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Merger Policy and Industrial Policy

Keith Cowling*

The article by Adams and Brock\(^1\) is a welcome and important antidote to current government thinking about merger policy, both in the United States and in Europe. In both regions, the government approach presumes the efficiency-creating properties of mergers and, therefore, adopts an extremely permissive stance. The declared imperative of international competitiveness echoes the view towards mergers which prevailed in Europe during the 1960s. Adams and Brock convincingly demonstrate that the creation of the European industrial giants during that decade was largely disastrous in efficiency terms. They also contrast the European experience with that of Japan, where a similar merger wave failed to materialize. The comparison points unambiguously to the superior efficiency-creating properties of the deconcentration tendencies which generally prevailed within Japan, in some cases despite government policy to the contrary.

However, while the analysis of Adams and Brock is both important and correct, I believe it is also incomplete. If bigness is a problem created largely by the laxity of past merger policy, then it is certainly correct to argue for stricter merger policy now and in the future; yet such an approach is unlikely to suffice. Not only is a policy required to control the further growth in the dominance of the giant corporations, but the problems posed by that very dominance must be addressed. I believe those problems should not only be addressed as issues of regulation, but also as issues of development. As democratic communities, we must re-act to the accumulated power of the major actors on the economic scene by regulating their behavior or by divesting them of at least some of their power. We must also act strategically to counterpose our own vision of

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the future to that of the dominant corporations. Thus, the regulatory and developmental roles of government are complementary in the search for a dynamic and efficient economy, and these roles require the development of some sort of industrial policy.

Many will argue against an industrial policy that is anything more than regulatory in character. Indeed, they will argue that the role of government should be limited to allowing market forces to work more effectively, rather than replacing them. Although there was a brief debate in the United States in the early 1980s concerning broader and deeper versions of industrial policy, this rapidly subsided in the face of the standard neoclassical arguments, coupled with a tangible improvement in the economy. Nevertheless, the problem of the lack of dynamism in the United States and European industrial economies remains. In the United States, the problem is manifested as a huge balance of trade deficit coupled with a very poor record of productivity growth; in Europe, a full employment growth path appears difficult to achieve because of the potential trade imbalances and inflation that could result. For example, the recent dash for growth in the United Kingdom has quickly come to a juddering halt as the government has reacted to a trade deficit proportionately larger than even that of the United States. The only major industrial nation to have achieved the twin goals of full employment and rapid productivity growth in recent years has been Japan. I believe that the Japanese example is as important in assessing the relevance of industrial policy as it was for Adams and Brock in assessing merger policy.

Just as there are systemic arguments for relying on market forces to play a central role in modern economies—arguments which are now vigorously espoused even within the centrally-planned economies—so there are parallel arguments for imposing on these market forces a coherent national economic planning system, within which market forces are allowed to operate. At present, there seem to be three fundamental reasons for imposing a coherent national economic planning system: transnationalism, short-termism and centripetalism. All of these reasons are related to the underlying concentration of power and, therefore, decision-making, which Adams and Brock have highlighted.

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4 For an extended discussion of these issues, see Lecture by K. Cowling, Planning, the Market and Industrial Policy, The Academy of Sciences, Budapest, Hungary (April, 1988).
The growth in dominance of the transnational corporation poses a significant potential threat for any national market economy. The global perspective and ambitions of the major industrial and financial corporations may cut across the interests of any particular nation-state. The fundamental issue relates to the asymmetry of power between corporation and community, which derives from the transnationality of the corporation compared with the locational rigidity of a specific national community. Any one nation can be deindustrialized by the actions of transnational corporations. Therefore, to protect itself, any national community must intervene in the strategy-making of the transnationals—or accept their dominance in its own affairs. Without such intervention, the strategy of the transnationals will become the national strategy, and this may have little correspondence to what is best for the nation.

The second basis for national economic planning is the systemic short-termism of the market. In this context, it is often argued that financial institutions adopt a peculiarly short-term perspective with regard to investment. What this generally means is that while incremental change can be handled quite well by market institutions, more fundamental changes involving quantum leaps in product, process or structure will not be handled so well. An active market for corporate control allows the short-term perspective of financial institutions to impinge much more decisively on the perspective of industry and is hardly conducive to the rational planning of the long-term future of the industrial base. Short-term decision making is crowding out long-term issues. No one is planning for the future within such market economies, so we need to establish mechanisms and institutions to do so.

The third basis for planning relates to the tendency for higher level activities and occupations to gravitate to the center. This has led to the loss of a substantial degree of local, regional, and, in some cases, national autonomy, with strategic decisions having major implications for such communities being made outside those communities. The same centralizing forces imply a siphoning-off of resources to the center, which reduces the capacity of the periphery to sustain its own economic, political and cultural development.

Thus, we have identified three central tendencies within modern market economies: transnationalism, short-termism and centripetalism. When taken together, these tendencies point to the need for national economic planning in order to achieve efficiency in the allocation and utilization of national economic resources. Economic power is being concentrated in fewer and fewer hands and this in turn is generating forces which progressively undermine the ability of people, and the com-
munities of which they are part, to assert their right to determine their own future. This is the essence of democracy—the ability of people and their communities to allocate resources in the way they choose. Thus, economic democracy is fundamental to maximizing a community’s economic welfare.

To begin to achieve economic democracy, people and communities must possess some significant degree of direct control over the dominant centers of economic power. They must possess regulatory control, and also the capacity and power to develop effective plans for the economic development of the community or nation as a whole. In theory, this requirement for economic democracy fits very easily within neoclassical economics since the neoclassical view focuses upon individuals making choices. In practice, however, it tends to cut across the grain of neoclassical analysis, which assumes an even distribution of power, ignores asymmetries of power, and, therefore, fails to encompass the requirement for democracy within the functioning of the economy.

However, while it is possible on theoretical grounds to argue for national economic planning to secure an efficient allocation of resources, many economists, and others, are quite naturally skeptical about the whole project. The world is littered with failed and disreputable planning systems. It is quite clear that under modern economic conditions, comprehensive centralized planning is both infeasible and undesirable. But all is not lost, for at least one major industrial country has evolved a planning system which has worked with enormous success. Like Adams and Brock, but now focusing more broadly on industrial policy, we turn to the case of Japan.

Japan is the most important example of a government taking a central developmental role in the economy without directly owning most of the productive assets. Although various departments and agencies of the state are involved in industrial strategy, the Ministry of International Trade and Industry ("MITI") has a central and dominant role. MITI targets certain key industries chosen after wide-ranging consultation and discussion, and works to ensure, by a variety of interventions, that those sectors grow rapidly and efficiently. The planning has been strategic, but, wherever possible, has been based on some notion of consensus. The Japanese recognized early that static comparative advantage was not an adequate basis for national economic development. To branch into other areas of economic activity required that the state be directly involved; the market could not be relied upon. The market had to be managed and

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directed, while nevertheless leaving it to do what it does best: looking after the myriad incremental changes required within the broad strategy, and of course running all the sectors which did not require strategic intervention.

The success of the Japanese economy is obvious—but how much of this success is the result of government planning? Adams and Brock appear to take the view that MITI was playing an entirely negative role and that it was only the resistance of industry to MITI's strategy that allowed the economy to express its true potential. MITI certainly made mistakes and its pursuit of giantism was misplaced, yet it would seem wrong to conclude from this that MITI did not have a major positive impact on the Japanese economy. Without a coherent, proactive industrial policy, I fear that the Japanese economy would have been dominated by outside interests, primarily from the United States. Developing national economic autonomy was essential to the transformation of the Japanese economy into the modern, dynamic industrial economy it is today, and a coherent industrial policy was a necessary but insufficient condition for achieving just that.

What is important to learn from the Japanese experience is not the detail of instruments, institutions and mechanisms—which may not be easily transplanted—but rather their approach to the problem. To attain similar success in the economies of the United States and Europe will require the same degree of government commitment to economic development as has been the case in Japan. The message of the Japanese experience is that, properly organized, strategic planning and the market are complements rather than substitutes. Each must be allocated its appropriate role.

While Adams and Brock make a compelling case for concluding that merger-induced bigness is bad, the logic of that position demands not only a stringent merger policy to prevent further deterioration in the situation, but also further action to help remedy the current position. The argument presented in this brief Article suggests that to address adequately the current position, a government not only needs to take a strong regulatory approach toward merger and monopoly, but must also adopt a vigorous developmental approach. This conclusion is based upon the theory that the systemic, negative effects of transnationalism, short-termism and centripetalism cannot be fully countered by a purely reactive policy, but instead require a complementary proactive one. The suggested role model is Japan, which based its own developmental policy on the nineteenth century United States experience. The need for a similar commitment to a proactive industrial policy in the late-twentieth cen-
tury United States will become increasingly evident over the next few years as the country begins to grapple with its present trade imbalance. It is important that the problem is not seen simply in terms of a macroeconomic adjustment, but rather that such adjustment is complemented by a long-term supply side policy—an active industrial policy. The same is true in Europe, which has been plagued by continuing high levels of unemployment. Adams and Brock are absolutely correct in recognizing that an industrial policy based on giantism is no way forward. Japan, in contrast and perhaps fortuitously, has demonstrated that industrial policy in conjunction with deconcentration is a winning formula. We can all learn from that experience.