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I have to commend Henry on his excellent forecasting in picking the subject matter for this conference. I first heard from Henry about this program in September of last year. I suppose that I would have given odds that Mr. Clinton was going to win, but certainly as it turned out, the fact of his victory has given a certain kind of realism and urgency to the subject matter of this conference that it might not have had quite so much of had Mr. Bush won.

I want to thank you for giving me the opportunity to do something that I do not often have the chance to do. I spend my time directing research efforts and presentations of my colleagues and myself on very specific real world tax issues which the United States Congress seems to have a great flare for throwing at us at breathtaking speed. I much less frequently have the opportunity to approach issues of the character that Henry has put on our agenda from a more abstract point of view. That is what I am going to do this afternoon, just to indulge myself, and I hope I will not overly burden you in the process.

I am supposed to talk about the role of tax policy in forging an industrial policy. I want to state at the outset that I am firmly convinced that, one, any efforts using any elements of public policy to establish an industrial policy framework for the U.S. economy would be, to put it mildly, ill advised; and, two, a tax system framed so as to promote industrial policy would also be ill advised and violate all of the basic canons of taxation. Both philosophic and analytical considerations take me to the position that I have just stated.

With respect to the former, my personal test is that the touchstone for all governing policies, no matter what their immediate objectives, should be to promote the freedom, the self-reliance and the responsibility of the individual. Given this as an operating principle, the question is what sort of institutional arrangements most closely comport thereto? In our economic life, the answer I submit is provided by the free market organization of economic activity. This is not a view that is unique to me. It has been carefully and eloquently articulated by Friedreich Von Hayek, Milton Friedman, and John Paul II, to mention only a few.

The distinguishing attribute of a free market system is its reliance

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The following text was compiled from the transcript of the remarks made by Mr. Ture at the Conference.

on voluntary exchange. The prices resulting from those voluntary exchanges reflect the preferences and the subjectively-perceived opportunity costs of market participants. Their responses to these market signals, in the allocation of their productive capacities, provide the maximum value of output at the least cost. What I have just defined for you is the economist's concept of efficiency. In short, the free market system not only respects the individual's right to determine what is best for him or her, it also for that reason maximizes the efficiency of the economy's operations.

An industrial policy, no matter how large nor how inclusive or small and parochial it may be, clearly is at odds with both the philosophical principles stated above and the efficiency objectives served by the free market organization of the economy. Any industrial policy necessarily must produce prices and costs that differ from those that would emerge in a really free market. It must, therefore, substitute the preferences of government policy makers — notice I say policy makers throughout this discussion in lieu of bureaucrats — from those of private sector individuals, in the process disregarding the costs thereby imposed on the latter. This displacement is, of course, the very essence of elitism.

The standard response to this view, as we have heard many times, is that there are situations in which the market fails to perform efficiently. The classical example of those situations is provided by externalities. Externalities are market outcomes in which the full costs of production are not assumed by the producers or consumers of the products involved — so-called social costs or negative externalities — or in which the full benefits are not realized by the producers or the immediate consumers — so-called positive externalities.

I must resist the temptation to dwell on the misuse of the externalities argument in favor of public policy dicta overriding market outcomes. Suffice it to say at this point that the standard public policy solutions to social cost problems are far more likely to make matters worse than better.

Industrial policy may be seen as a way of systematizing the displacement of private economic decision making by government fiats, more or less disguised. Note the connotation of the word "policy," to wit, the identification of an objective or set of objectives and specification of the strategies and tactics deemed to be most effective in achieving those objectives. Much of the discussion that I have heard, in the limited time I have been here, of industrial policy, clearly does not meet the requirements of that definition. But it should be obvious that the critical questions are whether any identifiable goal of industrial policy is itself an appropriate public policy objective and whether that goal is worth the cost that its attainment entails. In my text, I have underscored the latter, and I emphasize the consideration of the cost imposed by pursuit of public policy goals because they are, with very few, if any, exceptions, ignored in public policy formulation.

Policy makers seem to be unaware of the fact that there is no free lunch, that the pursuit of any policy objective, no matter how worthy it may seem to be, necessarily imposes opportunity costs on all the rest of the society.

What goals are to be pursued by the adoption of an industrial policy? I have worked in the public policy area, primarily in Washington, since 1951, and during those years I have heard or seen identified more such alleged goals of public policy than I can remember. They have ranged from the global to the parochial, from controlling and determining aggregate economic outcomes to such diverse concerns as keeping intact our gold stock in Fort Knox, promoting exports and achieving trade surpluses, taking the lead in implementing certain communication technologies, accelerating the nation's economic growth, and so on.

There may appear to be little to which to object with respect to any one of these goals. That is only because their costs are ignored. It is only when one also examines the cost their pursuit entails that the worthiness of the goals becomes a relevant policy issue.

Consider what may very well be the most difficult goal to criticize — accelerating the pace of economic growth. Faster growth is almost universally perceived to be an unqualifiedly appropriate objective. Faster economic growth requires dedicating a larger portion of available production capability to doing those things that expand that production capability and, therefore, doing less to satisfy other more immediate demands. Economic growth, in short, in itself imposes opportunity costs. I do not think any of us ever hears a discussion of what those opportunity costs are in the context of political discussions, or the desirability of promoting economic growth and how best to do that.

Suppose we were to conduct our economic lives in a free market, one in which government intrusion in any form was minimal, slight enough to have no significant weight in our decisions about how our available production resources and incomes are to be used. Suppose further that in this institutional environment the average annual rate of expansion of total output over a relevant period of time were, say, two percent. How would one justify the government's adopting public policies aimed at raising that growth rate to, say, three percent? The adoption and pursuit of any such public policy goal must impose costs on the public that, as market participants, they chose freely not to incur. What higher goal, presumably to be achieved by raising the growth rate, transcends the freely-expressed preferences of market participants, constrained by their subjective assessments of the opportunity costs they incur in the pursuit of their preferences.

Arguments about industrial policy seldom involve cost-benefit analysis of the sort I just suggested to you. Instead, they mostly rest on citations of the obvious advantages that have been achieved by the pursuit of this, that, or the other particular sort of goal of one or another form of industrial policy. Ignoring the costs of the pursuit of those policies, however, does not mean the costs are not there, and it certainly does not mean that they are not very often far larger than any gains that can possibly be obtained from them.

For example, industrial policy proponents typically cite the economic progress in Japan as the best case in point. They use one or another indicator of economic progress and achievement to demonstrate the gains industrial policy provided by an orientation of public policy. Even if one ignores obvious mistakes of the policy and the extent to which successful Japanese companies have thumbed their noses at the Ministry of International Trade and Industry ("MITI"), one should still question the meaningfulness of the indicators of success that are usually cited, most often the persistent and growing trade surpluses associated with attainment of market dominance in particular products in particular markets and the very high rate of economic growth that Japan has experienced over much of the post-war period.

How often do you hear one single word about the real costs, and the foregone alternative outputs incurred by the Japanese people in attaining these alleged gains of industrial policy in Japan?

Moreover, and perhaps more to the point, is that in attributing Japan's strong economic performance to industrial policy, far more fundamental economic impetuses for that country's growth are overlooked. Above everything else, the vigorous growth of the Japanese economy is explained by its very heavy rate of capital formation, measured as a fraction of its gross domestic product. This was made possible by the extraordinarily high private saving rate that was, in turn, a response to the extraordinarily high marginal productivity of capital resulting from the (initially) very low capital labor ratios. When the payoffs for saving a given amount of yens is very high because the marginal product of capital is very high, the cost of saving, that is the amount of current consumption that must be foregone to obtain any given amount of additional future income, is very low. It is important to note that as the rapid pace of capital accumulation increased the capital labor ratio of Japan, the private saving rate and the investment-Gross Domestic Product ("GDP") ratio have moderated. In turn, so has the rate of expansion of GDP. In short, if they were positive influences at all, MITI directives were much less consequential than basic economic factors in impelling Japan's impressive economic growth.

One of the side effects of industrial policy that is seldom, if ever, noted is its impairment of private saving and investment. Diligent pursuit of industrial policy is likely to raise the cost of private saving, hence reducing the share of income allocated to saving and investment.

I make that statement as a direct frontal challenge to the standard claim made on behalf of industrial policy that it is essential in order to raise the saving and investment rate.

Notice that it is inherent in the very nature of industrial policy for some investment decision-making to be shifted from market participants to public functionaries. As a result, industrial policy implicitly threatens any given existing set of property rights, because any shift in industrial policy targets will result in windfall gains and losses with respect to existing property rights. The consequence, necessarily, is to enhance the risk of property acquisition and ownership. Because the act of saving is itself the acquisition of property rights, the increased risk raises the risk-adjusted cost of saving.

As one might expect, savers require greater pre-tax returns on the capital into which they direct their saving so as to compensate for this additional risk. Achieving this higher return requires reducing the stock of capital relative to labor compared to what it otherwise would be. The final result is that the given amount of capital favored by the industrial policy is greater, but the overall stock of capital for the economy as whole is likely to be less than in the absence of an industrial policy.

Let me turn now to industrial policy in opposition to the principles of tax policy. There are many in the tax policy community who would insist that the question of whether taxation should be used to forge an industrial policy for the United States is moot, because the existing tax system is the very embodiment of industrial policy (I am sure you have heard that assertion made very frequently.). I think that is wrong, that those who hold this view mistakenly perceive in the ad hoc character of the existing tax system some grand government design to promote this or that. Instead the Internal Revenue Code is better explained as an accumulation of efforts to particularize tax treatment to the enormous variety of taxpayer circumstances and activity as well as to obtain the maximum amount of revenue from those with the least capacity, the least political clout, to prevent that from happening.

What federal tax policy for many years past has done is to embody Russell Long's famous dictum, "Don't shoot you, don't shoot me, shoot the fellow behind the tree." It has also been repeatedly observed, more astutely I think, that the existing income taxes really consist of a jumble of selective differential excises for which no broadly applicable philosophical rationale can be provided.

The industrial policy proponent sees this as an opportunity to bring order out of chaos in the interest of promoting some specific goals, whether it be promoting investment in targeted productive machinery and equipment, discouraging production and use of particular energy supplies or, more recently, all energy supplies, or what have you. His or her operating criterion is to determine the kind of tax change that will produce the biggest bang for the buck, the largest payoff with respect to the designated objective for the least loss in tax revenue to the Treasury.

The "biggest-bang-for-the-buck" approach implies mistakenly that the resources whose use is to be economized are federal tax revenues. It also implies acceptance of subsidizing some activities that contribute to growth, disregarding the fact that doing so necessarily raises the opportunity cost of one or more other growth-generating activities.

The free market adherent, on the other hand, sees the existing tax system as a set of major impediments to the efficient operation of the market system and seeks to identify and moderate the principal elements in the system that distort the market's price signals.

An industrial policy approach to revision in the tax system would, by its very nature, violate the principal canons of taxation. A policy that deliberately reduces the effective tax rates on returns for particular kinds of activities clearly violates the principal of horizontal equity, difficult as that principle is to articulate in any coherent fashion. The more highly differentiated the tax treatment of saving, investment, personal effort, and so forth in pursuit of industrial policy objectives, the more complex the tax law necessarily must become and the greater must be the cost of compliance and enforcement. And in the very nature of things, tax differentials aimed at industrial policy objectives must do gross violence to the least ambiguous of tax canons — tax neutrality, that is, the imposition of taxes in such a way as to least distort the relationships among prices and costs that would otherwise prevail in free markets.

An industrial policy orientation of tax policy would set in motion yet another vehicle for rent seeking, for efforts to obtain through government favors, rewards greater than those that would be generated by operations in the market system alone. This sort of orientation would put in front of every business decision maker the very great temptation to direct some of the businesses' resources to obtaining those favors in order to augment the businesses' profits without having to pass the market's tests. The result would be the substitution of government provided rents, tax subsidies, for market-produced rewards reflecting market participants' valuations of products and services.

By the same token, this necessarily means that greater real costs will be incurred in the production of the subsidized products and the services that would be incurred in the absence of the government-granted rents. The economy as a whole would suffer efficiency losses and would produce less valuable products from the use of any given amount of valuable production inputs.

It is difficult to identify any policy that impairs economic efficiency which can be called an effective means of promoting higher levels of economic performance or faster rates of growth.

There are, in fact, a great many changes that can and should be made in the existing federal tax system that would contribute to a more efficiently operating and faster growing economy. A program for such changes may be derived by much closer adherence to the tax neutrality criterion, that is, minimizing tax-induced relative price distortions. No "biggest-bang-for-the-buck" considerations would be involved. The formulation of this program would involve no promotion of any particular kind of activity or product line.

The existing tax system exerts a heavy bias against saving and in favor of consumption uses of personal income. It imposes differentially heavy tax penalties on the foreign, compared with the domestic, operations of American-controlled companies. It exerts a bias against corporate organization of business and in favor of unincorporated businesses. It is biased against using one's time, talents, energies, and other resources in producing income that enters into the income tax base as opposed to so-called "leisure" uses of these resources. It accentuates the bias against saving and against productive effort because the more productively one uses those resources, the greater and more harshly treated are the returns therefrom. It more harshly treats investment in some kinds of assets than in others. And so on.

A constructive tax policy, one that is consonant with the basic ethic identified earlier, and one that would strengthen the free market system in implementing that ethic, would seek to eliminate, or at least modify, the provisions in the existing tax system that produce the biases that I have just briefly outlined. Taxes are required for pricing out government activities in order to ensure that the policy makers are effectively disciplined in their government spending decisions. At the same time, however, the taxes we rely on to perform this essential function should do us the least harm. The closest we can get to achieving that goal is to make our taxes as nearly neutral as possible. An industrial policy approach in tax policy, I submit, is the very antithesis of that goal.