe were successful in the 1970s while nine of 10 found jobs in the rapidly expanding U.S. labor force. Since 1973, the U.S. industrial base, as measured by the index of industrial output, has grown more rapidly than that of any of the major European nations.

To quote U.S. venture capitalist Peter Brook, "It's incredible that some Americans are going to heavy state planning when I'm being asked to go to Europe to help them disband theirs. We shouldn't follow their mistakes. Hell, we're the ones with the answers."

But you might ask, what about Japan? Hasn't tripartite planning been largely responsible for their phenomenal rates of economic growth? What about MITI and the Bank of Japan?

We will examine this question and some past experiences with U.S. industrial policy in part two of this paper in the next issue of the *Pathfinder.*

—Thomas F. Walton
Director of Economic Policy Analysis, General Motors Corp.

SUBTLETIES OF TODAY'S MORAL CODE

In the "mediacracy," the level of public information is determined by what the media decide to print or air, and the prominence they decide to give it. Perhaps the low public esteem in which the media are held has something to do with the public's awareness that much of what gets covered, even if accurately reported, is less important than what's ignored.

Take the Bitburg affair, which should do even more than the first Reagan-Mondale debate to dispel the myth of Reagan the Great Communicator. Imagine deciding—unwittingly, to be sure—to visit a cemetery where German soldiers are buried, but not a concentration camp (it was later decided to visit a camp as well). And imagine saying that the German soldiers had been victimized by Nazism "just as surely as victims of the concentration camps."

But did the witlessness deserve the massive coverage it got to the point where it generated speculation about whether the administration could recover? Ceremonial events such as the one at Bitburg do have significance, but should PR gaffes be played as World War III?

If so, why wasn't far more hell raised when the Reagan administration joined all Western governments in sending an official (the vice president) to the funerals of the three Soviet leaders who have died in office in the last three years? Indeed, there was much speculation on whether Reagan had erred grievously in not going to Moscow himself to honor these great men.

Clearly, there are limits to the media's moral indignation. Or maybe there's a moral code at work here whose distinctions are too subtle for me to grasp. It's outrageous to do anything that would give even the vaguest appearance, however unintentional, of honoring Nazism. But apparently it is not outrageous to give the appearance of honoring Soviet communism.

But why? The Kremlin and the Third Reich were allies at the beginning of World War II, which began when they invaded Poland together to carve it up between them. The chief difference between Hitler and the Kremlin's despots is that Hitler was self-destructively reckless in carrying out his aggressions. Because the Kremlin is not wont to take such risks, it has had far more staying power, with no end to it in sight.

This, in turn, has allowed it to accomplish Hitlerian things on a scale far beyond that of Hitler himself. Six million Jews and millions more died in Hitler's camps. But those killed in the Kremlin's gulags number in the scores of millions, not to mention that the Soviet Union is the most anti-Semitic country outside the Arab world.

It's hard to say whether the Soviet's genocide in Afghanistan has yet gotten up to the pace the Nazis achieved from 1943-45. The borders are closed, and the Soviets have said they'll kill any unauthorized journalists they find. Still, by now there is ample evidence that they've killed more than a million Afghans, and driven about six million out of the country, which had a population of 15 million before their invasion.

Yet was it big news when, say, Francois Mitterrand went to Leonid Brezhnev's funeral and hailed him as a man of peace? Or when Jimmy Carter told Romania's brutal Communist despot, Ceausescu, that "our goals are the same"?

—Bradley Miller
Editorial Staff Writer
The Dallas Morning News

Dr. Hayek, a Nobel Laureate, Mrs. Hayek, and two directors of the Walter Eucken Institute, Drs. Bosch and Veit, met for lunch in a Black Forest Tavern.

WOULD YOU WANT THESE PEOPLE TO BUILD YOUR HOME?

According to the Grace Commission report, virtually all project completions are delayed at least 12 months, costing about $50 million annually in waste.

TRAVEL EXPENSES SOAR

Federal travel expenses totaled $4.8 billion during Fiscal Year 1982. Approximately 50 percent of that amount went for full-fare rates, despite the huge number of trips that easily should have qualified for substantial fare discounts. Can you afford to travel around the country with no attention to the costs?

GRACE REFORMS

The Office of Management and Budget, in a status report on the Grace Commission's recommendations, says that the government has acted on 879 of the commission's 2,478 recommendations. President Reagan's 1986 budget includes another 269 of the recommendations. About 85 percent of the remaining reforms will require "substantive legislation" by Congress.

TIME FOR A SIMPLE TAX CODE?

Twenty years of revisions in federal, state and local tax codes have cost the poor more than the rich, according to a recent Brookings Institute study.

Families in the poorest tenth of the population, which paid 17 percent of their income in federal, state and local taxes in 1966, will pay 22 percent this year. Meanwhile, families in the top tenth, with taxable incomes of more than $60,000 in 1980, will see their tax burden drop from 30 percent to 25 percent. In 1966, their tax burden was 1.8 times greater than that of the poorest families, but this year it will only be 1.2 times as great.

SOVIET POWER

Alexander the Great, Ceasar and Napoleon were watching a Soviet military parade on Red Square.

Alexander the Great said, "If I had had Soviet tanks, I would have conquered the whole world!"

Ceasar said, "If I had had Soviet troops, I would have conquered the whole world!"

Napoleon said, "If I had had the newspaper *Pravda,* the world still would not have known about Waterloo!"

REAL ECONOMICS

Real Economics was a talk given on April 2, 1985, in Dallas, by James C. Miller III, then chairman of the Federal Trade Commission, at a luncheon sponsored jointly by the Center for Education and Research in Free Enterprise and the Heritage Foundation of Washington, D.C. The views expressed are Dr. Miller's. They do not necessarily reflect the views of the other commissioners.

The Reagan Administration's economic agenda is based on what I call "real economics." It emphasizes the effects of government policies on incentives and their effects on the allocation of resources in a competitive marketplace. Thus, real economics is in sharp contrast with the demand-management, command-and-control approaches of decades past.

The federal deficit can be "explained" as a matter of inadequate tax revenues. And some would have you believe the solution, therefore, is simply to raise taxes. But real economics reminds us that the challenge is not just to reduce the deficit, but to close the gap in a way that doesn't interfere with economic growth. Once the problem is framed in this manner, we see that simply raising taxes is not an appropriate solution, however superficial its appeal. For one thing, every increase in taxes leads to a considerable waste of real resources because of distortions in the price mechanism. Experts peg this figure as high as 50 cents wasted for every dollar of additional tax revenue generated.

The current enthusiasm for some form of flat tax stems in large part from a recognition of how much harm is done by the current system's high marginal rates and its questionable preferences. That flat-tax proposals have been advanced by leaders of both major parties and at both ends of the political spectrum is, to my mind, a powerful confirmation of how firmly the perspective of real economics has taken root in Washington over the last few years.

What about other policy fields? Certainly real economics is as relevant to regulatory policy as to fiscal policy. For example, the Department of Commerce recently estimated that private industry spent $60 billion complying with environmental regulations during 1981. To put this in perspective, $60 billion represents about one-third of 1984's federal deficit and about one-half of the year's trade deficit. Now I ask you: are we really getting our money's worth from this vast commitment of resources?

As I have noted elsewhere, the task of developing a social contract that would enable us to move in the direction of much more cost-effective approaches based on real economics is one of the most important policy challenges we face today.*

In the international area, real economics focuses on the costs of protectionism. Existing restraints on imports would appear to cost U.S. consumers *at least* $12 billion each year. At the same time, however, real economics notes that restraints on the ability of U.S producers to sell overseas costs our economy billions more in lost opportunities.

It seems plain to me that we have, in fact, entered a decidely new era in national policymaking in the years since 1980. It is easy to lose sight of this if you focus too much on Capitol Hill squabbles over the policy issue of the moment. It is even easier to lose sight if you fix all your attention on the intellectual sparring of neo-Keynesians, monetarists, and supply siders in the rarefied heights of the academy. But if you step back from the daily wrangling of the politicians and look beyond the doctrinal disputes among the schools, you can see that, indeed, we have developed a surprisingly broad consensus on the proper direction of national economic policy.

Real economics focuses on the actual incentives of actual people to invest, to supply work efforts, and thus to enhance the production and delivery of goods and services. Real economics means not taking economic growth for granted. It means keeping uppermost in mind the effects of government policy on the suppliers of real goods and services in the economy, where the engines of growth are actually fueled and primed.

By the 1970s the lessons of the New Deal had been overlearned in Washington, with federal efforts to shelter and protect taken to quite bizarre extremes in some fields. The persistent stagflation generated perhaps even more anxiety and unease about the future than actual economic pain at the time. It seems to me the restoration of confidence in public institutions and in ourselves was the crowning achievement of Ronald Reagan's first term.

Confidence was certainly the issue in 1984. President Reagan's Democratic challengers could not deny his success in powerfully curbing inflation and then restoring an impressive rate of growth to the economy. The results on November 6 showed the voters may not have endorsed all the claims of "supply siders" or voted for any particular monetary strategy, but I do think they responded to the overall vision of the Reagan administration, with its reemphasis on fundamentals. I think voters really were sold on the idea that while government can play a valuable role as a backstop for the economy, sustained growth comes only from the voluntary actions of private investors and producers, responding to real incentives.

—James C. Miller III
Chairman, Federal Trade Commission

*See James C. Miller III, "Policymaking in Washington: Some Personal Observations," Distinguished Guest Lecture, Southern Economic Association Annual Conference, Atlanta, Georgia (November 14, 1984).

A member of the center's National Advisory Board, U.S. Sen. Phil Gramm of Texas is presented this year's "Watchdog of the Treasury Award" in recognition of his "leadership in the movement to bring wasteful government spending under control." The presentation, by Watchdogs of the Treasury, Inc., was made in Sen. Gramm's office in Washington.

CENTER DIRECTOR ATTENDS INTERLAKEN SEMINAR

INTERLAKEN SEMINAR

The 12th Interlaken Seminar on *Analysis and Ideology* was held from May 27-June 1, 1985, in Interlaken, Switzerland. Dr. Steve Pejovich, the center's director, and Dr. Steve Wiggins of Texas A&M's Department of Economics, were invited to participate in this seminar, which annually brings together university professors from the United States and Western Europe for a week of discussions. Karl Brunner of the University of Rochester is the director of the Interlaken Conference Series.

During his stay in Europe, Dr. Pejovich held seminars and discussions with faculty members and students at the University of Kiel, the Free University of West Berlin, the University of Belgrade and the Walter Eucken Institute in Freiburg.

PEJOVICH GUEST ON TV

Center director, Steve Pejovich, was a phone guest on Michigan's WUCN-TV's public affairs program with Andy Rapp, on July 3. The topic of the hour-long program was "Freedom in America: Opportunity or Oppression." The show was produced by former center publication director, Janet Joyce. In addition to television work, Janet is currently teaching at Saginaw Business Institute, and trying to start a business of her own.

A NEW FRIEND

Citizens for a Sound Economy (CSE) is a newly formed free market, public interest group in Washington, D.C. The CSE already has 150,000 members, making it a strong and effective force to counterbalance anti-market special interest groups, which abound in Washington. The CSE stresses issues like privatization, the Grace Commission Report, tax reform, free trade, and Social Security reform.

The CSE recently has released a study by Steve Pejovich of the Center for Free Enterprise on the Grace Commission's recommendation to privatize military commissaries. The study is the second in a series by respected economists and public policy analysts on the recommendation of the Grace Commission's Privatization Task Force. Pejovich found that if the management of military commissaries were privatized, significant cost savings would be achieved. The CSE's address is:

1222 C Street, NW, Suite 700
Washington, D.C. 20001

POLICY SEMINAR

Dr. Thomas Walton, director of Microeconomic and Strategic Studies at General Motors in Detroit, was the center's most recent guest. He participated in small, informal meetings with the center's friends and supporters in Dallas on the evening of June 17 and the morning of June 18. Commenting on the June 18 meeting, Henry Gilchrist, a well-known Dallas attorney and civic leader, wrote to us:

"It was really a treat to meet and listen to Tom Walton today. It is really exciting to participate in discussions such as this. It is also refreshing to know that there are people like Tom Walton in positions of influence who think like we do.

"I am really impressed with the work you are doing and I am very pleased that you are doing it at Texas A&M."

PATHFINDER

Volume 7, No. 4 August 1985

Published six times a year by the Center for Education and Research in Free Enterprise in cooperation with Educational Information Services, Texas A&M University, College Station, TX 77843. Telephone: 409-845-7722

Svetozar Pejovich, Director
S. Charles Maurice and Svetozar Pejovich, Editors
Lawrence C. Rose, Research Assistant

Contributors of $5 or more receive *Pathfinder* for one year; teachers in elementary and secondary schools may receive *Pathfinder* without a donation.

12th ANNUAL AMERICAN ECONOMY INSTITUTE CONCLUDED

The 12th annual American Economy Institute (AEI) was held on the Texas A&M University campus June 4-21. The institute was organized by the Center for Free Enterprise to assist Texas educators teach economics as required by House Bill 246. Among the many donors for the program were the Sid Richardson Foundation, Exxon and Tenneco.

Demand for this program far exceeded our ability to supply. More than 50 teachers were selected from over 250 applicants. These educators represented two dozen Texas cities, ranging from Mission to Houston. Teachers in attendance had a wide variety of backgrounds, which included history, government, social studies, business and economics.

Dr. Jackie Browning, member of the economics department at Texas A&M University, was the primary lecturer at the 1985 AEI. She was responsible for providing the theoretical background on a variety of topics, including scarcity and the operation of markets. Various academic and business executives offered guest lectures, which provided additional insight into specialized areas such as energy, regulation, unions, international trade, tax reform and welfare. The teachers also studied in great detail monetary policy, fiscal policy, the Federal Reserve system, inflation, unemployment and the federal deficit.

The 1985 AEI's format was altered slightly from previous years. In the past, participants were required to develop classroom-ready materials. This year, the emphasis was focused primarily on basic economic concepts. As Dr. Steve Pejovich, the center's director, stated in his closing address to the participants, "We felt that, as professionals, you would be able to incorporate the material in the classroom. Therefore, we decided to utilize our comparative advantage, the dissemination of knowledge about the free enterprise system and how it operates to allocate goods and services across competing wants in our economy." Judging from the evaluations of the educators, this was a well received strategy, although several participants expressed an interest in organizing informal study sessions to discuss teaching strategies.

One highlight of the three-week session was the barbecue dinner held at the Texas A&M Memorial Student Center during the last week of classes. This informal get-together allowed the educators to interact on an informal basis with several of the institute's speakers. The center's staff also was able to elicit many valuable comments and recommendations regarding future institutes.

Following are several comments offered by the participants:

"Dr. Browning is one of the best lecturers I have ever heard. She is extremely knowledgeable of the subject matter, current trends, and is unbiased. She does much for the image of college professors."

"I felt all the topics covered were highly useful to me, because I had such a weak background."

"I hated this course, but I also hate immunization shots. It was good for me! I learned a lot and stretched my brain."

"Thanks so much!!"

"Thanks for pulling me (kicking and screaming) into the pool of economics. My students will benefit and be better for it!!!"

"Great job. Highly productive!"

"It has been an experience that I will long remember. It should prove to be of significance in social studies teaching."

Ms. Tamsen L. Emerson
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THE RESULTS ARE IN

The results of the survey of educators has been compiled and is available to anyone interested. The Center for Free Enterprise staff wishes to thank all educators who took the time to fill out the survey concerning educator backgrounds. We received more than 290 responses nationwide. Out of those, 91 percent were from Texas educators.

There were several interesting trends indicated by the survey. Thirty-eight percent of educators responding have worked 14 years or longer. Forty-four percent, however, have been teaching free enterprise for three years or less. Sixty-six percent of the educators were secondary teachers and the most prevalent major area was history (35 percent). This was followed by business (18 percent), political science (13 percent), and social studies (11 percent).

Sixty-seven percent of respondents had at least one degree from a Texas institution of higher learning. More than 67 percent had less than three courses in economics, and only 38 percent felt that they were qualified to teach free enterprise when they first began to teach. After graduation, several educators sought to correct this deficiency. Forty-four percent took either graduate courses or attended seminars on free enterprise.

There was an overwhelming feeling that a specially designed course on free enterprise would benefit teachers (96 percent) Only 58 percent, however, would commit to taking such a course while 27 percent were uncertain.

Once again the center staff wishes to thank all respondents for their cooperation. The information gleaned from the survey will assist us in our future programming plans.

Educators attending the AEI are busy exchanging ideas at the barbecue dinner held at the Texas A&M Memorial Student Center.