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How Domestic Regulation Handicaps U.S. Global Business

by Murray Weidenbaum

One of the few advantages of being a former chairman of the Council of Economic Advisers is that you receive a lifetime supply of crystal balls. Of course, they are all cloudy. Nevertheless, I assume my task of forecasting the future of the American economy with a positive attitude.

How U.S. Business Adjusts to the Global Economy

Thus, I start with the good news. American industry has successfully made the painful but necessary transition to a more competitive, more global marketplace. It is the rare company that has escaped restructuring or downsizing or streamlining (choose your favorite euphemism for a corporation going on a crash diet). As you would expect, the results are uneven. Like the academic who could simultaneously publish and perish, many firms have succeeded in both cutting back the size of their work forces and reducing the productivity of those who remain.

But the more typical case results in a firm with increased productivity and enhanced competitiveness. Takeover threats and foreign competition have both served an unintentional but useful function — as incentives for taking the painful actions that reduce costs and raise product quality. Recall the TV clip of the newly reemployed auto worker who had just returned from a long and involuntary layoff. The reporter asked whether the job had changed. The unexpected response was: "It's a different world. I now know that how long I keep my job depends on how I do on the job." That was painful but perhaps necessary on-the-job training — or, perhaps more accurately, off-the-job education.

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Pay and productivity are more than alliterative terms. They do go together. People are learning, to the mutual benefit of management and labor.

In the 1990s, American industry is also benefiting from the upsurge of industrial research and development during the 1980s. A key crossover occurred in the early 1980s — the magnitude of company-sponsored R&D exceeded the total of government-financed R&D. That primary reliance on private R&D continues to this day. In retrospect, it was rather remarkable that this strategic change took place at a time of rapid expansion of military spending for new technology — as well as for military items generally.

Few analysts have appreciated the long-term impact of that crossover. The new — and continued — dominance of the private sector in the choice of investments in advanced technology makes more likely an accelerated flow of new and improved civilian products and production processes — perhaps comparable to the advent of missiles and space vehicles following the military R&D growth in the 1950s and 1960s.

Indeed, when we disaggregate the persistent trade deficit of the United States, we find that our exports of high-tech products now steadily exceed our high-tech imports. Yes, we do indeed enjoy a comparable advantage in the production and sales of goods and services that embody large proportions of new technology. That is the good news.

Assaults on American Business

Now for the bad news. American industry constantly fights a two-front war. The obvious — and open — opponent is the foreign competitor. I do not share the view of some of my business friends who welcome competition only among their suppliers. If business economists have any continuing professional responsibility, it is to remind their colleagues of the benefits of widespread competition in the marketplace.

The second front in the business wars is less benign. I refer to the pervasive tax and regulatory obstacles placed in the way of U.S. business — especially high-tech companies — by a host of federal, state, and local governments. These are often egged on by a bewildering array of self-styled, public-interest groups (that makes for an interesting acronym).

Consider some of the key high-tech industries — biotechnology, pharmaceuticals, and nuclear power. In each case, the most difficult problems faced by the industry has been dealing with the thicket of governmental reviews and approvals. No one agency can give an OK to go ahead. But the failure to receive the necessary authorization from any one of them can literally halt production.

Not too surprisingly, many high-powered American firms are increasingly turning to foreign markets. And not just for the export of U.S. production, but for investment in overseas R&D, production, and distribution facilities. I must confess to very mixed emotions on this account.

From almost every business viewpoint, this metamorphosis into the global enterprise makes good economic sense. Rapid advances in transportation and communication have broadened and deepened the effective markets for numerous products and services. Likewise, capital, information, labor and other key inputs to production are increasingly transnational. As the leading way of organizing economic activity, the business firm is successful — and can withstand a great deal of hostile action — because it is a constantly adapting mechanism. That continues to be the case despite the costly adjustments the companies have to make to comply with ignorant public policy.

But I find the growing internationalization of production regretful — to the extent that it is caused by increasingly coercive government in the United States. Take the energy company that explores in faraway Kazakhstan, or the mining enterprise that moves to Bolivia, or the medical devices firm that sets up a lab in the Netherlands, or the manufacturing corporation that builds a new factory in Guangdong. Those companies are not the villain. Our government is. Governmental officials in the United States lock up much of the nation's natural and labor resources for fear that somebody somewhere may make a profit. I vividly recall the meeting in

Warsaw with the Polish parliamentarians who teased us that the United States is now the last bastion of Marxist ideology.

The statistics — and their implications — are compelling. American-headquartered companies of every shape, size, and variety are increasingly present in the different parts of the world that welcome capitalistic enterprises. Many of our companies make more of their new investments overseas than here at home. Some of the best known American companies already have deployed a majority of their assets overseas — Manpower, Inc. (72%), Gillette (66%), Mobil (63%), Digital Equipment (61%), Exxon (56%), IBM (55%), Chevron (55%), Bankers Trust (52%), Citicorp (51%).

There is a powerful attraction from areas such as Southeast Asia, which has become the most dynamic part of the global economy. U.S. business planners cannot be oblivious to markets that register double-digit growth rates year after year and whose governments are encouraging such rapid expansion of the private sector.

This contrast in public policy toward business is ironic. Current and former communist and totalitarian nations are moving toward the decentralization of power characteristic of the private marketplace. In many ways, they are taking positive steps to encourage and attract new industry, including reductions in tax burdens and regulatory barriers. Meanwhile, the United States has adopted a political regime that moves in the opposite direction. I refer to rising levels of business taxation, regulation, employer mandates, and other costly evidences of government imposition on and discouragement of private economic activity.

Sadly, the response of business leaders is predictable: be cooperative or at least quiet, in the hope that the powers that be in Washington will pick on someone else. Thus, the business community was silent when the First Man and the First Lady slammed the pharmaceutical industry. In the process, the First Couple destroyed about $120 billion of the market value of these firms. The same passive response greeted the assault on the insurance industry. Most recently, senior legislators have gone after individual companies in the fast food industry. The attempt by the senior senator from Massachusetts to debate a Big Mac (in lieu of the chief executive who was committed to being elsewhere) was a shameful exercise of political power.

Far more serious is the sustained effort to move the health care system into the public sector. That is the only accurate way of describing the proposed change, especially in view of the courageous decision of the nonpartisan Congressional Budget Office to treat the employer mandates in the Clinton health plan as an on-budget transaction (i.e., as a federal government activity).

In earlier times — prior to the complexities of this two-front war — we used to refer to such a strategy as divide and conquer. The current version is more subtle than that. While the Secretary of Commerce is doling out ephemeral favors to some friendly firms — such as inviting them on an official trip to the Orient — the Secretary of Labor is trying to reduce the freedom of action of business managers by redefining the basic decisionmaking procedures in the work place as well as in the boardroom.

Yes, my crystal ball is cloudy. It is not clear to me whether the Clinton counterrevolution — my basis for contrast is, of course, the Reagan revolution — is just a passing phenomenon or whether the economic damage will be long lasting. Surely, world competition is not standing still. The European Union is in the process of expanding from 12 member nations to 15 or 16 and ultimately more. While we welcome the elimination of trade barriers within western Europe, the careful observer must note the growing tendency of those countries to trade with each other.

When the common market first got going, most (over 60%) of the foreign trade of those 12 nations was outside what is now the European Union. Today, most (again, over 60%) of the foreign commerce of those 12 nations stays inside the European Union. Given the established trading patterns of the prospective new Scandinavian members, it is very likely that this inward ratio will rise further.

Similarly, the economies of the Asian rim nations are moving closer together, at least in the standard measurable terms. Thus, the major source of foreign investment in Southeast

Asia is neither Europe nor North America. It is far closer — Japan, South Korea, Taiwan, and Hong Kong. Not too surprising, those four countries have become the major source of imports into Thailand, Malaysia, Indonesia, Vietnam, and southern China — as well as being the major destination for their exports. With the development of a substantial consumer base in Southeast Asia, the regionalization of production and consumption is bound to increase in that part of the world.

Meanwhile, here at home in North America, a similar trend toward regionalization is visible. Canada has been the number one market for U.S. products for a long period of time, with Japan in second place. Mexico is now giving the much larger Japanese economy real competition for the number two slot. The North American Free Trade Agreement (NAFTA) should provide an offset to the regionalization underway in Europe and Asia by increasing the tendency of U.S., Canadian, and Mexican firms to invest in and trade with each other. That is an easy forecast to make — even in the absence of the unfortunate domestic content restrictions embedded in NAFTA.

What are the prospects for the U.S. economy? In a great many different industries, American firms are still among the world leaders. U.S. firms rank number one (in sales volume) in aerospace, apparel, beverages, chemicals, computers, food products, motor vehicles, paper products, petroleum, pharmaceuticals, photographic and scientific equipment, soap and cosmetics, and tobacco. Their future shares of world markets — and the resultant impacts on domestic employment and income levels — will depend primarily on the individual actions of a host of business enterprises. Nevertheless, decisions by government will exert a strong influence on whether they help or hinder.

Needed Public Policy Changes

A more benign public policy environment here at home surely will enhance America's economic position in the twenty-first century. This is not a plea for subsidy of American business — or of any other sector of the nation. On the contrary, the domestic economy will fare much better from fewer government efforts to do something for — but more often to — private industry.

Here are a few suggestions for regulatory reform, both general and specific.

- Congress should incorporate a requirement for benefit-cost analysis in each key stage of the regulatory process — from writing the statutes to issuing regulations to reviewing the operation of regulatory programs.
- Government officials should avoid "legislative handcuffs" by emphasizing objectives to be achieved rather than precise methods to be used in complying with regulation.
- Government also should use risk assessment to set priorities for achieving greater protection of health, safety, and the environment in the most cost-effective manner.
- Government agencies should act in a timely fashion. For example, when a law requires getting a permit and the agency cannot meet the deadline, the permit should be granted automatically.

We should not forget that broad regulatory principles affect specific firms and individuals. The private sector should not be punished for the shortcomings of the public sector.