INTERGOVERNMENTAL STRATEGIES FOR
NATIONAL INDUSTRIAL POLICY

Mel Dubnick*
and
Lynne W. Holt**
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*Associate Professor
Department of Public Administration
University of Kansas
(913) 864-3527

**Department of Legislative Research
State of Kansas

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A. Introduction

Prior to 1984, proposals for a U.S. national industrial policy seemed destined to be a central issue in the upcoming presidential election. However, because of a strong economic recovery in 1983-84 and Walter Mondale's reluctance to emphasize that issue in his presidential campaign, industrial policy was pushed to the political agenda's periphery where it still lingers today.[1] Nevertheless, despite the present lack of presidential support, the concept of an American national industrial policy remains a credible one for many political leaders, and its advocates remain active and influential as major economic policy advisors to presidential hopefuls.

In a recently published critique of major industrial policy proposals, the present authors pointed to a blatant disregard for the possible role of states and other subnational jurisdictions in such national efforts. Many of the examined proposals were indifferent to potential contributions by subnational governments, and several were even based on policies that would override or preempt current state and local programs in the areas of economic development and social welfare policy. We predicted that such indifference and hostility to subnational involvement would prove to be constitutionally questionable and politically unwise.[2] Others have remarked, albeit from different perspectives, on the same point as the role of states and localities has started to receive greater attention from both scholars and political advocates of an American industrial policy.[3]

The primary purpose of this paper is to outline alternative strategies for a national industrial policy based on the assumption that subnational jurisdictions, particularly states, can and must be actively involved in the effort. A range of intergovernmental approaches is available to those who seek the adoption of an explicit industrial policy for the U.S.. At one end of that range are intergovernmental strategies that promote national economic development through interjurisdictional competition, unencumbered by federal intervention; at the other end are those strategies that assign to Washington a central role in determining the specific form and direction of subnational involvement in a national industrial policy. Included within this range are strategies that offer some mix of autonomy and direction for subnational governmental units.

For present purposes we will assume that there exists a consensus among national policymakers regarding the need for some form of national industrial policy.[4] Given that consensus, several preliminary yet crucial questions must be answered before discussing the range of intergovernmental strategic alternatives. First, is subnational involvement in this arena justifiable on economic as well as political and constitutional grounds? Second, do subnational jurisdictions have the policy tools and programatic (e.g. planning and coordination) capabilities that can prove effective in the achievement of national industrial policy objectives? And finally, does the federal government have the necessary constitutional, legal, and fiscal leverage over subnational governments to take full advantage of their potential contributions to a national industrial policy?

B. The Economic Strategy Justification

As noted, our recently published examination of national industrial policy proposals stressed the constitutional and political rationales for involving states and localities in any national program. While those factors alone might justify subnational government involvement in an industrial policy program, there are also valid economic reasons for that participation.

The economic case for intergovernmental strategies is based on the three major economic purposes most often mentioned as justifications for industrial policy: (1) the need to enhance America's competitive position in international markets; (2) the complementary need to facilitate adaptive changes in domestic markets toward new products, production techniques, and growth industries; and (3) the need to improve the U.S. economy's capacity to absorb the distress and dislocations caused by economic change. Different industrial policy advocates tend to emphasize at least one of these three general objectives; taken together, however, those objectives constitute a set of interrelated goals which any comprehensive industrial policy strategy should address.

(1) Enhancing America's competitiveness:

If there is a central theme in most discussions regarding industrial policy, it is the growing awareness among Americans that the United States has lost its "competitive edge" in world markets. The evidence of this is so clear and well known that there is little need to restate it in detail. Our trade deficit in manufacturing goods has greatly exceeded $30 billion per year, and our volume and value shares of world trade in that area have declined precipitously for nearly two decades. In the meantime there has been a steady increase in the volume and value of imported goods, particularly of products that compete with those of key sectors of the U.S. domestic economy (e.g., automobiles, steel).[5]

If one advocates the need for the U.S. to regain and maintain its competitive (if not dominant) position in the international economic arena, a relevant intergovernmental strategy would focus on how states and localities can directly[6] contribute to the improvement of American world trade. Until the late 1970s it would have been difficult to argue that subnational governments could play such a role. However, in recent years states and localities have become increasingly involved in international affairs, especially in economic relationships with foreign jurisdictions at all levels.[7]

Much of this subnational involvement developed in response to the changing international economic environment of the 1970s. As John M. Kline observed,

> International economic forces had penetrated to a level where state-government interests were affected and where states possess significant authority over legal or regulatory matters such as corporate chartering, land use, insurance and banking, the environment, government purchases, labor relations, civil rights, and police powers. Global interdependence thus provided both a motivation and method for state-government actors to become involved in international economic issues.[8]

Local officials have been just as aggressive as their state counterparts in pursuing international options in their efforts to revive or stimulate economic activity in their areas. For example, the recent announcement by Toyota Motors that it would build a plant in the American Midwest stimulated as much activity in some cities as did the GM Saturn plant competition several months earlier. This increasing sensitivity to international conditions and opportunities among state and local officials bodes well for developing an intergovernmental strategy for a national industrial policy.

(2) Improving the "fluidity" of domestic markets:

Many advocates of industrial policy (and, for that matter, many opponents) regard the decline of U.S. competitiveness in world markets as symptomatic of a much deeper problem in the American economy -- its lack of "fluidity." Many of America's economic problems can be traced to the inability of domestic resource markets -- particularly the human and capital resource markets -- to adapt both quickly and cost-effectively to new technological and world market developments.

Some analysts blame government for this lack of adaptability, while others focus their attention on labor or management.[9] Regardless of the perceived cause, many analysts consider a well designed and effectively targeted industrial policy to be a possible remedy. For those individuals, industrial policy is that collection of government programs intended to increase the responsiveness of America's productive resources to changing economic conditions.

States and localities can play a significant role in such a policy. Current competition among subnational jurisdictions in the area of economic development has reached such extremes that the results have been regarded as scandalous if not absurd.[10] The key questions seem to be (a) whether this competition is effective -- that is, whether it enhances the fluidity of domestic resource markets -- and (b) whether that competitiveness can be harnessed on behalf of national industrial policy objectives.

On the first issue, current research is inconclusive. The competition among subnational jurisdictions is based on a combination of policies that are packaged as economic development programs intended to attract new businesses or to convince current ones that they should remain and/or expand locally. Those programs often include: (1) a variety of <u>tax incentives</u>, with particular emphasis on relief from taxes on business property; (2) <u>expenditures</u> on human resource programs (e.g. education, job training), physical infrastructure (e.g. highways), public services (e.g. fire and police protection), and special amenities (e.g. recreation facilities and cultural attractions); (3) regulatory policies which more often offer relief from normal government restrictions on land use, environmental pollution, the costs of labor and transportation, and other factors;[11] and (4) risk-sharing policies such as loans and loan guarantees as well as investments in research and development efforts (primarily through special expenditures in higher education).

Much of the initial research indicated that factors other than these economic development policies influenced location decisions within the business community. The literature on industrial siting decisions, for example, indicated that such policies had a marginal impact at best.[12] In contrast, general demographic trends (toward suburbia and now exurbia, as well as toward the sunbelt) were found to be extremely important, as were various interregional and international patterns in markets for critical resources such as energy and other raw materials.[13]

More recent research, however, indicates relatively positive associations between subnational economic development policies and a variety of business investment indicators. For example, there is now evidence that state and local taxes do make a difference to specific sectors of the American economy, particularly "high-tech" firms.[14] In some preliminary analyses, Susan Hansen found that state industrial policies, when examined in regional contexts, do seem to have some (albeit mixed) impacts on economic development.[15] In addition, recent research by Richard Feiock (presented at this panel session) provides support for the argument that local development policies might make a difference in business investment decisions.

Regarding the second issue on the feasibility of harnessing subnational competition, it seems patently clear that competition among the fifty states and thousands of localities provides a unique opportunity for Washington to create a marketplace for human and capital resources that will keep the domestic economy "fluid."[16] It is often forgotten that open markets are not anarchies, but stages on which economic actors play out their roles through interactions structured around social and legal rules of conduct. As argued below, using such a perspective as a starting point, it is possible to have federal policies designed to develop and promote relevant resource markets that can stimulate investments in the human and capital needs of the American economy.

(3) Improving the absorptive capacity of the American economy:

An interesting feature of the industrial policy debate is the division it has created among its advocates on the left. While the dissension of Charles L. Schultze and other major liberal economists has become well-known,[17] a more important but less touted split has occurred between those who advocate industrial policy as an economic stimulant to generate new investment and those who would emphasize the need for relief from economic distress in areas where private sector decisions have caused the most damage. The former group is primarily concerned with increasing the fluidity of the American domestic market as well as increasing U.S. competitiveness in world markets;[18] the latter group wants to concentrate on improving the capacity of the American economy to absorb the distress and dislocations caused by major economic changes.

As the principal spokespersons for the "absorptive capacity group," Barry Bluestone and Bennett Harrison have described what they perceive as the central issues in the industrial policy debate: "How do we build a stable, humane, equitable community and still have economic growth? And how can we go about the business of constructing a productive economy which produces livelihoods without destroying lives?"[19] A central characteristic of the American economic system is the autonomy and power it provides "for corporate management, guaranteeing freedom from outside interference and particularly from government intervention. . . ."[20] That corporate power includes the unencumbered ability of managers to make major economic decisions for their respective companies -- decisions which are often made with an indifferent attitude toward their possible adverse impacts on the national economy in general and local economies in particular. Entire communities are, and will continue to be, affected economically and socially by these decisions, and certain communities with strong ties to adversely influenced industries (e.g., Youngstown and Detroit) face the greatest problems.

Because of these circumstances, Bluestone and Harrison argue that the national government should develop an industrial policy with the primary purpose of preventing and/or alleviating those problems of dislocation resulting from economic change.[21] Such a policy (termed "democratic socialist" by Bluestone and Harrison) might include: plant-closing legislation to protect workers and local communities; social legislation to guarantee a true minimum social wage; tax reforms to make the revenue system truly progressive; national economic planning, with an emphasis on dealing with the restructuring of the economy; and greater worker participation in corporate decisions, perhaps involving the opportunity for worker ownership. More traditional versions of this approach include greater federal government emphasis on job training, community redevelopment, and related policies that would help the nation get through economic transformations with as few disruptions as possible.

What role can states and localities play in this effort to enhance the absorptive capacity of the American economy? Supporters of this approach advocate a national planning effort in which the governments of states and local communities fully participate in the decision-making process. Gar Alperovitz and Jeff Faux justify this involvement on pragmatic grounds, viewing state and local governments as effective "horizontal mediating" institutions which represent the interests of diverse constituencies.[22] Such mediation makes good economic sense since the impacts of plant closings or other forms of economic distress on the economic health of states and communities calls for the kind of integrative leadership that subnational government officials can provide.[23]

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Is state and local involvement in a national industrial policy justifiable on purely economic grounds? This brief survey does not allow us to draw any firm conclusions other than to note that subnational involvement can certainly be rationalized on economic grounds. Whether discussing the improvement of the U.S. position in world trade, the fluidity of domestic markets, or the absorptive capacity of the national economy, it can be argued that subnational governments can have a major impact on industrial development. This conclusions leads us to ask whether those governments have the necessary policy tools and programatic capabilities (i.e., the abilities to plan and coordinate) that can prove effective in accomplishing the goals of a national industrial policy.

C. Appropriate Tools and Programatic Capabilities

Industrial policy, by most definitions, is based on the use of microeconomic policy tools instead of on the macroeconomic tools so often associated with traditional economic policy at the federal level.[24] To varying degrees, all states and most major localities have been using microeconomic tools since at least the early 19th century.[25] Today they continue to do so by offering industries tax incentive programs, research and development programs, training for the "hard-core" unemployed, programs to increase the export of selected industrial products, programs that provide feasibility studies to attract new industries, various industrial revenue bond financing programs, pollution control incentives, and other forms of assistance.[26]

State legislatures appropriate large sums of money to encourage the relocation and expansion of industries. Every state has authorized one to several divisions or freestanding agencies to assume those responsibilities. All states have some type of promotional or assistance programs to attract industries. For example, in Kansas the FY 1986 appropriations of $4.1 million from the State General Fund to the Kansas Department of Economic Development include $1.03 million for industrial development, $1.66 million for community and small business development, $0.75 million for travel and tourism, more than $52,000 for minority business funding, and $610,000 for high-tech research grants.[27] State economic development agencies generally provide informational, technical, financial and labor services to businesses and industries, as well as assistance with industrial site selection, planning, and technical services for local communities.[28]

Local governments have been no less active in their efforts to make their communities more attractive to prospective and expanding businesses. Besides substantial tax breaks, localities may offer the use of publicly owned land, "incubator facilities," locally operated job training programs, shared access to federal grant money (e.g. UDAG), IRB loan guarantees, and many other instruments.[29]

In short, there is no lack of relevant policy tools for subnational governments to use in conjunction with a national industrial policy effort. In the past, the only limits on state and local policy tools have been political, constitutional, or financial. More troublesome, however, will be the lack of state and local capabilities in the areas of program planning and coordination. An intergovernmental national industrial policy will not only necessitate a greater degree of national planning, but also greater economic policy coordination by both state and local governments. The historical record indicates that this will be no easy task.[30]

For example, state industrial policies occasionally embrace goals that are contradictory. An example is the unitary tax which allows a state to tax a corporation on the basis of its total international profits. Whereas the adoption of this form of taxation might increase state revenues, it has also prompted companies to leave those states that have implemented it. Because of Florida's unitary tax, for example, IBM put up for sale 2,000 acres it owned in northern Florida.[31] Meanwhile, states spend millions of taxpayer dollars in the form of incentives and grants to lure companies like IBM or GM's newly formed Saturn Division to locate within their boundaries.

As another example, several state legislatures have displayed reluctance to support not only "high-tech" university research, such as engineering, computer sciences, and molecular biology, but also less "fashionable" research in the applied sciences. With adequate funding, long-term research efforts could be encouraged, and faculty members could be retained and not so easily enticed by higher salaries to leave for the private sector. Although state funds are not always appropriated in sufficient amounts to boost faculty salaries and improve university working conditions that would help sustain long-term scientific research, these funds are nonetheless often pumped into high-technology ventures that would need to capitalize on regional pools of long-term expertise and research.

In yet another example, states and local governments might offer incentives such as IRB's or tax incentives to industries which depend strongly on a viable infrastructure to market their goods. However, these same units of government might also fail to provide sufficient funding for roads and other public services that are essential to the successful operation of those industries. Almost everything a state or local unit of government does can influence business decisions. However, because of a lack of articulated goals and complementary strategies, their strategies may fail to improve a region's economic base.

A major problem in subnational jurisdictions that hinders planning is that there is no consensus on what constitutes an effective use of state and local revenues to assist new and expanding industries, any more than there is a consensus on what constitutes an effective use of funds for the execution of a national industrial policy. As the currently raging debate on national industrial policy suggests, there is not even a consensus on the goals that such a policy should espouse, or whether there should be a national policy in the first place. On the subnational level, industrial policies could be said to exist but, like those on the federal level, they are largely <u>de facto</u> and not used in a coherent and planned manner.

Although many states have published state plans for high-technological development, these plans constitute a single facet of what a comprehensive economic development program could or should conceivably contain. Issues that might be addressed in an integrated state-level industrial policy would include: (1) strategies for assisting "smokestack" industries to expand, diversify, or modernize their operations; (2) comprehensive assessments of the state's work force for light industries, warehouses and distribution operations, and agricultural technologies; and (3) feasibility studies on how to use existing firms as an ongoing source for exports. Extant state and local efforts, whether consciously conceived or <u>de facto</u>, could easily be criticized for being merely a pastiche of strategies; but even more significant is the criticism that there is no evidence that the package of specific benefits a particular plan makes available to industries and businesses can conclusively affect or influence siting or expansion decisions. This means that taxpayers' money is often wasted.

All this is not meant to imply that state and local programatic capabilities cannot be improved. Our knowledge about industrial siting and business decision making has been increasing. For instance, it is now widely acknowledged that incentives should not be recommended across the board for all industries, since needs can vary significantly among industrial concerns. In particular, low-tech manufacturing industries seem to have different needs from high-tech industries. States must be cognizant of those differences when formulating incentive programs. According to Robert M. Ady, Executive Vice President of Faustus Company, companies choose locations on the basis of both cost and non-cost factors. On the one hand, for low-tech manufacturing plants, costs affected by location could be roughly apportioned as follows: labor-55%, transportation-40%, electric power-2%, occupancy-2%, and taxes-1%. On the other hand, cost factors for high-tech firms might be apportioned in an entirely different manner: labor-70%, transportation-15%, electric power-2%, occupancy-5%, and taxes-8%.[32] As Ady notes, the data suggest that high-tech firms are much more sensitive than manufacturing plants to labor cost and tax cost variations.[33] It would appear that transportation for manufacturing plants is critical because of the necessity of linking the production source to the market. High-tech firms, by contrast, are far less dependent on transportation but are more vulnerable to tax variations because they tend to be smaller, newer firms, less dependent on bulk production.[34]

On the low-tech side, states have been active for many years in providing generous incentives to attract large manufacturing concerns. Recent examples include GM's decision to construct the $6.5 billion Saturn Division plant in Spring Hill, Tennessee. Five years ago Nissan decided to locate a truck assembly plant in Smyrna, Tennessee. Now valued at $745 million, the Smyrna plant employs 3,000 on two shifts. The State of Tennessee and Rutherford County had offered

Nissan over $40 million for capital improvements and $7.3 million for training functions, besides a property tax exemption for at least seven years.[35] In yet another example, the Commonwealth of Pennsylvania, as part of its enticement for Volkswagen to locate a plant in New Stanton, provided Volkswagen with roads and railroad tracks valued at $30 million, $6 million in loans, and another $40 million loan arranged with the Pennsylvania Industrial Development Authority. Pennsylvania also purchased for $28 million the shell of an existing Chrysler plant and leased it to the company which, in turn, transformed the plant's interior.[36] Other examples of such inducement strategies include Ohio's investment of $3.2 million in drainage improvements, $700,000 in job training funds, and $7 million to improve state highways to assist Timken Company's expansion; South Carolina's investment of $2.7 million to lay water and sewer lines to improve roads to assist two new plants, (one of which was Japan's Sony Corporation); and Portland, Oregon's incentive program designed to attract the Wacker Siltronic Corporation from West Germany. Portland's melee of incentives included a low interest bond to purchase property for the plant; funding for the construction of roads and the upgrading of utility services at the plant; CETA training grants which were used to train unemployed local residents from low-income affirmative action groups; and a pledge to establish a state-university graduate engineering program in the Portland area to train corporate engineers.[37]

But it is in efforts to attract high-technology firms that most states have demonstrated their abilities to invest in programatic resources. In 1983, fifteen states established agencies designed solely to attract high-tech industrial investments.[38] Many states have also resorted to picking "winners" and "losers" for the receipt of certain grants. To assist new, technologically-oriented enterprises, the states of Connecticut, Massachusetts, Indiana, Michigan, New Mexico, and New York provide direct venture capital to support enterprises in their initial stages of development. The Massachusetts Technology Development Corporation was founded in 1979 and allotted $2.1 million for eleven projects in 1983.[39] The Connecticut Product Corporation provides venture capital to existing companies for new products, including some low-tech products. Its return from royalty payments averages 5 percent of product sales. Since 1973 its investments have totaled $11 million dollars in products and its receipt in royalties, $1.4 million.[40] Pennsylvania's Ben Franklin Partnership was founded by the state in 1982 as a consortium of universities, companies, industrial associations, labor groups, and venture capital organizations to conduct joint research projects, training projects, and to create marketable products and jobs. Total obligations by state and private sector sources for all projects funded under the auspices of this program in 1983-1984 were $38 million.[41]

States have also appropriated funds for university-based research and development. Stanford's involvement with high-tech in the Silicon Valley, Harvard's and MIT's involvement with Route 128, and North Carolina's with the Research Triangle Park are famous examples of this phenomenon. Less known, perhaps, is Arizona's legislative appropriation of $50 million to support a microelectronics and engineering center at Arizona State University -- funding that was matched by grants from a group of companies composed of Motorola, Sperry, and Garrett.[42] States have also appropriated funds for training people to fill positions in high-growth fields. The Massachusetts Legislature appropriated $3 million for an initial investment in the Bay State Skills Corporation, which was established in July 1981 as a quasi-public corporation that would link private companies with potential employees. The Corporation matches state funds with private corporate funding to train employees.[43]

Perhaps the most ambitious endeavor to date to boost a state's economy through a comprehensive programatic effort was Rhode Island's "Greenhouse Compact." The Compact was an agreement between businesses, universities, government, and labor to strengthen existing but languishing businesses in Rhode Island. It concentrated on the development, expansion, and retention of established businesses rather than on efforts to attract out-of-state businesses to Rhode Island. And while the Compact effort bodes well for state planning in general, its failure to gain voter support may be taken as a sign by other states that economic development planning remains politically vulnerable. A legislative bill on the "Greenhouse Compact" was passed, but the plan was defeated overwhelmingly by voters on June 12, 1984.[44]

Recent research also indicates the need to vary development strategies according to the size of business firms being solicited. In his article "Targeting Economic Development: an Examination of the Needs of Small Businesses," John Seley argues that existing economic development and incentive strategies fail to meet the needs of small businesses in the most cost-effective manner. Citing a study done by David Birch of MIT, Seley points out that small businesses tend to be much more concerned with expansion than with relocation; less than

0.2% of the firms relocate during any given year.[45] Because approximately two-thirds of all new jobs are in companies with twenty or fewer employees, Seley concludes that prevailing forms of state assistance to businesses are misdirected; they do not foster the growth of existing smaller businesses and instead concentrate on a smaller number of large, potentially mobile firms.[46]

However, Seley's observations, made in January 1981, may be somewhat outdated. State assistance to small businesses, for example, is becoming a "big business" proposition, replete with advocates and critics. Approximately half the states now engage directly in venture capital financing, and several states have eased regulatory and tax burdens on small businesses and directed state agency purchases to them. In addition, thirty state legislatures have established small business committees.[47] In 1983, four states provided direct grants to small businesses totaling $5.4 million, and twenty-one states obligated nearly $114.8 million to small businesses through loans.[48]

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The question of whether subnational governments have the policy tools and programatic capabilities to participate in an intergovernmental national industrial policy must be answered in the affirmative given the information we now have. The tools are obviously there, and for some of the more innovative and entrepreneurial states and localities the appropriate tools are likely to be created if they do not already exist.[48a] Programatic capabilities are more problematic. Recent efforts by states indicate that subnational governments may be more than competent to develop comprehensive plans.[49] What remains to be considered is whether the federal government has the capabilities to incorporate subnational governments into a national industrial policy designed along intergovernmental lines.

D. Federal Government Leverage

The ability of the federal government to obtain the cooperation of states and localities in national policy efforts has been demonstrated repeatedly for the past half century. The nature of the U.S. federal system has evolved into one that at times seems to operate in a much more unitary fashion than even the mildest advocates the federalist concept would find acceptable. Federal-state relationships have changed from a 19th century contentious formalism in which legal preemption was the only means for Washington to deal with state authority, to a post-World War II system of cooperation based on the federal use of its vast fiscal resources. In the 1970s the relationship developed into a more competitive situation in which Washington had to rely increasingly on mandates and across-the-board regulations to generate "correct" state and local behavior.[50] Even under the Reagan Administration, perhaps the most pro-state/local regime in decades, the national government has found it possible and desirable to exercise its financial and regulatory clout to promote national policies (e.g., to force changes in state liquor laws by threatening to withhold highways funds).

All this intergovernmental activity, however, has not directly involved the design or implementation of national economic policies. National economic policy has been primarily macroeconomic and therefore almost the exclusive province of Washington's policymakers.[51] Subnational economic development activities have constantly been regarded as peripheral at best, a set of factors that could easily be ignored. Intergovernmental programs were perceived as more appropriate for social, educational, and infrastructural programs. These programs had some impact on the American economy, but they were hardly regarded as part of the U.S.'s national economic policy.

Thus, the challenge of establishing an intergovernmental national industrial policy raises the question of whether past experiences and current IGR mechanisms provide a sufficient basis for such a program. This, in turn, begs the question of whether Washington has any real leverage over states and localities in the area of economic development. In short, is it feasible for the federal government to "nationalize" subnational economic policies?

As John Shannon and Bruce McDowell point out, "there are still many federal programs that contribute to economic development . . ." from small business assistance to job training grants and programs that provide support for education and research.[52] To a certain extent these economically relevant categoric and block grant programs can provide the federal government with some leverage in any effort to nationalize state and local economic development policies. But to be truly effective as a basis for generating subnational involvement, these ongoing grant programs must be valued as much as the more highly cherished "public works" grants (e.g., for highway maintenance, mass transit systems) which have traditionally been used to get state and local governments to cooperate in noneconomic policy programs. While the threat of losing CDBG or UDAG funding may stimulate state and local officials to act according to Washington's wishes, it is unlikely that such sanctions will have the kind of significant impact as would the potential loss of highway construction funds and similar large ticket IGR-financed items. Thus, the federal government has potential leverage over subnational governments proportional to its willingness to threaten state and local access to highly valued grant programs.

Another set of potential leverage points exists in the federal revenue system. We have recently seen just how important this aspect of IGR is to subnational governments. For example, changes (and proposals for further changes) in regulations regarding the use of industrial revenue bonds and similar instruments of tax exempt financing have drawn a great deal of attention from state and local officials. The Reagan tax reform provision calling for an end to the deductibility of state and local taxes provoked reactions from subnational governments, particularly those that might end up overall revenue losers as a result.[53] These and related concerns reflect the growing dependence of states and localities on certain provisions of the federal tax code; and this, in turn, indicates another area where the federal government can exercise some potential leverage in its development of an intergovernmental national industrial policy.

Federal leverage over states and localities can also be applied through decisions regarding the location of federally-funded civilian and defense facilities as well as the geographic allocation of funds for "pork barrel" projects and government contracts. Fiscal year 1983 federal expenditures for the wages and salaries of civilian and military employees totaled $432 per capita for the entire nation. Regionally, however, expenditures for wages and salaries varied considerably. They totaled $548 per capita in the Rocky Mountain states; by contrast the figure was $231 per capita in the Great Lakes region. Of the $669 per capita the federal government spent nationally on procurement contracts for FY 1983, regional figures range from expenditures in the Far West (excluding Alaska and Hawaii) of $1,124 per capita to $284 per capita in the Great Lakes region.[54] Given these disparities and the possible discretion that some federal political and administrative officials have in determining the distribution of direct federal expenditures, one can see how such conditions might be made to serve the needs of federal officials who seek leverage over subnational governments.[55]

Finally, the federal government might also rely on the leverage it has gained from its increasing regulatory hold on subnational governments.[56] By loosening or tightening the "mandate millstone" it has tied around the necks of state and local officials, federal policymakers might be able to generate some of the cooperation needed to develop an effective intergovernmental national industrial policy.[57]

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Does the federal government have the leverage over subnational jurisdictions to establish an effective intergovernmental national industrial policy? The answer seems to be a qualified yes. There are enough "leverage points" available to Washington to warrant a positive response, but it might take more than the mere existence of these leverage points to bring about the needed cooperation. How successful the federal government might be in developing an intergovernmental approach would seem to depend largely on two factors: the extent to which there is a consensus and the political will among federal policymakers to instigate such a policy; and the choice of intergovernmental strategy selected for the industrial policy effort. The final section of this paper addresses the latter concern.

E. Alternative Strategies

The argument that subnational governments should be instrumental in the development and implementation of a national industrial policy does not imply any particular policy design. On the contrary, several options exist that fall between the extremes of a "non-policy" toward subnational involvement and a full preemption of state and local activities that might interfere in federal efforts. The non-policy option would exist when the federal government attempts to devise a national industrial policy that is completely indifferent to the activities and potential role of subnational governments. Full preemption would involve explicitly prohibiting state and local actions which might interfere with or duplicate Washington's industrial policy programs. The wisdom and feasibility of either of those extreme options is questionable.

Between the two extremes are many options that vary according to several factors: the degree of involvement by federal officials, the autonomy allowed subnational jurisdictions in making specific program decisions, and the extent to which cooperation or competition among states and localities would be promoted. For present purposes we focus on three major intergovernmental policy strategy models that might be seriously considered: a subnational competition model, a fiscal federalism model, and a regional cooperation model.

The <u>subnational competition model</u> offers a strategy based on the assumption that the states and localities are not so much legal entities as competing firms in a national market for economic production factors (i.e., land, labor, capital). Put in simple economic terms, at present we have thousands of subnational jurisdictions competing with each other to become the primary supplier of key production factors for private sector firms which generate the demands for those resources. This is presently (and for the foreseeable future) a "buyer's" market. All types of business firms (but especially high-tech companies) can select among the many "bargains" being offered by states and localities. One could perhaps argue that interjurisdictional competition is inefficient and scandalous; however, one could likewise argue that such competitiveness can be directed and controlled to help achieve national industrial policy objectives. The subnational competition model would have the federal government develop an industrial policy program that would harness (rather than eliminate) that competition for national purposes.

This interjurisdictional production factor marketplace, like all markets, is subject to laws and policies which set the parameters and conditions for competition. To some extent all markets are malleable, and competition among states and localities can be viewed in the same light. At the moment the rules and regulations of interjurisdictional competition are a hodge podge of conditions which inadvertently (but effectively) favor some jurisdictions and private sector firms over others. Under the subnational competition model, the federal government would establish policies regarding that competition that would most effectively achieve its industrial policy objectives.

This might involve policies to make the competition among states and localities "fairer" by minimizing any interjurisdictional differences that might prove competitively advantageous. For example, this could be accomplished through policies that would equalize the distribution of federal facilities and allocation of federal procurement contracts among different the states. Similarly, the federal tax code could be modified to minimize advantages that certain states and localities might be receiving from provisions such as the deductibility of taxes.

The subnational competition model can also be used to provide advantages to some state or locality that is currently at a severe competitive disadvantage in the production factor marketplace. We already have a form of this approach on the state level in the often (mis)used "enterprise zone" concept. Allowing selected tax breaks and other incentives in specified jurisdictions or regions would certainly be feasible, although one can foresee many political and administrative problems arising due to the nature of American policymaking.

The subnational competition approach in all its variations is inviting for several reasons. Relying on "market forces," it complements the anti-planning and pro-marketplace attitudes of most Americans, and the long-term outcomes might just prove to be economically "efficient." Nevertheless, this approach has potential costs, particularly in the temporary inequities it will invariably generate and in the difficulties it creates for achieving short-term policy objectives. These costs will, in turn, generate pressures on policymakers to exercise more direct control over state and local decisions.

As a prime alternative, the <u>fiscal federalism model</u> would follow the traditional pattern of American intergovernmental relations through the use of categoric and block grants. Under this model we would rely on the traditional image of states and localities as legal/political entities subject only to incentives provided by a mixture of the "carrot and stick" approach. This can be accomplished by repackaging current grant programs relevant to economic development, developing new assistance programs, and placing them all under the direction of a single agency charged with achieving national industrial policy objectives.

The fiscal federalism strategy would provide the national government with considerable control over the specific roles to be played by subnational jurisdictions in an industrial policy program. Such an approach would be desirable under two conditions: first, if the national government were capable of developing a comprehensive and effective national plan; and second, if it was able to effectively allocate programatic functions to the appropriate levels of government. Both conditions require a high degree of political consensus and a well-developed, empirically-grounded set of economic and administrative theories.

A comprehensive plan would only be possible if national policymakers generally agreed about both the ends and means for achieving a national industrial policy. Such a plan would have to be based on a set of economic assumptions that would allow national policymakers to make the the "right" decisions regarding "winners" and "losers" in the industrial policy effort. Similarly, a consensus would have to be reached on the proper allocation of administrative functions to the various levels of government involved in the overall industrial policy program. Given the present divisiveness on the definition and objectives of industrial policy, it is doubtful if any of those preconditions can be met in the near future.

A <u>regional cooperation model</u> can be regarded as an attempt to steer a middle course between a subnational competition strategy and the fiscal federalism approach. One can view this strategy from two perspectives: as an attempt to create a decentralized national industrial policy, or as an effort to raise subnational competition to a regional level. In either case, the regional cooperation approach builds on a tradition of using regional programs for economic development purposes.[58] The key difference here would be the overall national purpose to which regional cooperation -- and competition among the regions -- would be applied.

There are potential problems in using this kind of approach. Since regional economic interests and objectives do not always coincide with those espoused by the federal government, regional "winners" might turn out to be national "losers."[59] In addition, regionally based programs of the past have often failed to realize federally-mandated objectives. Critics of regional approaches are quick to point out those past failures. Examples are cited of programs targeted to regions that were intended to revive distressed regions and communities but had failed to do so. These included the FHA and VA Mortgage Loan Guarantee Programs, The Public Works and Development Act of 1965, The New Towns Policy, and Urban Renewal.[60]

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There are obviously variations among (and mixtures of) these three major options for the employment of an intergovernmental strategy in a national industrial policy. We have attempted to briefly outline some of the possibilities and issues that these and related options might raise. Designing an intergovernmental industrial policy program would be no easy task, but such a program can be developed should federal policymakers decide to adopt that course of action.

ENDNOTES

[1]The best indicators that industrial policy was expected to be a major issue in 1984 were two actions taken by the Reagan Administration in 1983 in anticipation of the forthcoming election campaign. Although opposed to the idea of an industrial policy, Reagan found himself (1) proposing a major reorganization of the cabinet to more effectively deal with trade policies, and (2) establishing a special Presidential Commission on Industrial Competitiveness which was to report back to him by September 1984. On a positive assessment of the failure of the debate to materialize, see Herbert Stein, PRESIDENTIAL ECONOMICS: THE MAKING OF ECONOMIC POLICY FROM ROOSEVELT TO REAGAN AND BEYOND, revised (New York: Touchstone Books, 1985), pp. 379-380.

[2]See Mel Dubnick and Lynne Holt, "Industrial Policy and the States," PUBLIUS, 15, no. 1 (Winter 1985): 113-129; also see Mel Dubnick, "American States and the Industrial Policy Debate," POLICY STUDIES REVIEW, 4, no. 1 (August, 1984): 22-27.

[3]For example, among active political advocates see Bruce Babbitt, "The States and the Reindustrialization of America," ISSUES IN SCIENCE AND TECHNOLOGY (Fall 1984): 84-93; also Felix Rohatyn, THE TWENTY YEAR CENTURY (New York: Random House, 1984). Even the President's Commission on Industrial Competitiveness took (extremely) brief note of the subnational role in the last of its recommendations: "State and local governments and entrepreneurs play an important role in improving the competitiveness of industry. States should continue to exercise initiatives in this regard with Federal encouragement." See The President's Commission on Industrial Competitiveness, GLOBAL COMPETITION: THE NEW REALITY, Volume I (Washington, DC: USGPO, January 1985), p. 60. Among academics interested in this area, see the works cited below.

[4]There is, of course, considerable opposition to industrial policy at present from both the political left and right and from many corners of the academic community. See Herbert Stein, "Don't Fall for Industrial Policy," FORTUNE, 108, no. 10 (November 14, 1983): 64-66, 70, 74, 78; also in that same issue, Bruce R. Bartlett, "Industrial Policy: Crisis for Liberal Economists," pp. 83, 86. Also see Charles L. Schultze, "Industrial Policy: A Dissent," THE BROOKINGS REVIEW, 2, no. 1 (Fall, 1983): 3-12. For a more general set of critiques, see Chalmers Johnson (ed.), THE INDUSTRIAL POLICY DEBATE (San Francisco, CA: ICS Press, 1984).

[5]The dismal picture of the U.S. declining position in world markets is documented in many places. For a recent summary, see the background papers in The President's Commission on Industrial Competitiveness, GLOBAL COMPETITION: THE NEW REALITY, Volume II (Washington, DC: USGPO, January 1985), especially pp. 1ff. and 169ff.

[6]The stress here is on the direct contributions subnational jurisdictions to emphasize the explicit link between subnational activities and this particular industrial policy goal. Of course, it can be argued that states and localities contribute indirectly to the improvement of U.S. international competitiveness through many of their economic development programs; however, direct efforts more clearly reflect the intentions of subnational policymakers regarding their roles in promoting American world trade.

[7]See symposium on "Federated States and International Relations," in PUBLIUS, 14, no. 4 (Fall 1985).

[8]John M. Kline, STATE GOVERNMENT INFLUENCE IN U.S. INTERNATIONAL ECONOMIC POLICY (Lexington, MA: Lexington Books/D.C. Heath, 1983), p. 2.

[9]On the role of government as an obstacle to resource mobility, see Murray L. Weidenbaum, THE FUTURE OF BUSINESS REGULATION: PRIVATE ACTION AND PUBLIC DEMAND (New York: Amacom, 1980); on the impact of labor, see papers by Richard B. Freeman, John T. Dunlop, and R. F. Schubert in THE AMERICAN ECONOMY IN TRANSITION, edited by Martin Feldstein (Chicago, IL: The University of Chicago Press/NBER, 1980), pp. 349 ff.; and on the role of management, see William J. Abernathy, Kim B. Clark, and Alan M. Kantrow, INDUSTRIAL RENAISSANCE: PRODUCING A COMPETITIVE FUTURE FOR AMERICA (New York: Basic Books, Inc., 1983).

[10]On the absurdity of the competition, consider the almost circus-like atmosphere the surrounded state and local efforts to attract GM's new Saturn Division plant. On the scandalous nature of the competition, see Robert Goodman's THE LAST ENTREPRENEURS: AMERICA'S REGIONAL WARS FOR JOBS AND DOLLARS (Boston, MA: South End Press, 1979).

[11]For a general overview, see Lawrence Litvak and Belden Daniels, "Innovations in Development Finance," in FINANCING STATE AND LOCAL ECONOMIC DEVELOPMENT, edited by Michael Barker (Durham, NC: Duke University Press, 1983), pp. 19-27.

[12]For example, see Litvak and Daniels, pp. 19-27; Daryl A. Hellman, Gregory H. Wassall, and Laurence H. Falk, STATE FINANCIAL INCENTIVES TO INDUSTRY (Lexington, Mass.: Lexington Books/D.C. Heath, 1976), p. 41; Roger J. Vaughan, "State Taxation and Economic Development" in STATE TAXATION POLICY, edited by Michael Barker (Durham, NC: Duke University Press, 1983); and Michael Kierschnick, "Taxes and Growth: Business Incentives and Economic Development," in Barker (ed.), STATE TAXATION POLICY, esp. pp. 216-235.

[13]Litvak and Daniels, pp. 3-9; Vaughan, pp. 13-25.

[14]See U.S. Congress, LOCATION OF HIGH TECHNOLOGY FIRMS AND REGIONAL ECONOMIC DEVELOPMENT, Staff Study, 97th Congress, 2d session, 1 June 1982, p. 26.

[15]Susan B. Hansen, "The Effects of State Industrial Policies on Economic Growth," paper presented at the annual meeting of the American Political Science Association, Washington DC, September 1984.

[16]We have discovered only one study that examines the economic viability of such an approach. See David W. Rasmussen and Larry C. Ledebur, "The Role of State Economic Development Programs In National Industry Policy," POLICY STUDIES REVIEW, 2, no. 4 (May 1983): 750-761.

[17]See Schultze, "Industrial Policy: A Dissent."

[18]See Chapter 6 in Alice Rivlin (ed.), ECONOMIC CHOICES 1984 (Washington, DC: The Brookings Institution, 1984), esp. the statement of "policy criteria" on p. 135.

[19]Barry Bluestone and Bennett Harrison, THE DEINDUSTRIALIZATION OF AMERICA: PLANT CLOSING, COMMUNITY ABANDONMENT, AND THE DISMANTLING OF INDUSTRY (New York: Basic Books, 1982), p. 21.

[20]See John Zysman, GOVERNMENTS, MARKETS, AND GROWTH: FINANCIAL SYSTEMS AND THE POLITICS OF INDUSTRIAL CHANGE (Ithaca, NY: Cornell University Press, 1983), p. 266.

[21]See Bluestone and Harrison, THE DEINDUSTRIALIZATION OF AMERICA; also Gene F. Summers (ed.), "Deindustrialization: Restructuring the Economy," THE ANNALS, AAPSS, 475 (September 1984).

[22]Gar Alperovitz and Jeff Faux, REBUILDING AMERICA (New York: Pantheon Books, 1984), p. 276. On the concept of "mediating structures," see Peter L. Berger and Richard John Neuhaus, TO EMPOWER PEOPLE: THE ROLE OF MEDIATING STRUCTURES IN PUBLIC POLICY (Washington, DC: American Enterprise Institute for Public Policy Research, 1977).

[23]Ruth Fedrau, "Responses to Plant Closures and Major Reductions in Force: Private Sector and Community-based Models," THE ANNALS, AAPSS, 475 (September 1984): 80-95.

[24]See Dubnick and Holt, "Industrial Policy and the States."

[25]See especially Gerald D. Nash, STATE GOVERNMENT AND ECONOMIC DEVELOPMENT: A HISTORY OF ADMINISTRATIVE POLICIES IN CALIFORNIA, 1849-1933 (Berkeley, CA: University of California Institute of Governmental Studies, 1964).

[26]"The Fifty Legislative Climates," INDUSTRIAL DEVELOPMENT, (January/February, 1984), pp.4-29. Also see William Hamilton, Larry Ledebur, and Dorothy Matz, INDUSTRIAL INCENTIVES: PUBLIC PROMOTION OF PRIVATE ENTERPRISE (Washington, DC: Aslan Press, 1984).

[27]Kansas Legislative Research Department, 1985-1986 APPROPRIATIONS REPORT, pp. 2-7.

[28]See Robert J. Reinschuttle, ECONOMIC DEVELOPMENT: A SURVEY OF STATE ACTIVITIES (Lexington, Kentucky: The Council of State Governments, 1983) for a detailed survey of the activities offered by state economic development organizations.

[29]Hamilton, Ledebur, and Matz, INDUSTRIAL INCENTIVES.

[30] Theodore J. Lowi, among others, has attempted to explain why liberal governments cannot plan. See THE END OF LIBERALISM: THE SECOND REPUBLIC OF THE UNITED STATES (New York: W. W. Norton and Co., 1979), Part II. For evidence backing that view, see Nash, STATE GOVERNMENT AND ECONOMIC DEVELOPMENT.

[31]Peter W. Bernstein, "A Taxing War on Sticky-Fingered States," FORTUNE, June 25, 1984, p. 113. Also see STATE LEGISLATURES, 10, no. 9 (October 1984), 10. Then Treasury Secretary Donald Regan threatened to abolish the unitary tax if states fail to modify their current unitary taxation practices by July 31, 1985. States oppose Regan's position, claiming that it violates their taxing authority.

[32]U.S. Congress, Joint Economic Committee, INDUSTRIAL POLICY, ECONOMIC GROWTH AND THE COMPETITIVENESS OF U.S. INDUSTRY, 98th Congress, 1 session, pt. 2, July 13-20, 1983, p. 133.

[33]Ibid.

[34]See U.S. Congress, Joint Economic Committee, LOCATION OF HIGH TECHNOLOGY FIRMS AND REGIONAL ECONOMIC DEVELOPMENT, Staff Study, 97th Congress, 2d session, June 1, 1982, p. 16. The Joint Economic Committee conducted a survey of high-tech companies in the U.S. during the period, October 1981 to May 1982 and discovered that high-tech companies are "foot-loose" and do not consider factors, such as the access to raw materials, markets, and transportation to be important

in siting decisions. Nor are water resources, energy supplies, and climate considered to be important factors.

[35] Ruth Knack, "States Dangle Incentives, Foreign Automakers Bite," PLANNING, 49, no. 4 (April 1983), 21.

[36] Phyllis Feinberg, "Site Selection: Wooing the Corporate Customer," INSTITUTIONAL INVESTOR, 15, no. 5 (May 1981), 190-191.

[37] The examples of Ohio's and South Carolina's incentives were extracted from "Tax Cuts--and More--To Woo Businesses," U.S. NEWS AND WORLD REPORT, February 8, 1982, pp. 67-68. The example of Wacker Siltronic comes from Kline, STATE GOVERNMENT INFLUENCE IN U.S. INTERNATIONAL ECONOMIC POLICY, pp. 67-68.

[38] THE BOOK OF THE STATES, 1984-85 (Lexington, Ky: The Council of State Governments, 1984), p. 441.

[39] Peter W. Bernstein, "States Are Going Down Industrial Policy Lane," FORTUNE, March 5, 1984, p. 112.

[40] See Bruce Babbitt, "The States and the Reindustrialization of America," pp. 91-92.

[41] See Congressional Budget Office, THE FEDERAL ROLE IN STATE INDUSTRIAL DEVELOPMENT, July 1984, p. 34.

[42] See Bruce Babbitt, "The States and the Reindustrialization of America," p. 87.

[43] Eric Elbot, "Bay State Trains for Growth Industries," STATE GOVERNMENT NEWS, August 1983, pp. 7-8.

[44] "Rhode Island Votes on Greenhouse Compact," STATE GOVERNMENT NEWS, June 1984, p. 17.

[45] John E. Seley, "Targeting Economic Development: An Examination of the Needs of Small Business," ECONOMIC GEOGRAPHY, 57, no. 1 (January 1981), p. 36.

[46] Ibid, p. 50.

[47]Joann S. Lublin, "Development Aid from States is a Growing Factor for Firms," THE WALL STREET JOURNAL, 8 October 1984, p. 29.

[48]See Congressional Budget Office, THE FEDERAL ROLE IN STATE INDUSTRIAL DEVELOPMENT PROGRAMS, p. 19.

[48a]See Jack L. Walker, "The Diffusion of Innovations Among the American States," AMERICAN POLITICAL SCIENCE REVIEW, 63, no. 3 (September, 1969): 880-899.

[49]See comments in John Shannon and Bruce D. McDowell, "Interstate Competition for Industry," paper prepared for delivery at this panel session, especially pp. 13-14.

[50]Mel Dubnick and Alan R. Gitelson, "Nationalizing State Policies," in THE NATIONALIZATION OF STATE GOVERNMENT, edited by Jerome J. Hanus (Lexington, MA: Lexington Books, 1984), pp. 39-74.

[51]Dubnick and Holt, "Industrial Policy and the States," pp. 113-114.

[52]Shannon and McDowell, p. 14.

[53]See Hamilton, Ledebur, and Matz, INDUSTRIAL INCENTIVES, Chapter 4; also Shannon and McDowell, pp. 4-7.

[54]See Advisory Commission on Intergovernmental Relations, SIGNIFICANT FEATURES OF FISCAL FEDERALISM, 1984 EDITION, Report M-141 (Washington, DC: USGPO, 1985), pp. 22-23.

[55]For more background on the issues surrounding patterns of federal spending, see Robert Jay Dilger, THE SUNBELT/SNOWBELT CONTROVERSY: THE WAR OVER FEDERAL FUNDS (New York: New York University Press, 1982).

[56]For a survey of this aspect of IGR, see Advisory Commission on Intergovernmental Relations, REGULATORY FEDERALISM: POLICY, PROCESS, IMPACT AND REFORM, Report A-95 (Washington, DC: USGPO, 1984). Also see Dubnick and Gitelson, "Nationalizing State Policies."

[57]On potential strategies for dealing with regulatory federalism, see Donald F. Kettl, THE REGULATION OF AMERICAN FEDERALISM (Baton Rouge, LA: Louisiana State University Press, 1983), Chapter 8.

[58]See Martha Derthick, BETWEEN STATE AND NATION: REGIONAL

ORGANIZATIONS OF THE UNITED STATES (Washington, DC: The Brookings Institution, 1974).

[59]See Michael Bell and Paul S. Lande, "Industrial and Regional Development Policies: An Overview," in REGIONAL DIMENSIONS OF INDUSTRIAL POLICY, edited by Bell and Lande (Lexington, MA: Lexington Books/D.C. Heath and Co., 1983), p. 17.

[60]U.S. Congress, Joint Economic Committee, INDUSTRIAL POLICY MOVEMENT IN THE UNITED STATES: IS IT THE ANSWER?, 98th Congress, 2d session, June 8, 1984, pp. 55-57.