THE CASE AGAINST "INDUSTRIAL POLICY"

James C. Miller III

Introduction

As a professional economist, I have a deeply-rooted skepticism about the capacity of government to manage economic growth or technological change more efficiently than the free market. As chairman of the Federal Trade Commission, moreover, I am officially charged with keeping a suspicious watch on interference with free competition—even when such interference is sponsored by government itself. In the early 1930s, for example, the FTC played an active role in criticizing several of the anticompetitive industry "codes" sponsored by the ill-fated National Recovery Administration. Thus from where I stand it seems to me the burden of proof ought to be on those who advocate ambitious new ventures in governmental management of the economy.

There is no doubt the American economy has been through some very rough weather in the last 15 years. And like any patriotic American, I find myself stirred by the cry that we can and must do better in the remaining years of this century. But for the life of me, I cannot believe the answer lies in current proposals for an activist industrial policy. I come to this judgment for three simple reasons: first, proposals for activist industrial policy begin with faulty history; second, they proceed through untenable economic reasoning; and, third, they conclude with deluded political projections. In sum they are bad history, bad economics, and bad politics—three strikes that should declare a policy "out" in any league. Let me explain.

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The author is Chairman of the Federal Trade Commission. The views expressed are his own and do not necessarily reflect the views of the other commissioners. This paper is adapted from Chairman Miller's remarks at the Cato Institute's conference, "Planning America: Government or the Market?" (April 27, 1984).

Bad History

By almost any measure the United States is the richest country in the world. Our immense economic success has been achieved, for the most part, by reliance on the free market. Most people, of course, would be rather reluctant to abandon an approach that has worked so well in the past. The advocates of an activist industrial policy, therefore, seek to persuade us that our economy has actually been faltering over the past 15 years—that our industrial base has been dwindling and "unraveling." They warn us that our major international competitors have been steadily outperforming us—thanks to their embrace of centralized, governmental "industrial policies." If we do not learn to adopt these foreign methods, we are told, the United States will fall further and further behind, winding up as a humble provider of raw materials for the new economic superpowers of the 21st century.

At least in psychological and political terms, this alarming depiction of recent trends is crucial to the case for an activist industrial policy. But the picture is simply not true. It is based on a substantial misreading of economic trends over the past decade and a half. Let me briefly highlight a few aspects of recent economic history that strike me as most fatal to the case for an activist industrial policy.

First, the American economy actually displayed significant, broad-based growth during the 1970s—despite three recessions, repeated bouts of double-digit inflation, and an enormous escalation in energy costs. Total employment in the United States increased by 26 percent in the course of the decade. By contrast, employment in Japan increased by only 8 percent in this period, and the West German economy actually employed fewer workers in 1980 than it did in 1970.

Second, it is not true that this growth occurred only in peripheral service activities, at the expense of basic industrial production. Of the major industrialized nations, in the 1970s only Japan and Italy actually experienced higher rates of growth in industrial output. West Germany's industrial output increased at barely 60 percent of the American rate. During the decade, higher growth in other sectors did lead to a slight decline in the *relative* share of our GNP represented by manufacturing, but this was also true in most other countries. Indeed, in West Germany, Japan, and Great Britain the manufacturing share of GNP fell much more sharply.

Third, it is not true that American industry has been growing continually less competitive in world markets. The volume of manufactured goods exported from the United States increased by 100 percent between 1970 and 1980, while comparable exports from the

European Economic Community increased by only 84 percent over the same period. As recently as 1978 through 1980, U.S. exports were growing twice as fast as overall world trade, and by 1981 U.S. manufacturers had regained the total share of world markets which they had held in the late 1960s. Exports of high-technology goods, in particular, increased at an accelerating pace in the late 1970s—and far exceeded imports in this area. While it is true that our trade balances deteriorated substantially after 1981, this seems almost entirely attributable to secular changes in exchange rates, due in part to the greater speed of the American recovery, compared with those of our major trading partners. On the evidence of the last decade, then, there is no reason to assume American industry is losing its competitive edge in any fundamental respect.

No doubt certain of our traditional industries, such as autos and steel, have suffered greatly from foreign competition over the past 15 years. But these are highly unionized industries which have allowed their wage rates to climb far out of proportion to prevailing rates in other manufacturing sectors, while also laboring under a number of peculiarly adverse regulatory and tax policies. The foregoing data should make it clear that generalizations based on reverses in these few industries give a very misleading picture of our overall economic performance. To its credit, the report of Congressman John J. LaFalce's Subcommittee on Economic Stabilization (U.S. Congress 1983) does not indulge in the apocalyptic rhetoric that has often been adopted by the political patrons of these few industries. But by omitting all this encouraging information and relying on impressionistic assessments of particular problem areas, it does tend to obscure the enduring strengths of the American economy.

Finally, a word about productivity, on which the subcommittee report dwells at some length. Growth in labor productivity slowed to an alarming degree during the 1970s, true enough. But roughly comparable slowdowns were experienced by all other industrial nations during this period, even those which had earlier witnessed far higher rates of productivity gain. While the American performance seemed to put us near the bottom of the list of major industrial countries on this indicator, the statistics may be misleading. As George Gilder has recently emphasized, the enormous growth in the American labor force during the 1970s—as women, new immigrants, and young people of the baby boom generation flooded into the market—inevitably reduced capital formation per employed worker. Western Europe and Japan, without this great expansion in employment, naturally did not display the same statistical effect in their aggregate productivity figures (Gilder 1983, p. 37).

I am convinced that burdensome tax and regulatory policies also played a significant role in depressing real productivity growth in the United States during the 1970s. The reforms introduced by the Reagan administration in these areas now seem to be bearing out this diagnosis. Since 1980, productivity has been rising at an annual rate of 1.6 percent—more than twice the dismal pace of the 1973–80 period. And in 1983 productivity grew by some 2.6 percent—well above the average annual gains of the last 60 years. No exotic "industrial policy" was required. As the late Martin Diamond, my colleague at the American Enterprise Institute, used to say: We must have the courage to face the truth—however cheering it may be. In my view, then, a realistic assessment of our recent economic history simply cannot support the fearful interpretations that advocates of industrial policy have sought to draw from it.

Bad Economics

If an accurate history of our recent economic performance does not scare us into an activist industrial policy, might such a policy nevertheless still be worthwhile? I would certainly agree that we should aim to do better than we did in the 1970s. But the arguments advanced for an interventionist industrial policy as a superior economic approach seem quite implausible, and the evidence from other countries seems only to cast further doubt on these claims.

Advocates of an activist industrial policy have repeatedly called attention to the disturbingly low rates of capital investment in the United States over the past 15 years, especially compared with the rates experienced by other advanced industrial nations. On this they will get no quarrel from me, nor I suppose from any economist. Future expansion depends on adequate current investment, that seems pretty clear. And, of course, President Reagan's economic policy was designed precisely to address this concern—by curbing inflation and reducing taxes—thus encouraging private saving and long-term direct investment by business. In fact this program seems to be working, with business investment having climbed impressively over the past 18 months. No doubt the tax code could be still improved to provide even more encouragement for people to save and invest.

The advocates of an activist industrial policy claim the Reagan approach is insufficiently "targeted"; that is, insufficiently "discriminating." They insist government must go beyond encouraging savings and investment in a general way and must instead attempt to manage the content and strategy of investment within and among particular industries. Congressman LaFalce's subcommittee thus

proposes three new governmental entities, responding to what it portrays as three enduring structural problems in our economy: first, a Council on Industrial Competitiveness (CIC) to remedy our deficiencies in assessing microeconomic trends; second, a Bank for Industrial Competitiveness (BIC) to remedy the lack of "patient capital" for long-term speculative investments; and finally, an Advanced Technology Foundation (ATF) to remedy the inadequate support for high-tech research and development efforts in American industry (U.S. Congress 1983, p. 29). For all the rhetoric of "competitiveness" surrounding these proposals, they all seem to me to reflect a basic misunderstanding of what economic competition is about and why it is so essential to economic development.

CIC, for example, would supposedly synthesize insights about international trade opportunities with information about "the problems and promises of specific industries or sectors," as provided by particular "Industry Subcouncils" (p. 32). The subcommittee report tells us quite forthrightly that the purpose of this whole apparatus would be "to build a consensus about common economic problems" because "[c]onsensus-building must . . . be the principal cornerstone of anything called 'industrial policy' or 'industrial strategy' " (pp. 31–32).

But why this eagerness for "consensus"? As an enforcer of the antitrust laws, I admit I may be unusually suspicious of efforts to "build consensus" among competing firms. But even speaking simply as an economist, I must say I do not see what is so great about consensus. The central virtue of competition is that it stimulates innovation, reserving the greatest rewards precisely for those who break from established patterns. Anyone can follow a settled consensus; a competitive economy forces individual firms to look ahead, to be imaginative, to take risks—and fundamentally this is what drives economic development.

The subcommittee report says CIC would develop a "significant research staff" and a detailed "public data-base" because it "ought to know more about the state of our economy than do securities analysts on Wall Street" (p. 32). Well, I am sure many of us have had occasion to wish our stockbrokers had access to better information. But it is an illusion to suppose the element of risk in investment decisions could be significantly reduced just by making more information concerning economic activity publicly available. While we policymakers never seem to have enough information, the most crucial investment questions turn not on descriptions of the status quo, but projections into the future—which is always fraught with contingency and uncertainty. Only a stagnant economy is entirely predictable.

Moreover it is hard to see why a body of governmental experts would be any better at betting on the future—with other people's money—than hundreds of thousands of business executives and private investors, with their own wealth at risk.

The superiority of government experts is especially hard to credit when one recalls they would be gathering their prognoses from the consensus of established firms. If we had had a CIC in the early 1970s, would it really have foreseen the emerging threat to the American auto industry from Japanese imports? Perhaps CIC would have anticipated the success of the OPEC cartel in forcing up gas prices—as neither Henry Kissinger nor Milton Friedman did—and correctly project from this a vast new market for small, fuel-efficient cars.

Perhaps. But Japan's celebrated Ministry of International Trade and Industry (MITI), touted as an inspirational model of guiding expertise in the subcommittee report, was, in fact, no more prescient in this matter. In the 1960s it tried to consolidate several aspiring auto companies, and at one point proposed that the entire industry be merged into just two firms—Nissan and Toyota. MITI not only tried to discourage Toyota and Nissan from earlier attempts to penetrate the American market but later pursued the same pessimistic line with Honda when that company launched its own daring expansion into the American auto market in the mid-1970s.

The proposals for a government industrial bank and a publicly funded technology foundation tilt against the same economic logic and experience from the opposite direction. Just as American business has a "tendency to be 'blindsided' by foreign competitive threats which could easily have been foreseen," the subcommittee report assures us (p. 32), so it is also unduly backward in exploiting emerging opportunities. We are told that BIC would alleviate the shortage of "patient capital" for promising long-term ventures, while ATF would compensate for inadequate business investment in research and development. Now, as I have said, almost everyone agrees that general monetary and tax policies should indeed be very attentive to these concerns. But the idea of targeting government subsidies on selected industries or technologies of "promise"—as designated by the crystal-ball gazers in CIC or ATF—seems again to misconceive the virtues of competition.

If businesspeople and investors do not generally exhibit a great deal of patience with new ideas, that is no doubt largely attributable to the fact that most new ideas do not, after all, turn out to be good ideas or economically viable ideas in the prevailing circumstances. The patent office is crammed with the designs of barren inventions; patience is often no more than a prelude to failure. The trade

ministries in Britain and France patiently poured more and more capital into developing a supersonic passenger aircraft in the early 1970s—and were rewarded for their patience with the Concorde, a financial white elephant of international proportions. Japan's MITI patiently poured capital subsidies into that country's developing shipbuilding industry in the 1970s—and those "promising" new shipyards reduced their tonnage by about two-thirds from 1973 to 1978, and laid off some 46,000 workers between 1977 and 1983 (Boyer 1983).

These are by no means isolated exceptions. But since I have often been critical of others for basing policy on purely anecdotal evidence, perhaps we should not make too much of them. It is notable, however, that the subcommittee report fails to offer a single concrete example of *successful* governmental ventures in promoting new industries, let alone demonstrate that such successes really required governmental assistance to succeed. In my judgment it would surely take a great many such examples to make a convincing case that government officials would do a better job than millions of competing private investors.

Of course an aggregate of millions can include a great deal of foolishness along with some rare brilliance. But competition at least forces producers and investors to keep revising their judgments about which is which. Freed of the creative discipline of competition, government can be more patient than the market or more enthusiastic about new technologies, but there is every reason to doubt it will prove wiser in the long run. As Charles Schultze, chairman of President Carter's Council of Economic Advisers put it (1983, p. 12): "No matter that for every one winner in the race, there are nine losers—you can be sure the U.S. government's portfolio, twenty years later, would still have all ten."

This would be so even if we thought of government as nothing more than a conscientious investor. But, of course, no one does. Government is inescapably political. Advocates of an activist industrial policy rarely take this into account, however. If their proposals are implausible in their economic reasoning, they seem to be even more fanciful as political science.

Bad Politics

The report of Chairman LaFalce's subcommittee, for example, disavows any comparison between the old Reconstruction Finance Corporation (RFC) and its proposed BIC. Doubtless this was prudent, for the dismantling of the RFC in the early 1950s was provoked

by acrimonious congressional investigations, which exposed repeated episodes of cronyism and partisan manipulation in RFC loan policy. Instead the subcommittee invites us to consider its proposed bank as somehow akin to the International Monetary Fund (IMF). But the IMF deals only with governments, not with individual firms or industrial subsectors. And more important, it is not controlled by the recipients of its largesse but by the contributors of its capital, much like a business corporation. Thus the U.S. government, which provides 25 percent of IMF funding, retains 25 percent voting control over its decisions.

How would controling shares be distributed in the institutions that formulate or implement an activist industrial policy? Surely we would not reckon up different categories of taxpayers and accord them representation in proportion to the scale of their payments to the Internal Revenue Service. The subcommittee indicates that BIC and ATF would both draw their "policy guidance" from CIC. But who would guide CIC and its industry subcouncils? It is rather striking the subcommittee report says nothing about the influence the president or Congress would supposedly have on this body. We are not even told how the members would be appointed or on what terms they would serve. Instead we are simply told the membership of the CIC and its subcouncils would be "reflective of the major participants in our economy . . . drawn from the highest levels of leadership of busines, labor and academia . . . participating with top-ranking government officials and with national leaders representing other public interests" (pp. 32–33).

Pause for a moment over that catalogue and then ask yourself who these leaders might be and by what criteria they would be identified. Who ranks in the "highest levels of leadership of business"? If CIC had existed 10 years ago, who would have represented the computer industry? Presumably IBM and a few other corporate giants—some of which, like RCA, have since been driven out of the computer field altogether. Would CIC even have consulted, let alone recruited, those entrepreneurial geniuses who have developed the market for home personal computers in recent years? These men and women were unknowns at the time: their companies did not even exist. Perhaps an industry "leader" would have assured the CIC there was simply not much of a market for home computers—a conviction IBM apparently held until quite recently.

Who would represent the "highest levels of business leadership" on the issue of trade barriers? Surely the sheer size of the auto and steel industries would ensure a major say for those who stand to gain from restrictions. What about struggling young technology

companies which *may* become corporate giants in 10 or 15 years? Would their preferences for free trade be given equal weight merely on the strength of their *possible* future importance?

Balancing the status quo against the future would be only the beginning of the difficulty. Another problem would be to ensure fair representation of the unorganized against the organized. The leaders of major unions, for example, would surely claim to be the "highest levels of leadership" for labor. But who would speak for the still larger portion of American workers who do not belong to any union?

Somehow CIC and its subcouncils would not only make everyone feel represented but arrive at a "consensus" and "mobilize wide public endorsement for their strategies." Think of that. Milton Friedman and John Kenneth Galbraith, Ralph Nader and Jerry Falwell, Detroit and Silicon Valley—just give them a prestigious forum like CIC and they will arrive at a consensus acceptable to the whole country. Congress cannot even work out next year's federal budget without acrimonious wrangling, and even then almost everyone complains it has been wastefully pandering to special interests—always the special interests of the other guys, of course. Does anyone really believe CIC and its subcouncils would find it easier to agree on policy because the scope of their concerns would be expanded to embrace the whole economy? Or that their decisions would carry greater moral authority because the council members would be chosen by those with a better eye for leadership quality than the mere mass of voters?

The founders of this country were not so naive, The *Federalist* observed that "the latent causes of faction are sown in the nature of man" (Rossiter 1961, p. 79). It concluded that the only sure way of removing selfish factionalism in politics would be "by destroying the liberty which is essential to its existence"—a remedy . . . worse than the disease" (p. 78). Rather than pursuing the vain hope of consensus, the *Federalist* placed its hope in the likelihood that in a large country the very number and diversity of political factions would be an important and much-needed restraint on government. Our Founding Fathers, many of them students of Adam Smith, undoubtedly recognized that limited government would be more conducive to economic growth. But they were perhaps more inspired by their appreciation of what limited government could contribute to political stability and civic peace. The decisions of the market do not require a consensus. But attempts to impose a consensus on detailed aspects of economic development would be bound to provoke embittered factual conflict.

Concluding Remarks

In closing I want to acknowledge one great merit of the argument for industrial policy. It is quite true, as Congressmen LaFalce's subcommittee stresses, that the federal government has already established a wide variety of subsidies, trade barriers, and regulatory schemes to protect or promote particular industries. These programs have grown up piecemeal over several decades, and most were presented at their inception as mere incidental exceptions to the accepted rule of nonintervention. But now there are so many exceptions that the advocates of an activist industrial policy, with much justice, can claim they are simply proposing to do systematically and comprehensively what we have already been doing halfheartedly or absentmindedly. By the same token, if we are persuaded to reject their proposals for an activist industrial policy, we may well be inspired to reconsider the many existing programs that reflect similar fallacies and similar dangers.

In his celebrated argument for liberty of thought and discussion, John Stuart Mill observed that "a strong opinion . . . however true it may be, if it is not fully, frankly, and fearlessly discussed, it will be held as a dead dogma not a living truth" (Lerner 1961, p. 285). I believe that to be true; it is one more example of the virtue of competition. I, therefore, want to express again my genuine appreciation to Congressman LaFalce and other advocates of an activist industrial policy for challenging those of us who defend the free market to rearticulate and revitalize our own arguments. I still think their proposals are ill-conceived, but I am sure they are stimulating a very valuable national debate.

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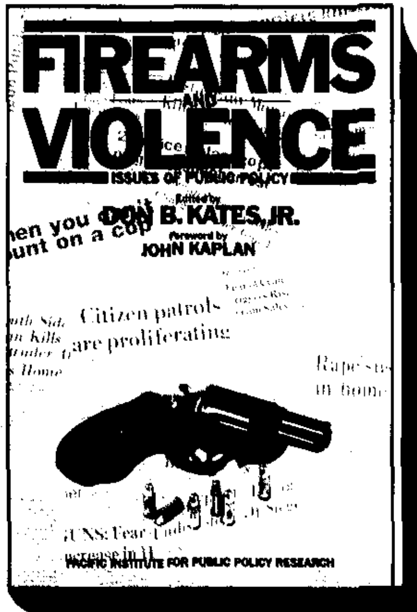

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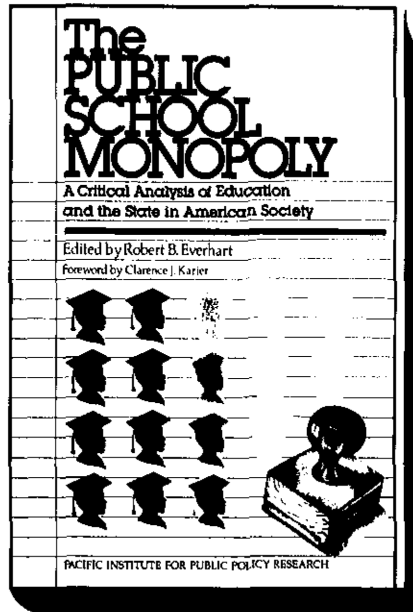

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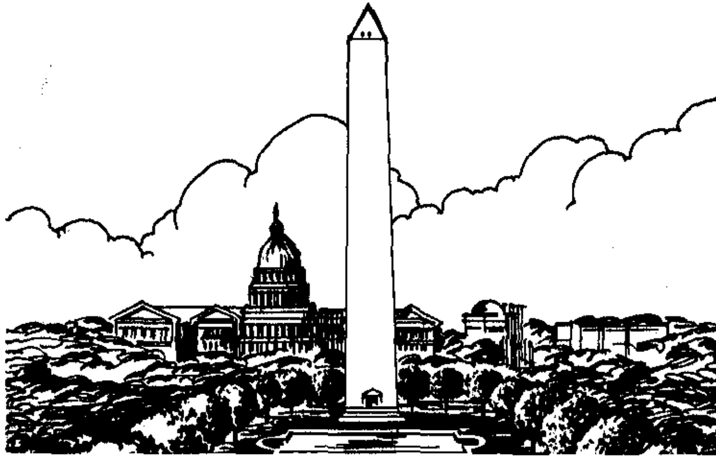

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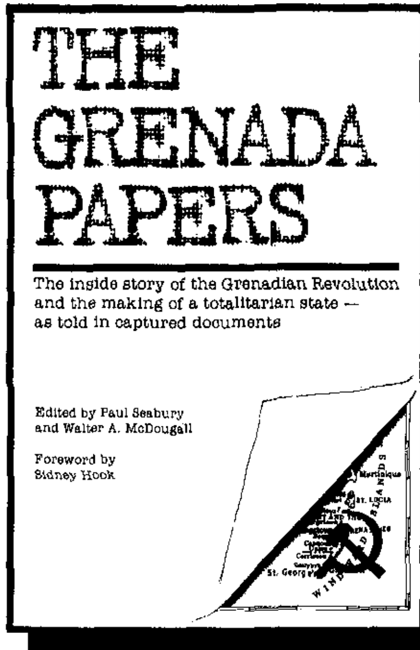

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