Commentary

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Wachter and Wachter raise some very important issues in their paper. Their analysis of the problems of displaced workers (based on a very restrictive definition) gives that concept precise definition, and they document their point of view very thoroughly. They take an optimistic view of unemployment, based on the belief that technological displacement will not be as great as the pessimists assume, and that economic growth and declining labor force growth will reduce the magnitude of the structural unemployment problem in the future.

Their policy prescriptions from this are not as clear, though presumably they would favor on-the-job training and a voucher system, but no large-scale expansion of selective labor market policies, because these cause budget increases, have tended to be "pro rather than countercyclical," and because the "underlying problem facing displaced workers is not employment difficulties or a shortage of jobs; rather it involves wages." In particular, the U.S. labor market "has exhibited a high variance in interindustry wage changes." They argue that job growth during the 1970s "suggests that the American economy has no difficulty creating jobs that fit the labor force."

Unfortunately, the nature of both the transitional economic period we are in and the limitations on our data and analytical techniques make it difficult to test the contrary point of view, but, in keeping with my role as a discussant, let me at least lay it out. In the first place, of course, while the displaced worker problem narrowly defined probably is not a very serious quantitative problem, the *structural* unemployment problem is much larger and, the evidence suggests, has become more serious with succeeding cyclical downturns. Moreover, the real issue is an *adjustment problem,* not simply measures to deal with displaced workers. In other words, the *fear* of displacement and the absence of a positive adjustment program to cause a more equitable sharing of the benefits and costs of change creates resistance to change that can be very costly in terms of economic effi-

ciency. The authors point out, quite correctly, that the largely ad hoc adjustment program we now have is mainly an income maintenance system and not one that facilitates adjustment.

However, there is evidence that positive adjustment programs can work. Incidentally, the Job Training Partnership Act (JTPA) of 1982, which replaced CETA, has a displaced worker component that does not have the same income limitations as most of CETA. Morever, there have been a number of positive adjustment demonstration projects that provide some insight into how a successful adjustment project might be constructed. The tripartite steel committee, organized in 1978 (and to be rechartered in 1983) sponsored adjustment pilot projects which provided some lessons, as the Downriver Community Conference Readjustment Activity Program in Wayne County, Michigan, which was funded by the Labor Department in 1980 as one of a series of adjustment demonstration projects. Unfortunately, while the Reagan Administration allowed Downriver to continue, it discontinued the other pilots. I believe these flexible, localized activities, based on specific problems and administered by labor, management, and community representatives, avoid many of the program uncertainties mentioned by Wachter and Wascher. For one thing, we avoid definitional difficulties (which lead to great administrative problems, as well as inefficiencies and inequities) by making a flexible array of services available to local projects based on an assessment of their needs. The probability that workers have been permanently displaced is a judgment that is more appropriately made by local labor market actors than by Congressional or administrative formula. It has never made much pragmatic, let alone equity, sense to try to determine why people have been displaced. It is in the national interest for adjustment to take place, whatever the reason for displacement. Moreover, workers and communities can receive whatever services they need for adjustment. Some workers need only job-search assistance to find new jobs; this is even true of some older workers with industry-specific training and long tenure. Others need relocation and retraining assistance, while others need basic education. Incidentally, it is not true that displaced workers are not also disadvantaged, because many of these workers, even those in relatively high-paying basic industries, have one or more disadvantages related to race, education, sex, or age. Functional illiteracy is a special problem for many workers, adults as well as young people. Indeed, by one estimate, about 20 percent of the American work force and about

half of all minority 17-year-olds are functionally illiterate. In any event, the main point is to tailor programs to individual requirements rather than to tight a priori definitions.

The Downriver project is illustrative. The first phase of that project (July 1980-September 1981) provided reemployment services to 1,500 workers laid off from automotive supply plants in southwestem Wayne County, Michigan. The second phase (November 1981-September 1983) included 500 additional workers affected by the closure of a number of automobile supply plants, including Pennwalt, Ford Michigan Casting, and Firestone. The main objective of this project was to help the displaced workers find reemployment. All participants were tested and given job-search training. Other services were provided as needed, especially classroom and on-the-job training and relocation assistance. **A** sample of 76 percent of all males laid off between June 1979 and December 1980 who remained in the Detroit area found the following characteristics: average age was 40 years, 30 percent were black, 40 percent had less than high school education, average work experience was 25 years (14 with the company from which they were laid off), the participants were mostly operative and craft workers earning over $9 an hour when laid off, and average unemployment benefits (including adjustment assistance) were 50 percent of wages.

During the first phase of the project, 49 percent of eligible workers participated, though participation was higher among younger, better-educated workers with less than 30 years experience. Fifty-seven percent of all participants received some form of retraining, approximately a third in classrooms. The average length of training was eight months, with high-tech courses somewhat longer, 50 percent of enrollees used local educational institutions, and one-fifth had on-the-job training.

When contrasted with a comparison group, Downriver raised the reemployment rate from 50 to 60 percent without the program to 75 percent with it, had a larger impact on the groups that would have had lower reemployment rates, and greatly increased access to training opportunities. Participants' reemployment wages averaged $8.20 per hour, 10 percent less than their last jobs, but $1 to $2 an hour more than they would have earned without the program. Moreover, the program "increased participants' average weekly earnings from an estimated $60 in the absence of the program to $124 with the program . . . with program costs averaging $1,750 per participant . . .

implies that the benefits accruing to participants alone exceed the social costs within a year."[1]

I believe that these and other selective labor market programs are much more significant components of a policy to deal with structural unemployment than Wachter and Wascher imply. In the first place, structural unemployment problems are likely to get worse, not better, during the rest of the 1980s. The demographic figures the authors cite are incomplete from a structural point of view. For example, the youth unemployment program never involved all young people, but involved dealing with the labor market problems of a hard core who had such multiple labor market disadvantages as race and sex discrimination, broken families, teenage pregnancies, poverty, criminal records, sustained unemployment, limited educational attainment, female-headed households, and heavy geographic concentrations in high-risk areas. There is strong evidence that selective activities like the youth entitlement program of the Youth Employment and Demonstration Projects Act of 1977 (YEDPA) and the Job Corps are cost-effective ways to deal with those problems. In other more difficult areas, such as teen pregnancies and the rehabilitation of people with criminal records, we need to develop specific programs to try to prevent problems and to salvage as many people as possible who already have been damaged. There is, in my opinion, no substitute for carefully constructed and evaluated local projects based on cooperation between the private sector and local communities to deal with these problems. Unfortunately, however, the prohibition of public service jobs for people who cannot find jobs in the regular economy makes it very difficult to continue some of the most successful of these programs — like the successful youth entitlement program, which provided jobs to make it possible for young people to stay in or return to school. There is also a need to improve labor market information systems.

This is not to argue, of course, that these programs were always successful or that they alone could solve the unemployment problems. These programs have had serious management and programmatic problems, but they have, on balance, been good investments for the country. We should continue to improve those with promise, eliminate those that don't work, and improve the management of all

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1. D. Alton Smith and Jane Julik, "Impact Findings from the First Phase of Operation," Abt Associates, May 20, 1983, pp. 7-8,.

of them. All of this can be done on the basis of the lessons we have learned from such programs in the United States and other countries. I believe, for example, that while inadequate in terms of resources, the JTPA makes what could be a major programmatic improvement by shifting more responsibilities to the states; previous experience demonstrated the inadequacies of too much decentralization (CETA) and too much centralization (MDTA). Moreover, the 1978 CETA amendments created a private-sector initiative, which is given a larger role in the JTPA.

Nor do I agree that selective labor market policies (jobs, training, labor market information, and other activites to improve the operation of labor markets) are necessarily pro-cyclical. I think it can be demonstrated that with all of their program delivery and management problems, the employment and training programs of the 1970s were initiated in a timely fashion, were cost effective, and therefore did not cause much, if any, inflationary pressure. Moreover, when unemployment declined after 1978, public service employment programs were phased down by the Carter administration with minimal political opposition. Indeed, in my view, they were phased out by the Reagan administration with too little political opposition. Selective labor market programs are much less inflationary than all of the alternatives (welfare, unemployment compensation, illegal activities) except regular jobs. Experience shows that these programs are much less expensive than tax cuts, which cost at least three times as much per job created. Moreover, I believe program improvements are possible to make public service employment programs much more cost effective and more countercyclical.

It is not appropriate, of course, to relate the timing of these programs to ***aggregate*** unemployment, but to the unemployment in the ***markets on which they are targeted.*** For example, three-fourths of the job growth of blacks between the summer of 1977 and the spring of 1979 were in YEDPA. This was the first job growth of young black males during the 1970s. The black youth unemployment rate was reduced from about 50 percent to just over 30 percent, while the overall unemployment rate declined from almost 8 percent to 5.6 percent. The fact that the overall unemployment rate was 5.6 percent did not mean that programs targeted on markets that still had over 30 percent unemployment were pro-cyclical. While it is true that the American labor market created more jobs during the 1970s than any other OECD country, in absolute and relative terms, jobs were not created

in the places where blacks are concentrated and jobs were not provided fast enough for all who wanted them, which is one reason that both employment and unemployment grew as jobs were created. Moreover, as the authors point out, there is a structural aspect of cyclical unemployment, so it makes sense to expand targeted jobs programs as unemployment rises and to reduce these programs as it declines. Triggers to unemployment can make these programs more like automatic stabilizers. Selective programs can overcome bottlenecks, improve labor market information, generally improve the operation of labor markets, and facilitate recovery at lower rates of inflation. They also provide for greater equity by making it possible to target resources on groups and places with the highest levels of unemployment.

However, these are not the main policies to reduce cyclical unemployment; that is the job of macroeconomic policy. But I would argue, on the basis of experience in the United States and abroad, that macroeconomic policy can be more effective if complemented by selective policies to deal with structural inflation and unemployment problems not reached very effectively with these general policies.

Wachter and Wascher could be right about the effects of technological change. It is clear that the fear of technological unemployment has been exaggerated in the past. It also is correct that engineering studies alone provide insight into the possibilities of displacement, but not the probabilities. Market forces obviously will control the rate of technological change, which is one of the reasons the Japanese use more robots, absolutely and relatively, than we do. In Japan, capital costs have been kept low while real wages have been rising, making it expedient to substitute capital for labor. The pattern in the United States has been the reverse: real capital costs have risen while real wages have declined, encouraging the substitution of labor for capital, a trend accelerated by rising energy costs, economic uncertainty, and the availability of low-cost, female, immigrant, youth, and minority labor pools.

There are, however, a number of cautions about the authors' optimistic projections. One uncertainty is immigration. With Third World unemployment and underemployment at 50 percent and little prospect for improvement over the rest of this decade. we cannot be sure that increased immigration — which probably accounted for at least 20 percent of the U.S. labor force growth during the 1970s — will not more than offset the decline in the number of young people in

the work force during the 1980s. Moreover, I would give careful attention to arguments of people like Wassily Leontief, 1973 Nobel laureate in economics, who warns that the technological changes related to information technology are different from those of the 1950s and 1960s, when we had faster growth and much less international competition. Moreover, according to Leontief, information technology is more ubiquitous and does not just displace low-wage physical labor.[2] During the 1950s and 1960s, technological changes in agriculture displaced people who could get better jobs because of growing employment in other sectors. Leontief doubts that we will have enough jobs at acceptable wages for all who wish to work. Moreover, the new technology could reduce skill requirements more than it increases them, contributing to a widening in income gaps. We do not have the information to resolve this problem, but I think Leontief raises important points.

Finally, let me make a few comments about the author's concentration on relative wages as a factor in displacement. There is no question that many of the workers displaced from relatively high-wage basic industries, like steel and autos, will have difficulty regaining their real wages. However, we should not infer too much about the total economy from the steel and auto experiences, as important as they are. It seems to me that the appropriate program objective should be to reduce the income loss of displaced workers as much as possible, which the Downriver project suggests can be done with direct program intervention. However, as the authors emphasize, it is unlikely that all of the wage loss can be maintained. Adjustment programs also must provide incentives for people to participate in positive adjustment activities.

I think, moreover, that an analysis which attributes the displacement problem only to relative wages is incomplete. It is not just relative wages that caused the problem in the United States during the 1970s. Except for a few conspicuous exceptions, real wages declined in the United States relative to other industrialized countries, at the very same time some of our manufacturing industries were losing their competitive position in international markets. The important consideration was not wages, but ***unit labor costs*** (wages adjusted for productivity growth or decline). American unit labor costs were accelerated by declining relative productivity growth and rising

2. **"Inquiry,"** ***USA Today,*** **Thursday, Aug. 4, 1983.**

money wages. The reasons for the declining productivity were broader than labor markets. I think the most important problem was that some of our basic non-competitive firms have been forced to adopt to international competition and have had great trouble achieving their traditional profit thresholds and therefore would not reinvest in their basic industries. In addition, some internal management systems in these industries were more appropriate to mass production of goods than they were to high value-added goods, where information technology and quality are more important. The Japanese have lower profit thresholds and different internal cost structures and are therefore much more competitive in some markets. Moreover, since Japanese companies tend to maintain employment and capacity during downturns, they have much better ability to respond to increasing demand during recovery. The consequence of this, along with the overvalued dollar and undervalued yen, probably is to cause some American companies to permanently lose market shares. Though most American companies, even in manufacturing, are still competitive in international markets, some companies in industries like steel have found it easier to shift capital to more profitable activities than to continue to try to compete. This is partly a wage problem, because industrial relations systems were built on older, less competitive economic realities. But this is also a public policy program, because productivity is influenced by regulations, economic stability, and public investments, as well as management and industrial relations systems. In fact, it remains to be seen whether Caterpillar, which had a fairly successful global strategy in competing with Komatsu, can survive the multiple blows dealt by its industrial relations system, the worldwide recession (resulting in part from our national and international economic policies), an overvalued dollar, an undervalued yen (resulting from Japanese policies), and the economic embargo of the Soviet Union, all of which made it possible for Komatsu to overcome the competitive constraints that Caterpillar's global strategy had imposed upon that company before 1982.[3] Caterpillar had been so successful in keeping prices low in Japan that Komatsu had difficulty deriving the cash flow to compete in international markets. But the boycott and economic difficulties have helped Komatsu relative to Caterpillar.

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3. See Thomas Hout, et al, "How Global Strategies Win Out," *Harvard Business Review,* Sept.-Oct. 1982, pp. 100-102.

Moreover, the need for systemic flexibility and adaptability requires greater attention to capital and product as well as labor markets.

Thus, management systems probably have been less important determinants of productivity and international competitiveness than *overall economic policy.* Indeed, *I* am persuaded by the evidence that American *private managers* have done a better job than American *public managers.* It would take much .greater improvements in productivity than we are likely-to achieve to overcome the consequences of exchange rate differentials, which automobile industry officials estimate to be about two-thirds of the cost differential between the United States and Japan.[4] The undervalued yen and the overvalued dollar are the consequences of economic policies in Japan and the United States. Without a stable economic environment created by comprehensive and coordinated economic policy, the so-called Japanese management system, which has caused high productivity and competitiveness in key industries, would be very hard to maintain.

Also, I believe the Japanese industrial policy has played an important role in the so-called Japanese miracle. However, the term industrial policy has lost some of its meaningful communication because it means different things to different people, and many critics do not define industrial policy as I would. It is especially inappropriate to judge the consequences of industrial policy in a country like Japan by comparing it with a neo-classical competitive profit-maximizing model, because that is not the model that most Japanese companies use for decisionmaking. Their model of maximizing market share might be considered irrational from a profit-maximizing view. But in Japan, size carries considerable prestige and tangible benefits.

There are, however, a number of obstacles in evaluating the relative importance of industrial policy in the Japanese context.

- Japanese economic policy has been systematic and comprehensive, making it difficult to separate "macroeconomic" or monetary and fiscal policy from targeted policies to influence particular industries. For example, throughout most of the period of rapid growth, there was no independent monetary policy because there were poorly developed securities markets and the Bank of Japan was an arm of the ministry of finance. The government therefore used credit as a means

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4. See *New York Times,* Sept. 11, *1983,* p. F-4.

of encouraging particular industries. Other policies were designed to increase savings, reduce consumption, and encourage investment in industries with the best growth opportunities. Japanese policy has contained a flexible mix of macro and selective policies.

- Moreover, Japanese objectives are based on elaborate consensus-building processes, are dynamic in the sense that they have changed through time (from building basic industries, to rapid economic growth, to the present policy of more balanced growth and the development of new technology) and contain such important non-economic objectives as national pride and overcoming national humiliation resulting from defeat in war and the realization that "made in Japan" was a mark of inferiority during the 1940s and 1950s.
- The Japanese system is not a case of the government picking winners and losers. It is the case of public-private consensus forecasts of industries with varying growth potential. Government policy based on these forecasts has been to use credit and regular government policies to encourage growth and provide an equitable means to phase down those industries with little growth potential. The Japanese consider their system to be one that facilitates orderly adjustment.
- There is no sharp dichotomy between public and private activities. The consensus process attempts to establish flexible and changing relationships between the public and private sector. The Japanese think there is a natural and mutually beneficial organic relationship between the public and private sectors. This belief tends to avoid the adversarial relationship predominating in the United States. The consensus process tends to provide better information to the parties in that process and to encourage cooperation where that is appropriate, but intense competition within Japan and in international markets for market share.
- One of the weakest arguments against industrial policy is to point to examples of specific industrial policy failures in other countries. If infallibility has to be a criterion for success, then we are all doomed to failure. Critics point to the famous case where MITI attempted to dissuade Honda from remaining in the automobile industry as an example of failure. On the contrary, it is an example of how the system works. If the Japanese system had really been planning, they would have kept Honda out of the automobile business. But an industrial policy based on consensus is not planning. Japanese

firms can and have ignored consensus industrial estimates. The system is consensual, not oppressive. The parties to the consensus process continue to make their own decisions, but on the basis of much better information, especially about the motives and behavior of the principal economic interests involved in the consensus process.

Similarly, the fact that actions are taken on the basis of consensus forecasts facilitates the correction of mistakes. For example, the Japanese steel industry built excess capacity during the 1960s and 1970s on the basis of an overly optimistic consensus growth forecast. The fact that the forecast was based on public-private consensus made it possible to reduce capacity without a lot of the adversarial blaming that goes on in the United States about who is responsible for the steel industry's problems.

- The Japanese have shifted policies through time and currently incline more to selective policies (i.e., education, training, improved information systems, a stable economic environment) that affect all industries, rather than to those that are industry-specific, as was the case in earlier times. Moreover, the government's power relative to the private sector has diminished as private enterprises have become more affluent.

However, higher Japanese savings, flexible institutions, and well-trained workers didn't just happen — they were the consequence of Japanese policies. A very strong case can be made that without close public-private cooperation in establishing and implementing economic objectives, the Japanese could not have established their present strong economic position in the world. Judged from a static, neo-classical profit-maximizing model, the Japanese policies might have appeared to be irrational at any given point in the process. But judged against their own objectives, it is hard to argue that they have not succeeded. Moreover, it is hard to argue that they could have achieved their impressive economic results without comprehensive public policies.

After all, the Japanese had no comparative advantage in steel, autos, electronics, and other industries in the 1950s. Without governmental protection from foreign competition, heavy investments in human resources, credit allocation, and other assistance to industry, the Japanese believe they still would be the relatively underdeveloped country they were in the 1950s. It is true that the Japanese had an advantage in catching up with American technology, but they did more than catch up in management and public policymaking institu-

tions. It also is true that the Japanese probably will have more trouble in the future, but I think their consensus decision processes and flexible institutions give them important advantages in dealing with change in an internationalized information world. The U.S. has overwhelming capital, productivity, and resource advantages, but we have limited means to coordinate and cooperate in public policy area.

As noted, it is hard to assign a relative weight to the importance of Japanese industrial or targeted policies because these policies are closely integrated with other public and private activities. There can be little doubt that the outcome of the total process has been impressive.

Finally, while the Japanese experience is more of an argument for industrial policy than against it, this does not mean that such policies would work in the very different American institutional environment. However, I believe we must adopt more coordinated and comprehensive economic policies, in which macro policies are supplemented by selective activities, including adjustment policies to facilitate an equitable sharing of the benefits and costs of change, and especially measures to shift resources out of industries with limited competitive potential. We cannot pick growth industries and those that will decline. But we can forecast them, and labor, management, and government can adapt their regular activities to these forecasts — including disagreeing with them, as the Japanese do. It would be irresponsible to leave all of these activities to market forces alone because of the market defects conceded by even the most conservative free market supporters.

Clearly, the government will inevitably take actions that will affect markets. It seems to me that it would be much better to make these actions more coordinated and less ad hoc. Moreover, it is hard to avoid the need for a logical division of labor between public and private actions. Clearly, public interventions that might distort a perfect market can improve the markets we are likely to have. In the real world, the United States does not have the option of deciding whether or not to adopt policies that have differential impacts on industries. The federal government already does that, including almost a trillion dollars in loans and loan guarantees. The question is whether or not a more coordinated approach to focus these resources more on national objectives would improve our overall economic performance.

I believe we could do a lot better with means to improve coordination and consensus-building. This will not be easy to achieve in our

political and institutional environment, but we should improve our political and governmental processes as well as our markets. Economists too easily assume that the political process is inherently flawed and that markets are more perfectable, but I am not sure that the case can be made.

As noted, I believe selective labor market and other interventions have a role to play as part of an overall, more effective, more comprehensive policy to create the economic environment to make it possible for American labor and management to be more competitive, whatever we call those selective interventions. However, change will be a continuing process, so we not only need to train and educate our people so they can adjust to change, we need also to develop new and more flexible product and labor market institutions to achieve a more equitable sharing of the benefits and costs of adjustment and reduce resistance to change by those who are afraid they will bear the costs while other reap the benefits.

In sum, displaced workers constitute a small part of the structural unemployment problem. Measures to deal with that problem should be part of a larger effort to make our economy adapt to change more readily. This requires comprehensive economic policies where selective policies complement macroeconomic policies.