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Industrial Policy and the States

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The emergence of industrial policy proposals on the national scene raises the prospect of a greater role for the states in American economic policy. Four types of industrial policy proposals are described, each representing a distinctive strategic orientation. After describing the implied role of states in each type, we argue that state involvement is politically necessary if any proposal is to succeed in the national policymaking arena. We assess the four strategic proposals in light of that contention and conclude that two of the approaches—infrastructure investment and subnational jurisdiction proposals—have an advantage over the better known trade policy and sectoral targeting strategies.

Until recently, state officials could consider the ongoing debate over American economic policy as a spectator sport. It had been almost half a century since states played any significant role in national economic policy discussions. The Keynesian “fiscal revolution”¹ had succeeded in restricting economic policymaking to the national arena where macroeconomic approaches could be managed and manipulated rather easily. If states played any role in the Keynesian economic regime, it was that of victim. “At the Federal level,” observed Walter W. Heller, “economic growth and a powerful tax system, interacting under modern fiscal management, generate new revenues faster than they generate new demands on the Federal purse. But at the state-local level, the situation is reversed. Under the whiplash of prosperity, responsibilities are outstripping revenues.”²

Nor have the states fared any better in the economic policy approaches advocated by supply-side economists³ and adopted by the Reagan administration. Although, under the administration’s “de facto new federalism”⁴ states are playing a greater role in most domestic policy arenas, their participation in the extremely important arena of economic policy

¹See Herbert Stein, *The Fiscal Revolution in America* (Chicago: University of Chicago Press, 1969).

²Walter W. Heller, *New Dimensions of Political Economy* (New York: W.W. Norton, 1967), p. 118.

³George Gilder, *Wealth and Poverty* (New York: Basic Books, 1981).

⁴S. Kenneth Howard, “De Facto New Federalism,” *Intergovernmental Perspective* 10 (Winter 1984): 4.

remains peripheral at best.

However, the recent emergence of national industrial policy proposals might lead to substantial changes in the states' situation. While differing somewhat in their details, the major proposals now being discussed are all based on the idea of dealing with current economic problems through the direct application of microeconomic policies that focus on the development or revitalization of specific sectors of the American economy. We argue that a more central role for state governments in economic policymaking is implied in this proposed shift from macroeconomic to microeconomic techniques. Specifically, state involvement in a national industrial policy program is more than technically viable and strategically desirable. Providing the states with a major role in the formulation of industrial policy is likely to be a political necessity.

In light of these observations, it is surprising that the role of states is rarely addressed explicitly in the current debate over national industrial policy. Therefore, before examining the grounds for state involvement in industrial policymaking, we will survey the growing literature which addresses the debate in order to understand the authors' relative indifference to state efforts and to establish a less ambiguous picture of industrial policy as an alternative to the Keynesian and supply-side paradigms.

WHAT IS INDUSTRIAL POLICY?

A first approach toward a better understanding of industrial policy would be to posit a clear definition of the idea. Defining industrial policy is no simple task, however. In fact, the search for such a definition raises more questions than it resolves. Specifically, in order to define industrial policy, one must deal with two basic issues: (1) whether industrial policymaking involves intent on the part of policymakers, and (2) whether it includes passive as well as active forms of policy efforts.

Regarding policymaker intentions, Robert B. Reich, one of the leading advocates of industrial policy strategies, argues that the existence of industrial policy does not necessarily depend on an explicit awareness exhibited by public officials. "A nation's industrial policy," he states, "is the sum of its microeconomic policies—like tax rules, research and development grants, credit subsidies, and import restrictions—as they affect the pace and direction of industrial change."⁵ Basing his critique of American economic policy on this definition, Reich is able to argue that the problem is not the lack of an industrial policy in the United States, but rather the absence of a coherent and consciously designed program. "Our industrial policy lies buried, and the choices it embodies are never clearly posed."⁶

⁵Robert B. Reich, "An industrial policy of the right," *The Public Interest* 73 (Fall 1983): 3.

⁶*Ibid.*, 8. Also see Ira C. Magaziner and Reich, *Minding America's Business: The Decline and Rise of the American Economy* (New York: Vintage, 1982), pp. 4–6; and Reich's *The Next American Frontier* (New York: Penguin, 1983).

In contrast to Reich, Barry Bluestone offers a definition which is quite clear on the matter of policymaker intentions.

Industrial policy is *the coherent and planned use of government tax, subsidy, procurement and capital instruments to encourage investment and disinvestment in a manner consistent with growth and the minimization of the social costs of industrial transformation and dislocation. It is the use of already existing government instruments in a new form to modify the timing and velocity of capital investment and disinvestment.*⁷

For Bluestone it is the “coherent and planned use” of various policy mechanisms which creates industrial policy, and not merely the objective consequences of those policies (i.e., their impact on the “pace and direction of industrial change”). Thus, while Bluestone and Reich agree that industrial policy involves the use of microeconomic instruments, they disagree on the level of policymaker consciousness needed in order to declare that an industrial policy actually exists.

Implied in both Reich’s and Bluestone’s definitions is a second common ground between the two, namely, the view that industrial policy involves *active* government pursuit of policy objectives. However, here too there exists some disagreement among industrial policy proponents. Some argue that industrial policy can be a passive as well as an active policy undertaking. For example, Arthur Levitt, Jr., head of the American Stock Exchange, regards industrial policy as the creation and maintenance of a “climate within which entrepreneurship can flourish.” As such, a national industrial policy program “should concentrate . . . on eliminating obstacles—at home and abroad—to real growth in our economy.” Not surprisingly, Levitt’s version of industrial policy includes such policy prescriptions as lowered federal budget deficits, reduction of equity and corporate taxation, deregulation, and similar steps to reduce or eliminate government activity.⁸ If there actually exists a Reagan administration industrial policy, or if there could be one reflecting the ideological views of its leadership, it would likely be passive and based on a withdrawal of government from economic arenas as a means for facilitating industrial growth.

Disagreements regarding the nature of policymaker intentions and policy passivity merely indicate the ambiguities that currently plague discussions about industrial policy. Just as there are disagreements over the definition of industrial policy, there is also no consensus regarding the strategies most

⁷Barry Bluestone, Speech delivered at LTV Forum on *Basic Industries in Trouble: Why . . . and Are There Solutions?* (Dallas, Tex.: The LTV Corporation, 1983), p. 25. Also see Bluestone and Bennett Harrison, *The Deindustrialization of America: Plant Closings, Community Abandonment, and the Dismantling of Basic Industry* (New York: Basic Books, 1982).

⁸Arthur Levitt, Jr., “Industrial policy: slogan or solution?” *Harvard Business Review* 62 (March/April 1984): 6–8. Also see, Committee for Economic Development, *Strategy For U.S. Industrial Competitiveness: A Statement By the Research and Policy Committee* (New York: Committee for Economic Development, 1984) and Peter F. Drucker, “Our entrepreneurial economy,” *Harvard Business Review* 62 (January/February 1984): 59–64.

appropriate for an effective national industrial policy program. The issue of a role for states in industrial policymaking needs to be addressed in the context of the various strategic approaches that are advocated by major proponents.

INDUSTRIAL POLICY STRATEGIES

For present purposes we will adopt a view that assumes industrial policy to be inherently both intentional and active, in essence agreeing with the main tenets of Bluestone's definition. From among the many industrial policy proposals that meet those minimal criteria, four general types are distinguishable based on strategic differences. These include industrial policy programs that emphasize (a) trade policy, (b) sectoral targeting, (c) infrastructure investment, and (d) subnational jurisdiction competition.⁹

Trade Policy

Trade strategies include those proposals that give priority to the competitive position of the United States in the world economy. The central assumption of this approach is that America's current economic malaise is due to two interrelated developments: the internationalization of the American economy, and the country's failure to meet the competitive challenges of the advancing industrial nations of East Asia and Western Europe.

The economy's internationalization is evidenced by America's growing trade deficits, particularly in fuels and lubricants, automotive products, and consumer goods.¹⁰ That the United States is at a critical comparative disadvantage in world trade is a more debatable assumption.¹¹ Nevertheless, the view that the United States is competitively disadvantaged in world trade remains a key premise for advocates of a trade policy strategy.¹² While one response is to argue for policies that seek an end to America's growing interdependence in the world economy, the more common response is to advocate an industrial policy that lives up to the world trade challenge.

Strategically, the advocates of the trade policy approach believe that the United States cannot meet the international market challenge effectively unless it adopts an industrial policy that focuses all its efforts—domestic as well as foreign—on that primary objective. "We cannot achieve long-term

⁹Compare with typology offered in "Industrial Policy: Is It The Answer?" *Business Week*, 4 July 1983, pp. 55–57.

¹⁰See William H. Branson, "Trends in United States International Trade and Investment Since World War II," *The American Economy in Transition*, ed. Martin Feldstein (Chicago: University of Chicago Press, 1980), pp. 208–211.

¹¹*Ibid.*; also Branson, "The Myth of Deindustrialization," *Regulation* 7 (September/October 1983): 24–29, 53–54; Robert Z. Lawrence, *Can America Compete?* (Washington, D.C.: Brookings, 1984).

¹²See Bruce R. Scott, "National strategy for stronger U.S. competitiveness," *Harvard Business Review* 62 (March/April 1984): 77–91.

economic recovery,” argues Bruce R. Scott, “as long as U.S. policy focuses on short-term consumer welfare and on the entitlements and subsidies of a welfare state.”¹³ It follows that there must be a cohesiveness in trade policy and *all related endeavors*. This will be achieved, in part, through a formal centralization of trade policy in a “governmental body capable of formulating a reliable and effective strategy for the United States in the world economy.”¹⁴ But it will also involve the mobilization of other economic and social programs that will help the United States to compete internationally. “If we have a lesson to learn” from Japan and other competitors,

it is that all sectors of public policy must be integrated with one another and not compartmentalized. We tend to treat social welfare policy, with its concern for the unemployed and underprivileged, as though it were in conflict with industrial policy, with its concern for profits and investments. Industrial strength is the basis upon which rests a nation’s ability to provide for its needy.¹⁵

From this perspective, domestic economic and social policies are not only relevant to industrial policy, they are an inseparable part of the governmental world trade strategy.

Sectoral Targeting

Sectoral targeting strategies simultaneously complement and differ from trade policy approaches. They involve efforts to concentrate industrial policy resources and incentives on particular industries or regions which are perceived to be worthy of attention. Under a trade policy approach, the government would target only those industrial sectors which enhance America’s competitive advantage in the world economy.¹⁶ It is in this context that Japan’s Ministry of International Trade and Industry (MITI) is often posited as a model for American industrial policy.¹⁷ However, sectoral targeting would be stressed in those cases where the primary objective of industrial policy is *not* related to world trade, but rather to promote growth, revitalize troubled industries, or offset the negative consequences of industrial decline.

Sectoral targeting has often been described as a process of selecting

¹³Bruce R. Scott, “Can industry survive the welfare state?” *Harvard Business Review* 60 (September/October 1982): 82.

¹⁴George Cabot Lodge and William R. Glass, “U.S. trade policy needs one voice,” *Harvard Business Review* 61 (May/June 1983): 77.

¹⁵Roy Hofheinz, Jr. and Kent E. Calder, *The Eastasia Edge* (New York: Basic Books, 1982), pp. 237–238.

¹⁶See Scott, “Can industry survive the welfare state?” and Scott, “National strategy for stronger U.S. competitiveness.”

¹⁷The role and real impact of MITI in the Japanese economy is both widely discussed and hotly debated. For example, compare the views of Hofheinz and Calder, *The Eastasia Edge*; George Gilder, “A Supply-side economics of the Left,” *The Public Interest* 72 (Summer 1983): 29–43; Charles L. Schultze, “Industrial Policy: A Dissent,” *The Brookings Review* 2 (Fall 1983): 3–12, esp. 6–7; and Philip H. Trezise, “Industrial Policy in Japan,” *Industrial Revitalization: Toward a National Industrial Policy*, ed. Margaret E. Dewar (New York: Pergamon, 1982), pp. 177–195.

industrial winners and losers with the underlying assumption that government is technically and politically capable of making such choices in the public's interest. According to advocates of sectoral targeting, America's economic problems are both structural and strategic. Structurally, the economy is viewed as an arrangement of industrial sectors, some in a state of decline and some with untapped potential for growth.¹⁸ Strategically, there are two ways of dealing with declining and growing industries other than by merely ignoring them.

Declining industries can be treated by means of government policies that assist workers with retraining and relocation, subsidize new business development in adversely affected regions, and help firms salvage the portions of the declining industry that eventually could become competitive on its own. Government can also adopt protectionist policies aimed at those imports which threaten to undermine the declining industry.¹⁹

Regarding growth industries, the government can help them reduce their short-term capital and labor costs by funding research, subsidizing high risk investments, helping in the development of foreign markets, and underwriting educational and training programs. Alternatively, "a nation can forego a consciously constructed policy and allow its promotional policies to be shaped by politically powerful businesses and geographic regions and by the necessities of its defense programs." This second approach, state Magaziner and Reich, "results in a hodgepodge of subsidies, loan guarantees, tax expenditures, and procurement contracts."²⁰

Historically, the U.S. government has relied on businesses to dictate policies with respect to both declining and growing industries.²¹ Prescriptively, however, sectoral targeting advocates prefer, in each situation, the first approach which places greater emphasis on a coherent national policy.²²

In programmatic terms, sectoral targeting advocates are very pragmatic. There are no specific policy mechanisms to be favored, for any tool running the gamut from tax breaks to worker ownership of plants to centralized planning and administration may prove useful.

Infrastructure Investment

Advocates of infrastructure investment assume that the health and vitality of industrial life in America depend on certain basic conditions which, if allowed to deteriorate or disappear, would generate economic crises. Amitai Etzioni, for example, suggests the existence of "seven elements of industrialization" that "made for an affluent America": "transportation of resources and goods; communication of knowledge and signals; secure

¹⁸Magaziner and Reich, *Minding America's Business*, pp. 197-234.

¹⁹Ibid., pp. 198-199.

²⁰Ibid., pp. 199-200.

²¹See Dewar, ed., *Industrial Revitalization*.

²²See Magaziner and Reich, *Minding America's Business*; also Bluestone and Harrison, *The Deindustrialization of America*.

supplies of *power*; *human capital* . . . ; *innovative capacity*; *supportive legal/financial institutions*; and the accumulation of *capital goods*.”²³

What happened to the U.S. economic machine which once provided for the richest and most powerful nation in the world? As I see it, a generation of underinvestment in the seven elements of industrialization, in the infrastructure and capital goods sectors, coupled with a generation of overconsumption, threw the U.S. economy into reverse gear.²⁴

In order to correct for a generation of misguided infrastructure investment patterns, Etzioni prescribes a “semitargeted reindustrialization” policy that diverts resources from both public and private consumption and redirects them for investment in those seven crucial areas so as to enhance the economy’s overall productivity.²⁵

Also included in this category are industrial policy proposals for new financial institutions (e.g., a Reconstruction Finance Corporation or National Industrial Development Bank) that would make “patient capital” more readily available to those in the private sector wishing to undertake promising risks which other sources of capital funding tend to avoid. Again, the idea is for the entrepreneur to work with government, not for it; the key decisions and ideas under these proposals are from the private sector. The government provides the fundamental institutional arrangements and facilitating environments within which industrial investment can and will occur.

Thus, infrastructure investment strategies attempt to be more facilitative than determinative in their effects. In this sense, the approach is related to several passive industrial policy proposals which call for the elimination of government obstacles to business activity while advocating public sector efforts to structure an environment favorable to industrial development.²⁶ However, in creating the appropriate environment to facilitate business transactions, infrastructure investment strategies require a somewhat more active and committed government involvement in the use of tax expenditures, subsidies, and other microeconomic policy tools.

Subnational Jurisdiction

Subnational jurisdiction strategies are less widely debated, but they are perhaps the proposals that come closest to current policy arrangements. If the United States does have an industrial policy, it appears to take the form of state and local competition for industry and other businesses. Through economic development planning and related policies (e.g., industrial revenue bonds, loan guarantees, worker training programs) state and local jurisdic-

²³Amitai Etzioni, *An Immodest Agenda: Rebuilding America Before the 21st Century* (New York: McGraw-Hill, 1983), chapter 8, esp. p. 193.

²⁴*Ibid.*, p. 211.

²⁵*Ibid.*, chapter 13, esp. pp. 315–316.

²⁶Amar Bhidé, “Beyond Keynes: demand-side economics,” *Harvard Business Review* 61 (July/August 1983): 100–110.

tions have been offering numerous options for private sector companies.²⁷ It is the conscious and systematic harnessing of state and local efforts through national policies that constitutes subnational jurisdiction approaches.

Underlying these industrial policy proposals is the premise that the form and direction of state and local economic development programs can be significantly influenced by federal policies.²⁸ Under numerous industrial development plans, state and local governments explicitly intervene in several production and distribution factors considered central to the success of businesses: markets, transportation, land, energy, capital, and various amenities.²⁹ To the extent that such interventions can be controlled or manipulated by federal policies, it is possible to fashion a national industrial policy based on state and local programs. Competition among states for certain industries may be strengthened or weakened; the design of local subsidy programs can also be shaped by federal tax codes or securities laws. For example, the availability and size of federal aid to local governments can be based on a jurisdiction's willingness to establish and maintain enterprise zones or to develop and enforce federally acceptable land use policies.³⁰ Similarly, some have argued that federal policies and programs originally designed to provide relief to economically depressed and distressed regions should be modified to emphasize the objectives of "promoting economic efficiency and growth in the national economy."³¹

From the perspective of a national industrial policy, the approaches advocated under this strategy are indirect means for accomplishing policy objectives because they are based on restructuring the environment of decision-makers in industry rather than on taking direct federal action. However, these strategies depend on direct government actions by state and local jurisdictions. Proponents of these methods note that the foundation for such approaches is already in place and might prove to be the easiest path toward the construction of a national policy. Thus, this category of industrial policy proposals cannot be ignored despite its relative obscurity compared to that of the other three strategies.

INDUSTRIAL POLICY ROLES FOR THE STATES

As national policies, the four approaches to industrial policy explicitly or

²⁷See Robert Goodman, *The Last Entrepreneurs: America's Regional Wars for Jobs and Dollars* (Boston: South End, 1979).

²⁸Lawrence Litvak and Belden Daniels, "Innovations In Development Finance," *Financing State and Local Economic Development*, ed. Michael Barker (Durham, N.C.: Duke University Press, 1981), pp. 7-9.

²⁹Robert J. Vaughan, "State Taxation and Economic Development," *State Taxation Policy*, ed. Michael Barker (Durham, N.C.: Duke University Press, 1983), pp. 13-25.

³⁰Robert J. Vaughan, "Federal Policy and State and Local Fiscal Conditions," *The Urban Impacts of Federal Policies*, ed. Norman J. Glickman (Baltimore, Md.: Johns Hopkins University Press, 1980), pp. 483-489.

³¹Michael E. Bell and Paul S. Lande, "Industrial and Regional Development Policies: An Overview," *Regional Dimensions of Industrial Policy*, eds. Michael E. Bell and Paul S. Lande (Lexington, Mass.: Lexington Books, 1982), p. 12.

implicitly address the role of the states in the programs being advocated. In this section, we examine and assess the roles assigned to states under each strategy.

Trade Policy and the States

If one values a major and relatively autonomous role for states in a national industrial policy, the prospect of a strategy based on the trade policy approach cannot be regarded in a positive light. The bias toward policy centralization, were this strategy adopted, implies a considerable loss of independence for American states not only in the arena of economic development, but also in the provision of social services and welfare.

Trade policy advocates emphasize policy cohesiveness and coordination, particularly in the area of world trade. This strategy generally requires the creation of a centralized policymaking process to deal with America's international trade. Implied in such an approach is a need to curtail state activities that might interfere either directly or indirectly with that centralized effort. Thus, state-sponsored trade missions to Asia, Latin America, or Europe led by governors or other public officials might be eliminated, or might need special clearance through a federal trade agency. Direct or indirect state activities that might be interpreted as subsidies to a particular industry would be permitted (if at all) only if they complemented decisions and choices made by national policymakers. In short, promotional economic activity by the states could very well be curtailed or subsumed under the overall national effort.

An even more important factor in the advocates' support of trade policy strategies is their belief that America's inability to compete in international markets is due in part to an "overindulgence in the welfare state."³² Despite popular images to the contrary, the federal government is not the only source of welfare state policies and programs. States and localities also provide varying levels of support for the indigent and needy. Similarly, other forms of relief for wage earners and even middle class citizens are important dimensions of public policy in many states. Efforts to control or tie the welfare system to trade policy programs—a link that is central to the arguments of such proponents as Bruce R. Scott³³—also means tying states to the national industrial policy effort. Thus, in social policies as well as in economic development, the states by necessity and mandate must defer completely to a national program either through the implementation of complementary policies or through preemption by federal officials.

It is therefore understandable that advocates of trade policy approaches rarely mention the states in their proposals. The very nature of these strategies means that the diversity of policies and other incentives provided by state and local governments could not be tolerated. Nor would it be acceptable

³²Scott, "National strategy for stronger U.S. competitiveness," p. 90.

³³Ibid; also Scott, "Can industry survive the welfare state?"

to continue state and local programs that might negate the potential impact of a truly comprehensive industrial policy scenario, especially one that seeks the reinstatement of the United States to its previous status in the world economy.

Sectoral Targeting Approaches

As with trade policy approaches, centralization is also the proposed norm for sectoral targeting strategies. The key difference between the two is based in the sectoral targeting strategy's greater concern for domestic and social goals. The somewhat myopic focus of trade policy advocates on regaining America's competitive edge in world markets is replaced with references to economic equity³⁴ and investments in human capital³⁵ which are deemed essential to America's long-term industrial health.

To accomplish these ends, several proponents of sectoral targeting strategies call for the creation of "a national bargaining arena for allocating the burdens and benefits of major adjustment strategies." They believe that

Such an arena would enable the nation to achieve a broad-based consensus about adjustment. It would enable government, business, and labor to fashion explicit agreements to restructure America's industry. . . . Perhaps most important, the *single arena* could provide a focus for an ongoing national debate about human capital investment and the appropriate allocation of the gains and losses from such change.³⁶

According to Reich, the tools used in implementing industrial policy programs developed in this arena would be "supple" rather than "blunt"—restructuring agreements rather than bailouts, training and employment vouchers rather than "prayerful macroeconomics," and so on. Implied in these mechanisms are approaches involving direct relationships between the national policymaking body and the targeted sectors.

What role might the states play in these relationships? Actually, very little according to the most vociferous advocates of sectoral targeting. National industrial policy would be implemented through trade associations and member businesses, national unions and their locals, and industrial firms and the communities which surround them. This would be true for both the economic and social dimensions of the national effort: "Business enterprises . . . will largely replace geographic jurisdictions as conduits of government support for economic and human development," states Reich. "Companies, rather than state and local government, will be the agents and intermediaries through which such assistance is provided. As a result, economic development programs and social services will be closely linked."³⁷ In their

³⁴Lester C. Thurow, *The Zero-Sum Society: Distribution and the Possibilities for Economic Change* (New York: Penguin, 1980), p. 194.

³⁵Reich, *The Next American Frontier*, pp. 246–251.

³⁶*Ibid.*, p. 276; emphasis added.

³⁷*Ibid.*, p. 248.

discussion of reindustrialization policies, Bluestone and Harrison point quite favorably to worker and community ownership, but they do not indicate any significant role for state and local governments. In fact, they are even critical of current economic policies and actions of states and localities, particularly in the Sunbelt and Snowbelt regions.³⁸

Given this low level of trust in state governments, it is not surprising that these government jurisdictions are provided with almost no role in sectoral targeting strategies. Investment and disinvestment decisions would be made by national policymaking institutions representing major sectors of the American economy. In addition, Reich and other sectoral targeting advocates would authorize those bodies to formulate and implement social welfare policies and programs viewed as relevant to a comprehensive national industrial policy effort. Carried to its logical extreme, such a strategy might render state governments administratively irrelevant and, for the most part, mere legal formalities that do nothing more than promulgate basic law enforcement duties. As with trade policy approaches, the policy effectiveness of states under sectoral targeting strategies would be questionable.

Infrastructure Investment Strategies

Although a bias toward centralization is implied in the trade policy and sectoral targeting strategies, decentralization seems characteristic of the two remaining approaches. Infrastructure investment strategies, particularly those posited by Etzioni, explicitly avoid any direct government intervention in private sector decisions. As noted above, these strategies are facilitative rather than determinative, and thus operate without any central coordinating body. Proponents of this approach are usually highly critical of Japan's experience under MITI in the post-World War II era or the likelihood that the Japanese model could be transferred to the United States. Instead, they tend to see a multiplicity of loosely related, functionally specialized decisionmaking units as desirable, thus providing a bias toward reliance on the "guided" (as opposed to "directed") marketplace and/or administrative decentralization.

Given such assumptions, the states might play a significant role. As channels through which public funds and national policies can pass, states could provide national industrial policy decisionmakers with some interesting avenues for implementation which, for the most part, are already in place. Obviously, there can be investments in infrastructure items which are traditionally provided, in large part, by states and localities (e.g., highways, water treatment facilities). In addition, through a variety of mandates and conditional grants-in-aid, the federal government could promote needed changes in a state's regulation of utilities or financial institutions. Changes in tax codes and securities laws have potential intergovernmental impacts as well. They too can be used to bring about shifts in state policies that will generate more or less investment in "semitargeted" areas.

³⁸Bluestone and Harrison, *The Deindustrialization of America*, pp. 180-188.

While states can play a major role in infrastructure investment strategies, such a national industrial policy approach can avoid making use of subnational jurisdictions if designed to do so. Put briefly, infrastructure investment approaches are not necessarily dependent on either states or localities. While subnational jurisdictions may prove to be convenient options for implementing a national infrastructure investment strategy, alternative mechanisms are available. For example, instead of pursuing adjustments in the state regulation of banks in order to generate more funds for promising but risky ventures, the federal government could create a Reconstruction Finance Corporation or similar institution to lend such money on a nationwide basis. Similarly, the national government could offer loan guarantees or special training programs in lieu of state programs.

Of course, the decision to use or not to use subnational mechanisms would be an important one, and it is unlikely that advocates of this approach would leave that either to chance or to the choices of political leaders. Given the current level of state involvement in economic development and related endeavors, there probably exists considerable incentive to use subnational units for any infrastructure investment scheme. However, implied in the work of Etzioni and others who take this approach is the need to design the institutional arrangements for infrastructure investments in a "rational" manner.³⁹ This, in turn, seems to indicate that the logic of "fiscal federalism"⁴⁰ would be most relevant in the sense that the specific roles of the states would be determined through an analysis of what particular functions are appropriately performed by the different planes of government.

Subnational Jurisdiction Strategies

By definition, the proposals in this category are clearly dependent on active state and local involvement. Subnational jurisdictions are significantly involved in economic and industrial development. Despite variations in the degree of involvement, there is hardly an aspect of the industrial process or commerce in general that is not somehow influenced by some state or local program. In subnational jurisdiction approaches, national policymakers recognize that fact and build upon it.⁴¹

What is important to understand about this approach is what it means for the relationship between national and state governments. The present level of economic development activity among the states is due in great part to their autonomy and to an interstate competitiveness that increases during times of economic stress. Because of the Keynesian bias toward macroeconomic techniques noted above, economic policy in the United States is one of the few areas where there still exists what Daniel J. Elazar

³⁹On the importance of rationality, see Etzioni, *An Immodest Agenda*, chapter 10.

⁴⁰On fiscal federalism, see Wallace F. Oates, *Fiscal Federalism* (New York: Harcourt Brace, 1972); also Richard A. Musgrave and Peggy B. Musgrave, *Public Finance in Theory and Practice* (4th ed.; New York: McGraw-Hill, 1984), chapter 24.

⁴¹Bell and Lande, "Industrial and Regional Development Policies," pp. 14-17.

terms a “noncentralized” relationship between national and state governments.⁴² A subnational jurisdiction strategy would not attempt to limit state activity severely; but it would attempt to control and guide state and local policies through the administrative decentralization of a national industrial policy program.

Thus a superordinate-subordinate relationship is implied in subnational jurisdiction approaches—a hierarchical relationship that might challenge some traditional constitutional and policy norms. Until recently, the movement of American intergovernmental relations toward hierarchical arrangements fit quite well with this strategic approach.⁴³ However, that trend has been brought into question by recent U.S. Supreme Court decisions that seem to breathe some life into traditional views of federalism, particularly as reflected in the Tenth and Eleventh Amendments. Nevertheless, the precedents for such an intergovernmental approach are easily found in other domestic policy arenas (e.g., welfare, environmental, and social regulation), thus making this approach a viable option for the design of a national industrial policy.

THE NECESSITY OF STATE INVOLVEMENT

The future role of the states in a national industrial policy obviously depends on which, if any, of these four approaches emerges from the current debate to become the primary focus of serious legislative deliberations. Among the four approaches, only the subnational jurisdiction strategy clearly depends on the involvement of state governments in a national industrial policy effort.⁴⁴ Infrastructure investment strategies are not necessarily dependent on state involvement, but state activities seem to fit well into such schemes. Finally, states are unlikely to play any major role in an industrial policy based on either the trade policy or sectoral targeting approaches as they are now presented.

On a technical level, each of the four strategies presents policymakers with viable options. In articulating their particular approaches to a national industrial policy, proponents of each perspective have been quite effective in describing and rationalizing the institutional forms required to implement their respective proposals. Thus, as posited by trade policy and sectoral targeting advocates, the arguments against state involvement seem as logical and persuasive as those made for it by supporters of the infrastructure investment and state and local approaches.

However, when assessed on policymaking grounds, the number of strategic options is suddenly reduced to only those that include state involvement. Once

⁴²Daniel J. Elazar, “Cursed By Bigness Or Toward A Post-Technocratic Federalism,” *Publius: The Journal of Federalism* 3 (Fall 1973): 240–241.

⁴³*Ibid.*; also see Mel Dubnick and Alan R. Gitelson, “Nationalizing State Policies,” *Nationalizing State Government*, ed. Jerome J. Hanus (Lexington, Mass.: Lexington Books, 1981), pp. 31–74.

⁴⁴Bell and Lande, “Industrial and Regional Development Policies,” p. 14.

moved from the arena of popular debate and campaign rhetoric to the legislative arena, industrial policy proposals will have to make political as well as technical sense. The political logic of Washington affects all legislation, and the more salient the issue, the more likely it is that its resolution will reflect that logic. In the case of a national industrial policy, the current political logic is likely to mandate a major role for the states.⁴⁵

There are at least two reasons for concluding that states will play such a significant role. First, any national industrial policy legislation must take into account current state activities in industrial and economic development. All national industrial policy proposals are based on the use of microeconomic tools to effect changes in private sector decisionmaking. In the economic policy arena, many of these "tools" are in the possession of state governments. Of course, the federal government has effectively used tax expenditures, subsidies, and defense contracts in a variety of its domestic policy endeavors, but rarely as a major component of its economic policies. Meanwhile, states and their local subdivisions have been using many of those same policy instruments for the expressed purpose of enhancing their economies through development programs which they regard as important to their future.

The scope and growth of those state efforts are considerable. Typically they take four forms: financial assistance, tax incentives, training assistance, and special assistance programs (e.g., low-cost industrial sites and research parks, university cooperation and support programs, streamlined procedures for development).⁴⁶ To promote and administer those programs, every state has either created an economic development agency or assigned such functions to an already established unit. In thirty states those agencies have cabinet-level status, and in several states economic development agency budgets exceeded \$100 million in FY 1983.⁴⁷ Even more impressive has been the increase in the number of states making use of those tools. A sampling of financial assistance and tax incentive programs in the states in 1966 and 1984 (Table 1) shows both their diversity and how much more they have been used in recent years.

Those who formulate a national industrial policy cannot ignore this activity. They must decide on how to deal with these long-standing and expansive state programs and the agencies which implement them. Strategically, those policymakers can handle state involvement in three different ways: constitutionally through federal preemption of state jurisdiction in the areas of

⁴⁵See Miles Friedman, "The Political Question: Can We Have A National Industrial Policy Or A National Regional Policy?" *Regional Dimensions of Industrial Policy*, eds. Bell and Lande, pp. 21-46. Also see James L. Sundquist, *Politics and Policy: The Eisenhower, Kennedy, and Johnson Years* (Washington, D.C.: Brookings, 1968).

⁴⁶U.S. Congress, Joint Economic Committee, *Industrial Policy Movement in the United States: Is It the Answer?* 98th Cong., 2nd sess., 8 June 1984, pp. 51-52.

⁴⁷Robert J. Reinschuttle, *Economic Development: A Survey of State Activities* (Lexington, Ky.: The Council of State Governments, 1983), p. 2.

TABLE 1
Selected State Financial Assistance and Tax Incentive Programs, 1966 and 1984

Program	Number of States with Program	
	1966	1984
State loans for building construction	11	28
State loans for equipment and machinery	8	25
State financing aid for existing plant expansions	14	35
Corporate income tax exemptions	11	28
Personal income tax exemptions	15	22
Excise tax exemptions	5	16
Tax exemptions or moratorium on land, capital improvement	11	34
Tax exemptions or moratorium on equipment, machinery	15	33
Tax exemptions on manufacturers' inventories	19	43
Sales/use tax exemptions on new equipment	16	40
Tax exemptions on raw materials used in manufacturing	32	46
Tax exemptions to encourage research and development	3	18

Source: 1st and 18th Annual Reports on "The Fifty Legislative Climates," in 1966 and 1984 issues of *Industrial Development* (Conway Publications, Inc.).

industrial and economic development; politically by formulating a national program that essentially ignores state efforts in the area; or programmatically by incorporating states into any major national industrial policy program.

Of the three, only the programmatic solution seems realistic. Preemptive actions are unlikely to be effective even if they withstand legal challenges to their constitutionality. The dilemma inherent in legal preemption is that such an approach can only deal with the expressed intentions of state policymakers and not the unexpressed consequences of state laws. To be truly effective, any federal preemption would have to eliminate the policy instruments as well as the policy itself. State industrial and economic development programs utilize the traditional powers (to tax, to regulate, and the like) and tools of state government to influence business decisions; there is very little the federal government can do to reduce those powers. Thus, while states might be theoretically precluded from overtly interfering in a national industrial policy program, it would clearly be impossible to assure full state compliance with such a program. The political solution poses a different problem, for it is likely to be self-defeating. By attempting to ignore or circumvent state programs by constructing a national program around them, federal policymakers might be fostering policies that hinder or even counteract the effects of a national industrial policy.

A second reason for concluding that the states will be deeply involved in any national industrial policy rests on the strong political leverage which the states exert in Washington. The pull of state and local interests is increasingly powerful among members of Congress.⁴⁸ Intergovernmental and "public interest" lobbies have become a significant force,⁴⁹ as have regional coalitions in Congress.⁵⁰ The impact of these forces, when mobilized, can be significant.

In the case of industrial policy, there are two reasons for assuming that such mobilization will occur. First, some industrial policy proposals pose an obvious threat to state policy prerogatives, not only in the area of industrial and economic development but also in state control over welfare, transportation, education, and other policy areas. Faced with such threats, state lobbyists and their allies would likely react by working for the defeat or the substantial modification of those proposals. Second, once state officials become aware of the potential opportunities for state involvement in a national industrial policy, they are likely to press for programs designed to favor local or regional interests. Entrepreneurial inclinations are not limited to the private sector, and states have been particularly effective in making the most out of their relationships with the federal government.⁵¹ An intergovernmental industrial policy would provide a new arena within which states could achieve some of their local economic goals.

It is difficult to predict the future of industrial policy proposals. On the one hand, they may disappear from the political agenda as quickly as they have emerged. A recent report prepared for the Joint Economic Committee of the Congress gives credence to such a development. State and local governments are currently experimenting with innovative means to induce regional growth.

While the jury is still out on how successful their strategies will be, it does seem clear that the industrial policy practices of the state and local governments offer little positive encouragement to those who advocate industrial policy at the national level. Ironically, like the Japanese, state and local governments are moving away from industrial policy at a time when the backers of industrial policy in the United States are encouraging "full steam ahead" at the national level.⁵²

⁴⁸Morris P. Fiorina, *Congress: Keystone of the Washington Establishment* (New Haven, Conn.: Yale University Press, 1977).

⁴⁹Donald H. Haider, *When Governments Come to Washington: Governors, Mayors, and Intergovernmental Lobbying* (New York: Free Press, 1974); also see Samuel H. Beer, "The Adoption of General Revenue Sharing: A Case Study in Public Sector Politics," *Public Policy* 24 (Spring 1976): 127-195.

⁵⁰Robert J. Dilger, *The Sunbelt/Snowbelt Controversy: The War Over Federal Funds* (New York: New York University Press, 1982).

⁵¹For example, see Martha Derthick, *Uncontrollable Spending for Social Services Grants* (Washington, D.C.: Brookings, 1975).

⁵²U.S. Congress, Joint Economic Committee, *Industrial Policy Movement in the United States*, pp. 50-51.

On the other hand, under conducive political and economic circumstances, particularly if a large segment of the American economy undergoes another recession, national industrial policy proposals may become the center of policymaking attention. Given the latter scenario, we can predict that state involvement in a national industrial policy program will be a central issue in congressional deliberations. Politically, the proponents of policies that provide for greater state involvement are likely to emerge victorious. Advocates of infrastructure investment and state and local strategies are therefore at an advantage. Unless those who argue for a trade policy or sectoral targeting approach adjust their strategies to political realities, they are bound to have little influence on a national program, should one ultimately emerge.