

TO: WALTER F. MONDALE
FROM: Bill Galston
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INTRODUCTION

In your speech to the IUD last May, you committed yourself in general terms to a "new industrial policy." You called for:

- increased investment in people;
- a shift of capital toward more productive investment;
- a strategy to keep more of our innovation and high-quality jobs here at home;
- cooperative arrangements among business, labor, and government to restructure ailing industries;
- improved coordination of government decisions that affect our competitiveness; and
- special assistance for hard-hit individuals, communities, and regions.

In the months since your speech, the debate over industrial policy has been gathering momentum. Bob Reich's new book has sparked serious discussion. The Kennedy task force and the House group under the direction of Stan Lundine and John LaFalce have issued serious reports. The Rohatyn/Kirkland/Shapiro committee will in all probability make its recommendations public before the end of the year.

In my judgment, the time is now ripe for you to give additional specificity to your own industrial policies. In so doing, you can:

- strengthen your leadership position in this area;
- address the concerns of the millions of Americans who are deeply troubled by declining American competitiveness;
- draw a sharp contrast with Sen. Glenn; and

--add a crucial element of the plan for our economic future that can be used to attack and defeat President Reagan.

This memorandum has two sections. First, it summarizes the basic case for industrial policy. Second, it lays out the most important options in the different areas of industrial policy. The point of the options section is not to recommend all of these alternatives, but rather to present them for your consideration. In compiling the list of options, I have drawn selectively from the Kennedy and LaFalce reports, from the AFL-CIO industrial policy, and from Bob Reich.

THE CASE FOR INDUSTRIAL POLICY

The fundamental purpose of economic policy is to promote balanced, sustainable economic growth and provide jobs for all Americans who want or need to work. We cannot settle for a permanent unemployment rate of 6 or 7 percent, as the Reagan administration and even some Democrats seem willing to do. This would imply more than 7 million Americans without jobs. It would also imply Hispanic unemployment of 10 percent, Black unemployment of 15 percent, youth unemployment of 20 percent, in perpetuity. This is an unacceptable economic policy in a democracy.

Achieving the growth and jobs we need will require international competitiveness, because the United States is more open to, and dependent upon, the world economy than ever before.

- In the past decade, U.S. exports have more than doubled as a percentage of sales, and imports have risen more than 150 percent.
- The other industrialized nations have fully recovered from the ravages of war and now challenge us across the board.
- Newly-industrialized countries are developing economic capabilities in areas traditionally dominated by advanced industrial nations.
- Multinational corporations and new financial mechanisms that radically increase the mobility of capital are spreading industrial production around the globe.

Regaining our competitiveness will require economic change. We cannot hope to regain our edge by preserving the status quo -- even if that were possible, which it is not. America has always been the most progressive, dynamic, flexible society on earth. It still is; the future is made for us. That is our strength, and we must build on it.

Economic change produces serious social, economic, and political stresses. We have always seen a great deal of this, and we will see more. Basic industries have been hard-hit. Workers -- particularly mature workers -- have been displaced. Entire communities, states, and regions are staggering under the burden of rising demands for social services and declining tax bases.

The fundamental challenge we face today is to reestablish competitiveness while dealing fairly and humanely with the problems of adjustment induced by economic change

To do this, we need three things we don't have today.

First, a sensible macroeconomic policy that lowers real interest rates and increases the supply of affordable capital for productive investment. The current budget deficits are profoundly destructive of our future. They're consuming nearly all the net private savings in this country and raising real interest rates to record levels. And, as you have argued repeatedly, the deficits are distorting currency values, fostering protectionism, depriving other nations of needed capital, and exacerbating the international debt crisis.

Second, a farsighted international economic policy:

- cooperation for world growth;
- a coordinated attack on currency distortions;
- reforms in the international banking and financial system;
and
- a much more assertive stance on trade to bring about a fairer and more open regime of international commerce.

Third, a coordinated set of targeted policies to deal with specific problems, industries, and regions. As you have argued, in the absence of appropriate macroeconomic and international policies, targeted measures will be futile. But even with appropriate broad policies, targeted measures will still be essential.

Among the general arguments for targeted policies, the following seem to me to be the most important.

- There are social costs and benefits that don't show up on private balance sheets.
- Market mechanisms are indifferent to regional, sectoral, and distributional consequences of economic change.
- Public investment is needed to enhance the operation of the market and to create new opportunities (past examples include the Erie Canal and the Interstate Highway System).

--Some worthy investments are simply too large or too risky for the private sector to undertake without assistance.

--The government has unique powers, including the capacity to coordinate different market actors and sectors of our society, and the ability to alter the international context of domestic economic activity.

There are two urgent reasons to undertake a new industrial policy.

The first is the dire prognosis for our basic industries. If we continue to do nothing to revitalize them, they will become increasingly vulnerable to international competition, and management will continue to redeploy capital into other areas. To be sure, substantial strides have been made in some industries, such as autos, in the past few years. But others, such as steel, have made little progress. And all will suffer without public initiatives to bolster and supplement the private sector.

Those who say we should abandon basic industries to their fate just don't understand their importance. We need them

--to ensure our national security;

--to provide markets for emerging high-tech industries; and

--to secure our employment base.

The second urgent reason for new targeted policies is that we need them to match the efforts of our major competitors. In many of the key industries of the future -- new mainframe aircraft, semiconductors, 256K RAM chips, advanced machine tools, superfast computers, artificial intelligence, and more -- we are in danger of losing out to countries that are aggressively using labor/management/government cooperation to develop these key industries.

In the face of international competition backed by foreign governments, we cannot afford a policy of unilateral industrial disarmament.

As you know, many growth-oriented businessmen and liberal economists object to industrial policy in principle. They contend that government cannot possibly allocate resources better than the private sector, that industrial policy will inevitably turn into a political boondoggle that cannot be justified on economic, social, or military grounds, and that its outcome will be endless subsidies for perennially uncompetitive industries -- in short, the British disease.

These are real risks, and it would be foolish to deny them. But doing nothing is also risky. Besides, the arguments offered by opponents of industrial policy are not supported by the facts. The United States has had what amounts to a targeted policy in agriculture for more than a century. In textiles, a targeted policy turned a sick industry into a exporter of \$3 billion each year. Just recently, the success of the tripartite effort to save Chrysler Corporation was dramatically highlighted by Iacocca's announcement of the early loan repayment. And of course, our trading partners -- especially the Japanese -- have successfully used targeted measures to nurture emerging industries and expand market shares. Finally, as Bob Reich has stressed, the choice is not between the "free market" and "planning." We already have a multitude of targeted policies -- piecemeal, and frequently contradictory. The real choices are between purposive, consistent policies and measures that serve no real public purpose. The real issue is whether we will use targeted policies in a futile effort to preserve the past, or in a progressive effort to build the future.

INDUSTRIAL POLICY OPTIONS

1. Invest more in people.

A. You have already proposed:

- a comprehensive education program
- expanding the investment tax credit to cover a portion of new private sector investments in employee training.

B. Additional possibilities:

- expand unemployment benefits to cover a portion of retraining costs.
- give the unemployed "retraining vouchers" that could be redeemed by businesses that hire and retrain them.
- Institute a Retraining Loan Program paralleled to the present Guaranteed Student Loan Program.
- initiate a "GI Bill" for displaced workers.

2. Shift capital toward productive investment

A. You have already proposed:

- making the 25 percent R&D tax credit permanent
- eliminating the capital gains tax for long-term investment in smaller business and for gains that are rolled over into new smaller businesses
- relaxing antitrust restrictions on pooled R&D and joint ventures

- toughening Federal Reserve Board oversight of loans for speculation, mergers, and acquisitions.

B. Additional possibilities:

- bring the Federal Financing Bank back into the unified budget.

- establish a Credit Budget to counteract the current bias in favor of tax expenditures.

- establish a federal government council to monitor and coordinate the federal impact on financial markets

- help create a secondary market for small industrial loans

- provide federal support for state and local Development Banks

- allow (or mandate) pension fund investments in Regional Development Banks.

- deny interest deductions for loans directed toward the purchase of existing assets (except housing).

3. Keep our high technology and high quality jobs at home.

A. You have called for stronger presidential leadership to publicize the problem of technology exports, and you have "pleaded" with American multinationals to keep our future here at home. You have not, however, proposed specific steps to accomplish this goal.

B. Additional possibilities

- A portion of this problem stems from the fact that it is very difficult to obtain financing for the crucial period in which new ideas are translated into marketable products and processes. Steps to increase patient capital and to improve the dissemination of technology (see Section 7) would probably help.

- As you know, earnings on overseas investments receive two kinds of special treatment. First, they benefit from a tax credit equal to the amount of foreign taxes actually paid. Second, remaining U.S. taxes are deferred until the profits are actually repatriated. Phasing out this second provision would increase incentives to invest here at home.

4. Cooperate to restructure and revitalize ailing industries.

A. You have endorsed business/labor/government cooperation to deal with this problem. You have stated that if cooperation is to work, all parties must bring something to the table. In particular, government must come with a range of tools: grants, loans, export assistance, import and regulatory relief.

B. Additional possibilities

- The Kennedy task force has called for a Council on Economic Cooperation and Competitiveness, which would conduct the federal industrial strategy debate and preside over a number of sectoral committees.
- The LaFalce committee, in addition to endorsing a Council on Industrial Competitiveness along the Kennedy lines, also supports a "Bank for Industrial Competitiveness," one task of which would be to help negotiate "revitalization finance" for ailing industries.
- The AFL-CIO favors a National Industrial Policy Board, which would preside over on RFC and also control a wide range of targeted trade, tax, and antitrust measures.

5. Improve the coordination of government industrial policy decisions.

A. You have stated that we already have an industrial policy - but it's fragmentary, scattered, uncoordinated, frequently contradictory, and all too often unintended in its effects. You have advocated "mechanisms to learn what government is already doing; to improve information about specific industries, to get the jump on our competitors' plans, to mobilize every weapon in our economic arsenal, and to ensure that our government speaks with one voice in every sector of industrial policy, from credit to trade."

B. Additional possibilities

- The Kennedy Council on Economic Competitiveness and Cooperation, the LaFalce Council on Industrial Competitiveness, and the Economic Cooperation Council proposed by the House Democratic Caucus would all fulfill this function.
- Cong. Don Bonker has recently proposed the establishment of a new Department of Commerce and Trade, which would include an Industrial Competitiveness Council and provide a forum for coordinating trade negotiations, international finance, export promotion, and industrial policies.

6. Assist hardhit workers and communities.

A. You have stated that it is unacceptable for certain individuals and regions to bear a disproportionate share of the burdens of needed economic change. You have mentioned a number of programs for consideration, but as yet you have not endorsed a full package.

B. Additional possibilities

- Plant closing notification legislation
- job counselling and placement services when plant closings cannot be avoided
- targeted assistance for employment, infrastructure, and economic development
- expanded unemployment benefits
- health insurance for laid-off workers
- a mortgage guarantee insurance fund to protect displaced workers against losing their homes
- improved pension portability
- federal support for state economic adjustment services
- improved state and local access to national economic data
- tax changes to reduce current incentives to close older plants, increase incentives for retrofitting and modernization of existing facilities

7. An additional area: Technology promotion

A. You have spoken in general terms about the need to foster technologied innovation, and you have proposed measures to increase support for basic research and development. Many experts now believe that the real bottleneck occurs, not at the level of basic research, but in transforming good ideas into marketable products and processes. Too many American patents are sold to - and exploited by - foreign firms. These are ideas that we should be using to build our future.

B. Some proposals

- The Kennedy task force has proposed a joint government-/industry/academia/research center committee to identify strategic technologies (e.g., chips, fifth-generation computers), assess the targeted efforts of our competitors, and

tion.

- The Kennedy task force has also proposed Technology Extension Centers, modeled after the Agricultural Extension Service, to assure effective transfer and utilization of new technology. Then centers would: serve as clearinghouses for new technology; channel federal R&D to the private sector; provide assistance to new enterprises; establish joint industry/university centers for Industrial Technology
- The LaFalce committee has proposed a federal "Advanced Technology Foundation" that would provide grants for applied research and disseminate information about key research findings.
- Robert Reich has proposed "Applied Research Centers" in which companies in a particular industries could participate in joint research under the auspices of regional universities. The federal government would share equally in funding research projects.

CONCLUSION: THE NEXT STEPS

The preceding section contains what are in my judgment some of the most important specific proposals in the area of industrial policy. You must now answer some key questions:

1. Do you wish to make industrial policy a core element of your general economic program?
2. Do you favor or oppose a federal bank to
 - a) provide funds to help restructure and revitalize ailing industries?
 - b) increase the supply of patient capital for economic innovation?
3. Within each overall goal, which programs (if any) appear to you to be substantively and politically attractive enough to merit further study?

On the basis of your reaction to this memorandum, I will prepare additional materials for your consideration. If you give us the green light, we will organize an industrial policy summit conference sometime between Christmas and New Year. Key participants will include: Dave Smith (from Kennedy's staff), Ira Shapiro, key members of the LaFalce committee, the top policy people from organized labor, Stu Eizenstat, Frank Weil, Bob Reich, Ira Magaziner - and anyone else you designate.



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