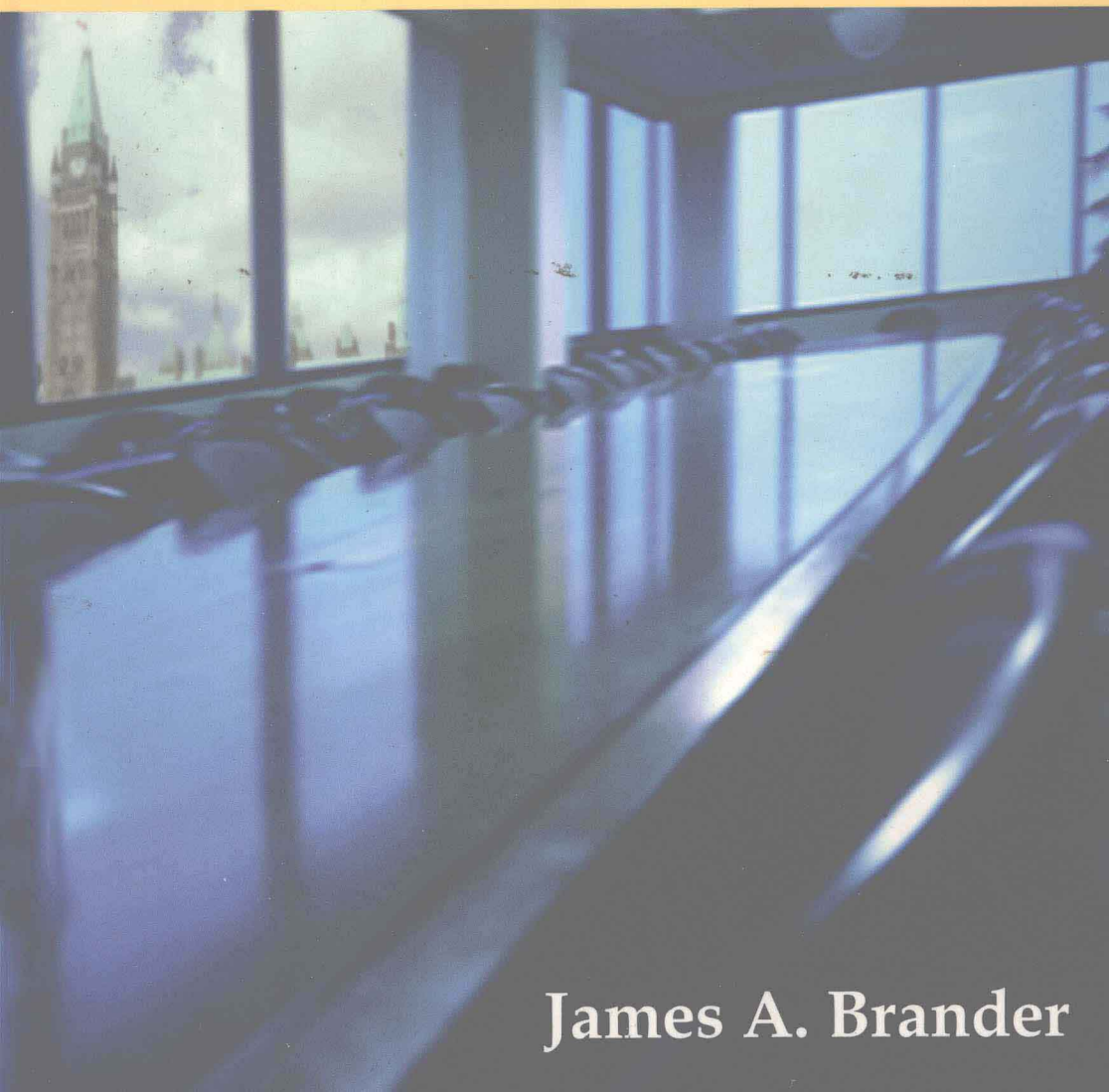


GOVERNMENT POLICY *toward* BUSINESS

Fourth Edition



James A. Brander

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To my daughter, Cathy

About the Author

James Brander is the Asia-Pacific Professor of International Business in the Sauder School of Business at the University of British Columbia (UBC). He did his B.A. in economics at UBC, and completed a Master's degree and Ph.D. in economics at Stanford University. Prior to taking a position at UBC, he taught at Queen's University. He has published widely in academic journals, particularly in the areas of international trade policy and industrial organization, and also in the areas of finance and resource economics. He is the co-author of the most cited paper ever published in the *Journal of International Economics*. He served a term as Managing Editor of the *Canadian Journal of Economics* and served as Associate Dean of the Sauder School. He has also been active in consulting and in government policy advising, particularly in the areas of international trade policy and competition policy, and has been a frequent media commentator on these areas.

Preface and Acknowledgments



This book is intended for use as a textbook in courses dealing with public policy toward business. It is based on my lecture notes from a course entitled 'Government and Business,' taught in the Sander School of Business at the University of British Columbia (UBC). The book has been widely used in schools of business or management for courses related to public policy. In addition, the book has been used for public policy courses in public administration programs, economics departments, and political science departments, and as a supplementary text for a variety of other courses. Many university level courses deal with public policy toward business, and I believe that this book can be successfully used in most of them.

The book proceeds from conceptual principles to specific policy areas. Specific policies are viewed as applications of general policy principles and, after reading the book, students should be able to readily understand new policy issues that confront them.

The book offers an institutionally and theoretically up-to-date treatment of the major areas of Canadian public policy toward business including competition policy, regulation, international trade policy, environmental and resource policy, macroeconomic policy, and other areas. The current edition is the fourth edition. Despite various expansions, the book continues to provide a streamlined overview of the major public policies that affect business and can be covered comfortably in a one-term course.

An important theme in the book is that policy can be viewed partly as the result of pursuit of 'public interest' objectives by policy-makers, and partly as the result of competition for policy influence among various private interests. Both the 'public interest' and 'private interest' approach to policy are examined at a conceptual and institutional level, and many examples illustrating both interpretations of policy are provided.

Material in this book is drawn from several areas of study, including political science, philosophy, and psychology. The underlying discipline that contributes most to the central framework of the book is, however, economics. This reflects the fact that most policies affecting the business environment are focused on economic objectives. This book is not very technical, and presumes only that readers have a general familiarity with introductory economics. There are a few graphs and equations, but not many. The emphasis instead is on the basic insights and conceptual tools of economics, as they apply to business-related public policy.

I have accumulated many debts in the preparation of the four editions of this book. First, I would like to thank my wife and colleague Barbara Spencer, who made major contributions to the chapters on competition policy and made many other suggestions on all four editions. I would also like to offer special thanks to my father, Stuart James Brander, who read the manuscript for the first edition and provided many helpful comments. I have relied heavily on input from my colleagues at UBC, including the following people: Trent Appelbe, Tony Boardman, Murray Frank, Keith Head, Peter Nemetz, John Ries, Tom Ross, Jim Vercammen, and Bill Waters. I have also benefitted from suggestions made by Ph.D. students at UBC including Jen Baggs, Clive Chapple, and Elizabeth Croft.

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1

Objectives and Overview



1.1 Introduction

This book is concerned primarily with government policies directed toward business. Such policies are an important focus of political debate, and are a staple item on the evening news. In addition, dealing with government policies toward business is a very important activity in the private sector, and implementing such policies is a major function of the public sector. This book is directed principally toward students in business, economics, and public policy, many of whom will deal professionally with public policy issues within either the public sector or the private sector. It should also be useful for other readers with an interest in the analysis of public policy.

Most citizens of modern developed countries expect government policy to play an important role in their lives. We expect governments to provide law enforcement, education, and a variety of other goods and services, and we expect, or at least accept, that governments will finance these activities by imposing taxes, along with other means. Most of us also recognize that government policy has some influence on unemployment, inflation, interest rates, and general business conditions. Many people, however, are surprised when they discover the extent to which consumer decisions and the business decisions of private sector firms are affected by government intervention. We might wonder what all this government intervention is intended to achieve, and why governments choose the policies that they do. We might

also wonder whether the chosen policies are effective methods of pursuing the intended objectives. This book is concerned with these and related issues. More precisely, it offers a systematic method for analyzing government policy affecting business.

This analysis subdivides naturally into two questions:

1. What should the role of government be?
2. What factors explain the actual conduct of government?

The first question is sometimes described as “normative” or “prescriptive,” because in answering it we are trying to suggest or “prescribe” what governments should do. The starting point in the analysis of this question is that government policy toward business should seek to promote the public interest. Therefore, consideration of question 1 is also called the “public interest approach” to policy analysis.

The second question is “positive” or “descriptive” in that it tries to explain or describe why things are as they are. It is possible that actual policies toward business will be just as normative analysis suggests they should be. Frequently, however, actual policies coincide very poorly with normative analysis, and we are forced to conclude that the general public interest was not the major determinant of policy.

In answering question 2, we normally assume that actual policy is the outcome of a “market” for political influence in which politicians are pursuing political or personal advantages, public sector managers are trying to advance their careers, and special interest groups, including business lobbies, are pursuing their private objectives as well. Analysis of question 2 is therefore often referred to as the “private interest approach” to policy analysis. It is also sometimes referred to as the study of “public choice.”

1.2 The Normative Approach to Policy Analysis

We have established that normative analysis starts with the assertion that government policy should seek to promote the public interest. Unfortunately, it is difficult to say exactly what the public interest is. Conceptions of the public interest are reflections of basic values and vary over time and across social, religious, and other groups. Nevertheless, there is a well-established set of goals that are widely accepted as legitimate objects of government attention. These goals are discussed briefly below, and will form the central themes of this book.

1. *Economic efficiency*: In rough terms, pursuit of economic efficiency corresponds to trying to make the per capita benefits from the consumption of

goods and services as high as possible. In a world where simple economic scarcity and poverty remain major problems, this objective is very important. In Chapter 2, the concept of economic efficiency is described more carefully.

2. Macroeconomic stabilization and growth: One of the most serious problems of market-based economies is that they are prone to cyclical swings in business activity and employment. After the experience of the Great Depression of the 1930s, most citizens of western (and many other) countries came to regard stabilization of these cyclical fluctuations, and provision of reliable employment opportunities, as important objectives of government policy. More broadly, the objectives of macroeconomic policy are to smooth the business cycle, to keep unemployment rates low and stable, to keep inflation rates low and stable, and to assist in promoting economic growth.

3. Fairness (equity): Pursuit of economic efficiency seeks to make the overall size of the “economic pie” as large as possible. Fairness or equity is concerned mainly with the distribution of that pie among different claimants. In Canada, for example, we have a system of taxation and social welfare that taxes the relatively well off and gives money and other resources to the poor. In addition to redistribution, public policy is also targeted toward other conceptions of fairness. For example, health care policy in Canada is dominated by a conception of fairness that all individuals should have essentially the same level of health care, at least for certain core medical services. In addition, there are laws that seek to prevent discrimination by employers on the basis of sex, race, or (within certain limits) age, on the grounds that such discrimination is unfair in some fundamental way. Other ideas of fairness lead to public policy that seeks to protect the interests of children and others judged unable to adequately defend their own interests.

4. Other social objectives: Governments sometimes pursue objectives that are not directly related to economic efficiency, macroeconomic stabilization, or fairness. For example, governments of many countries have sometimes tried to promote “national unity” or “national culture” as a goal in itself, and some policies, such as limitations on gambling and alcohol consumption, have their roots in a desire to promote certain values. Such policies may be categorized simply as “other social objectives.”

Any normative rationale for policy must be based on one of these four categories of objectives. For example, one important type of government policy toward business is environmental regulation, which, among other things, seeks

to limit the damage done to the environment by various industrial activities. This policy is based primarily on the idea that unregulated business activity may cause inefficiently high levels of environmental damage. In other words, the normative rationale for environmental policy is based mainly on economic efficiency. In addition, some environmental legislation has its roots in the idea that fairness requires that certain aspects of the environment be protected for the benefit of future generations.

1.3 The Positive Approach to Policy Analysis

The positive approach to policy analysis focuses on the objectives, behaviour, and interaction of individuals and groups who influence policy decisions. Instead of focusing on what policy should be, as normative analysis does, positive analysis examines the reasons why policy takes the form it does. One important influence on policy decisions is voting. Another arises from special interest groups, including business lobbies, who spend time and energy trying to influence government policies. Public sector managers (or bureaucrats) themselves are an important influence, as are elected politicians. Chapter 5 of this book examines these various groups and their effect on the policy-making process.

1.4 The Major Policy Areas

Many areas of government policy affect business in one way or another. There are, however, certain policy areas that are particularly important in that they specifically or primarily target business. The largest part of the book will be devoted to a systematic discussion of these major policy areas:

- international trade policy
- environmental policy
- competition policy
- price and entry regulation
- public enterprise and Crown corporations
- macroeconomic stabilization policy and the public debt

As this list suggests, government policy influences business activity in a wide variety of ways. Some policy areas, such as price regulation and Crown ownership, are directed toward specific firms and industries. Other policy areas are more like framework or background policies, as they do not target any specific firms but instead broadly affect the business environment. Policies in this category would be macroeconomic stabilization policy and international trade policy. Perhaps the best way to see the influence of government on the private sector is by way of example. The following case illustrates the important effect of government policies and decisions on business.