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Norman B. Ture addressed a conference at Lehigh University on March 31, 1982, while serving as Under Secretary of the Treasury for Tax and Economic Affairs. The topic was "Reindustrialization: What Are The Issues?"

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Reindustrialization: What Are The Issues?

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I am very pleased to have been invited to participate in this conference on reindustrialization of the American economy. When Richard Aronson and Attiat Ott spoke to me last fall about this program, the subject matter was very much on peoples' minds. As we meet this evening, however, the more urgent focus of our attention is the recession, high interest rates, the level and rate of unemployment, or the Federal government's deficit. In a word, our concerns have become more immediate, and by the same token our perceptions of the longer-term course of the economy's development and of the influences of public policy thereupon have dimmed. While I certainly do not deprecate these immediate problems, I urge that they not be permitted to divert us unduly from continuing attention to the long-run goals of economic policy.

The questions to which I want to direct my discussion this evening are whether reindustrialization, per se, is an appropriate or pertinent objective of public policy and how the public economic policies of the Reagan Administration are likely to impact on this process.

Reindustralization as a Policy Objective

To preface this discussion, the term "reindustrialization" must be put into an appropriate perspective. The term might be deemed to imply that the extent of industrial activity that at one time characterized the U.S. economy has since been materially reduced, and that, accordingly, the focus is on restoring industrial activity to some former absolute or relative level. At the risk of

repeating information that may have already been presented, permit me to point out the ambiguities in any such perception. If the "correct" measure of industrialization is the fraction of total output which originates in manufacturing, there is little occasion for concern about reindustrialization. In the decade of the 1950s, GNP originating in manufacturing averaged 24.5 percent of total output; in the 1960s, manufacturing output was 24.7 percent of total GNP, and in the 1970s, manufacturing GNP averaged 24.6 percent of total GNP. In other words, if we select this measure of industrialization, no change has occurred over the last thirty years.

On the other hand, we might look to the distribution of employment as the more appropriate indicator of how industrialized the U.S. economy is. Here the story told by the U.S. Department of Labor's data is indeed startling. In the decade of the 1950s, the total number of wage and salary workers -- full and part-time -- employed in nonagricultural establishments increased by 9,514,000. Of this increase 2,234,000 or 23.5 percent occurred in manufacturing establishments. In the 1960s, the total employment increase was 17,116,000 of which 3,492,000 or 20.4 percent is accounted for by gains in manufacturing. In the 1970s, total jobs grew by 19,439,000; manufacturing jobs in 1979 were only 873,000 more than 10 years earlier; the gain in manufacturing employment was only 4.5 percent of the total increase. And in 1980 when total employment was 20,180,000 more than in 1969, manufacturing employment was only 133,000 more than in 1969; the manufacturing employment gain was all of 0.66 percent of the total increase over the 11 years.

Accounting for Changed Work Patterns

How is one to account for this disturbing change in the ways in which people work? In some part, the small fraction which manufacturing represents of the aggregate expansion of employment since 1969 may be explained by demographic and sociological factors. Gains in employment of women accounted for roughly two-thirds of the total increase in jobs between 1969 and 1980, reflecting an extension of the trends toward greater participation by women in the labor force and in employment outside the home. While the data are sparse, it appears that a relatively large proportion of the additional jobs occupied by women were part-time; part-time employment is much less frequent in manufacturing than in trade, services, and finance -- the industries in which total employment gains were by far the greatest in the 1970s.

Not all of the explanation for the falling share of total employment in manufacturing, however, is to be found in the employment gains by women and by teenagers, with preferences for part-time, nonmanufacturing jobs. Some part must be found either in slowing demands for labor services in manufacturing, in the failure of manufacturing employment to afford adequate after-tax rewards for labor services compared with those in other industries, or in both of these phenomena. These, in turn, must be ascribed to the marked deceleration in the increase in the capital :labor ratio -- a development of the 1970s which afflicted much of the economy but which was particularly consequential in manufacturing. Several factors contributed to the slowing pace

of additions to production facilities in relation to the growth in labor; the preemption of significant amounts of saving by mandated capital outlays for pollution control and safety equipment and the marked and sudden erosion of the productivity of much capital as a result of the abrupt shifts in the conditions of energy supply are two sets of such factors. Inflation interacting with an obsolete tax system, heavily biased in its basic characteristics against saving and capital formation, were extremely weighty adverse influences.

These data strongly suggest that it is not solely or even primarily basic developmental forces that account for the dramatic shift in the relative use of labor services in the 1970s away from manufacturing and toward services, trade, and finance. Some significant part of the explanation is to be found in adverse effects of various public policies on the costs of and rewards for manufacturing use of production resources compared with other types of economic activity. And while manufacturing output as a share of the total has not collapsed, there can be little doubt that if we are to achieve a sustained and vigorous resurgence of economic growth, the prime mover will have to be the manufacturing sector. In short, "reindustrialization" is important not merely or even principally for its own sake but far more importantly as a major vehicle for the expansion of production capability, productivity, real wage rates, and total output which is the more basic goal of economic policy.

Neutrality Is the Goal

Having identified the significance of reindustrialization in this manner, it might be concluded that the Reagan Administration's program would be fashioned around giving priority to industrial growth over other uses of the economy's total production capability. Let me hasten to put this in its proper perspective. It is the very antithesis of the supply-side analysis which is embodied in the Reagan economic program to single out any particular kind of activity, any particular product lines, any particular industry to promote or to inhibit through public policies. The very essence of that analysis and of the Reagan program is to disengage government from the direction and control of the use of our production capability to the maximum extent possible. The very essence of the program is to enhance, to the maximum possible extent, the function of the free, private market system in allocating the Nation's labor, capital, and other resources among the myriad alternative uses to which they can be put. Decisions about how much of our existing resources should be used to add to production capability as opposed to adding to our current consumption should be made by the interactions of households and businesses in the market, not by government directive. What types of capital are acquired, what industries acquire them, what products they produce are decisions for investors and businesses, as mobilizers of resources, to make in response to market signals, not government fiats. How much of our time and resources to allocate to market-oriented, market-directed employments and how much to "leisure" are decisions we should make as individuals, in response to the costs and rewards we encounter for all of the alternatives, not in response to government penalties or subsidies.

It is obvious that in this context the Reagan Administration's perception of reindustrialization and the strategies to be pursued in attaining it are at the polar extreme of those perceptions and those strategies which have been identified as the "new industrial policy." The latter identifies the inadequacies of market performance -- market failure -- as the cause of the slowing growth of our industrial capacity and asserts the need for government to select particular kinds of investment in particular industries to produce particular categories of goods and services as growth targets. The policy prescriptions which follow in order to implement this selection process involve highly selective devices -- tax differentials, credit controls, etc., i.e., a wide array of subsidies and penalties. The implementation of the Reagan program, in sharp contrast, focuses on identifying and reducing, if not eliminating, these subsidies and penalties -- on producing the most nearly neutral policy impacts.

Supply-Side Strategies for Reindustrialization

The fundamental premise upon which the Reagan economic program is based is that if government policies and actions less interfere with its operations, the market system can and will perform effectively -- far more so than it has. As a corollary, the outcomes of the functioning of the market system, operating in a much freer atmosphere than in the past, are deemed to be not only acceptable but, indeed, the best, overall, that can be achieved. This is not blind faith in the perfection of markets. Instead, it is the basis for a fundamental policy prescription that the responsibility properly to be assigned to government is to seek to identify the sources of market failure and to seek to facilitate more efficient market operation. Increasing market efficiency calls for reducing the weight of diverse influences which distort the signals -- relative prices -- which markets emit as guides to the most efficient and satisfying use of our resources.

A Four-Part Program

This is the key to the Reagan Administration's economic policies. It is embodied in the four-part program which the President presented to the Nation last year.

Attaining the program's goals requires providing the institutional arrangements in which the private market mechanism can more efficiently perform. To this end, clearly, the thrust toward an ever-mounting edifice of complex regulations must be reversed. The policy concern is not to dismantle the existing regulatory system nor to abandon totally the use of regulatory powers. Instead, the effort is to change the focus of regulation from mere circumscription, constraint, and control of how households and businesses perform toward allowing them to perform more efficiently by internalizing, where possible, relevant benefits and costs.

Secondly, government spending programs must be revised, not merely to reduce the extent to which they preempt the economy's production capability but also to assure that any such preemption is directed toward appropriate objectives and in such ways as to offer the greatest

possible assurance of efficient pursuit of these objectives. In turn, this requires rejecting the assumption that government programs have and are entitled to a life of their own. The urgency in curbing Federal spending growth derives in large measure from recognition of the fact that virtually all government outlays change relative prices and costs, often unintentionally and in ways which are not perceived. The side effects of government outlays may go unnoticed by public policymakers but they nevertheless act to pair the efficiency with which markets function. Reducing the growth in these outlays is an effective way of moderating their adverse effects on market efficiency.

Third, if the market system as a whole is to operate efficiently, our single most critically important market -- the financial market -- must do so as well. To be sure, any number of factors may adversely pact the functional effectiveness of the financial market. We have, over the years, accumulated a ponderous complex of regulations of the structure and operation of financial institutions. Modification or elimination of these antique constraints is a high priority goal of the Administration in the interests of allowing financial institutions to perform more efficiently. Just as important, however, is to establish firmly a monetary policy which is consonant with efficient financial market functioning. Our financial markets perform the essential functions of informing us about the costs and rewards for exchanging current consumption for future income, of mobilizing our saving and directing it into its most productive uses. Insofar as monetary policy results in erratic and unpredictable changes in the stock of money, it imposes costly barriers to efficient portfolio management and distorts and confuses information about the real terms of trade between the present and the future. And where the growth in the supply of money is too rapid, the consequent inflation interacts with the tax system to accentuate real tax rates and their adverse effects on working, saving, investing, risk-taking, innovation -- the activities on which we depend for economic progress. Financial market efficiency requires moderate, steady growth in the supply of money.

Finally, the Reagan program lays great stress on constructive tax provisions in the interests of allowing markets to perform efficiently and of reducing tax impediments to growth-generating activities. The aim here is a system of taxation which least distorts the signals cast up by the market system with respect to the most rewarding uses of production capabilities. The focus of tax policy is to minimize the excise effects of taxation, i.e., the alteration of the (explicit or implicit) relative prices which would prevail in the absence of taxation. Neutrality is elevated to be the primary criterion of a good tax system.

The Core of the Tax Program

This was the guiding principle in the President's tax program which emerged ultimately as the principal part of the Economic Recovery Tax Act of 1981. The core of the tax program for individual taxpayers is the staged reduction in bracket -- marginal -- tax rates, followed by indexing to avert inflation's cancelling these rate reductions. It is the taxpayer's bracket rate

which affects the cost and reward he incurs for an incremental hour of work and for an additional dollar of saving. Only by reducing bracket rates -- for all taxpayers, not merely some deemed to be more worthy than others -- is it possible to reduce the tax disincentives for market-directed and rewarded work and to moderate the inherent income tax bias against saving and investment. The principal component of the tax program affecting business taxpayers is the drastic and dramatic revision in the tax provisions regarding capital recovery. The Accelerated Cost Recovery System which replaced the antique depreciation system business had long endured was impelled by the perception that some such change was necessary to reduce the basic income tax bias against saving invested in durable capital, particularly during an inflationary era. There was a growing awareness of the fact that under the then existing depreciation system, restricting the saving of write-offs of capital investments against taxable income to the original cost of the facilities and extending these write-offs over relatively long periods, the real value of these offsets against income subject to tax was eroded by inflation as reflected in the increasing cost of replacement assets. Some calculations indicated that during periods of particularly strong inflation, the real tax rate on the returns to durable capital was vastly greater than the statutory corporation income tax rate -- indeed, in some cases approached or exceeded a confiscatory 100 percent.

This untoward and unintended taxation of the returns to durable capital, of course, impacted with extraordinary weight on industries where production technology involves relatively large amounts of such capital. It was this perverse interaction of inflation with the depreciation system which, it was perceived, accounted to a significant extent for the marked deceleration in the growth of the capital:labor ratio. While certainly not the only adverse influence on industrial growth, the old depreciation provisions must surely have been important constraints on that growth.

Replacing depreciation with the Accelerated Cost Recovery System, to repeat, was motivated by the perceived need to reduce existing tax inhibitions on industrial expansion. This change in the tax structure will in time contribute in a major way to the expansion of total private saving and capital formation upon which both reindustrialization and total economic growth so critically depend.

Contrasting Policies

This policy initiative well illustrates the difference between the supply-side strategy and the "new industrial policy" approach to reinvigoration of the industrial sectors of the economy. The supply- side strategy, embodied in the Accelerated Cost Recovery System tax change, as at removing government-imposed -- in this case, by taxation -- distortions of market signals, distortions which had led to significantly slowing growth in the types of capital on which manufacturing and related activities heavily rely. By moving toward greater tax neutrality, this type of tax change allows the market system to work more efficiently -- to direct production

resources toward their most productive uses. The facts and circumstances of the economy strongly urge that a major result of this tax change and consequent improvement in market operation will be much stronger industrial growth than the economy has realized for many years past. But note that this is a collateral result of more efficient market operation, not an end in and of itself.

In contrast, the 'new industrial policy" would have set up highly differentiated tax provisions, aimed at inducing particular types of activities which political decision makers deemed to be good, important, worthy of subsidy, what have you. Such an approach relies on the judgment of people whose familiarity with business operations very often is extremely limited. Moreover, it insists on the superiority of those judgments over the personal dictates of the market. And it is prepared blithely to disregard the market's signals. The consequences of that approach might well include the rapid advance of industries x, y, and z and the retardation of industries a, b, and c, not because the former are, against any objective test, more valuable or valued than the latter but because a small handful of government decision makers prefer them. The consequences for the growth of the total economy and the efficiency with which it uses its scarce resources can be approximately perceived by even a cursory examination of the economies of Eastern Europe.

Conclusion

The sources and magnitude of the deindustrialization of the U.S. economy are not unmistakably clear. Neither is the need for nor the means for achieving reindustrialization. The ambiguities to be encountered in this respect should confirm us in a preference for allowing efficiently functioning private markets to resolve these issues and should constrain us against resorting to selective and discriminatory public policies.

The Reagan economic program is predicated on confidence in the operation of the market system provided that distortions of that operation, induced by government interference, can be minimized. In all of its principal respects, the program seeks to free up the market system by reducing tax, spending, regulatory, and monetary policy constraints on market functions. The basic strategy relies on a policy which improves rather than frustrates the market system's performance.

The realization of these policies' goals will certainly provide us with a more efficient and productive economy. Whether that economy will also be more heavily industrialized than it has been over the past thirty years one should hesitate to assert. A conservative projection would be for a modestly larger fraction of total employment and a slightly larger share of total output originating in manufacturing than over the last decade. But a more important result which can be confidently projected is a more rapid expansion than over the last decade in total capital, total

employment, and total output, with manufacturing and allied activities holding at least their long-term shares.

All of us, I believe, would be inclined to view such results as consonant with reindustrialization. And we would be sure that this economic progress is solidly based on efficiently functioning private markets, the outcomes of which are not unduly subject to public policy whims.

Achieving these results call for a grand design of public policy. It is a time for boldness and creative imagination in formulating and implementing such policies. Last year we realized substantial progress in setting these policies in place. Let us hope that impatience in our present difficulties does not lead us to undo the program before it is fully launched.