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Implementation of an Industrial Policy

*Richard K. Thomas**

Iwould like to start by recalling an old story. There was a young cowhand who goes into this little town in Montana. He goes to the only saloon in town, where there is a poker game being run by a shark. He has two months' wages in his pocket and just loves to play poker. He sits down and starts playing. In about an hour he has lost half of his grubstake. A townsman who is standing at the bar feels sorry for this kid and goes over and whispers in his ear, "Hey, kid, that guy is a shark. The game is rigged." The kid looks at him, shakes him off and continues to play. The townsman thought perhaps the kid did not hear what he had said. So he goes back after about fifteen minutes and says, "Kid, did you hear what I am saying? The game is rigged. You can't win. The cards are marked. It's a fixed game." The kid looks up at him and waves him aside. He proceeds then for the following hour to lose all of his wages, except for a few bucks. He gets up from the table, goes over to the bar and has a drink. The townsman asks him whether he had heard him telling him that the game was rigged. The cowhand says, "Oh, yeah, I heard you the first time." The townsman replies, "Well, why didn't you quit?" The cowhand, exclaims incredulously, "What do you mean quit? It's the only game in town."

The only thing wrong with that story is that the kid should have taken his gun and straightened the game out. That is the main point of my presentation. The best industrial policy or strategy for the United States and Canada is to keep on playing "free trade poker". We should, indeed, straighten the game out where it needs to be straightened. If we play free trade poker, I think we will be big winners over the next twenty years. We might even wind up surprising folks and growing as fast or faster than Japan.

The reason is industrial policy, in fact, does not work. It simply does not work. The most important problems facing the United States are home grown. Health care costs, and irrational over-regulation, are sucking away most of our growth, eviscerating the chances for our industrial economy to blossom in any way in the future. They have to be attacked.

After that, free trade is the key to an industrial policy. Opening the Japanese and, more broadly speaking, the Asian markets more fully

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The following text was compiled from the transcript of the presentation made by Mr. Thomas at the Conference.

to our manufacturers — not to start subsidizing our own — is the answer.

My main point then is that free trade and free competition are what made the United States and Canada successful. We are good at it. It is why we are the richest nations in the earth. We should stick with free markets. However, we should fix what is badly wrong in the current economic system. One of those things is the health care explosion both in the U.S. and Canada. Another one is unproductive and inane regulation in our environmental cleanup and other social efforts.

Take regulation first. We have, in the United States particularly, a design and command system in most regulation, in which a bunch of lawyers sit down and design the machinery for the cleanup for nearly every industry in the country and then order that it be put in place. Unlike the Japanese, we do not set a standard that has to be met for emissions and then stand back and let engineers, scientists, business and economists figure out how best to meet those standards. We should imitate the Japanese in this regard and should not leave detailed regulation writing to lawyers reading academic and scientific journals and pretending that they know what to do.

Almost invariably this has been our choice in the United States. The result is we are spending \$140 billion a year on environmental clean-up alone. This is about one-third of the net private investment in this country and we are getting far too little cleanup for this. Half these costs are wasted. Some of our laws are absolutely absurd. An example is the Superfund, which is a special tax laid on business to clean up toxic waste sites. Eighty percent of it goes to legal fees, because the law is wilfully confused and created to generate litigation, not to clean anything up. The other twenty percent is used on an almost random basis to move barrels of contaminated wastes to supposedly safer places. It has recently been scientifically determined that, after ten years, this is achieving absolutely nothing in terms of improvement in the ground water underneath these sites. We are literally pilfering our future and absorbing vast amounts of investment funds to achieve nothing.

As for the rest of it, the best industrial policy that we can pursue is an anti-industrial policy abroad. We should make relentless attacks against foreign subsidies and against closed foreign markets and we should put real teeth into this fight.

I am opposed to industrial policy on our own part because it simply does not work. The only reason we think it does is because Japan and Europe, particularly Germany, grew more rapidly than the United States and Canada did in the post World War II era, and they have all pursued industrial policies, more or less. Therefore, we assume that is the key to the success.

This is post-hoc, ergo propter hoc reasoning. That is to say, when a

rooster crows and the sun rises, the rooster assumes that he raises the sun. It is not true. It just happens to be coincidence. The real reason why Germany and Japan grew fast is that they have great economic and cultural traditions. They work hard, smart, and honestly, just as, more or less, do the United States and Canada. Without those human traits in a culture, a nation does not get anywhere very fast.

The reason why Germany, Japan and Europe outgrew North America in the post-war World War II era is that they had a double or triple catchup. North America itself had a catchup after 1945. There were backlog productivity gains, resulting from a total lack of civilian investment from 1930 until 1945. There was actually a net decrease in investment during the 1930s. All the inventions, and the new ideas being created during the period did not receive the investment to make them a reality. For example, the twenty-year and thirty-year mortgage in the United States did not exist before the 1930s. Tract housing, the ability to carpet bomb a square mile of countryside with houses, was invented and started in the 1930s but there was almost no market, and hence little investment. There were fantastic scientific inventions too—television, commercial passenger aircraft. However, there was almost no development of these until 1946.

At the end of World War II, when the civilian investment could again get started, the United States for the next twenty-five years grew 1.5 to 2 times faster than was its historic norm. We were ticking off 3.5 to 3.8 percent growth rates during that entire period, versus something more like two percent as our historic tendency.

In Europe there was a double catchup available. They had the same catch-up that we had, lack of civilian investment from 1929 through 1945. However, they were starting at half or less of the efficiency levels, and half or less the income levels of the United States and Canada. Therefore what they did was to look abroad and take and transplant whole North American systems, products, and ideas. Imitation was much easier than invention. Investment in proven products, and technologies is simply far more profitable, more quickly, than investment by trial and error in new technologies. As a result of their catch-up, Germany and Europe generally grew 1.5 to 2 times as fast as we did in the first twenty-five year period up into the early 1970s.

Japan had a triple catchup. It had more than the double European catchup. Japan was also overcoming Less Developed Country ("LDC") status. Japan from 1868 until 1948 had invested all of its resources, and all of its efforts to modernize, into building a military machine. It was a LDC, with modern cannons. It had only a token automobile industry in the 1930s and virtually nothing of what we consider a modern industrial and commercial culture. Japan had not only our catchup, and the European catchup, but they had the whole LDC catchup to go. The consequence was that Japan grew twelve percent a year from 1948

until the early 1970s, twice as fast as Europe and three to four times faster than the U.S.

What has happened since then? As all the developed countries finished their catch-up, growth rates began to decline. The fastest growing declined most rapidly. Japan scored only about 4.5 percent growth in the 1980s. They now hope to get 3.5 percent growth in the 1990s. It will probably be more like three percent, which will be more or less what our growth rate can and should be in North America. Europe's growth plummeted during the 1970s and since the 1980s we have out-grown Europe, even Germany, in terms of gross output increases per year.

We are all now involved in inventing the future. The important thing to remember is that while all growth has been slowing, Europe and Japan have been doing just about as much or more industrial policy than they ever did before. It has not helped them. In fact, it is a net drag, and is helping choke them now. We should not try to imitate disaster. My industrial policy, as a result of this, is twofold.

One is to attack health care costs. It is impossible to overstate the consequences of the health care cost explosion in our society. It is really not understood at all. Since the 1970s two-thirds of all the United States' economic growth has gone to expand health care services in our society. We devoted five percent of our total output in 1970 to health care costs. It had reached eight percent by 1980, twelve percent by 1990 and fourteen percent by 1992. It is going to be over twenty percent by the year 2000 if we do not do something about it. In fact, right now health care costs are growing almost two percent of GNP each year. If we get three percent growth, that means two-thirds of the growth would have gone into expanding medical services.

The economic consequences of this are as follows. Health expenditures are producing extended life spans. However, they do not increase the wealth of society at all. We have added five years to our life expectancies in the last twenty years in the United States. These extra years are tacked on at the end of life, when people are non-producers, consuming what somebody else produces.

Bill Clinton ran on a policy of trying to increase real wages. He told U.S. workers that he could get their real wages after taxes and inflation-growing again. The fact is, real wages have been static for two decades. However, real compensation, that is, wages plus fringe costs — most importantly health care — have grown about two percent a year during this whole time span. However, all of the increased compensation has gone to workers increased health care for their own family and increased payroll taxes to pay for health care and social security for increasing numbers of retirees. The working people in this country pay for ninety to ninety-five percent of the elderly's health care costs.

The growth of our medical service sector, to the exclusion of practically everything else, has not been a conscious act of policy. Yet it has been our industrial policy, *de facto*, for the last twenty years. Nothing in the way of real industrial policy that we may now undertake — trying to fiddle around with a few more billion dollars in R&D or R&D tax credits for industrialists — will have any impact whatsoever on our economy and our ability to start generating increased wealth again until we control health care prices. We are turning our country into one massive hospital ward. We have to stop it. So that is my first industrial policy.

The second part of my industrial policy is that we have to become really aggressive and serious about other countries that are practicing industrial policy. Let me give two examples.

The Europeans continue to subsidize, not only the research, but also the production and sales of Airbus to the tune of three or four billion dollars a year. Boeing and McDonald Douglas, without subsidy, are trying to compete with these guys. We should simply say to Europe that you must stop this subsidization within six months or we are going to bar any future sales of Airbus in the United States. I hope Canada would join us for a united North American front. The Europeans will then retaliate by not allowing any of our equipment in their market. However, we account for half of the commercial aviation industry in the world. The Europeans have only twenty-five percent. We should be willing to fight for the remaining twenty-five percent of the aircraft market elsewhere in the world, even on a subsidized basis if we have to. We have to confront this practice because this kind of industrial policy is unfair to U.S. producers, European taxpayers, and it is destructive to world trade.

As for the Japanese, I would give them a flat, overall target of trade surplus reduction. This year their surplus is going to go up another thirty to forty percent. I would tell them you have four years, starting in 1994, to reduce your overall trade surplus with the world by three-quarters, or some formula such as this.

We leave it up to them to figure out how to go about getting it done. Their industrialists can rush over here and invest more, so they do not have to bring so many parts over. They can acquire more parts here, so they do not have to export more. Their cartels are already in existence. They can rearrange it anyway they want. They do not even have to buy it from the United States. The surplus reduction target is a multilateral deal. We are trying to reinforce the multilateral trading system, not destroy it.

Right now the multilateral system is under constant assault by the Japanese because most of its trade with its developed competitors is now subject to voluntary restraints of one kind or another. Tariffs which are supposed to rule the GATT system— have become superflu-

ous. The U.S. has automobile restraints, tool and television quotas, and so forth. Europe has concocted a whole series of restraints, with market penetration levels for the Japanese that are at half or less of what they are here.

The problem is that the free trade system is being slowly demolished by Japan's relentless insistence on being world exporters only and not accommodating imports. Under my system, if they do not meet the annual target the U.S. reduces Japan's exports to us by a set figure. Confronted with that prospect, the Japanese will change.

I would conclude by saying this about industrial policy: if political decisions about technology, products and services were, in fact, better than free markets, then the Soviet Union would have won the cold war. Even Japan's legendary Ministry of International Trade and Industry ("MITI"), has a huge closet full of skeletons. People do not think about it. But, MITI, in fact, opposed creation of an automobile industry in Japan. MITI supported — and widely over-built — the shipbuilding and heavy steel industries. It wildly and foolishly created aluminum and copper smelting industries. The Japanese have spent the last twenty years trying to get rid these. All of its steel companies are now losing money.

Just recently Japan has wasted five billion dollars investing in supercomputers. A couple of computer wizards, one in Cambridge and another in Silicon Valley, discovered that the secret to supercomputing was to hook up regular computers with some high-speed switching gear and have what is called massive parallel computing. Cray Research, our big unsubsidized supercomputing company, is almost going out of business on account of this discovery. MITI in Japan has just closed down research after five billion dollars in taxpayer funds on their own supercomputer research. Another example is High-Definition Television. Four years ago, it was widely said Japan was supposed to rule the world. Japan let in HDTV. Then they discovered that the government and industry had bankrolled the wrong technology. They had spent four billion dollars on it but all Japan has is a hermaphrodite system that is part digital and part analog. Nobody is going to adopt it. The Japanese consumer is not going to buy \$15,000 television sets. The world is adopting a new all-digital standard. I could go on because there is a long, long list of failure. It has not been successful for Japan.

So, when you hear politicians or even journalists saying "industrial policy, industrial policy, industrial policy," the response is, "markets, markets, markets."