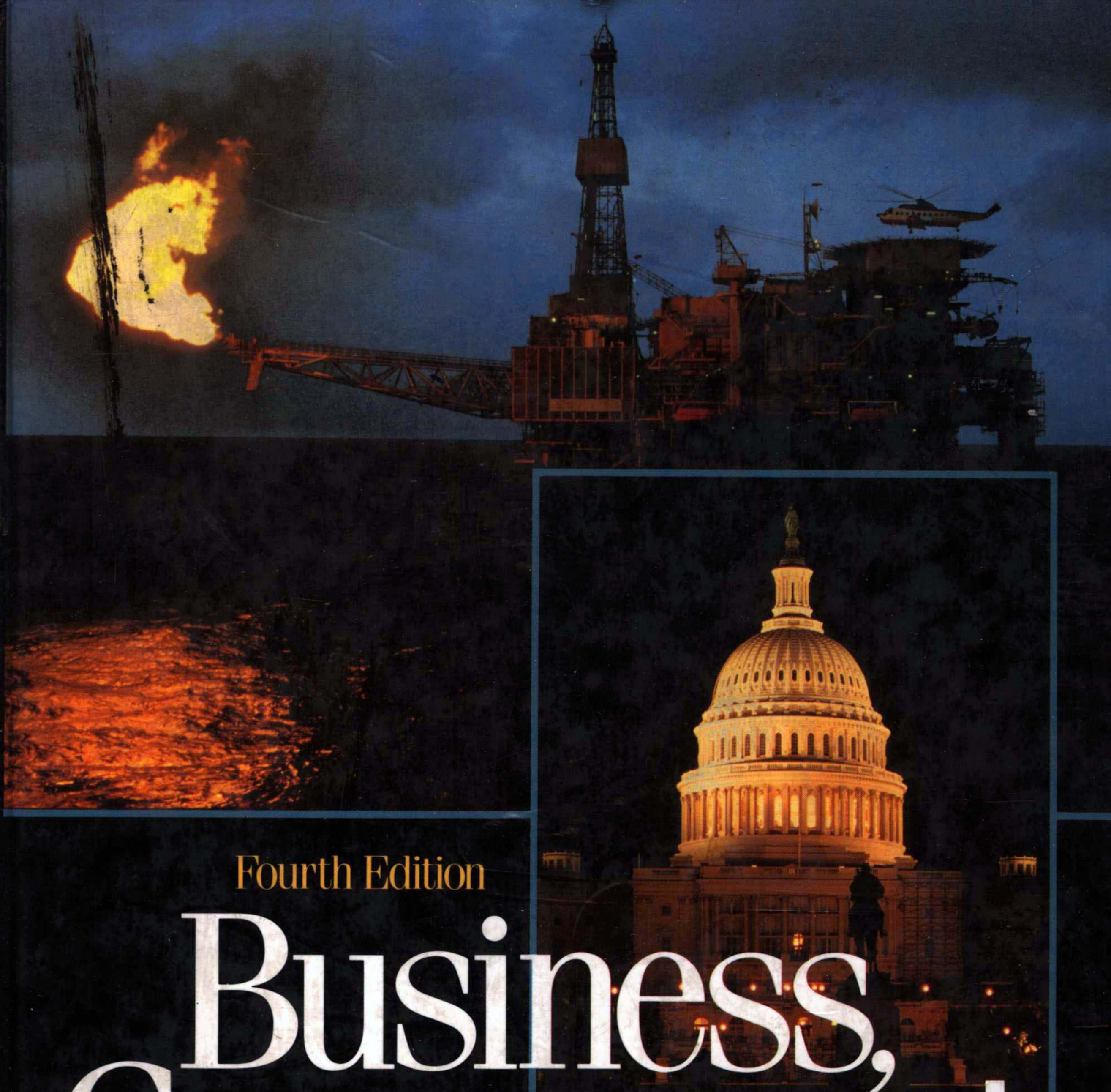

Fourth Edition

Business, Government, and the Public

Murray L. Weidenbaum

BUSINESS, GOVERNMENT, AND THE PUBLIC

Fourth Edition

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PREFACE

Public policy—especially as shaped by a host of government and interest group interactions—is a pervasive influence on the business firm. This book is designed to provide an understanding of both sides of that relationship, covering the different ways in which government policy affects the activities of the modern corporation and the key responses on the part of business.

The fourth edition represents a special effort to meet the needs and desires of the two main sets of users—students and faculty in schools of business and in departments of economics. As someone who teaches both a graduate MBA course and an upper level undergraduate economics course, I have tried out a preliminary version on both groups of students and have benefited from their reaction. Thus, this edition simultaneously adds some relevant economic analysis and eliminates much tedious description and jargon in an effort to be more user–friendly.

Part One, the shortest section of the book, is an overview of the different tools that government has available to influence business decision making. Part Two covers the field of government regulation in both the social and economic areas. Changes have been made to reflect recent developments in public policy. Separate chapters cover traditional economic regulation (including expanded treatment of anti-trust) and the trend toward deregulation. The chapters on environmental and energy regulation have been combined, as have the chapters on automobile and consumer product regulation.

Part Three presents much new material reflecting the expanding array of public policy issues affecting business: competitiveness, protectionism versus free trade, corporate bailouts, defense production, and taxation. The chapters on industrial policy and national planning have been dropped, but the still-relevant portions of them are included in the new chapters on competitiveness and taxation.

Part Four deals with the key responses of business to government influence. The chapter on issues management has been strengthened, and the closely related chapter on business-government relations has been expanded to include much of the material previously contained in a separate chapter on trade associations.

Part Five contains a new chapter on corporate takeovers. In the last chapter, which focuses on the future of the American corporation, an effort is made to identify the oncoming changes in government policies affecting private business.

As in the previous editions, the focus of this book is on the future practitioner—the business executive who will be dealing with issues of public policy as a day-to-day aspect of the job. Also, it is hoped that this book will assist present and future government officials and members of interest groups to appreciate better the various consequences of their actions on the business system.

The preparation of this book was supported in part by the Center for the Study of American Business. The author is indebted to Thomas Phelps and Mark Vaughan for their helpful research. Christine Moseley carefully typed the various drafts and helped ready the manuscript for publication. Sadie Cohn also ably assisted with the typing of the manuscript. The author is particularly grateful to Kenneth Chilton, Associate Director of the Center, for carefully reviewing the entire manuscript and for making numerous helpful suggestions which improved the book.

Murray L. Weidenbaum

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ABOUT THE AUTHOR

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Murray L. Weidenbaum is one of America's most widely quoted academics. He holds the Mallinckrodt Distinguished University Professorship at Washington University in St. Louis, where he also serves as Director of the University's highly-regarded Center for the Study of American Business. From January 1981 to August 1982, he served as President Reagan's first Chairman of the Council of Economic Advisers. In that capacity, he played a major role in formulating the economic policy of the Reagan Administration and was a major spokesman for the Administration on economic and other domestic issues.

He has held a variety of business, government, and academic positions. Dr. Weidenbaum was the first Assistant Secretary of the Treasury for Economic Policy, and served earlier as Fiscal Economist in the U.S. Bureau of the Budget, and as Corporate Economist at the Boeing Company. Dr. Weidenbaum is a member of the boards of directors of the May Department Stores Company, Contel Corporation, and Harbour Group.

Dr. Weidenbaum is known for his research on business–government issues, taxes, government spending and regulation. He is the author of five books, this latest being *Business, Government, and the Public,* 4th edition, (Prentice-Hall, 1990). He has written several hundred articles in publications ranging from the *American Economic Review* to *The Wall Street Journal*. He also prepares a monthly column for *The Christian Science Monitor*.

Dr. Weidenbaum received his Ph.D. from Princeton University and honorary LL.Ds from the Baruch College and the University of Evansville. He also has received the Distinguished Writers Award from the Center for Strategic and International Studies, the Alexander Hamilton Medal "in recognition of distinguished leadership in the Department of the Treasury," the Leavey Prize for excellence in private enterprise education from the Freedoms Foundation, and the Adam Smith Award from the Association of Private Enterprise Education. Furthermore, he has been inducted into the Free Market Hall of Fame, and he served as president of the Midwest Economics Association in 1985–86.

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THE POWERS OF GOVERNMENT AND BUSINESS

The chairman of the board of American Conglomerate Unlimited has just summoned the board's secretary (a bright young attorney with an MBA). The purpose is to review the agenda for the upcoming meeting of the company's board of directors.

PREPARING FOR THE BOARD MEETING OF AMERICAN CONGLOMERATE UNLIMITED

Aside from the usual committee reports — audit, finance, executive compensation, and nominations — the ACU board meeting will focus on the chairman's quarterly review of operations. The current year is progressing better than the previous one but is falling substantially short of the objectives set at the board's summer planning meeting. A longer-than-usual list of problems has arisen that the chairman desires to discuss with the board.

- The Industrial Machinery Division is behind schedule on its new factory. The reason is the unexpected difficulties encountered in securing all of the federal, state, county, and municipal permits required for construction.
- The Consumer Products Division has been turned down again by federal regulators on key new products that it has developed. One cosmetic has

been rejected by the Food and Drug Administration. Two chemical compounds have failed to receive clearance by the Environmental Protection Agency.

- The Government Products Division has been in the headlines in recent weeks because of a congressional investigation of alleged cost overruns and influencing peddling in connection with the tanks that it produces for the Army.
- The Farm Equipment Division has reported another loss, caused by the continuing penetration of markets by imports. Despite its long-term opposition to government interference in the economy, the division's management and the general counsel are urging the company to petition the International Trade Commission to stem the tide of imports. Consumer groups are ambivalent on the issue, because their supporters in the union movement have shifted to a protectionist position.
- The treasurer has deferred the bond issue scheduled for this month in view of the recent sharp runup in interest rates. Renewed inflationary pressures have fueled speculation about further upward movements in rates.
- The senior vice-president for human resources has been spending most of her time in Washington, trying to settle a class action suit instituted by the Equal Employment Opportunity Commission. The company has been receiving unfavorable national publicity on this score.
- The vice-president for labor relations has begun preliminary negotiations with the International Association of Machinists on the expiring labor contract. Because ACU is in a bellwether industry, the Secretary of Labor has publicly urged restraint on inflationary increases in wages and fringe benefits.
- The secretary of the board has been meeting with representatives of the Sisters of Loretto and the National Council of Churches to discuss a resolution against doing business in Northern Ireland that the two groups want to introduce in the company's annual proxy statement.
- The executive board of the Chamber of Commerce of the United States has asked for a go-ahead to nominate ACU's CEO as the next chairman of that broad-based business association.

The list goes on, but the chairman is reluctant to raise more of these "extraneous" or "nonbusiness" issues with the board all in one meeting. He wonders out loud whether American Conglomerate Unlimited is properly staffed and organized to handle this variety of matters. The secretary suggests bringing in some Washington-based consultants to advise the company. This, the chairman objects, would at best be a "quick fix," a short-term solution; similar matters would likely come up the next year.

The secretary asks to what extent some of these "oddball" problems have arisen, or at least worsened, because ACU's managers are not sufficiently trained

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or experienced to deal with them. "Precisely," replies the chairman. At this point, the company's lead investment banker calls with word of a possible takeover threat.

This scenario, of course, is hypothetical and simplified, yet problems like these regularly arise in American corporations. The need for training of the current as well as the next generation of managers to meet such problems is widespread. This book is a response to that need.

The public sector influences private-sector decision making in a great variety of ways. Most analyses of the interaction between business and government focus on the pros and cons of public policy actions. This book turns the tables on that conventional approach. Rather than just attempting to play public policymaker, we will also examine the interactions between business and government from the vantage point of the private business firm and its management.

THE POWER OF BUSINESS

The government agency and the business corporation are two of the most powerful institutions in modern society. The shifting and complicated relationships between them exert great influence on the changing performance of the economy and on the lives of citizens. These relationships range from cooperative to competitive, from friendly to hostile. In its fundamentals, it is an uneasy relationship, each side possessing basic powers and yet each having an important need for the other. In the United States, the result is a mixed economy in which the public and the private sectors interact in many ways.

The basic power of the business firm lies in the widespread recognition that it is a fundamental mechanism for achieving human progress. The public's strong belief in the role of private markets, competition, and the independent business firm ultimately limits the ability of government to dominate the economy and to intervene in the operation of private enterprise.

As we will see in great detail, governments at all levels are involved in business decision making. But before we examine that aspect of the business–government relationship, it is useful to understand the underpinnings for continuing public support of the private enterprise system.

A brief reconnaissance of national experiences in modern times reveals that capitalistic economies generally perform much better than those with a much larger governmental presence. Most notably are those in societies ruled by communist and socialist governments. Moreover, the capitalistic nations, on balance, provide their citizens with more personal freedom.

History shows us that economic performance is not necessarily a question of natural resources, inherited wealth, culture, or geography. Looking at the developed nations of Europe — with similar levels of resources and culture — it is clear that the capitalist countries of the West generally outperform the communist economies of the East. In Asia, the nations with a large and vibrant private business sector — Taiwan and South Korea, for example — outperform the communist economies of North Korea and China.

As for resources and inherited wealth, Spain and Great Britain present a striking contrast. Despite the hoards of gold and silver it received from the Americas in the early stages of modern economic experience, the highly controlled economy of Spain has remained for centuries at a relatively primitive level of development. The initially far more modest but also far more open economy of England, especially in the postmercantilist era, led the economic development of the globe for long periods — and it is blossoming once again. In our own time, a nation with few natural physical endowments — Japan — has become the economic wonder of the post-World War II era.

What common characteristics do the successful economies have? A cluster of key interrelated factors stands out: a strong business sector, competition, decision making in the marketplace, and decentralization of power.

Any doubt about this last factor can be dispelled by thoughtfully turning a globe of the planet. It becomes clear that the countries with a large and strong private sector tend to be those that provide their citizens with a large degree of individual liberty. On reflection, that is not coincidental. The decentralization of power that is essential for capitalism to prosper is also the basic way of avoiding a totalitarian society. Turning to the United States specifically, this country's high degree of economic freedom did not just happen; it has extensive constitutional underpinnings.

THE U.S. CONSTITUTION AND ECONOMIC FREEDOM

The delegates at Philadelphia two centuries ago were acutely aware that an economic system organized primarily along the lines of private enterprise was a necessary precondition to national strength and the preservation of a democratic political system. A similar high priority was assigned to the protection of private property rights. As a result, the Constitution contains many provisions intended to preserve commercial freedoms.[1]

The Fifth Amendment (of the original Bill of Rights) states in part, ". . . nor shall private property be taken for public use, without just compensation." This is generally referred to as the "takings clause." Rooted in English common law, the takings clause recognizes that property rights can be invaded for public, but not for private, purposes. Government may exercise a power called "eminent domain" to take private property for public use, such as for building a highway. The normal expectation, however, is that the owner of property ceded for eminent-domain purposes will be fairly recompensed by the government. In 1987 the Supreme Court held that a property owner is entitled to payment of just

[1]See Peter T. Butterfield, *The Meaning of the U.S. Constitution* (Washington, D.C.: Heritage Foundation, 1987).

compensation when land-use regulations deny reasonable use of property, even though the owner retains the nominal right of ownership. That landmark decision established a limit on government power to control the use of private-sector resources.

The Founding Fathers understood very well that basic to the functioning of the private enterprise system is the right to enter into binding contracts. They wished to provide a stable environment for business, conducive to trade and investment and protected from excessive political manipulation. In that spirit, Article I, Section 10, of the Constitution states, "No State . . . shall pass any Law impairing the Obligation of Contracts. . . ."

That is amplified in the Fourteenth Amendment, which states, "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws." The national government thus established the "rules of the game," in the form of restraints on the exercise of government power, a basic precondition to the effective functioning of private markets.

In retrospect, as a result of key constitutional provisions, the United States became one of the earliest "common markets" in the global economy. Under the earlier Articles of Confederation, in contrast, the individual stages — which continue to be sovereign in our federal system — imposed taxes, quotas, and other barriers on interstate commerce. Recognizing that an economic system based on private enterprise depends upon the free flow of goods and services, Article 1, Section 8, of the U.S. Constitution gives the Congress the power ". . . to regulate Commerce with foreign Nations and among the several States. . . ." Also, this "commerce clause," as will be shown later, has been the fundamental legal basis for expanded federal government regulation of the domestic economy.

Article 1, Section 9, provides that "no Tax or Duty shall be laid on Articles exported from any State. No preference shall be given by any Regulation of Commerce or Revenue to the Ports of one State over those of another; nor shall Vessels bound to, or from, one State, be obliged to enter, clear, or pay Duties in another." It is unlikely that the high degree of prosperity achieved by the American economy could have been achieved without constitutional protection.

Because the American society rests on the foundations of capitalism as well as democracy, we inevitably encounter tensions and uneasy compromises. As individuals, we attach different weights to the two sets of values, and we reach different conclusions on particular policy issues that define the scope of the marketplace and the limits of the political process. In the broad span of history, the United States has displayed a remarkable ability to hammer out the compromises needed to balance the two value systems.

At least implicitly in most of our debates, Americans rely on some unifying principles that promote consensus. Thus, we recognize that the government needs a strong private enterprise system for two different reasons — as a support and also as a counterweight. As a support for government in a capitalistic system, the business sector is the goose that lays the golden eggs. The marketplace finances the public efforts to educate our youth, aid the poor, and promote the national defense. To be crass but accurate, the material resources required to fulfill the objectives of the public sector come from the tax base provided by a healthy private sector.

As a counterweight, the decentralization of power inherent in a private enterprise economy is a limit on government that is essential to the survival of democracy. As Arthur Okun noted, it is a remarkable uniformity of history that a fully collectivized economy has never produced a single free election or one free press.[2]

Turning to the other side of the coin, the success of the private enterprise system depends critically on the government and the exercise of its legal powers, such as those enumerated in the Constitution. It is almost a paradox to note that the most basic attributes of a market economy — the value of contracts, promises to pay, and money itself — all stem from the power of politicians and bureaucrats to penalize the violators of the rules of the market game. Indeed, without the government as referee, there could be no game. In enforcing such restraints, society draws a line between liberty and license, and between legitimate access and trespass.

Clearly, the reconciliation between the pressures of the private marketplace and the demands of the public sector is a matter requiring careful balance. Before discussing where that balance should be, it is helpful to analyze the reasons for the relative success of capitalistic systems. Reliance on private enterprise to produce and distribute goods and services is not a matter of blindly accepting a "black box" whose workings we cannot fathom.

THE BASIS FOR THE SUPERIORITY OF THE MARKETPLACE

In this age of information, we need to remind ourselves of the basics. For centuries, the competitive marketplace has transmitted volumes of vital information beyond the capability of the most sophisticated central planning authority. By the use of the price system, the marketplace transmits signals to many thousands of producers that reflect the values of hundreds of millions of consumers, offering profits for the production of those goods whose value to consumers exceed their costs to producers. The much-maligned, but universally used, influence of profits serves as the magnet that pulls resources into their most productive use. The paradox of Adam Smith's "invisible hand" continues to be pertinent. In the competitive marketplace, economic self-interest serves as an engine of social welfare.

[2]Arthur M. Okun, *Capitalism and Democracy: Some Unifying Principles,* a paper presented at Columbia University, New York City, October 31, 1978.

Competition can create values for the consumer far greater than the wealth it bestows on successful entrepreneurs and their financial backers — and those consumer benefits are widely distributed. Clearly, an enormous social surplus was created by the dramatic transformation of energy use masterminded by Thomas Edison.

But maintaining a competitive economy does not come easily. The favorable implications of Smith's invisible hand are undermined by monopoly. Monopoly is the very antithesis of competition. It imposes a logic of scarcity rather than productivity. It enforces rigidity rather than responsiveness, consumer exploitation rather than consumer sovereignty. And in this area economic ignorance is pervasive.

Visions of monopoly conjure up big businesses swallowing small businesses. Yet, in practice, a competitive marketplace generates new businesses more rapidly than old businesses can take them over. In fact, often those new businesses elbow out established larger firms from their dominant positions in major markets.

The truth is that the typical cases of monopoly arise from the actions of government. The postal monopoly did not arise from the overpowering success of a single large enterprise but rather from the government's unwillingness to let new enterprises enter this market. Visions of David and Goliath come to mind, but with a less happy ending.

From time to time we read in the United States about the Postal Service taking to court a few youngsters who offer to deliver Christmas mail more efficiently or more cheaply than the government's own postal monopoly. Invariably, Goliath wins; the government's monopoly over the delivery of first class mail and the use of the homeowners' mailbox is absolute.

In other instances, government awards monopoly power to private companies, notably in the areas of transportation, communication, and utilities. As we will see in later chapters, curbing that use of the government's power to create private monopolies can reduce costs and result in a more efficient economic system.

Assessing the role of private enterprise in a democratic society is not a choice among polar alternatives. Friedrich Hayek explained that point clearly in his *Constitution of Liberty:*

> A functioning market economy presupposes certain activities on the part of the state; there are some other such activities by which its functioning will be assisted; and it can tolerate many more, provided that they are of the kind which are compatible with a functioning market. . . . The range and variety of government action that is, at least in principle, reconcilable with a free market system is thus considerable.[3]

[3]F. A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960), pp. 224–225.

In practice, the democratic capitalistic nations are not uniform in the relative size of the market economy. Each draws the line between the public and private sectors at a different point. Moreover, that point varies over time, as would be expected in a free society. It seems quite clear, however, that in the case of the more successful societies — successful in both economic production and personal liberty — the bulk of economic activity is performed in the market economy.

THE NATURE OF MODERN BUSINESS–GOVERNMENT RELATIONS

Government is a continuing presence and often one of increasing influence in business decision making. As pointed out in the literature on public choice, government officials are motivated by incentives that often may be closer to their own needs and desires than to broad principles of public interest. In this view, as expressed most forcefully by Nobel Prize winner James Buchanan, "Bureaucrats could no longer be labeled 'economic eunuchs.' "[4] The mythology of the faceless bureaucrat following orders from above is thus replaced by the notion of government employees who make policy choices as well as carry out the decisions of others (e.g., voters).

Government influences business decision making of all types — planning, research and development, production, marketing, personnel, finance, facilities, and so forth. The organizational chart of a hypothetical industrial firm, shown in Figure 1-1, conveys graphically the diverse nature of federal involvement in many aspects of business. It is as if there were an overlay of regulatory agencies matching the formal positions on each company's organization chart. To compound the problem, in reality there is a multiplicity of such overlays, representing also state and local governments as well as international organizations, such as the United Nations. In practice the precise nature of business–government relationships will vary by industry, size of firm, location, type of product, and markets served.

The modern array of government intervention affects management at all levels — from the board of directors to new hires on the production floor. The reach of government action extends to business managers with both line and staff responsibility and embraces the most senior executives, middle management, and first-line supervision.

We will examine first the different types of actions that government takes that can affect the business firm. Then we will see how these actions influence business decision making.

[4] James M. Buchanan, "The Economic Theory of Politics Reborn," *Challenge*, March–April 1988, p. 5.

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