INDUSTRIAL POLICY

Lost in transition

The type of industrial policy that is now in vogue reflects the vices of both Washington and corporate America.

By John B. Judis
WASHINGTON D.C.

In the early '80s, when a small, intrepid band of policy intellectuals began proposing that the U.S. adopt an industrial policy—a strategy of government intervention to bolster competitiveness—they were almost universally scorned. Industrial policy, said Jerry J. Jasinowski, former Carter administration official and executive vice president of the National Association of Manufacturers (NAM), "is irrelevant, unworkable and likely to worsen our industrial problems."

But a decade later, industrial policy has become *de rigueur* in Washington. It happened even before Bill Clinton's election. Last April *Business Week* did a special issue trumpeting the virtues of industrial policy. "Call it what you will, the nation needs a plan to nurture growth," the magazine declared. Even NAM joined the chorus. William Morin, NAM's director of technology, told *Defense News*, "We will have a pragmatic rather than dogmatic approach to industrial policy. It will be a more enthusiastic and activist approach."

Clinton's victory was the capstone of industrial policy's march from ignominy to celebrity. At Clinton's December economic summit, four of the original proponents of industrial policy—banker Felix Rohatyn, economist Laura Tyson, policy expert Robert Reich and business consultant Ira Magaziner—were present, and the latter three joined Clinton's administration. Not only Clinton himself but Vice President Al Gore has been an outspoken advocate of government industrial policies. Industrial policy will be central to the economic strategy that the administration plans to unveil this month.

It sounds like another success story in the history of ideas—and a cause for rejoicing among liberals who favor a greater public role in private commerce. But when one looks closer at what *Business Week*, the NAM or congressional Democrats now *mean* by industrial policy, one discovers that the term's connotation has changed substantially from the early '80s. Industrial policy used to be about restructuring American business; now it is about subsidizing it. Industrial policy used to be something worth cheering; now it is something to be wary of.

In its original form, industrial policy represented an alternative to both New Deal liberalism and Reagan conservatism. It entailed government intervention not simply in the macroeconomy of budgets and taxes, but in the way investments are made and work is organized. The idea had its roots in European social democracy and in '60s utopian radicalism.

The three people most responsible for its introduction were Rohatyn, Reich and Magaziner. Rohatyn, a partner at Lazard Freres in New York, had been a protégé of French planner Jean Monnet and a student of European social democracy. He had also served as the chairman of the Municipal Assistance Corporation that oversaw New York's finances, and was influenced by the success of the Chrysler and New York City bailouts.

Rohatyn believed that the same approach could be applied to other American industries and cities. He wanted the government to create a development bank modeled on the Depression-era Reconstruction Finance Corporation. The bank, overseen by a tripartite commission from business, government and labor, would grant loans to ailing industries in exchange for their agreement to undergo "shared sacrifice" and to use their capital to improve their firm's long-run prospects.

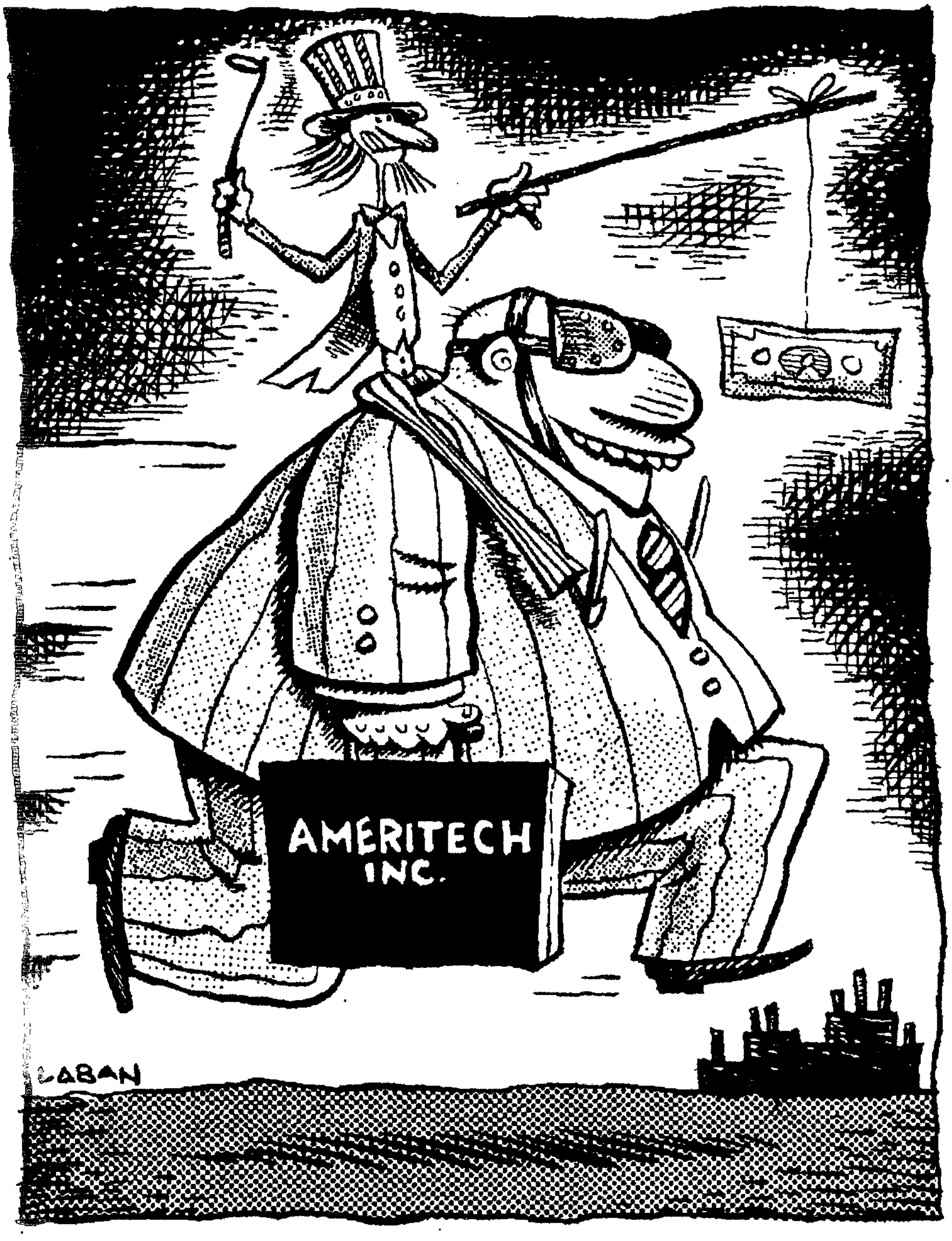
Rohatyn's form of industrial policy did not simply consist of subsidies. It rested on an explicit agreement, a new social contract among labor, business and government.

Reich, a former counsel of the Federal Trade Commission, and Magaziner, a whiz kid from the Boston Consulting Group, were both veterans of the '60s ferment. Writing in 1981 in *Minding America's Business*, they argued that the United States already had an industrial policy headquartered in the Pentagon and other federal agencies, but that it was totally uncoordinated and subject to the imperatives of the Cold War and the whims of political pork-barrelling. They wanted to make it explicit and subject to clear government control and direction.

Reich and Magaziner proposed putting federal research and development funding, antitrust policy and trade relief under a new agency that would self-consciously coordinate federal policy to improve industries' competitiveness. Like Rohatyn, Reich and Magaziner wanted to use the promise of subsidies and trade and antitrust relief to exact changes in behavior from industry. They thought government should exact a *quid pro quo* for aid it conferred.

Even more than Rohatyn, Reich and Magaziner were critical of sclerotic labor-management relations and of managers' use of their funds for what Reich called "paper entrepreneurialism"—buying other businesses, speculating in real estate and currency. Their watchword was "restructuring." The two wrote, "The key goals of industrial policy are economic restructuring and improvement of competitive productivity."

Liberal policy experts and neo-liberal Democrats liked Rohatyn, Reich and Magaziner's ideas, but most business leaders heartily disapproved of a plan that would force fundamental changes upon them. Once the recovery began in 1984, most Washington policy experts returned to the illusions of Reagan-era supply-side economics and deregulation. Democratic presidential candidate Walter Mondale did not even include industrial policy in his 1984 presidential campaign.



But the idea did not disappear. It went underground and then reappeared under a different name—competitiveness strategy. In 1984, the Reagan administration tried to co-opt the concept of industrial policy by setting up the Commission on Industrial Competitiveness, chaired by Hewlett-Packard CEO John Young. When Young's commission issued a report recommending government action, however, Reagan officials balked at accepting it. The commission was disbanded.

In 1986, Young and CEOs from Motorola, Xerox and other high-tech firms set up a private Council on Competitiveness (not to be confused with the similarly named council headed by former Vice President Dan Quayle) that issued reports warning that the U.S. was falling behind Japan in critical technologies and urging government action. The council's competitiveness strategy descended from what Rohatyn, Reich and Magaziner had called industrial policy.

Some of the same firms that set up the Council on Competitiveness sparked the creation in

1988 of Sematech, a consortium of semiconductor firms that won $100 million annual government funding from DARPA, the Defense Advanced Research Projects Agency, to devise new manufacturing processes for the next generation of computer chips. Reagan went along with Sematech because he believed it was necessary for national security.

During the Bush years, American businesses and trade associations, aided by the Council on Competitiveness and other organizations like Rebuild America, fought to secure funding for high-tech research and for other consortia. While they were spurned by the Bush administration, they won Democratic support for a series of initiatives that were included last summer in a "U.S. Economic Leadership Strategy." The Democratic plan, which Gore sponsored and which the Democrats have reintroduced this winter, embraced government investment in fiber-optic communication networks and bullet trains, expansion of civilian research and development, conversion of federal defense laboratories to civilian use, subsidies for firms to commercialize products using advanced technologies, funding of new environmental technologies and tougher trade laws to force open foreign markets.

Clinton echoed these proposals in his campaign. In addition, he called for "a new federal agency to support and coordinate research in developing new, critical civilian technologies and moving these ideas to the marketplace." As the fog of the Reagan-Bush years lifted, Democrats and the business press began to describe these initiatives as an "industrial policy."

But along the way something happened to the underlying idea of industrial policy. These policies consisted primarily of subsidies and tax breaks for high-technology industry. In its special issue, *Business Week* described industrial policy approvingly as boosting "research spending across a wide range of technologies," granting tax breaks to make it "cheaper for the private sector to invest in research, development, and new equipment," providing "technical assistance" for smaller companies and funding "high-speed communications networks."

None of these proposals exacted a *quid pro quo* from business or labor that would lead to restructuring American industry. Instead, these proposals amounted to transferring to the civilian sector the methods that the Pentagon used to create a viable military industry. These proposals also mirror the kind of government stimulus programs that the Transportation and Agriculture Departments have tried for years. In their industrial policy, Rohatyn, Reich and Magaziner offered public subsidies in order to encourage industry to use their private funds more productively. In the congressional and business version of industrial policy, these subsidies are no longer the means, but the end.

There is nothing intrinsically wrong with subsidies. Government subsidies helped to build the American aircraft and computer industries and to make American agriculture the most productive on earth. But in the present context, public subsidies aren't large enough to fill America's investment gap. Most of the capital available to investment is in private—not public—hands. IBM's recently announced $1 billion cuts in product development exceeded the entire budget for DARPA.

Kenneth Courtis, senior economist for the Deutsche Bank in Tokyo, told the Joint Economic Committee last May that the U.S. would have to boost its private spending on plant, equipment and research and development by $891 billion a year to remain competitive with Japan. Harvard Business School professor Michael Porter estimated $500 billion at Clinton's economic summit. Unless private

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