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Industrial Policy In A Federal Structure: State Industrial Policy In the United States

*Joel Rogers**

Before considering state industrial policy efforts directly, let me say something about the scope and limits of the national initiatives that currently frame them. I abstract initially from fiscal concerns — ie., whether there is any money to do that which is proposed — and only look at content.

THE CLINTONIAN VIEW OF INDUSTRIAL POLICY

The “new Democrats” of the Clinton administration came to power on the promise of delivering an economic policy different from the “tax and spend and regulate” policies alleged of old-style Democrats. Whether they can deliver on that promise in a way that preserves discernible differences between Democratic and Republican economic policy is anyone’s guess. The purported distinction from past policies on which this promise rests goes something like this.

Under “old” Democratic views, direct government regulation of prices and other conditions of market entry, the use of government purchasing power to subsidize favored economic practices, the redistribution of income on the basis of need rather than contribution, and other efforts to alter the terms and conditions of economic reward were acceptable means of “promoting the general welfare.” The “new” Democratic view holds that such policies are generally pointless, self-defeating, or malign. They generate excessive bureaucracies, inappropriately substitute government judgment for market judgment, are insufficiently attentive to labor supply effects, or otherwise presume greater government capacity to shape the economy than is warranted.

Of the many reasons offered for this change of view, the most basic concerns a fundamental change in the structure of the U.S. economy itself. A generation ago, the story goes, the U.S. operated as an essentially closed domestic system. In that context, effective government control of the domestic economy was indeed possible. Now, however, the U.S. operates in a truly international economic system, characterized by the relatively free flow of capital and goods across national

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The following text was compiled from the transcript of the remarks made by Professor Rogers at the Conference.

borders. In this world, government can no longer directly determine — *a fortiori* not with the command-and-control regulation and macro-economic policy tools available from old — the character of production within its borders, largely because the very notion of economic “borders” is meaningless.

This view, it is emphasized, does not amount to a prescription for *laissez faire*. The Clintonians, like the Dukakisites before them, believe that government has an important role to play in securing “good jobs at good wages.” That role, however, is both diminished and changed by the new environment. Instead of vainly trying to constrain capital’s choices in economic development, government should use its power to improve the factors of production at capital’s disposal. It should invest in physical infrastructure, diffuse technology, and improve the country’s human capital base. This, it is hoped, will make it an attractive site for investment by firms offering good jobs — in particular, those roving multinationals that locate their best jobs in rich nations even as they source much production to poor ones. And that, it is thought, is about as much as it is reasonable to hope for.

Completing this story is a certain description of the current character of economic activity within the U.S. itself. On this description, unrelenting pressures (again, heavily, international ones) are forcing a restructuring of U.S. firms away from Taylorist production and toward “high performance” forms of work organization engaged in “quality competition.” As used in contemporary debates, “high performance” organization roughly denotes the most complete and flexible deployment of firm resources to advance continuous innovation. “Quality competition” denotes a market strategy emphasizing non-price product or service features — variety, customization, performance, timeliness in delivery, attendant servicing of customers — as well as cost. Under a regime of quality competition, products and services are essentially all viewed as capital goods. Customers assess their price/performance ratio, rather than price alone.

In a world economy densely populated by countries and firms paying a fraction of U.S. wages, such a quality strategy is essential to preserving living standards. After all, unless customers are getting a quality premium, they will not be willing to absorb “premium” labor costs. But, again, according to the Clintonian view, firms are already moving in the high-performance direction — and, it is assumed, paying labor a premium as they do so. There exists a happy congruence between what firms find they need to do to be profitable and what the society needs to secure the general welfare.

Government’s role in facilitating the high performance transition at home is equivalent to what is recommended for making the U.S. an internationally attractive investment site — education, technology diffusion, modernized infrastructure. High performance work organization

— characterized by flexible automation, on-line quality control, multi-skilled work groups, flattened management hierarchies, increased cross-department communication, greater autonomy for front-line production workers in all manner of decisions — requires workers with high and broad skills, which recommends greater efforts in education and training. To meet demand for high-performance supplier chains, government should help diffuse technology be diffused to those small and medium-sized enterprises (“foundation firms”) currently frozen out of capital markets. And to satisfy demand for modern logistics, it needs to revamp its rotting infrastructure.

WHAT IS WRONG WITH THIS PICTURE?

What are we to make of all this as a description of the world, and of appropriate policy? What I make of it is that it is seriously wrong-headed. To be sure, international competition is real, and the tasks of social management of the economy have importantly changed. To be sure, something like “quality competition” is necessary to defending living standards in the United States. And, to be sure, industrial restructuring of the right sort will require better education, more technology diffusion, and the repair and modernization of our infrastructure. But the way in which any of these tasks will need to be discharged, the degree to which firms will need to be pressured to accomplish them, and whether their accomplishment alone exhausts the list of needed or possible interventions depends on one’s analysis of the options available to government, and the actual facts of current restructuring in the United States. And on both these fronts I think the Clintonians are mistaken.

For starters, the picture of a more or less complete internationalization of the U.S. economy is overdrawn. To believe the Clintonians, the economy is now one in which all factors move freely across borders, except those sunk in the ground or attached directly to human beings; the institutional infrastructure of production (labor market institutions, producer associations, community ties of various stripes and kinds) is largely irrelevant to the quality of production; and government has no hard ground on which to stand in imposing any social control over the economy. The real economy, however, is one in which most goods and services are still not directly exposed to international competition; it is one in which quality competition is critically contingent on immobile institutional supports (providing training and integrated social services, facilitating firm innovation and learning, enabling and encouraging producers to live up to international quality standards, attaching to this support a variety of antecedent conditions on its receipt); and it is one in which government purchasing power alone provides a powerful weapon to shape the path of development. This reality suggests that the room for maneuver and guidance is far greater than the Clintonians

would have us believe. Government need not be entirely timid.

And the government had better not be timid, since the path of current economic restructuring in the U.S. is not nearly as happy as the Clintonians like to think. Most U.S. firms are not responding to competitive pressures by going the "high-wage, high-performance" route, but by either "sweating" labor under conditions of very low investment in training and new technology, or by advancing a species of "lean commodity production" that uses advanced quality and production cost-cutting tactics, but does not share the resulting productivity gains with labor. This pattern of response is what explains the last twenty years of data on wage decline, wage depression among the fastest growing segments of the economy, and the weak or negative relation, on a firm and sectoral basis, between productivity growth and wages. Far from a happy congruence between what is needed for profitability and what is needed for general welfare, "good" firms are losing out to "bad" firms pursuing tactics which, if generalized, will be (already have been) disastrous for living standards.

What the U.S. needs most to do in this context is foreclose the low-wage option on restructuring. With a stick of direct labor market and production regulation, and a carrot of government purchases and assistance awarded those firms moving in the desired direction, it needs to push restructuring in a direction other than the one it now "naturally" takes. This need not involve government substitution of its judgment for that of firms on how results are best achieved. Nor must it take the form of "picking winners and losers" by industry group. However, it will require setting social standards of performance for firms and using government power to enforce them. Regrettably, this is just what the administration appears unwilling to do. One consequence of this unwillingness will be a continuation of present trends toward declining living standards and increased inequality. A more immediate consequence is that even the administration's narrower agenda of industry assistance will not enjoy broad business support, and will have limited effect. That agenda assumes an industry demand for higher quality factors — in particular, human capital — that in most cases does not exist. Advancing it risks having all the production and labor market effects of pushing on a string.

HARD BUDGET CONSTRAINTS, AND HARD LIBERALISM

Finally, hard budget constraints and an exceptionally "liberal" institutional terrain create barriers to effective government intervention — even of the narrower kind favored by the Clintonians. To take only one example, the administration had made clear its interest in devising a "school to work" transition system in the U.S. heavily modeled on German apprenticeship. But the amounts of money being talked about are trivial. To put this in perspective, German apprentices each cost

employers about \$4,500 a year on average (in some areas of manufacturing, the costs is several times this), in what are typically four year programs of “dual” workplace-school instruction. Were a German apprenticeship system extended to the U.S., with the sixty-five percent rate of coverage for the total high school cohort claimed in Germany, it would cost U.S. employers about thirty-two billion dollars annually. No one seriously believes that anything approaching this effort will be made in the U.S. anytime soon on behalf of young front-line workers.

Even if the money were available, however, a variety of institutional supports on which the German system relies are not available here. In addition to high schools delivering young adults with sound knowledge tested at national standards (something that it *would* be possible to do something about, albeit also costly), the German system relies on several such institutional supports. One is a dense network of more or less obligatory business association. This assures requisite take-up rates among business of young apprentices and serves to generalize standards across firms. A second is a fairly “patient” relationship between banks and industry. This enables firms to invest in the skills of the future workhorse even during recession. A third is an incredibly highly regulated youth labor market. This makes it possible to set trainee allowances low, which makes training itself affordable to firms. It requires, however, limiting the availability of non-apprentice employment. A fourth, indispensable both to the provision and monitoring of training, is competent and nearly universal worker representation (in the forms of works councils), and a powerful labor movement able to regulate training-compensation trade-offs and to push for industrial upgrading society-wide. Fifth and finally, as that which apprenticeship both feeds and relies on, is an industrial culture in which firms are already organized in ways that take advantage of advanced skills. This is what pulls the string.

None of this is available in the United States. All of it would be powerfully resisted if anyone tried to build it. And in no case can it be built overnight. This lends an air of unreality to the bold claims being made for youth apprenticeship, but not that program alone. There are similar budget constraints, and similar institutional gaps, in virtually all the proposed areas of Clintonian intervention. And so I am skeptical of it going very far. So much, however, for the national scene.

STATE-BASED INDUSTRIAL POLICY

We can back into discussion of state-based industrial policy by noting four constraints — other than national policy itself — that frame it. Where appropriate in this comparative discussion, I note the contrasts with Canadian provinces.

•There are many American states, and the share of U.S. product (or, generally, even particular industry segment) taken by any one of them

is not commanding. This limits the leverage any single state government has over business practice within their borders, and institutionalizes pressures for a "Delawarization" of business regulation — interstate competition to attract business by freeing it of constraints. Contrast this with Canada, which has one fifth the number of sub-national jurisdictions, and where two provinces — Quebec and Ontario — together claim a majority share of national product.

- States have limited authority to intervene in many areas that are relevant to industrial upgrading. State regulation of private sector labor relations, for example, is heavily preempted by federal legislation on that subject, as is state regulation of private pensions. Again, by contrast, Canadian provinces have far more substantial autonomous powers.

- With the exception of primary and secondary schooling, states appear in industrial policies in the U.S. chiefly as fiduciary or other agents of the federal government itself. One consequence is that their program structure and administration tends to mimic the pathologies of the national government. So, for example, the federal U.S. training effort consists of 125 different programs administered by fourteen different federal departments and agencies, many with roughly identical target populations and purposes but all with different mandates. By law, this sprawling effort is largely replicated at the state level, with resulting inefficiencies. With a weaker federal role, by contrast, Canadian provinces have been able to move more quickly on program reorganization.

- States are lacking in funds. Federal supports to areas of need, in particular cities, have been deeply cut over the last twenty years. The fiscal burden of state responsibility for certain aspects of public health insurance has ballooned with health care costs themselves. A variety of new federal mandates on state action, without federal financing, have added to the strain. And taxes have been very hard to raise. As a result, state efforts to provide more than essential social services are limited, and most states are even more reluctant than usual to do anything that might be construed as limiting business.

Always subject to the first three limitations, and more recently the last as well, state development efforts in the postwar period have moved through a series of phases. Each phase is more or less closely identified with the emergence of a particular strategy of development, though the pursuit of new strategies has typically not led to outright abandonment of the old. Today the residue of each is found in most state development efforts.

From the immediate postwar period on through the early 1970s, state policy consisted almost exclusively of boosterism — extolling their virtues as a site for investment and general business attraction ("smokestack chasing") — as greased by direct grants, tax abatements, and other easily monetized incentives. A second phase, beginning in the

late 1970s and continuing through the early 1980s, saw states move from general business attraction and deal greasing to the targeting and capitalization of potential "winner" firms — a sort of "development bank" model. A third phase, and dominant today, is a "modernization service" model. Here, the state is less concerned with picking nascent winners than in upgrading what it already has — chiefly through improvements in the delivery of training, and through technology diffusion. Finally, and evident only in a few states, we have recently begun to see what has been described as an "associative" model of development. Here, states explicitly seek to develop cooperative institutional linkages among firms, between labor and business, or between the private sector and the state — industry networks, training consortia, and tripartite labor market boards would be examples, respectively — to diffuse learning, or achieve needed scale in the delivery or receipt of training or new technology. The state invests directly in the "institutional infrastructure" (as described above) needed for a well-run economy.

Again, I do not want to overdraw these distinctions, or suggest that the most recent strategies are dominant. Although the most vocal state development offices think of themselves as chiefly in the business of "modernization," for example, old fashioned subsidies for attraction and retention still comprise the bulk of development efforts. Michigan, for example, commonly cited as a leading example of state-based modernization, spends thirty times more on tax abatements for business than it does on all its modernization services. This said, let us look at what states are doing in modernization — in particular, again, in technology diffusion and training.

Since 1980, about twenty-eight states have established one or another species of technology extension services. Budgets are low — currently about eighty-three million dollars total annually, or less than three million dollars a state. Industry support is relatively weak — of the eighty million dollars, only eight percent is supplied by industry, or about \$240,000 on average per state (roughly, the cost of lunch in New York). Programs are often university-based, and consist largely of deal-by-deal tie-ins between university researchers and local business in solving some particular production problem or commercializing some new research. At least some programs, however, have a significant field staff. These meet with owners (often invited in to discuss some narrow production problem), try to gain their confidence, and offer various advice on new technologies, business practices, and sources of state support — very much like the more familiar agricultural extension programs.

State technology programs are new, diffuse, and insignificant enough not to have been subjected to much systematic evaluation. The general result appears to be that they are considered unobjectionable,

and in some cases they develop animated support from business clients, but they are not used widely or deeply (in the sense of leading to full firm restructuring).

Moving to training, there is a huge amount of action in the states around educational reform, and at least part of this concerns reform of post-secondary vocational training. "School to work" transition programs are widespread, although subject to the constraints noted before. Perhaps more promising, community colleges and vocational and technical schools have developed extensive outreach programs to local business. These not uncommonly descend into an "offer them any course they want" mentality that threatens college program integrity, but also has the happy effect of getting these educational institutions at least thinking of themselves as an agent of modernization. In my home state of Wisconsin, for example, much of the manufacturing extension service work is done *through* the vocational and technical college system.

In addition to standard fee-for-service arrangements on course instruction, about forty-four states have programs for "customized" labor training *grants* funded out of unemployment insurance or general revenue. Taken together, these programs represent about \$400 million in annual expenditures, although variation across states is huge (California alone accounts for more than quarter of that total, while one state program has little over \$100,000 budgeted annually). Such training grants are generally used to limit job loss or ease the pain of it. They typically go to firms that are in the process of shutting down or downsizing. At least some states, however, have sought to use customized training grants as a spur to modernization. A few — Maryland is perhaps most advanced in this — combine non-training-related modernization services with customized training funds in integrated packages of assistance provided to firms "moving in the right direction." Firms satisfying various antecedent conditions of upgrading get significant support. Those that do not satisfy those conditions do not get the support. Here, at least, state policies advance on federal policies in choosing to favor some sorts of firms over others. Moreover, the combination of grants and services is in many cases a big enough carrot to get firms to change behaviors.

If training monies and technology assistance/extension are increasingly related in dealings with firms, many states have moved to consolidate service delivery more generally, across both programs and the different client bases of individuals and firms. While the goal of "one stop shopping" for labor market services remains elusive, there does seem to be significantly better information exchange among programs than in the recent past. And in some states — here I think Wisconsin is the leader — there are fledgling efforts to develop regional labor market boards combining both integrated service delivery and joint employer efforts on training, standard setting, and advanced tech-

nology use. I would expect to see many more such efforts in the coming years. As these sorts of services become more important, people will be less patient with outmoded political boundaries on their provision, and more insistent that their delivery, as well as content, be bounded by real divides in the economy.

Such flexible program integration, functionally tied to regional labor markets and directed toward a certain path of restructuring, is of course much easier to talk about than achieve, however. While there is definite learning going on at the state level, there are very few places one can point to where serious industrial policy efforts are being made. The vast bulk of traditional state development efforts are not coordinated meaningfully with training. Despite superficial talk of program integration, separate fiefdoms for boosters, developers, and modernizers is the norm. Despite the rhetoric of "good jobs at good wages," the effective goal of economic development administration is still generally seen as "helping business" — any business. (Here, the repeated injunctions from the reinventing government crowd to "get close to your customer" are uninstrucive, or worse, when the customer's behavior itself needs to be changed.) The institutional constraints noted at the outset remain real. And given the Clintonians view on what industrial policy should be, the supporting framework of federal action is not present. By and large, then, these laboratories of democracy remain laboratories of frustration.

