Commentary

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President Guffey introduced this conference by noting that "Industrial policy is one of the most important public policy issues that we face in the 1980s.'' I fear that he is correct. Pervasive industrial policy discussions do probably presage adoption of some sort of industrial policy. But as almost every economist at this conference has argued, specific micro-oriented industrial policies are likely to be mistakes. Indeed, the conference volume might profitably be retitled ***Why Industrial Changes do not Call for Public Policy Changes.*** Lawrence's paper addresses many of the claims about our recent economic history that provide the basis for industrial policy recommendations. He debunks a number of myths about the reindustrialization of America. I agree with the thrust of his analysis, so I will digress briefly to discuss the general industrial policy debate.

Limited economic knowledge has many costs. Our inability to control, predict, or even explain economic events has contributed to secular stagnation, and to the recurrent cyclical downturns which have plagued us in recent years. A more subtle cost is borne by both the economics profession and the public. When experts can promise nothing more arresting than doubt, uncertainty, and incremental minor improvements, others will not fear to tread. There are no popular quack cures for polio or broken bones, but quack cures abound for cancer, arthritis, and the common cold. It is only when established professions fail that the ducks come out.

The simple fact is that we as a profession do not have any clear idea of how to reverse the productivity slowdown, which dramatically reduced worldwide growth in prosperity. Nor are we united in a view as to how price stability and acceptably high levels of employment can be reconciled. This ignorance has provided the fertile soil in which the twin supply side movements of the right and left have taken root. It is minimally accurate to say of the early supply side movement that the view that tax cuts would be self-financing helped elect a president, but was never endorsed by any respected professional economist. If the original supply side economics was, as Bill Nordhaus once charged, "economic laetrile," then much of what flies under the banner of industrial policy is chiropractic economics — at best ineffectual and more likely wrenching. As with chiropractors, the false hopes of miracle cures deters the search for real solutions.

The parallel between the supply side and industrial policy movements is very close. Both promise rapid gain with little pain. Both derived from idealogues only to become politically acceptable when endorsed by serious presidential candidates of the opposition party. Both were supported by highly selective analyses of foreign experiences — Hong Kong and Singapore in the supply side case and Japan in the industrial policy case. Both proceeded with little or no enthusiasm from professional economists. One policy has already failed; the other waits in the wings. There is, however, one important difference between supply side and industrial policies. The excesses of the supply-siders can in due course be corrected by recognizing the costs of large deficits and raising taxes. The costs of an activist industrial policy are potentially much greater. The government, even should it desire to do so, is likely to find it almost impossible to extricate itself from entanglements in the allocation of capital across industries. Indeed, the record of public economic activity provides very few examples of withdrawal from activities that benefit significant interest groups.

I turn now to Robert Lawrence's excellent paper. While I am in broad sympathy with his analysis, I want to record two potentially important caveats. First, the link between evidence on the de-industrialization of America and policy inferences is a weak one. Suppose we could accurately target industries where the market was allocating too little capital. This would be desirable even if there were no evidence that our manufacturing industries were in decline. Conversely, even if industrial problems had only domestic roots, protectionist policies might be appropriate if policies addressing true causes were not feasible. One does not pump air into the part of a flat tire that is leaking.

The second limitation on Lawrence's work is that he relies exclusively on aggregate national income accounts statistics. This is all that we have available, but I wonder whether they miss some of what American industry is good at. Before flying out here I played tennis further into the dusk that I could have a decade ago, before the invention of the yellow tennis ball. I hit the ball better with my oversized tennis racket. My trip here was more convenient because sophisticated technology enabled the airline to provide me with boarding passes and seat assignments for all legs of the trip at the first stop. It was more productive because of the calculator and dictaphone I carried in'·my shirt pocket. It was more pleasant because the jetway shielded me from the thunderstorm that raged as I left Boston. All of this represents progress since 1970. My guess is that none shows up in the national income accounts. Taking account of quality changes would probably only Strengthen Lawrence's conclusion that the manufacturing sector has held up surprisingly well.

Lawrence's empirical analysis shows that many of the arguments advanced by those who favor industrial policy do not stand up to empirical testing. He properly emphasizes five important truths. First, traditional relationships between U.S. manufacturing and GNP have held up recently. Manufacturing output and employment are no more depressed than one would expect in a deep recession. Second, U.S. manufacturing has fared better than manufacturing in most other nations. Employment growth has been more rapid than in any other major industrial country and output growth has been more rapid than in any of the European nations. Third, we remain No. 1. U.S. productivity exceeds that of all our foreign competitors by about 15 percent. Fourth, until the very recent upsurge in the exchange rate, the foreign trade sector has created more jobs in export industries than have been eliminated by imports. Fifth, the rate of structural change as measured by the dispersion in industrial growth rates has not increased during the 1970s.

Given these five facts, an important question remains. Why, with manufacturing performing so robustly, with exports playing a positive role, and without particularly rapid structural change, has a crisis been so widely perceived? One answer that contains a lot of truth is that the current wave of hysteria reflects a confusion of macro and micro issues. On this view, the apparently structural problems we see are really just the consequences of deficient aggregate demand. In a less depressed economy, apparently structural problems would melt away. The risk, though, is that prices will not remain stable in an economy strong enough to eliminate structural difficulties.

There is a second important answer to the question of why, given Lawrence's data, U.S. competitiveness has attracted such great concern. We may still be producing as much as we were before, but production is occurring on much less favorable terms. Had Lawrence looked at the data on profitability and real wages in manufacturing, he would have found much more cause for concern. Real wage growth and profitability performed dismally in the 1970s as the terms of trade shifted against U.S. manufacturing. In part, this reflected erosion by competition from foreigners of monopoly power enjoyed by U.S. firms. Autos and steel are examples here. Note that such competitive pressures will encourage production while simultaneously lowering factor returns. In part it reflected shifting world patterns of comparative advantage, as other nations caught up with the United States. Whatever the reason for the change, the pain caused has been real, and has appropriately attracted attention.

A third reason for the recent upsurge of concern about American competitiveness is the changing nature of our public institutions. As the bailouts of Chrysler, Lockheed, New York, and now the big banks attest, our society is becoming increasingly attentive to squeaky wheels. This development increases the incentive of those hurt by economic change to publicize their plight. The importance of this phenomenon is evidenced by the explosive growth of the trade association industry during the 1970s.

A fourth reason for the furor is also rooted in the dynamics of the political process. Foreigners do not vote. Blaming our woes on international competition is politically inexpensive. Pressures to promote U.S. competitiveness imposes visible costs only on foreigners. The domestic costs of protection — higher prices for U.S. consumers and less pressure on American firms — are not readily apparent.

What then should be done? As others have stressed, the most important thing we can do is to put our macro house in order. Economic recovery and a more balanced policy mix will do more to promote desirable industrial change than any conceivable package of microeconomic policies. If we do attempt structural policies, we should adhere to two principles. First, policies should be general rather than specific in promoting objectives. We should strive to encourage desirable activities which the market may underfund, such as basic research or worker retraining, rather than trying to pick winning industries. We have some hope of doing the former; the government's record in breeders and synfuels shows that we cannot do the latter. Second, we should design policies that are not susceptible to political manipulation. Economic policies are not made solely or even significantly on the basis of economic efficiency. Political factors inevitably enter and their influence is seldom benign. Where identifiable groups of individuals or companies are to be singled out for special treatment of either a positive or negative sort, the potential for political manipulation is greatest.

Robert Lawrence's paper is a valuable weight on top of the Pandora's box of industrial policy. We can only hope that its message is heeded by the gurus of the industrial policy movement, and by the eager politicians who form their congregation. Following Lawrence's important work, future industrial policy advocates will have to begin with a demonstration of what for too long has been an undocumented premise — the existence of industrial problems which go beyond those that could be expected to result from current macroeconomic policies.