

# Rhode Island

## *Sunset for Industrial Policy*

Allan Feldman

As late as a year ago, “national industrial policy” was taken seriously as one of the Democratic left’s most promising “new ideas.” It was a central theme of both Walter Mondale’s and Gary Hart’s candidacies. And it was picking up support among businessmen as the answer to Japanese competition, even though economists from the Brookings Institution to the Heritage Foundation had decisively shown that Japan’s advances were achieved in spite of, rather than because of, its industrial policy.

But today industrial policy is dead as a political idea. It was killed by the voters of Rhode Island on June 12.

Usually in special statewide referenda, only 8 percent to 12 percent of Rhode Island’s voters come to the polls. But on June 12, more than 29 percent turned out to vote on a proposal, called the Greenhouse Compact, that would have done for the state’s economy what the advocates of industrial policy would like to do for the nation’s. The proposal had been endorsed by Governor J. Joseph Garrahy, most of the state legislators, Senators John Chafee and Claiborne Pell, Congressman Fernand St. Germain, the presidents of all the universities in Rhode Island, the state’s Chambers of Commerce, the heads of Textron and Fleet National Bank, and the state AFL-CIO. Proponents of the compact outspent its opponents by \$300,000 to \$15,000. But in spite of—or, perhaps, because of—its eager embrace by the state’s political establishment, the state’s voters turned thumbs down 121,079 to 29,998, or 4 to 1 against.

The compact lost like nothing ever lost before in Rhode Island. It was crushed in each of the 39 communities in the state. Its best performance was in Narragansett, Governor Garrahy’s hometown, where it was turned down 2 to 1. In Providence, it was beaten 3 to 1. In Warwick, the state’s second largest city, it was smashed 5 to 1. In working-class Central Falls, where people would presumably be excited about more jobs and higher wages, it was trounced 4 to 1.

### **\$250 Million Price Tag**

The compact was largely the brainchild of Ira C. Magaziner, a management consultant, industrial-policy advocate, and adviser to Democratic presidential hopefuls Walter Mondale and Gary Hart. Mr. Magaziner, a former Brown University student activist, coauthored

*Minding America’s Business* (with Robert D. Reich of Harvard), a blueprint for a national industrial policy. He hoped to make Rhode Island a shining example to other states and to the nation.

Mr. Magaziner made the following arguments on behalf of the Greenhouse Compact:

(1) Jewelry, textiles, machinery, and other old-line major industries in Rhode Island are declining, and will not survive foreign low-wage competition. Without a major program, jobs will be lost and income will fall.

(2) There is too much fighting between labor, management, and government. (In fact, Rhode Island has been the locale for some of the country’s longest strikes, including a two-year-old strike still going on against Brown and Sharpe Manufacturing Company. Some observers other than Mr. Magaziner attribute these long strikes to the state law providing unemployment benefits to all strikers after a six-week waiting period.)

(3) Rhode Island needs a Strategic Development Commission, which would build an economic-policy consensus among representatives from organized labor, banking and business, government, and the universities.

(4) This commission should steer the Rhode Island economy toward growth areas, using a combination of powerful levers:

- a \$60 million “grant-note” program to encourage firms to hire more workers. A firm would apply to the commission for a loan of about \$2,000, which it would get if it hired a worker at a wage of roughly \$8 per hour. If the job lasted 12 years, the loan would be forgiven. The commission predicted 30,000 jobs could be created through these grant-notes to businesses.

- a \$40 million “new product development program.” A business with an idea for a better mousetrap would apply to the commission for funds. If the mousetrap succeeded and made a profit, the firm would pay back the funds at an “equity” rate. If the mousetrap failed, the firm wouldn’t have to repay a cent.

- a \$40 million “business greenhouse” program to fund new firms. Venture capital partnerships would be licensed by the commission, and granted large tax subsidies for financing new Rhode Island businesses.

- a \$50 million “research greenhouses” program to establish applied research facilities. Four such greenhouses were described by the commission, in robotics, geriatrics and gerontology, clinical trials, and thin film materials. These would be allied to existing research programs at the University of Rhode Island and Brown University. This program would create the major industries of Rhode Island’s future.

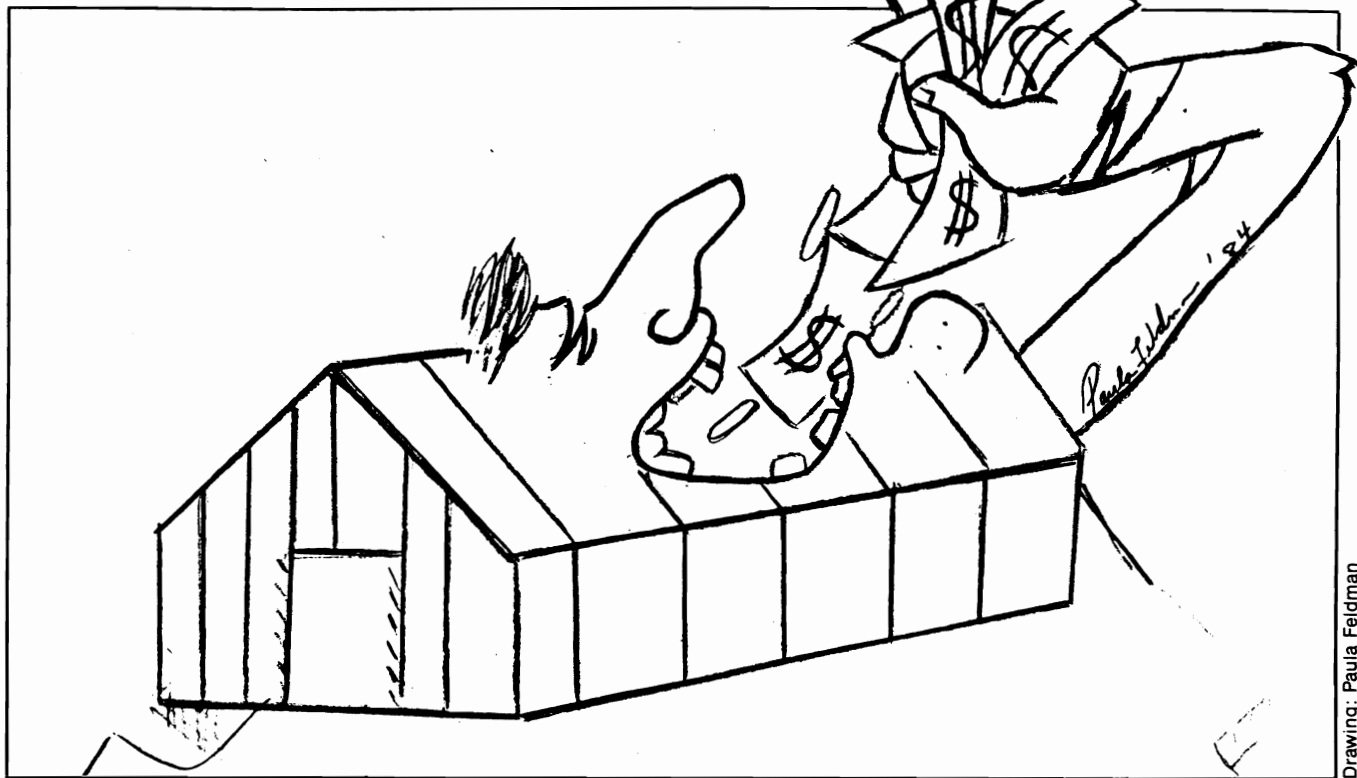
The Greenhouse Compact was to cost around \$250 million in public funds, in a state with fewer than a million people. A federal program with the same per capita price tag would cost around \$60 billion.

### **High Taxes and Poor Policy**

The intellectual case against the compact was made by a group of economists from Brown University and the

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Drawing: Paula Feldman

University of Rhode Island. We dissected the pro-Greenhouse arguments point by point:

(1) Although manufacturing wages are low in Rhode Island, personal income is about on par with the national average. The state's economy has been expanding without the Greenhouse Compact; the number of jobs grew by 15 percent between 1970 and 1980.

(2) There have been long strikes in Rhode Island, but it doesn't have the labor-management problems of Michigan, or Pennsylvania or New York. In fact, a relatively small fraction of the Rhode Island private-sector work force is unionized; the big unions here are public-sector unions.

(3) The commission is not needed. Bankers and venture capitalists are available to lend money to promising businesses. If a firm has a good idea for a better mousetrap, private financing is available. If the commission were created, its decisions would inevitably be politicized. It would give money to firms that couldn't get private financing and therefore were poor risks. It would give money to firms with cozy relationships with the governor, or with legislative leaders, or with the AFL-CIO.

We raised other arguments against the compact: It was biased in favor of the export sector, a neo-mercantilist stance contrary to 200 years of economic analysis. Its arithmetic regarding the grant-note program was phony: A \$2,000 grant would not induce a firm to create and maintain for 12 years a job it would not otherwise have created. Furthermore, the compact would have meant higher taxes for a state already heavily taxed.

Why did voters turn so overwhelmingly against industrial policy in Rhode Island? What do they say? The *Providence Journal* did some nonscientific post-referen-

dum sampling. Here are some reactions from no-voters: "You're going to be paying more taxes, and there's too many taxes now. . . ." The compact was "political cynicism" and wouldn't be good for small businesses. "New Hampshire has done a fine job with a simple operation. You don't have to set up a commission and go through all this hoopla."

More comments came in letters to the editor, printed two weeks after the referendum: "The voters are weary of the 'good old boy politicians' and do not trust a government almost totally controlled by one party." "When [Democratic legislative leaders] appointed themselves to the Greenhouse Commission, they compromised its credibility, which was already suspect to the taxpayers." "Long live free enterprise."

### Spirited Opposition

Voters in Rhode Island, a heavily Democratic, blue-collar state, rebelled against the Greenhouse Compact for three basic reasons. First was taxes. The Greenhouse proponents said the compact programs would be self-financing. But Rhode Island voters knew \$40 million from the state treasury does not come from the tooth fairy. They knew \$120 million in state debt would have to be paid back with interest. Rhode Island taxpayers are willing to pay for highways, bridges, schools, hospitals, and other efforts for the common good. But they are not willing to pay taxes to provide grants for big businesses and big banks. They don't like welfare for the rich.

Second was power politics. Mr. Magaziner and other Greenhouse architects had been genuinely concerned about keeping politics and venality out of the commission. But the commission was to disburse \$250 million in

public funds, and so the Rhode Island legislature properly insisted on participation by legislators—i.e., politicians. And of course union, banking, and business leaders insisted on their own participation. A commission of saints might have been endorsed by Rhode Island voters, but this industrial-policy program required a commission of human beings.

The voters rebelled against placing all that money and all that power in the hands of an elite group of wealthy and politically connected people. Small businessmen (of whom there are at least 20,000 in the state) felt that the program benefits would go to the big firms like Textron, firms that have the accounting and legal staffs to prepare the applications and do the monitoring the commission would require, firms that have the political connections and the clout that gets the attention of the governor or the director of economic development. The owners of the little businesses saw nothing in it for them. They saw no reform of business climate problems, like high taxes, high energy costs, high worker's and unemployment compensation costs, and the striker's-benefits law. Rhode Island voters felt that economic development is fine, but profits shouldn't be doled out of the public purse, by politicians, to their friends and cronies.

Third was populism. The vote against the Greenhouse Compact was a vote against the establishment. The voters not only saw that this industrial policy program was a power grab, they also viewed it as a power grab by the ins. The compact had been endorsed by virtually all the political leaders of the state. It was pushed by the university presidents. It was pushed by the heads of the Chamber of Commerce, by the big banks. It was pushed by the Rhode Island Commodores, a group of self-described "business, professional, and community leaders, who serve as ambassadors for the state." It was vigorously pushed by the *Providence Journal*. The compact was endorsed by practically everybody who is anybody in Rhode Island.

But when all those Very Important People endorsed the compact, the average voters got suspicious. Then they got resentful. And the more important people endorsed the compact, the more resentful the voters got. The voters knew the Greenhouse Compact wouldn't lift the tax and regulatory burdens on those struggling to rise; it would provide grants to those already at the top. It wouldn't shrink the state bureaucracy; it would expand it. It wouldn't improve business for the struggling jewelry manufacturer; it would boost Fleet National Bank's venture-capital subsidiary. It wouldn't cut the average voter's taxes, but it would slash Narragansett Capital Corporation's taxes. It wouldn't improve schooling for the son or daughter of the average worker in Providence, but it would support Brown and URI research faculty.

A statue of the Independent Man stands above the Rhode Island statehouse. As the state's leaders marched under the banners of industrial policy, the state's voters looked toward the Independent Man, and made up their own minds, in spirited opposition to the establishment.

In short, let's keep taxes down, let's not put more public money and power in the hands of the politically connected, and long live free enterprise. 