A New Approach to Business-Government Planning

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Just pick up any daily newspaper and you will read allegations of corporate "slush" funds, "imperialistic" multinational corporations, companies "polluting" the environment, forcing their employees to work under "cancer-inducing" conditions, "constantly" raising their prices—and earning "obscene" profits to boot.

What should the business community do about this situation? In my work, I have identified three different approaches. The first is the simplest. Ralph Nader and his associates say that you should confess your sins and mend your ways.

The second approach is advocated by various business associations as well as individual business executives—launch a campaign to sell the free-enterprise system. This can include hiring advertising firms to sell free enterprise in the same way that you sell corn flakes.

I do not say that either of these two approaches is wrong. A certain amount of positive and factual speaking on the benefits of the private enterprise system can be very useful. But sole reliance on that approach is insufficient. It puts you on the defensive, literally defending every goof on the part of every business executive. Also, some of the allegations of the critics may at times be valid. They should be answered with substantive change instead of with belabored explanations. But let us not concede too much too soon.

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Business has been taking it on the chin as revelations of so-called political slush funds have been uncovered. It is altogether fitting that lawbreaking be exposed and punished. Corporate contributions to federal election campaigns are illegal.

Yet there is another aspect of these illegal business contributions to political causes which has been ignored. When we turn to more traditional types of crime, we find that the progressive thinking is not limited to punishment, but it extends to uncovering the causes. By identifying the conditions that breed crime, it is hoped that public policy can be modified so as to reduce or eliminate those conditions—a preventive approach to lawbreaking.

A parallel can be drawn to the Watergate-related cases of unlawful corporate political contributions and their attempted coverup. What was the underlying motive for these illegal acts? The dominant motive was not usually a desire to enrich the individual corporate executives who were involved, or even to enhance their positions in the company. Neither was the typical motive the desire to get the Federal government to grant a particular favor to the firm ("favors" in the form of government contracts were the object of many of the payments to citizens of other nations).

Rather, the illegal contributions were usually a response, often reluctant, to the demands from the representatives of a powerful government which was in the position to do great harm to the company. Whether the government would abuse its vast power in the absence of an adequate payment was a risk that many managements decided not to take.

But it is not surprising that so many of the executives who were im-
To put it bluntly, the market for ideas is fundamentally different from the market for the traditional products of business. The differences include the research and development process, the distribution channels, the marketing methods, the personnel, the time horizon and the method of financing.

Just think of the major "products" that led to the tremendous expansion of governmental controls in the health and safety area. We start with the muckrakers - Ida Tarbell, Upton Sinclair, etc. several generations ago - then "100 Million Guinea Pigs" during the 1920s and, more recently, Rachel Carson's "Silent Spring" and Ralph Nader's "Unsafe At Any Speed."

None of these extremely influential products was developed, produced or marketed through the same channels that business firms are accustomed to using. For better or worse, they are products of the intellect. If the pen was mightier than the sword in an earlier day, the typewriter and the printing press are still holding their own today. Each let us not concentrate entirely on the product side, on the mere design and manufacture of the document.

The channels of distribution are important. None of these items came from a company or a labor union or an advertising agency or a government agency or any other obviously self-serving institution. Each apparently was the product of an individual who wrote what he or she believed. Each was widely reviewed and reported in the newspapers and magazines which potential book buyers, and others, read.

This is the intellectual arena the proponents of the private enterprise system must enter and compete in. In the last year, I have become very optimistic about the prospects for long-run success in that arena because the basic notion that over-regulation of business is not in the public interest because it increases the prices that consumers have to pay.

That is the heart of our positive counterattack—not a very theoretical proposition, but a very practical approach: the notion that the average citizen should be concerned about the free enterprise system because it benefits him or her directly. Likewise, the unwarranted attacks on our economic system by the regulators.

Simultaneously, it is naive—and in the long run, much of business will be technologically obsolete—simply to ignore the basic thrust comes from the awe, the admiration to the political process, much of the new products and facilities.

The future of the private enterprise system in the U.S. for a long time is going to be determined by the outcome of the current debate that is now heating up about government regulation and deregulation. Do not get your hopes up too high. The vast regulating apparatus that has developed in Washington over many years is not suddenly going to be dismantled. But this new national debate does give us the opportunity for the first time to bring to everyone's attention some basic facts, facts known to every businessman, but not to the public. The single fact that I find most important—in getting the attention of the public—is that it is the consumer who ultimately bears the burden of over-regulation of business.

The proponent of new government controls focus all of their attention on the potential benefits—and often those benefits can be real and substantial. But they overlook the large costs which are so often involved, costs to both the taxpayer and the consumer—and that, I find, is the Achilles heel of the regulators.

Whether we like the idea or not, we must realize that a massive expansion of government controls over industry is now underway. Government officials are playing a larger role in what traditionally has been internal business decision-making.

But we also must recognize that it is difficult to criticize their basic mission. They have to possess the personality of Scrooge to quarrel with the intent of these new regulations. After all, who is opposed to safer working conditions, better products for the consumer, elimination of discrimination in employment, or reduction of environmental pollution? And in fairness we must acknowledge that the programs established to deal with these problems have yielded benefits to the nation.

But at what costs? The costs of over-regulation of business are felt by our citizens in many ways: Higher taxes to pay for the regulators. Higher prices of the products we buy as a result of the regulation. Loss of productivity and jobs. A slower rate of introduction of new and better products. And less capital available for new undertakings.

Specificially, Federal regulation adversely affects the prospects for economic growth and productivity by levying a claim for a rising share of new capital formation. This is most evident in the environmental and safety areas.

Let us examine the flow of capital spending by U.S. manufacturing companies just prior to the recent recession. In 1969, the total new investment in plant and equipment in the entire manufacturing sector of the American economy was $25 billion. The annual totals rose in the following years, to be sure. But when the effect of inflation is eliminated, it can be seen that 4 years later, in 1973, total capital spending by U.S. manufacturing companies was no higher. In real terms, it was approximately $26 billion both in 1969 and 1973.

That is not the end of the story, however. In 1973, a much larger proportion of capital outlays was devoted to meeting government regulatory requirements than to new construction and safety areas—$3 billion more to be specific. Hence, although the economy and its needs had been growing substantially in those 4 years, the real annual investment in modernization and new capital had actually been declining.

The situation was worsened by the accelerated rate at which existing manufacturing facilities were being closed down because of the rapidly rising costs of meeting government regulations. It means that they were no longer economically viable. Specifically, about 350 foundries in the U.S. have been closed down in the past 4 years because they could not meet requirements such as those imposed by the Environmental Protection Agency and
the Occupational Safety and Health Administration. This may help to explain why the American economy, for a substantial part of 1973, appeared to lack needed productive capacity, despite what had been large nominal annual investments in new plant and equipment in recent years.

The agencies carrying out federal regulations are proliferating. In the past decade alone, we have seen the creation of the EPA, the FEA, the CASB, the NBFP, the MES, the NHTSA, and the OSHA. That's just one of the alphabet soup.

The cost of maintaining this army of enforcers is huge. The $3 billion a year tax dollars is devoted to supporting a regulatory workforce in excess of 74,000 people. The costs of government regulation are rising far more rapidly than the sales of the companies being regulated. Regulation literally is becoming one of the major growth industries in the country.

But this represents only the tip of the iceberg. It is the costs imposed on the private sector that are really huge, the added expenses of business firms that must comply with government directives, and that inevitably have to pass on these costs to their customers.

One direct cost of government controls is the growing paperwork burden imposed on business: the expensive and time-consuming process of submitting reports, making applications, filling out questionnaires, and responding to orders and directives.

Here is a striking example. One large oil company is required to file approximately 1,060 reports annually to 35 different agencies including the Federal Power Commission, the Federal Energy Administration, the Small Business Administration, and the Bureau of Indian Affairs. In the last half of 1978, the Standard Oil Company of Indiana had to add to its list of required paperwork 16 major new reports to be submitted on a regular basis.

Duplication inevitably occurs. The company must report its oil and gas reserves to the FEA, the FPC, the FTC, and the Geological Survey. Each report must take a somewhat different form. It requires 636 miles of computer tape to store the data that Standard must supply to the FEA. In total, Indiana Standard has 100 fulltime employees whose work is centered around meeting federal regulations, at an annual cost of about $3 million.

Another hidden cost of federal regulation is a reduced rate of introduction of new products. The longer it takes for new products to be approved, the less they will be made. For example, as a result of the more liberal policy in the U.K. toward the introduction of new drugs, Britain has been able to introduce useful new drugs, either sooner than the U.S. or exclusively.

A recent case is the new asthma drug beclomethasone dipropionate (BD). Although this drug has been used successfully by millions of asthma patients in England, it still has not received the approval of our Food and Drug Administration. BD is a safe and effective replacement for the drugs now given to chronic asthma patients, and does not have their adverse side effects. Unlike BD, the steroids now used in this country, such as prednisone, stunt growth in children, worsen diabetes, and increase weight through water retention. The delaying procedures of the FDA are not only increasing the costs imposed on the American consumer but also preventing American consumers from having access to the newer and better product.

The Food and Drug Act is delaying the introduction of effective drugs by about 4 years. As a result, we are no longer in the lead in medical science. The U.S. was the 30th country to approve the anti-asthma drug metaproterenol, the 32nd country to approve the anti-cancer drug adriamycin, the 51st country to approve the anti-tuberculosis drug rifampin, the 64th country to approve the anti-allergenic drug cromolyn, and the 506th country to approve the anti-bacterial drug co-trimoxazole.

The regulators really seem to have the private sector scared. Take a recent example, the TCE. The Occupational Safety and Health Administration ordered a ban on the chemical TCE, the time had been used in decaffeinated coffee.

It seems that the government used a rather generous dose of the chemical on the entire planet. It was the equivalent of an adult being drinking 50 million cups of decaffeinated coffee every day for his entire lifetime.

What was the industry's reaction? To laugh at to example of government overkill. (After all, your bladder would give out or you would drown before you had to worry about cancer). Hardly. With the cyclamate controversy, one may have to conclude that major chemical producers have merely changed to another chemical. Frankly, I don't blame them, given the public atmosphere that has been created by the government.

It is high time that we speak out on this issue.

Government regulations often have strong adverse effect on employment. This has been demonstrated in the minimum wage area where teenagers have increasingly been priced out of labor markets. Our Center recently published a study that showed that the 1966 increase in the statutory minimum wage resulted by 1972 in teenage employment in the U.S. being 320,000 lower than it would otherwise have been, a youth unemployment rate in 1972 3.5% higher than otherwise would have been the case.

In the construction labor area, where unemployment rates are substantially above the national average—government regulation also acts to price some segment of the workforce out of competitive labor markets. Under the Davis-Bacon Act, the Secretary of Labor, promulgates "prevailing" wages to be paid on federal and federally-subsidized construction projects. A study of studies has shown that these Federally-mandated wage rates are often above those that actually prevail in the labor market when they are done.

Although only to a minor degree, perhaps, the equal employment opportunity program may tend to increase unemployment by delaying the filling of job vacancies. To the extent that employers must undergo protracted job searches prior to hiring employees, the average length of unemployment is likely to be longer. It is not uncommon for a position to remain unfilled despite the presence of the government requiring them to have not been met.

It is inevitable that the prohibition of government controls should lead to conflict among controls and controlers. In the rules of a given agency work at cross purposes with each other. More serious and more frequent are the contradictions between official rulings of 2 or more government agencies where the regulated have little recourse. Obviously, you cannot build a factory if it violates the standards of a government. You have to make sure, of course, that in cleaning up air pollution you do not generate water pollution.

For example, the desulfurization of coal to reduce air pollution requires a combination with lime. But in the process, large quantities of solid waste, calcium sulfate, are generated. Disposing of calcium sulfate creates water pollution problems. As another example, Federal food standards require meat-packing plants to use tile and stainless steel in the processing line. Surfaces that are easiest to clean are usually tile or stainless steel. But tile and stainless steel are highly reflective of noise. They may not always meet the standards set for occupational safety and health.

Each regulatory agency seems to be exclusively preoccupied with its own narrow interest, and is oblivious to the effects of its actions on the company, a whole industry, or even to society as a whole.

The action of the Environmental Protection Agency, regarding fire ants offers a good case study. EPA told the Agriculture Department that it is imposing severe restrictions on the use of the pesticides which can kill fire ants. EPA had a major ant program underway to get rid of those ants. EPA's ruling is preventing the Department from carrying out its eradication program. The Agriculture Department believes that fire ants may spread over a third of the U.S. The insects may not harm the crops as much as EPA thinks pesticides do, but their bite is very painful and can even
cause death. But in the traditional bureaucratic division of labor, EPA apparently is not concerned with the fact that it is all people. I suggest, facetiously, that the Agriculture Department try to breed a special strain of fire ants that only bite high-handed government regulators.

On Aug. 20, 1973, the commission banned certain brands of aerosol spray adhesives as an imminent hazard. Its decision was based primarily on the preliminary findings of one academic researcher who claimed that they could cause birth defects. After more careful research failed to corroborate the initial report, the commission lifted the ban on March 1, 1974. Why do I mention this case? Depriving consumers of spray adhesives for less than 7 months does not seem to be too harsh in view of the desire to avoid serious threats to people's health.

In fact, the admission of error on the part of the commission is commendable. Its prompt recision of the initial action would seem almost to break speed records for a government agency.

But there is more to the story. It seems that a number of pregnant women who had used the spray adhesives reacted to the news of the commission's initial decision by undergoing abortions for fear of producing babies with birth defects. The sadness of this case is hardly reduced by the fact that everyone involved was trying to promote the public health and safety.

Indeed, this case illustrates the dilemma of government regulators. Had the commission failed to ban spray adhesives and the initial research subsequently been validated, an equally sad scenario could have resulted. Clearly, the government's involvement in such areas as product safety and job health requires a careful balancing of numerous factors, both objective and subjective.

This is not a general attack on all forms of government regulation of private activity. Unless you are an anarchist, you do believe that the government should set rules for society. But to concentrate exclusively on the well-intentioned objectives of government policies and to ignore the serious side effects is unwittingly to fall into the trap of adopting the totalitarian notion that the end justifies the means.

In legislating regulatory programs, there are very important questions which need to be faced and answered: what rules to set, how to make them, and how to carry them out.

Because of the very substantial and often adverse side-effects that they give rise to, society should take a new hard look at the existing array of government controls over private business. A substantial effort should be made to eliminate those controls that generate excessive costs to the society.

Rather than blithely continuing to proliferate government controls over the economy, an alternative means of achieving important national objectives should be explored and developed, solutions that expand rather than reduce the role of the market.

To the enthusiasts for more Federal regulation, I urge that they stop, and listen — to the operation of existing Federal rules and regulations, and see how the bright dream turns into reality. But criticism and government critics do not suffice. If we are going to improve the situation, we are going to have to develop specific proposals.

A good beginning to streamlining government regulation, oddly enough, can be based on the environmental regulations themselves. We are now required to examine the impact on the environment of the various actions that we take. Sometimes it seems that you cannot sneeze without filing an environmental impact statement. Would it not also be appropriate to require each environmental agency to assess the impacts of its action on the nation as a whole and particularly on the economy? And to show that the benefits of its actions exceed the costs imposed on the public?

Surely a cleaner environment is an important national objective. But it is not the only national objective, and certainly society has no stake in selecting the most expensive and most disruptive way of achieving its environmental goals.

I have in mind the recent case of the developer who felt obliged to include every type of weed in his environmental impact statement — and how to keep them. I am not advocating a greater fish fry approach.

Indeed, let us mourn for all the trees that have needlessly been cut down to provide the paper for all those overblown business reports to government.

We should require the same balance of costs and benefits for the other regulatory programs, including product safety, job health, equal employment, energy, etc. As in most things in life, the sensible questions are not one or the other, but rather of more or less and how.

To an economist, it seems proper that government regulation should be carried to the point where the benefits equal or exceed the costs — and no further. Overregulation — which I define as situations where the costs exceed the benefits — should be avoided. But if we ignore the costs, we are bound to operate in the zone of overregulation.

What do we do about it? I do not expect the government to really improve until consumers learn that it is they who ultimately pay the growing costs imposed by government regulations. And remember these costs hit the public in two ways: higher taxes to cover the expenses of the government agencies doing the regulating and higher prices of the products produced under government regulation.

Perhaps even more fundamental is the notion that government regulation is a powerful medicine. It needs to be taken very carefully, in limited doses, and with full regard for all the adverse side-effects. We must avoid unwittingly overdosing the patient. Better yet, we must quit following the advice of well-meaning individuals who fail to understand the consequences of their proposals.

Basiclly it is attitudes that need to be changed. A case in point relates to weeds. On the surface, it appears to be at most only a matter of excessive caution on the part of the Consumer Product Safety Commission.
Surely, the society desires to reduce the accidents that occur on the job. To this end, the Congress established a new agency with thousands of employees and an operating budget of several million dollars. The agency in turn has promulgated an array of rules, regulations, and requirements which have resulted in literally billions of dollars in private sector outlays—and in more complaints from business than almost any other government program.

What have been the results? More forms are now filled out. More safety rules are posted. More fines are levied. But, as shown by the available statistics, there has been no reduction in accident rates in American industry.

In the case of the job safety program, as in numerous areas of government involvement, the important original concern of the public and the Congress has been converted to the bureaucratic objective of not violating the rules and regulations. "You won't get into trouble if you don't violate the safety standards," is the bureaucratic response, even if as many accidents occur as before.

The emphasis shifts to such trivia as raising and answering these types of questions: How big is a hole? When is a roof a floor? How frequently must spittoons be cleaned? The results in terms of the safety objective are almost invariably disappointing. Yet, the reaction to this situation is virtually predictable: redouble the existing effort — more rules, more forms, more inspections, and thus higher costs to the taxpayer and higher prices to the consumer.

A more satisfying answer requires a basic change in attitude, and one that is not limited to the job safety program. If the objective of public policy is to reduce accidents, it should focus directly on the reduction of accidents. Excessively detailed regulation is often a substitute for hard policy decisions. Rather than issuing citations to employers who fail to fill out the forms correctly or who do not post the correct notices, the emphasis ought to be placed on those employers with high and rising accident rates.

But the government should not be concerned with how a specific company achieves the objective of a safer working environment. Some may find it more efficient to change work rules, others to buy new equipment, and still others to retrain workers. But that is precisely the kind of operational business decisionmaking that government should avoid, but which now dominates so many of these regulatory programs.

Without diminishing the responsibility of the employers, the sanctions under the Federal occupational safety and health law should be extended to employees, especially those whose negligence endangers other employees. The purpose here is not to be harsh, but to set up effective incentives to achieve society's objectives.

I am not proposing to eliminate all government regulation of business. We must realistically acknowledge the important and positive benefits that have resulted from many of the government's regulatory activities—in terms of less pollution, fewer product hazards, ending job discrimination, and achieving other socially desirable objectives of our society.

We must also realize that these Federal programs were established by the Congress in response to a surge of rising public expectations about corporate performance. Although business executives rarely talk or write in terms of the costs and benefits of their actions to society as a whole, they often are aware of that basic justification for governmental intervention.

The president of Chrysler furnished a cogent example in justifying governmental automobile pollution controls:

"...large part of the public will not voluntarily spend extra money to install emission control systems which will help clean the air. Any manufacturer who installs and charges for such equipment while