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The Case Against Another Business-Government Partnership

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Presentation to the Foreign Policy Institute, Johns Hopkins University, Washington, D.C., June 19, 1989

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THE CASE AGAINST ANOTHER BUSINESS-GOVERNMENT PARTNERSHIP

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George Santayana was absolutely right. Those who do not learn from history are doomed to repeat the mistakes of the past. Thus, it is sad to see the mighty efforts now underway to revive the discredited concept of government handouts to save some particularly worthy companies or industries.

Peeling away the label, we find several common and fundamental shortcomings to the latest notion that the taxpayer should provide financial assistance to firms suffering from that terrible disease known as competition.

To be fair, let us note that every business coming to Washington for financial help just detests the term bailout. Each of them firmly believes in competition -- at least on the part of its suppliers. But when other companies attempt to sell similar products at lower prices -- or better products at the same price -- that process is called unfair competition, or predatory pricing, or foreigners capturing our markets.

Let us tackle the major myths that accompany the proposals for federal bailouts --- also known as business-government partnerships, be these cozy arrangements "business-led" or "government-led."

Shortcomings of Business-Government Partnerships

Myth #1 -- Business-government partnerships do not involve government control over business, just some helpful federal assistance. It is fascinating to see how many otherwise smart, tough corporate executives think they can obtain generous benefits from the U.S.

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Treasury without any government strings attached. Any business manager who is so naive should not be let out alone at night, much less let loose in Washington.

In a burst of bipartisanship, I quote former Senator William Proxmire, a Democrat from Wisconsin: "Money will go where the political power is. Anyone who thinks government funds will be allocated to firms according to merit has not lived or served in Washington very long."

Myth #2 -- Government action will be more fair and effective than unplanned competition in the marketplace. New and growing firms may be economically strong, but they are politically weak. They lack either a record of extended financial contributions to political candidates or the detailed knowledge of lobbying techniques. Moreover, the successful ones are too busy making and selling their products to devote their time and energy to politics.

In contrast, the past is overrepresented politically. Old firms may be economically weak, but they are politically strong. They possess well-developed relationships with key political figures. I am referring to the much vaunted "access" which is the goal of much of the PAC contributions. The "sickies" also have more incentive to lobby.

The result is a very uneven contest. The political process favors old-line businesses over new enterprises, and declining industries over growing sectors of the economy.

Just consider the actions taken in any recent session of Congress. After paying all due homage to the virtues of the high-tech industries, the committees regularly report out bills appropriating large sums for agriculture, mining, fisheries, shipbuilding, and other old sectors of the economy that already are overinvested.

Myth #3 -- Past bailouts may upset the sensibilities of supporters of competitive private enterprise, but they work. That hokum is not supported by the facts. Take that darling of business-government partnerships, the Reconstruction Finance Corporation. Too many have forgotten that the RFC was eliminated by the Congress because it had become a national embarrassment. Almost all of the money went to companies that subsequently failed. Knowing a highly-placed insider was the key to getting the goodies.

More recently, we had the Synthetic Fuels Corporation. To my knowledge, there were no scandals involved; just a mere waste of a few billion dollars of taxpayer money before this boondoggle was closed down.

But what about successful bailouts, like Chrysler? Once again, the economist has to be the wet blanket. It is true that the company did not have to file any formal bankruptcy papers. But the specific actions it took closely resemble those of a company going through Chapter 11. To the creditors who received only 30 cents on the dollar, the pain was as great as if the company had formally gone broke.

Myth #4 -- Foreign business-government partnerships have worked well. Japan's MITI is usually heralded as a fine example. But look at the details. MITI tried to keep Mazda and Honda out of the automobile business because it badly underestimated the growth of Japan's export market.

And then there was MITI's textile fiasco. Between 1956 and 1974, MITI brought and scrapped 180,000 looms to enforce the textile cartel that it had set up. You appreciate that I am not using the exact bureaucratic language that was employed to describe this particular business-government partnership. However, at the same time, almost 160,000 illegal looms came into production. In fact, more textile companies were operating in Japan after MITI's efforts than before.

What Does Work?

Let me inject an upbeat note. Studying the lessons of history also yields a positive approach. Let us examine the Japanese response since 1987 to the rapidly rising yen in world currency markets. On their own, Japanese companies took quick and tough actions to restore their global competitiveness. Within weeks or months of the change in the external financial environment, many of them adopted vigorous campaigns to improve productivity. Executives reduced their own salaries. Efforts to upgrade quality were made. Some manufacturing operations were quickly moved to lower-cost locations. MITI was not in the forefront of these necessary business adjustments to change.

There is an American counterpart to these actions. During the past five years, many U.S. companies have taken the painful actions necessary to reduce costs, raise productivity, and improve their competitiveness. Quality has become a key focal point. Moreover, counter to the general impression about the short-range orientation of American business, private sector outlays for research and development in the 1980s have exceeded public sector expenditures for R & D.

Conclusion

There are many important tasks that only government can perform, ranging from ensuring the national security to providing a system of justice. But one thing that democratic political systems cannot do well at all is to make critical choices between particular firms and industries.

Using taxpayers' money to promote the well-being of any company or industry in the marketplace is fundamentally unfair to the other companies that pay those taxes. Worse yet, such an approach is destined to turn any effort to promote competitiveness into another political pork barrel.

There is an economic policy that can improve the performance of American industry. It focuses on creating a policy environment that fosters competitiveness. The five ingredients are well known:

1. *Really reduce those budget deficits*. This will directly increase the availability of funds for business investment in R & D and capital equipment -- and indirectly reduce the cost of capital to American business firms. But I said "really reduce." That does not mean playing the old Washington shell game of moving big spending programs off budget -- and then moving them back in when we count up the federal government's total borrowing.
2. *Keep the tax system stable for a while*. This will promote more certainty in business planning. When the time comes that taxes can be cut, the focus

should be on encouraging saving and investment.

3. *Shift the composition of the federal budget to investment outlays*. The current emphasis in promoting consumption via transfer payments is outmoded. A growing share of government spending should be devoted to education and R & D and similar basic investments in a more productive economy.
4. *Reform government regulation of business*. Cut away the growing thicket of permits, restrictions, and other regulatory obstacles that face any new undertaking -- be it the building of a factory or the exporting of a new item.
5. *Stabilize the growth of the money supply*. Encouraging a more predictable growth in the flow of credit helps to spur economic performance.

A word of warning: these five steps are not a guaranteed cure. There is no assurance that any one company or industry or region will benefit from the reduction of government obstacles to business performance. But the economy as a whole and citizens in general will be better off. The positive approach puts the onus on labor and management in each company to deal with the competitive problems that face them, which is where the responsibility properly belongs.

To those who insist that, because there is a problem, government must act, my response is: OK. Don't just stand there, undo something.