Industrial policy is criticized, even by liberals and Democrats, as requiring a degree of political integrity and wisdom on the part of the Government that America cannot hope to achieve. There may be something to such criticisms, but an intelligent industrial policy could get around them. Such a policy would rely on incentives rather than on Government planning and control, and would reward particular economic activities (capital formation, research and development, more effective use of human resources) rather than selected industries (computers, bio-technology)—and thus probably could work even in our less than perfect society.

The essence of this approach is not to pre-empt or coerce decisions made in the marketplace but rather to change the economic environment in which they are made. This kind of change takes place continuously—the result of changes in technology, the status of competitive firms, the level of interest rates and so on—and new Government incentives to invest, explore and export will not do violence to the working routine of the market economy. Yet, such incentives could help nudge the economy in useful directions. In fact, such incentives are hardly new to the American economy—from the early days of land-grant colleges to the Economic Recovery Tax Act of 1981.

The main tools of such a policy would be tax and credit incentives. Tax incentives are long familiar. Economists do not agree about how effective they are, but they do seem to work better to encourage reallocation of investment among various economic activities than to enhance general levels of saving. Hence, it might be easier to increase investment for capital goods and infrastructure than to increase the total level of capital formation—as Ronald Reagan has started to do.

What kind of incentives would be most effective? Let’s reduce the tax on capital gains for those who invest for longer periods than one year, but increase it for quick-buck speculators. Let’s set up tax-deferred accounts (like individual retirement accounts) from which one could withdraw funds without penalty only for vocational and professional education, training and retraining.

Nor is there anything new about providing credit on favorable terms (low rates, no collateral, long repayment schedules, etc.) to encourage activities such as college education, municipal services and construction of low-income housing. In the past, many of these incentives were intended to encourage private and public consumption.

In contrast, an industrial policy might apply the same kind of incentives to foster investment in capital goods, the infrastructure, research and development and human resources—wherever they can be found, both in new industries and in basic ones.

Such tax and credit incentives differ from existing ones in that they would focus on activities that have been relatively neglected—restoring infrastructure, research and development and encouraging human resources. They would also add incentives where present ones may not be sufficient or are undermined by high interest rates—particularly in the formation of capital and investment in plant and equipment.

By focusing on economic activities that run throughout the economy rather than on select industries, the suggested policy would put less burden on Government decision-making. Thus, introducing incentives to promote investment in research and development requires only a judgment that is preferable to more investment in, say, residential real estate. It does
not necessitate a judgment about which of many thousand possible research projects– or which high-tech industries– are more likely to pan out.

Similarly, favoring more saving and investment does not require predicting which specific industries will be winners in the next decade. The market will decide which industries are likely to make best use of the additional capital. Finally, improving the education and basic skills of the next generation does not require predicting which occupations will require a larger share of the labor force.

Such a policy would also be much more immune to political pork-barreling. Since none of the targeted economic activities are specific to this or that Congressional district, public resources would flow where their use makes most sense– not to those Congressional districts whose representatives have most clout.

In short, such incentives are compatible with American tradition, have a fine record and are largely immune to the main criticism raised against command-and-control industrial policy.