7 Business, Government, and Regulation

CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

1. Articulate a brief history of government's role in its relationship with business.
2. Appreciate the complex interactions among business, government, and the public.
3. Identify and describe government's nonregulatory influences, especially the concepts of industrial policy and privatization.
4. Explain government regulation and identify the major reasons for regulation, the types of regulation, and issues arising out of regulation.
5. Provide a perspective on regulation versus deregulation along with accompanying trends.
6. Describe major types of regulatory reform and their characteristics.

Few issues seem to excite businesspeople as much as government's role in society. This became especially true when government began playing a more active role in the 1960s and 1970s. Over the past 30 years, the depth, scope, and direction of government's involvement in business has made the business/government relationship one of the most hotly debated issues of modern times. In addition, government's role, particularly in the regulation of business, has ensured its place among the major stakeholders with which business must establish an effective working relationship if it is to survive and prosper.

Business has never been fond of government's increasingly activist role in establishing the ground rules under which it operates. Business has almost always been against an increased role for government, especially the federal government. In contrast, public interest has been cyclical, going through periods when it has thought that the federal government had too much power and other periods when it has thought that government should be more activist. President Ronald Reagan came into office in 1980, when the public was growing somewhat weary of an active federal role. President Reagan's favorite saying was that "government isn't the solution; it's the problem." He seemed to hit a responsive chord with the public at that particular point in time. In 1982, 38 percent of a Gallup Poll sample indicated the federal government had too much power. By 1986, this figure had fallen to 28 percent, with 41 percent of the public sample now indicating the federal government should use its power more vigorously.[1]

Throughout the decade of the 1980s, the federal government played less and less of a role, especially in terms of monitoring and regulating business. It was not without

reason, therefore, that in late 1989 *Time* magazine ran a cover story entitled "Is Government Dead?"[2] This article was not limited to government's role vis-à-vis business but criticized government's lack of initiative and responsiveness on a host of problems facing the United States, such as the unprecedented opportunity to promote democracy in Eastern Europe, the spreading plague of drugs, the plight of the underclass, and the dire need for educational reform. In essence, the Reagan Revolution of an inactive federal government had left the public with a desire for government to become active again. It was against this backdrop that Republican candidate George Bush was elected president in 1988.

The George Bush administration turned out to be a one-term presidency. Bush was narrowly defeated by Democratic candidate Bill Clinton in 1992. During the Bush administration, the country witnessed a growth in the rate of federal government spending that exceeded that of the Reagan years. This trend continued with President Clinton. Ironically, these increases in government spending occurred during periods in which the administrations in office were simultaneously advocating the downsizing of government.

The midterm elections for Congress in 1994 ushered in conservative Republican majorities in both the Senate and the House of Representatives. This election was perceived by many as a significant message to President Clinton that the American people were displeased with the escalating role of the federal government in their lives. Some exit polls suggested that resentment of big government was a major factor in the political tide shifting.[3] The tide has continued to shift. A survey by the National Election Studies at the University of Michigan indicates that the public's faith in government is beginning to grow again.[4] However, another study by the American Enterprise Institute contends that Americans remain wary of their federal government.[5] While a strengthened economy has reassured some, many people remain skeptical of government's role in their lives.

In this chapter we will examine the relationship between business and government, although the general public will assume an important role in the discussion as well. A central concern in this chapter is the government's role in influencing business. Exploring this relationship carefully will provide an appreciation of the complexity of the issues surrounding business/government interactions. From the prospective manager's standpoint, one needs a rudimentary understanding of the forces and factors that are involved in these issues before one can begin to talk intelligently about strategies for dealing with them. Unfortunately, more is known about the nature of the problem than about the nature of solutions, as is common when dealing with complex social issues. In the next chapter, we will discuss how business attempts to influence government and public policy.

A BRIEF HISTORY OF GOVERNMENT'S ROLE

In the early days of the United States, the government supported business by imposing tariffs to protect our fledgling industries. In the second half of the 1800s, government gave large land grants as incentives for private business to build railroads. Several railroads had grown large and strong through mergers, and people began to use them because their service was faster, cheaper, and more efficient. This resulted

in a decline in the use of alternative forms of transportation, such as highways, rivers, and canals. Many railroads began to abuse their favored positions. For example, a railroad that had a monopoly on service to a particular town might charge unfairly high rates for the service. Competitive railroads sometimes agreed among themselves to charge high but comparable rates. Higher rates were charged for shorter hauls, and preference was shown to large shippers over smaller shippers.

Public criticism of what were perceived as abusive practices led to the passage of the Interstate Commerce Act of 1887, which was intended to prevent discrimination and abuses by the railroads. This act marked the beginning of extensive federal government regulation of interstate commerce. The act created the Interstate Commerce Commission, which became the first federal regulatory agency and a model for future agencies.[6]

Many large manufacturing firms and mining firms also began to abuse consumers during the late 1800s. Typical actions included the elimination of competition and the charging of excessively high prices. During this period, several large firms formed organizations known as trusts. A trust was an organization that brought all or most competitors under a common control that then permitted them to eliminate most of the remaining competitors by price cutting, an act that forced the remaining competitors out of business. Then, the trusts would restrict production and raise prices. As a response, Congress passed the Sherman Antitrust Act in 1890, which became the first in a series of actions intended to control monopolies in various industries. The Sherman Act outlawed any contract, combination, or conspiracy in restraint of trade, and it also prohibited the monopolization of any market. In the early 1900s, the Sherman Act was used by the federal government to break up the Standard Oil Company, the American Tobacco Company, and several other large firms that had abused their economic power.[7]

The Clayton Antitrust Act was passed in 1914 to augment the Sherman Act. It addressed other abusive practices that had arisen. It outlawed price discrimination that gave favored buyers preference over others and forbade anticompetitive contracts whereby a company would agree to sell only to suppliers who agreed not to sell the products of a rival competitor. The act also prohibited an assortment of other anticompetitive practices. Also in 1914, Congress formed the Federal Trade Commission, which was intended to maintain free and fair competition and to protect consumers from unfair or misleading practices.[8]

Another great wave of regulation occurred during the Great Depression and the subsequent New Deal of the 1930s. Significant legislation included the Securities Act of 1933 and the Securities and Exchange Act of 1934. These laws were aimed at curbing abuses in the stock market, stabilizing markets, and restoring investor confidence. Significant labor legislation during this same period signaled government involvement in a new area. Several examples were the 1926 Railway Labor Act, the 1932 Norris–LaGuardia Act, and the 1935 Wagner Act.

During the New Deal period in the 1930s, government also took on a new dimension in its relationship with business, actively assuming responsibility for restoring prosperity and promoting economic growth through public works programs. In 1946, this new role of government was formalized with the passage of the Full Employment Act.

In the present period, government has passed considerable legislation, involving itself deeply in the affairs of business. Prior to the mid-1950s, most congressional

legislation affecting business was economic in nature. Since that time, however, legislation has had social goals as well. Much legislation of the past three decades has been concerned with the quality of life.[9] Several illustrations of this include the Civil Rights Act of 1964, the Water Quality Act of 1965, the Occupational Safety and Health Act of 1970, the Consumer Product Safety Act of 1972, the Warranty Act of 1975, and the Americans with Disabilities Act of 1990.

Just as the areas in which government has chosen to initiate legislation have changed, the multiplicity of roles that government has assumed has increased the complexity of its relationship with business. Several of the varied roles that government has assumed in its relationship with business are worth looking at because they suggest the influence, interrelationships, and complexities that are present.[10] These roles indicate that government:

1. Prescribes the rules of the game for business.
2. Is a major purchaser of business's products and services.
3. Uses its contracting power to get business to do things it wants.
4. Is a major promoter and subsidizer of business.
5. Is the owner of vast quantities of productive equipment and wealth.
6. Is an architect of economic growth.
7. Is a financier.
8. Is the protector of various interests in society against business exploitation.
9. Directly manages large areas of private business.
10. Is the repository of the social conscience and redistributes resources to meet social objectives.

After examining and assessing these various roles, one can perhaps begin to appreciate the crucial interconnectedness between business and government and the difficulty both business and the public have in fully understanding (much less prescribing) what government's role ought to be in relation to business.

Near the end of the Clinton presidency, it was becoming apparent that government's role, as always, was not going to fade away but would continue to grow or decline in response to the political mood, as it has for decades, between laissez-faire and intervention. One view was that the pendulum was swinging over a narrower arc with a belief that the new role of government in the economy would emphasize pragmatism and modest, achieveable goals rather than idealism and great expectations, in order to provide a stable environment in which the economy could grow.[11] Because the public has learned that regulations bring advantages and disadvantages, it expects a careful cost-benefit analysis of proposed regulations.[12]

THE ROLES OF GOVERNMENT AND BUSINESS

We do not intend to philosophize in this chapter on the ideal role of government in relation to business, because this is outside our stakeholder frame of reference. However, we will strive for an understanding of current major issues as they pertain

to this vital relationship. For effective management, government, as a stakeholder, must be understood.

The fundamental question underlying our entire discussion of business/government relationships is, *"What should be the respective roles of business and government in our socioeconomic system?"* This question is far easier to ask than to answer, but as we explore it, some important basic understandings begin to emerge.

The issue could be stated in a different fashion: Given all the tasks that must be accomplished to make our society work, which of these tasks should be handled by government and which should be handled by business? This poses the issue clearly, but there are other questions that remain to be answered. If we decide, for example, that it is best to let business handle the production and distribution roles in our society, the next question pertains to how much autonomy we are willing to allow business. If goals were simply the production and distribution of goods and services, we would not have to constrain business severely. In modern times, however, other goals have been added to the production and distribution functions: for example, a safe working environment for those engaging in production, equal employment opportunities, fair pay, clean air, safe products, employee rights, and so on. When these goals are superimposed on the basic economic goals, the task of business becomes much more complex and challenging.

Because these latter, more socially oriented goals are not automatically factored into business decision making and processes, it often falls on government to ensure that those goals that reflect concerns of the public interest be achieved. Thus, whereas the marketplace dictates economic production decisions, government becomes one of the citizenry's designated representatives charged with articulating and protecting the public interest.

A Clash of Ethical Belief Systems

A clash of emphases partially forms the crux of the antagonistic relationship that has evolved between business and government over the years. This problem has been termed "a clash of ethical systems." The two ethical systems (systems of belief) are the *individualistic* ethic of business and the *collectivistic* ethic of government. Figure 7–1 summarizes the characteristics of these two philosophies.[13]

The clash of these two ethical systems partially explains why the current business/government relationship is adversarial in nature. In elaborating on the adversarial nature of the business/government relationship, Jacoby offered the following comments:

> *Officials of government characteristically look upon themselves as probers, inspectors, taxers, regulators, and punishers of business transgressions. Businesspeople typically view government agencies as obstacles, constraints, delayers, and impediments to economic progress, having much power to stop and little to start.*[14]

The business/government relationship not only has become adversarial but also has been deteriorating. The goals and values of our pluralistic society have become more complex, more numerous, more interrelated, and, consequently, more difficult to reconcile. The result has been increasing conflicts among diverse interest

FIGURE 7–1 The Clash of Ethical Systems Between Business and Government

Business Beliefs	*Government Beliefs*
• Individualistic ethic	• Collectivistic ethic
• Maximum concession to self-interest	• Subordination of individual goals and self-interest to group goals and group interests
• Minimizing the load of obligations society imposes on the individual (personal freedom)	• Maximizing the obligations assumed by the individual and discouraging self-interest
• Emphasizes inequalities of individuals	• Emphasizes equality of individuals

groups, with trade-off decisions becoming harder to make. In this process it has become more difficult to establish social priorities, and consensus has in many cases become impossible to achieve.[15]

Social, Technological, and Value Changes

As we attempt to understand why all this has happened, it is only natural to look to changes in the social and technological environments for some explanations. According to Daniel Bell, since World War II four major changes have had profound impacts on American society in general and on the business/government relationship in particular. First, out of local and regional societies a truly national one has arisen.[16] Second, we have seen a "communal society" arise, characterized by a great emphasis on public goods and the internalization of external costs. Third, the revolution of rising expectations has brought with it the demand for "entitlements"—good jobs, excellent housing, and other amenities. Fourth, a rising concern has emerged for an improved "quality of life."[17]

In addition to these, six other societal value changes have shaped the course of business/government relations. These are the youth movement, the consumer protection movement, the ecology movement, the civil rights movement, the women's liberation movement, and the egalitarian movement.[18]

In a sense, this last movement—the egalitarian movement—embraces all of the others, because it represents an effort to create an equitable balance of all facets of what is good in life in the United States. Thus, the value changes that have taken place "have multiplied the number of political decisions that have to be made relative to the number of decisions made in markets."[19] And to the extent that these political decisions affect business—and they do to a great extent—we can understand the basic conflict arising once again in a clash between individualist and collectivist belief systems. Government's responses to changes taking place in society have put it in direct opposition to business in terms of both philosophy and mode of operation. Although one might argue that this clash of belief systems is not as severe today as it once was, the basic differences still serve to frame the positions of the two groups.

INTERACTION OF BUSINESS, GOVERNMENT, AND THE PUBLIC

This section offers a brief overview of the influence relationships among business, government, and the public. This should be helpful in understanding both the nature of the process by which public policy decisions are made and the current problems that characterize the business/government relationship. Figure 7–2 illustrates the pattern of these influence relationships.

One might rightly ask at this point, "Why include the public? Isn't the public represented by government?" In an ideal world, perhaps this would be true. To help us appreciate that government functions somewhat apart from the public, it has been depicted separately in the diagram. In addition, the public has its methods of influence that need to be singled out.

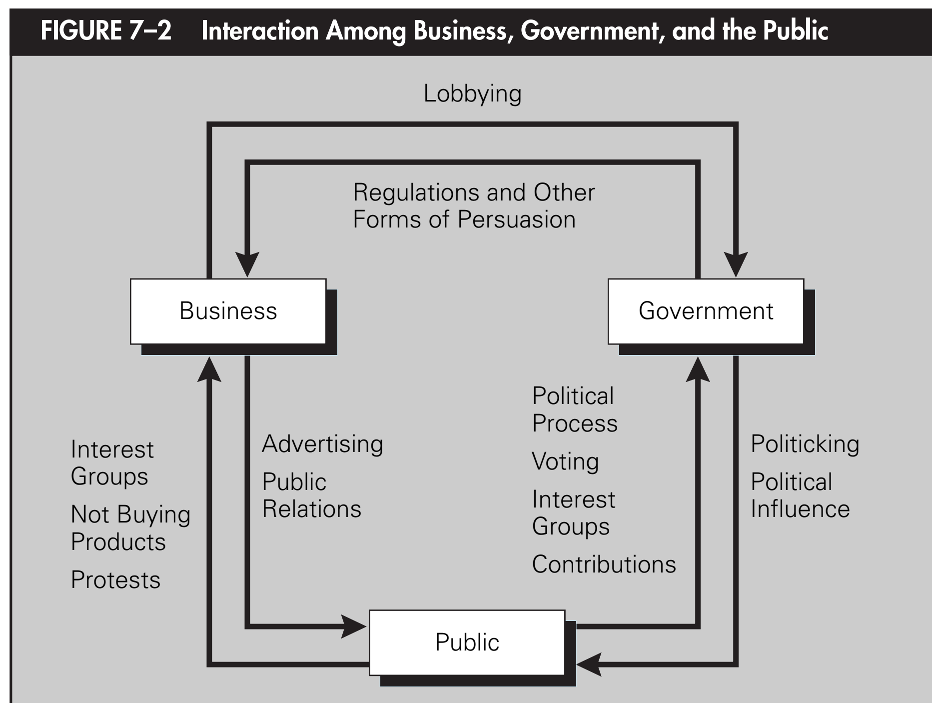
Government/Business Relationship

Government influences business through regulation, taxation, and other forms of persuasion that we will consider in more detail in the next section. Business, likewise, has its approaches to influencing government, which we will deal with in Chapter 8. Lobbying, in one form or another, is business's primary means of influencing government.

Public/Government Relationship

The public uses the political processes of voting and electing officials (or removing them from office) to influence government. It also exerts its influence by forming special-interest groups (farmers, small-business owners, educators, senior citizens,

FIGURE 7–2 Interaction Among Business, Government, and the Public



truckers, manufacturers, etc.) to wield more targeted influence. Government, in turn, uses politicking, public policy formation, and other political influences to have an impact on the public.

Business/Public Relationship

Business influences the public through advertising, public relations, and other forms of communication. And the public influences business through the marketplace or by forming special-interest groups (for example, People United to Save Humanity, American Association of Retired Persons, Friends of the Earth, American Civil Liberties Union) and protest groups.

Earlier we raised the question of whether government really represents the public. This question may be stated another way: "Who determines what is in the public interest?" In our society, determining the public interest is not a simple matter. Whereas government may be the official representative of the public, we should not assume that representation occurs in a straightforward fashion. As we saw in Figure 7–2, the public takes its own initiatives both with business and with government. The three major groups, therefore, are involved in a dynamic interplay of influence processes that determines what is currently considered to be in the public interest.

Our central concern in this chapter is with government's role in influencing business, and we now turn our attention to that topic. Here we will begin to see more clearly how government is a major stakeholder of business. Government's official priority is in representing the public interest as it sees and interprets the public's wishes. But, like all large bureaucratic organizations, government also takes on a life of its own with its own goals and agenda.

GOVERNMENT'S NONREGULATORY INFLUENCE ON BUSINESS

Recognizing that in 1998 the federal government's budget went over the $1.5 trillion mark, approximately one-fifth of the U.S. gross domestic product, we can begin to appreciate the magnitude of the effect government has on all institutions in society. We will limit our treatment to the federal government's influence on business, but we must be repeatedly reminded of the presence and influence of state and local governments as well.

Broadly speaking, we may categorize the kinds of influence government has on business as *nonregulatory* and *regulatory*. In the next major section, we will focus on government regulation, but in this section let us consider the wide range of nonregulatory influences that government has on business.

Two major issues merit consideration before we examine some of the specific policy tools or mechanisms government uses to influence business. These two major issues are (1) industrial policy and (2) privatization. Industrial policy is concerned with the role that our government plays in the world of international trade, and privatization zeroes in on the question of whether current public functions (for example, public education, public transit, social security, fire service) should be turned over to the private (business) sector. Both of these issues have important implications for the business/government relationship. They are both important, because they seem to come into and out of popularity on a fairly regular basis.

Industrial Policy

Important initial questions include, *"What does industrial policy mean, and why has it become such a hotly debated issue?"* An ***industrial policy*** may be defined as follows: "Any selective government measure that prevents or promotes changes in the structure of an economy."[20]

This very broad definition by itself does not give us enough focus to understand the concept. Let us elaborate. One school of thought thinks of industrial policy as some variation of the British model, wherein government provides help for older, declining industries. Therefore, when steel company executives in the United States argue for tax breaks and tariffs that would enable them to survive and compete with foreign competition, they are asking for an industrial policy.[21]

Another school of thought is exemplified by Robert Reich in his book *The Next American Frontier,* wherein he argues for a national industrial policy that attempts to identify *winning* (or sunrise) industries and foster their growth. As for *losing* (or sunset) industries, industrial policy would have as its goal redirecting resources into growth fields.[22]

Variations on these themes could yield a variety of industrial policy schools of thought. Five schools of thought that give us insights into industrial policy include the following: the accelerationists, the adjusters, the targeters, the central planners, and the bankers.[23] The ***accelerationists*** would try to pinpoint industries that promise to become strong international competitors and position them to move rapidly into world markets. Their goal would be to accelerate changes already signaled by the marketplace. The ***adjusters*** would offer adjustment assistance to declining industries in return for commitments that they would slim down, modernize, and help their employees relocate and train for new skills and jobs.

The ***targeters*** would target a select group of sectors or industries (for example, high tech, agriculture, energy, finance, health care equipment) to be turned into engines for growth. The ***central planners*** would advocate growth-oriented macroeconomic policies that would come close to comprehensive planning. Finally, the ***bankers*** would advocate a federally backed industrial development bank that would provide "patient capital"—money that could be sunk into a high-risk venture for 5 to 10 years or longer.

The debate over industrial policy became more active upon publication of Reich's *The Next American Frontier* in 1983 and the realization of our drab economic performance during the 1979–1982 period, when the United States lost significant ground to Japan as the world leader in industrial expansion. Many experts saw the very survival of the U.S. economy at stake in the face of subsidized foreign competition from Japan and other industrialized countries. Indeed, in 1987 a trade confrontation arose between the United States and Japan over the significant trade imbalances arising out of these issues.

During the Reagan (1980–1988) and Bush (1988–1992) administrations, the notion of industrial policy was not looked upon with great favor. Both of these administrations advocated a free-market posture rather than government activism via industrial policy. President Clinton, however, has proposed several actions that typify an active industrial policy. Clinton-initiated U.S. industrial policies include supports (subsidies, tax breaks, contributions) for shipbuilding, information infrastructure, oil and gas tax breaks, and advanced technology.[24]

Some of the most recent policy initiatives center around global electronic commerce. Many analysts believe that the Internet could become the most active trade vehicle in the United States within a decade. However, businesses are often wary of becoming involved in Internet commerce because they are unsure of the legal environment and they fear government regulation and taxation will stifle Internet commerce. The Clinton administration has taken an activist stance in promoting the Internet by issuing a Framework for Global Electronic Commerce. This framework outlines key principles for supporting the evolution of electronic commerce, identifies where international efforts are needed, and designates the U.S. governmental agencies responsible for leading the effort.[25]

Even an issue as simple as naming domains has created controversy. Network Solutions (*www.networksolutions.com*), a private, Virginia-based company, had received an exclusive government contract for assigning and registering Internet domain names in the most popular top-level domains: .com, .net, .org, and .edu. In 1998, the Commerce Department proposed that the registration process be transferred to a newly developed, private nonprofit corporation, made up of representatives of various Internet stakeholder groups. The Department also recommended that up to five new top-level domains be added. Meanwhile, the Geneva-based Council of Registrars (*www.gtld-mou.org*) was planning to implement its own registering program while adding seven new top-level domains. Clearly, the worlds of business and politics often overlap, and the actions of one can profoundly impact the other. Up-to-date information about the government activity surrounding global electronic commerce is available at *www.ntia.doc.gov*,[26] Web site for the National Telecommunications & Information Administration.

Arguments for Industrial Policy

Proponents of an industrial policy (more active role of government in the business sector) cite a variety of reasons for supporting it. First, of course, is the declining or threatened competitiveness of the United States in world markets. A second argument is the use of industrial policy by other world governments, including Germany, Britain, France, and Italy. A third major argument is that the United States already has an industrial policy but it is the haphazard result of unplanned taxes, tariffs, regulatory policies, and research and development policies. Others have called our current system an ad hoc industrial policy because the United States has, in fact, intervened in many specific industries as emergencies have arisen. Protection schemes have been used in the apparel, auto, and steel industries to deal with foreign competition. The federal government's decision in 1979 to provide loan guarantees to Chrysler Corporation and Chrysler's early repaying of its $1.2 billion loan are cited by many advocates as an example of

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One of the Internet-related problems facing the administration is ***cybersquatting***. Cybersquatters are people who register names that correspond to well-known brand names and trademarks in the hope they will receive a lucrative payoff when the real company goes to register that name. For protection, companies have been forced to pre-emptively register and maintain any names they might ever choose to use. Recently, moves to combat cybersquatting have occurred on several fronts. In April 1999, Network Solutions purged 18,000 registrations that were held by suspected cybersquatters. They said they had a legal right to reclaim those names because the registration fee, $70 for two years, had not been paid on time. At the same time, the World Intellectual Property Organization (WIPO), a United Nations agency, was drafting new domain name registration rules, designed to address the issue of cybersquatting. To learn about the range of cybersquatting issues and/or check to see if your name is registered as a domain, go to **www.igoldrush.com**.

how federal intervention can benefit companies, employees, and communities at no net cost to the United States Treasury.

Arguments Against Industrial Policy

Critics of industrial policy also have significant reasons for their views. Critics say that government interference reduces the market's efficiency. How do you keep politics out of what ought to be economic decisions? Some politicians, as well as experts, think the United States should focus on rescuing steel and other "sunset" industries. Others argue we ought to promote emerging "sunrise" industries, such as high-technology electronics.

Those who oppose industrial policy say that foreign success with it has been very overrated. It is argued that Japan, for example, has had as many failures as successes with its government's development agency, Ministry of International Trade and Industry (MITI). MITI is generally credited with helping to build Japan's computer, semiconductor, and steel industries, but efforts to promote the aluminum-refining, petrochemical, shipping, and commercial aircraft industries were viewed as failures.[27] One economist, Gary Saxonhouse, reports that Japanese support for research and development is less than that in the United States. He says that less than 2 percent of nondefense business research and development is financed by government in Japan, compared with 22 percent in the United States.[28] Further, Japan's favorable industrial policies (keiretsu), combined with lifetime employment, are ill suited to surviving economic recessions: The Japanese business system has produced too few entrepreneurial risk-takers.[29]

Finally, attempts at forming an industrial policy have been criticized as being irrational and uncoordinated and composed largely of "voluntary" restrictions on imports, occasional bail-outs for near-bankruptcy companies, and a wide array of subsidies, loan guarantees, and special tax benefits for particular firms and industries. Thus, such efforts have constituted an industrial policy by default.[30] One could argue that the United States is incapable of developing a successful and planned industrial policy, given its experience and the composition of the public policy process that has characterized past decision making.

There is an ebb and flow of interest in the concept of industrial policy depending on which administration is in office. And because many of the problems that initially started the current debate on industrial policy in the 1980s are still with us, it is easy to believe that it could continue to be a business/government debate for years to come. This is particularly true given the increasing importance of international competitiveness. Either way, industrial policy is a powerful nonregulating approach by government to influence business.

Privatization

Whereas industrial policy is a macro policy issue more oriented toward international trade and world markets, privatization is more focused on the domestic scene. Privatization threatens to displace "partnerships" as the primary buzzword when people talk about the contribution business can make to the solution of problems that beset the public and government. ***Privatization***, generally speaking, refers to the process of "turning over to" the private sector (business) some function or service that was previously handled by some government body. To understand privatization, we need to

differentiate two functions government might perform: (1) *producing* a service and (2) *providing* a service.[31]

Producing versus Providing a Service

A city government would be *providing* security if it employed a private firm to work at the coliseum during the state basketball playoffs. This same city government would be *producing* a service if its own police force provided security at the same basketball tournament. The federal government would be *providing* medical care to the aged with a national Medicare program. The "production" of medical care would be coming from private physicians. The government would be providing *and* producing medical care if it employed its own staff of doctors, as, for example, the military does. The terminology can be very confusing, but the distinction must be made, because sometimes government provides a service (has a program for and actually pays for a service) and at other times it also produces a service (has its own employees who do it).[32]

The Tennessee Valley Authority (TVA) was once widely regarded as a model for how electric power should be produced and distributed. Now there is talk of proposals to sell TVA to the private sector to increase its efficiency. Conrail, Amtrak, the postal service, public housing, and even public lands are federal enterprises that some are arguing should be sold to the private sector.

Private Firm versus Government-Provided Services

A study compared eight government services provided by local governments with those same services provided by private firms. The services were street sweeping, janitorial operations, refuse collection, payroll administration, traffic signal maintenance, asphalt surface repair, tree trimming, and lawn care. In seven out of eight services, the private firms showed a savings of 37 to 96 percent over the government-provided services.[33]

In the United States, the idea of free enterprise managing the public's affairs is catching on everywhere, even in Washington. To date, there is more evidence of actual privatization in cities, counties, and states than perhaps anywhere else. In Fairfax County, Virginia, officials signed an $11 million agreement for private fleet maintenance. Indianapolis signed an $87 million agreement to have a private company operate two of its wastewater treatment facilities.[34] School districts in Florida, Minnesota, Maryland, and Connecticut signed contracts with Education Alternatives, Inc. (EAI), to manage and administer their public schools.[35]

Privatization has become a worldwide movement, especially in Europe. Across the continent and in Great Britain, governments are selling off big, government-owned businesses to private investors. It has been estimated that nearly 100 government-owned industries in Western Europe are likely candidates for privatization during the next few years. It is projected that billions of dollars worth of government holdings are candidates for privatization by 1998: France ($81.3 billion), Italy ($34.6 billion), Germany ($23.9 billion), Spain ($20.7 billion), Britain ($13.4 billion), and Sweden ($10 billion).[36]

Proponents of privatization in both the United States and Europe suggest that the functions of entire bureaucracies need to be contracted out to the private sector. They maintain that government at all levels is involved in thousands of businesses in which it has no real comparative advantage and no basic reason for being

involved.[37] Proponents also argue that publicly owned enterprises are less efficient and less flexible than competitive private firms. It should be acknowledged, however, that privatization is not always easy, cost efficient, and effective. For example, the Baltimore Board of School Commissioners canceled its contract with EAI citing low achievement scores and high costs. It then found success by obtaining a $400,000 grant from a private foundation and implementing a plan by a Baltimore school principal.[38] Therefore, care must be exercised as this approach is undertaken.

These two issues—industrial policy and privatization—are largely unresolved. They continue to be discussed and experimented with, however. They could have significant implications for the business/government relationship for years to come.

We should now return to our discussion of the ways in which government uses various policies and mechanisms for influencing business.

Other Nonregulatory Governmental Influences on Business

Government has a significant impact on business by virtue of the fact that it has a large payroll and is a *major employer* itself. At all levels, government employs millions of people who, as a consequence of being government employees, see things from the government's perspective. This influence is felt by business throughout society. Government is also in the position of being a standard-setter: The 8-hour work day began in the federal government. When the Reagan administration broke the air traffic controller's strike in 1981, it ushered in wage restraints in the private sector.

Government is one of the largest *purchasers* of goods and services produced in the private sector. Some key industries, such as aerospace, electronics, and shipbuilding, are very dependent on government purchasing. Government can exert significant influence over the private sector by its insistence that minorities be hired, depressed areas be favored, small businesses be favored, and so on. Changes in government policy can dramatically change a firm's business environment.[39] For some firms in narrow markets, such as defense, the government dominates and controls whether or not those firms have a good year—indeed, whether or not they survive at all.[40]

Government influences the behavior of business through the use of *subsidies* in a variety of ways. Generous subsidies are made available to industries such as agriculture, fishing, transportation, nuclear energy, and housing and to groups in special categories, such as minority-owned enterprises and businesses in depressed areas. Quite often these subsidies have special qualifications attached.

Government also influences business, albeit indirectly, by virtue of its *transfer payments*. Government provides money for social security, welfare, and other entitlement programs that total hundreds of billions of dollars every year. These impacts are indirect, but they do significantly affect the market for business's goods and services.[41]

Government is a major *competitor* of business. Organizations such as the TVA compete with private suppliers of electricity, the Government Printing Office competes with private commercial publishers and printing firms, and the United States Postal Service competes with private delivery services. In areas such as health, education, recreation, and security, the competition between government and private firms runs the gamut of levels—federal, state, and local.

Government loans and *loan guarantees* are sources of influence as well. Government lends money directly to small businesses, housing providers, farmers, and energy companies. Often such loans are made at lower interest rates than those of private competitors. Loan guarantee programs, such as the one provided to Chrysler, is another way in which government's influence is felt.[42]

Taxation, through the Internal Revenue Service, is another example of a government influence. Tax deductibility, tax incentives, depreciation policies, and tax credits are tools that are all at the disposal of the government. A critical example of the government's taxing power occurred when a "luxury tax" was added as a minor part of the government's deficit reduction package in the early 1990s. This new luxury tax ended up virtually crippling the boatbuilding industry. It led to massive layoffs and adversely affected dozens of related industries. Ironically, the luxury tax resulted in less tax revenues than it produced.[43]

Monetary policy, although it is administered through the Federal Reserve System, can have a profound effect on business. Although the Federal Reserve System is technically independent of the executive branch, it often responds to presidential leadership or initiatives.

Finally, *moral suasion* is a tool of government.[44] This refers to the government's attempts, usually through the president, to "persuade" business to act in the public interest by taking or not taking a particular course of action. These public-interest appeals might include a request to roll back a price hike, show restraint on wage and salary increases, or exercise "voluntary" restraints of one kind or another.

GOVERNMENT'S REGULATORY INFLUENCES ON BUSINESS

For more than two decades, government regulation has been the most controversial issue in the business/government relationship. Government regulation has affected virtually every aspect of how business functions. It has affected the terms and conditions under which firms have competed in their respective industries. It has touched almost every business decision ranging from the production of goods and services to packaging, distribution, marketing, and service. Most people agree that some degree of regulation has been necessary to ensure that consumers and employees are treated fairly and are not exposed to unreasonable hazards and that the environment is protected. However, they also think that government regulation has often been too extensive in scope, too costly, often unreasonable, and inevitably burdensome in terms of paperwork requirements and red tape.

Businesspeople, more than the general public, have felt these disadvantages and have borne the frustration of attempting to live up to government's expectations. An Arthur Andersen Enterprise Group study found that, among midsize companies, "government relations" represented its most significant challenge, exceeding the challenges of health care and insurance and turning a profit. The study revealed further that the companies estimate they spend 36 percent of their time on regulatory compliance.[45] In another survey of affluent business owners, 85 percent said that "government policies" most threaten their privately held companies. Government policies were seen as more of a threat than the difficulty of attracting and keeping skilled workers, rising interest rates/slow growth, and inflation.[46]

Regulation: What Does It Mean?

Generally, ***regulation*** refers to the act of governing, directing according to rule, or bringing under the control of law or constituted authority. Although there is no universally agreed-upon definition of federal regulation, we can look to the definition of a federal regulatory agency proposed years ago by the Senate Governmental Affairs Committee.[47] It described a federal regulatory agency as one that:

1. Has decision-making authority.
2. Establishes standards or guidelines conferring benefits and imposing restrictions on business conduct.
3. Operates principally in the sphere of domestic business activity.
4. Has its head and/or members appointed by the president (generally subject to Senate confirmation).
5. Has its legal procedures generally governed by the Administrative Procedures Act.

The commerce clause of the U.S. Constitution grants to the government the legal authority to regulate. Within the confines of a regulatory agency as outlined above, the composition and functioning of regulatory agencies differ. Some are headed by an administrator and are located within an executive department—for example, the Federal Aviation Administration (FAA). Others are independent commissions composed of a chairperson and several members located outside the executive and legislative branches—such as the Interstate Commerce Commission (ICC), the Federal Communications Commission (FCC), and the Securities and Exchange Commission (SEC).[48]

Reasons for Regulation

Regulations have come about over the years for a variety of reasons. Some managers probably think that government is just sitting on the sidelines looking for reasons to butt into their business. There are several legitimate reasons why government regulation has evolved, although these same businesspeople may not entirely agree with them. For the most part, however, government regulation has arisen because some kind of market defect or market failure has occurred and government, intending to represent the public interest, has chosen to take corrective action. We should make it clear that many regulations have been created primarily because of the efforts of special-interest groups that have lobbied successfully for them. The governmental decision-making process in the United States is characterized by congressional regulatory response to the pressures of special-interest groups as well as to perceived market failures.

Four major reasons or justifications for regulation are typically offered: (1) controlling natural monopolies, (2) controlling negative externalities, (3) achieving social goals, and (4) other reasons.

Controlling Natural Monopolies

One of the earliest circumstances in which government felt a need to regulate occurred when a natural monopoly existed. A ***natural monopoly*** exists in a market where the economics of scale are so great that the largest firm has the lowest costs

and thus is able to drive out its competitors. Such a firm can supply the entire market more efficiently and cheaply than several smaller firms. Local telephone service is a good example, because parallel sets of telephone wires would involve waste and duplication that would be much more costly.

Monopolies such as this may seem "natural," but when left to their own devices could restrict output and raise prices. This potential abuse justifies the regulation of monopolies. As a consequence, we see public utilities, for example, regulated by a public utility commission. This commission determines the rates that the monopolist may charge its customers.[49]

Related to the control of natural monopolies is the government's desire to intervene when it thinks companies have engaged in anticompetitive practices. A recent example of this was the Justice Department's investigation of the Microsoft Corporation case in which the company was accused of anticompetitive trade practices. Some of Microsoft's competitors might have been happier if the Justice Department had explicitly prohibited Microsoft from using its dominance in computer operating systems to achieve an advantage for its own applications programs, but lesser sanctions were used instead. In July 1994, the company signed an agreement to stop some of its sales practices that the Justice Department said squelched competition and bullied competitors such as Novell, Apple, IBM, and Lotus.[50] Since then, however, the company's tactics for marketing Web browsers, its deals with Internet service providers, and its purchases of video technology companies have drawn the continued scrutiny of the Justice Department.[51]

Controlling Negative Externalities

Another important rationale for government regulation is that of controlling the *negative externalities* (or spillover effects) that result when the manufacture or use of a product gives rise to unplanned or unintended side effects on others (other than the producer or the consumer). Examples of these negative externalities are air pollution, water pollution, and improper disposal of toxic wastes. The consequence of such negative externalities is that neither the producer nor the consumer of the product directly "pays" for all the "costs" that are created by the manufacture of the product. The "costs" that must be borne by the public include an unpleasant or a foul atmosphere, illness, and the resulting health care costs. Some have called these "social" costs, because they are absorbed by society rather than being truly incorporated into the cost of making the product.

Preventing negative externalities is enormously expensive, and few firms are willing to pay for these added costs voluntarily. This is especially true in an industry that produces an essentially undifferentiated product, such as steel, where the millions of dollars needed to protect the environment would only add to the cost of the product and provide no benefit to the purchaser. In such situations, therefore, government regulation is seen as reasonable, because it requires all firms competing in a given industry to operate according to the same rules (costs).

Just as companies do not voluntarily take on huge expenditures for environmental protection, individuals often behave in the same fashion. For example, automobile emissions are one of the principal forms of air pollution. But how many private individuals would voluntarily request an emissions control system if it were offered as

optional equipment? In situations such as this, a government standard that requires everyone to adhere to the regulation is much more likely to address the public's concern for air pollution.[52]

Achieving Social Goals

Government not only employs regulations to address market failures and negative externalities but also seeks to use regulations to help achieve certain social goals it deems to be in the public interest. Some of these social goals are related to negative externalities in the sense that government is attempting to correct problems that might also be viewed as negative externalities by particular groups. An example of this might be the harmful effects of a dangerous product or the unfair treatment of minorities resulting from employment discrimination. These externalities are not as obvious as air pollution, but they are just as real.

Another important social goal of government is to keep people informed. One could argue that *inadequate information* is a serious problem and that government should use its regulatory powers to require firms to reveal certain kinds of information to consumers. Thus, the Consumer Product Safety Commission requires firms to warn consumers of potential product hazards through labeling requirements. Other regulatory mandates that address the issue of inadequate information include grading standards, weight and size information, truth-in-advertising requirements, product safety standards, and so on. A prime example of recent labeling requirements can be seen on canned goods and other products at the grocery store. Most canned goods now carry a "Nutrition Facts" label that provides consumer information on calories, fat content, and quantities per serving of sodium, cholesterol, carbohydrates, proteins, and vitamins.

Other important social goals that have been addressed include preservation of national security (deregulation of oil prices to lessen dependence on imports), considerations of fairness or equity (employment discrimination laws), protection of those who provide essential services (farmers), allocation of scarce resources (gasoline rationing), and protection of consumers from excessively high price increases (natural gas regulation).[53]

Other Reasons

There are several other reasons for government regulation. One is to *control "excess profits."* The claim for regulation here would be aimed at transferring income for the purposes of economic fairness. For example, as a result of the Arab oil embargo between 1973 and 1980, oil stocks went up suddenly by a factor of 10. One argument is that the extra profits collected by these producers are somehow undeserved and the result of plain luck, not wise investment decisions. So, in situations such as this in which profits are drastically, suddenly, and perhaps undeservedly increased, an argument has been made for government regulation.[54]

Another commonly advanced rationale for regulation is to *deal with "excessive competition."* The basic idea behind this rationale is that excessive competition will lead to prices being set at unprofitably low levels. This action will force firms out of business and ultimately will result in products that are too costly because the remaining firm will raise its prices to excessive levels, leaving the public worse off than before.[55]

These "other" reasons for regulation are not cited much anymore, and arguments against them could be set forth. They are mentioned primarily to round out

our discussion of the various rationales that have been given over the years for government regulation.

Types of Regulation

Broadly speaking, government regulations have been used for two central purposes: achieving certain *economic* goals and achieving certain *social* goals. Therefore, it has become customary to identify two different types of regulation: economic regulation and social regulation.

Economic Regulation

The classical or traditional form of regulation that dates back to the 1800s in the United States is ***economic regulation***. This type of regulation is best exemplified by old-line regulatory bodies such as the Interstate Commerce Commission (ICC), which was created in 1887 by Congress to regulate the railroad industry; the Civil Aeronautics Board (CAB), which was created in 1940; and the Federal Communications Commission (FCC), which was established in 1934 to consolidate federal regulation of interstate communications and, later, radio, telephone, and telegraph.

These regulatory bodies were designed primarily along industry lines and were created for the purpose of regulating business behavior through the control of or influence over economic or market variables such as prices (maximum and minimum), entry to and exit from markets, and types of services that can be offered. It is estimated that the industries subject to economic regulations by federal and state agencies accounted for about 10 percent of the gross national product.[56]

In the federal regulatory budget today, the major costs of economic regulation are for (1) finance and banking (e.g., Federal Deposit Insurance Corporation and Comptroller of the Currency), (2) industry-specific regulation (e.g., Federal Communications Commission and Federal Energy Regulatory Commission), and (3) general business (e.g., Department of Commerce, Department of Justice, Securities and Exchange Commission, and Federal Trade Commission).[57]

Later we will discuss deregulation, a trend that significantly affected the old-line form of economic regulation that dominated business/government relations for the past 100 years.

Social Regulation

The 1960s ushered in a new form of regulation that for all practical purposes has become what regulation means to modern-day business managers. This new form of regulation has come to be known as ***social regulation***, because it has had as its major thrust the furtherance of societal objectives quite different from the earlier focus on markets and economic variables. Whereas the older form of economic regulation focused on markets, the new social regulation focuses on business's *impacts on people*. The emphasis on people essentially addresses the needs of people in their roles as employees, consumers, and citizens.

Two major examples of social regulations having specific impacts on people as *employees* were (1) the Civil Rights Act of 1964, which created the Equal Employment Opportunity Commission (EEOC), and (2) the creation of the Occupational Safety and Health Administration (OSHA) in 1970. The goal of the EEOC is to provide protection against discrimination in all employment practices. The goal of OSHA is to ensure that the nation's workplaces are safe and healthful.

An example of major social regulation protecting people as *consumers* was the 1972 creation of the Consumer Product Safety Commission (CPSC). This body's goal is to protect the public against unreasonable risks of injury associated with consumer products. An example of a major social regulation to protect people as *citizens* and residents of communities was the 1970 creation of the Environmental Protection Agency (EPA). The goal of EPA is to coordinate a variety of environmental protection efforts and to develop a unified policy at the national level.

Figure 7–3 summarizes the nature of economic versus social regulations along with pertinent examples.

Whereas the older form of economic regulation was aimed primarily at companies competing in *specific* industries, the newer form of social regulation addresses business practices affecting *all* industries. In addition, there are social regulations that are industry specific, such as the National Highway Traffic Safety Administration (automobiles) and the Food and Drug Administration (food, drugs, medical devices, and cosmetics). The consequence of social regulations (beginning in the 1960s) has been a matrix effect whereby many firms get hit by industry-specific regulations and also the newer form of social regulations. Figure 7–4 summarizes the major U.S. independent regulatory agencies along with their dates of establishment. In addition to these, we should remember that there are several regulatory agencies that exist within executive departments of the government. Examples of this latter category include the following:

Agency	*Department*
Food and Health Administration	Health and Human Services
Antitrust Division	Justice
Drug Enforcement Administration	Justice
Occupational Safety and Health Administration	Labor
Federal Highway Administration	Transportation

FIGURE 7–3 Comparison of Economic and Social Regulations

	Economic Regulations	***Social Regulations***
Focus	**Market conditions, economic variables (entry, exit, prices, services)**	**People in their roles as employees, consumers, and citizens**
Industries affected	**Selected (railroads, aeronautics, communications)**	**Virtually all industries**
Examples	**Civil Aeronautics Board (CAB)** **Federal Communications Commission (FCC)**	**Equal Employment Opportunity Commission (EEOC)** **Occupational Safety and Health Administration (OSHA)** **Consumer Product Safety Commission (CPSC)** **Environmental Protection Agency (EPA)**
Trend	**From regulation to deregulation**	**Stable—No significant increase or decrease in agencies**

FIGURE 7–4 Major U.S. Independent Regulatory Agencies

Agency	*Year Established*
Interstate Commerce Commission*	1887
Federal Reserve System (Board of Governors)	1913
Federal Trade Commission	1914
International Trade Commission	1916
Federal Home Loan Bank Board	1932
Federal Deposit Insurance Corporation	1933
Farm Credit Administration	1933
Federal Communications Commission	1934
Securities and Exchange Commission	1934
National Labor Relations Board	1935
Small Business Administration	1953
Federal Maritime Commission	1961
Council on Environmental Quality	1969
Cost Accounting Standards Board	1970
Environmental Protection Agency	1970
Equal Employment Opportunity Commission	1970
National Credit Union Administration	1970
Occupational Safety and Health Review Commission	1971
Consumer Product Safety Commission	1972
Commodity Futures Trading Commission	1974
Council on Wage and Price Stability	1974
Nuclear Regulatory Commission	1974
Federal Election Commission	1975
National Transportation Safety Board	1975
Federal Energy Regulatory Commission	1977
Office of the Federal Inspector for the Alaska Natural Gas Transportation System	1979

*Terminated in 1995. Replaced by the Surface Transportation Board.

The new wave of government regulation brought about in the past 30 years through use of the social regulatory model has had sweeping effects on society. It has signaled a new and seemingly increasing role for government in the affairs of business. As a consequence, no manager today, whether she or he operates a small neighborhood grocery store or manages a Fortune 500 firm, is exempt from the many and varied standards, guidelines, and restrictions that the government imposes. Close attention must be paid to these issues, just as close attention needs to be paid to making traditional managerial decisions. To better appreciate the impact that government regulation is having on business, it is helpful to consider some of the issues that have arisen as a direct outgrowth of government regulations.

ETHICS IN PRACTICE

To Comply or Not to Comply with the Government Regulation?

Every summer and Christmas vacation for the past 4 years I have worked in the maintenance department of Gilman Paper Company. Working there to help finance my college education, I have been exposed to many questionable practices. One of the most prominent problems is the adherence to safety regulations.

OSHA (Occupational Safety and Health Administration) requires that a vessel-confined-space entry permit be filled out before a person enters the confined area, and that a "sniffer" (a device used to detect oxygen deficiencies and other harmful or combustible gases) be present and operational whenever a person is inside. A *confined space* is defined as any area without proper air ventilation and/or an area more than 5 feet deep. For example, tanks and pits are confined spaces.

Anytime a person enters or leaves a confined space, the person is required to place her or his initials on the entry permit. This is for the physical protection of the worker and the liability protection of the company. If workers are seen violating this policy, they can be reprimanded or fired on the spot.

In my many experiences with these confined spaces, I have observed on numerous occasions that these policies are not broken by the workers, but by the supervisors. It is their responsibility to obtain these permits and sign them, as well as obtain the use of a sniffer. Sometimes the supervisors and the workers will forget that we are working in a confined space, and thus forget the permit and sniffer. When someone has realized that we are in a confined space, however, the supervisors have often asked us to initialize the permit at various places as if the permit had been there all along.

When we are working for extended periods of time in these areas, the sniffer's batteries often go dead as well. Instead of following regulations and leaving the area until a new sniffer is obtained, the supervisors often tell employees to stay, declaring, "The air is fine. You don't need a sniffer!"

My problem is this: Should I sign these permits when I know it is dishonest, or should I do the "right" thing and let OSHA know that this regulation is being broken time and time again? After all, I'm not even a full-time employee, so who am I to cause trouble?

1. Does this sound like just one more example of a needless government regulation?
2. Who are the stakeholders in this case, and what are their stakes?
3. What should I have done in this situation? Is this regulation important, or is this just more government "red tape"? Should I have just "gone along to get along" with the supervisors?

Contributed by Dale Dyals

Issues Related to Regulation

It is important to consider some of the issues that have arisen out of the increased governmental role in regulating business. In general, managers have been concerned with what might be called "regulatory unreasonableness."[58] We could expect that business would just as soon not have to deal with these regulatory bodies. Therefore, some of business's reactions are simply related to the nuisance factor of

having to deal with a complex array of restrictions. Other legitimate issues that have arisen over the past few years also need to be addressed.

Benefits of Regulation

To be certain, there are benefits of government regulation. Employees are treated more fairly and have safer work environments. Consumers are able to purchase safer products and receive more information about them. Citizens in all walks of life have cleaner air to breathe and cleaner water in lakes and rivers where they go for recreational purposes. These benefits are real, but their exact magnitudes are difficult to measure.

One study designed to determine the benefits of regulation was done by the Center for Policy Alternatives at MIT. This study claimed that billions of dollars were saved each year as a direct result of federal regulation. The study found that effective health, safety, and environmental regulations reduced rates of job-related deaths and injuries, resulted in increased productivity, fostered the development of new and better products and processes, and decreased environmental abuse.[59] The specific benefits identified included the following:

- Air pollution control benefits ($5 billion to $58 billion annually)
- Avoidance of lost-workday accidents and deaths during a 2-year period (cost reduction of $15 billion)
- Water pollution cleanup resulting in a $9 billion gain due to increased recreational use
- Crib safety standards resulting in reduced injuries to infants (44 percent injury reduction over 6 years)[60]

Of course, the benefits listed above are estimates, and the dollar amounts become quickly outdated, but they do serve to remind us of the relative magnitudes of the benefits that are derived from government regulations.

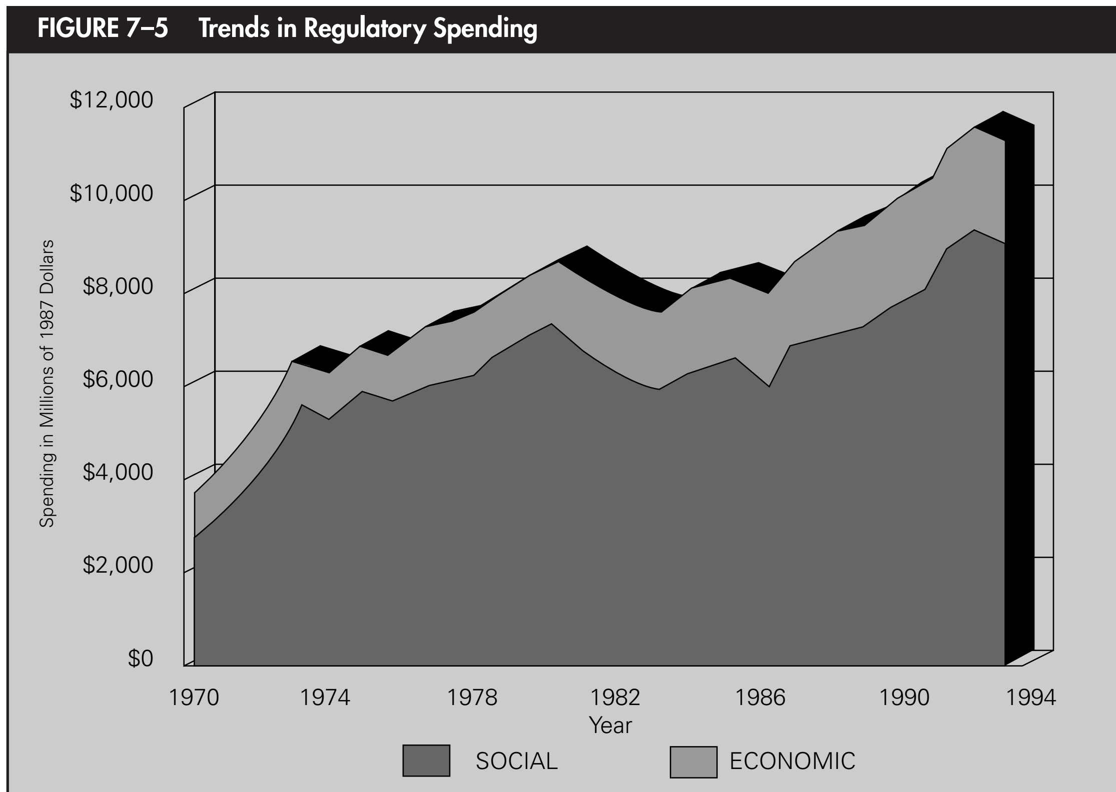
Costs of Regulation

Costs resulting from regulation also are difficult to measure. However, let us consider in more detail what some of these costs are. Weidenbaum has argued that the costs that result from government regulation may be grouped into three categories: direct, indirect, and induced.[61]

Direct Costs. The ***direct costs of regulation*** are most visible when we look at the number of new agencies created, aggregate expenditures, and growth patterns of the budgets of federal agencies responsible for regulation. There were 14 major regulatory agencies prior to 1930, over two dozen in 1950, and 57 by the early 1980s. The most rapid expansion came in the 1970s.[62] Figure 7–5 illustrates the magnitude of the changes that occurred from 1970 to 1994. Figure 7–6 summarizes the costs of federal regulatory agencies in 1998.

Indirect Costs. In addition to the direct costs of administering the regulatory agencies, there are ***indirect costs of regulation*** that need to be identified. The costs of government regulation get passed on to the consumer in the form of higher prices that

FIGURE 7–5 Trends in Regulatory Spending



SOURCE: Center for the Study of American Business, Washington University. Derived from the Budget of the U.S. Government and related documents, various fiscal years.

constitute a "hidden tax" of government. Each year, billions of dollars are added to the costs of goods and services because of regulation. One estimate is that, on average, each dollar Congress appropriates for regulation results in an additional $20 in costs imposed on the private sector.[63] One part of these added costs is the paperwork burden that business must absorb. There is an endless flow of forms, reports, and questionnaires that business must complete to satisfy the requirements of the regulatory agencies.

Induced Costs. The ***induced effects of regulation*** are diffuse and elusive, but they constitute some of the most powerful consequences of the regulatory process. In a real sense, then, these induced effects have to be thought of as costs. Three effects are worthy of elaboration:[64]

1. *Innovation is affected.* When corporate budgets must focus on "defensive research," certain types of innovation do not take place. To the extent that firms must devote more of their scientific resources to meeting government requirements, fewer resources are available to dedicate to new product and process research and development and innovation. One industry affected in this way is the drug industry. Economists estimate that stringent FDA regulations seriously

FIGURE 7–6 Costs of Federal Regulatory Agencies in Fiscal 1998

Social Regulation	
Agency Category	***Millions of Dollars***
Consumer Safety and Health	$ 5,906
Job Safety and Working Conditions	1,314
Environment	5,979
Energy	505
Total Social Regulation	$13,704
Economic Regulation	
Agency Category	***Millions of Dollars***
Finance and Banking	$ 1,623
Industry-Specific Regulation	484
General Business	1,364
Total Economic Regulation	$ 3,471
Grand Total (Social and Economic Regulations)	$17,175

Derived from the Budget of the U.S. Government and related documents.

hinder innovation in the drug industry. The consequences are a slowed pace and a decreased number of new drugs arriving on the marketplace for consumer use.

2. *New investments in plant and equipment are affected.* To the extent that corporate funds must be used for regulatory compliance purposes, these funds are diverted from more productive uses. One estimate is that environmental and job safety requirements diminish by one-fourth the potential annual increase in productivity. It should also be pointed out that uncertainty about future regulations has an adverse effect on the introduction of new products and processes.[65]
3. *Small business is adversely affected.* Although it is not intentional, most federal regulations have a disproportionately adverse effect on small firms. Large firms have more personnel and resources and are therefore better able to get the work of government done than are small firms. In one study of small-business owner-managers, responses were solicited as to what they expected of government. Out of a list of nine choices, tax breaks for small firms was listed first and relief from government regulation was a close second.[66] More than any other group, small business seems to feel keenly affected by government regulation.

The frustrations of many small-business owners and managers about government regulation are conveyed by Frank Cremeans's experience. On one single day, as owner of Cremeans Concrete & Supply Co. in Ohio, he was visited by officials from four separate federal and state regulatory agencies. They dropped in unannounced on his concrete business on the same day in January. The four agencies were the EPA, OSHA, the local health department, and the mine-inspection agency. Mr. Cremeans said he could not believe it. He had to drop everything and spend the entire day dealing with the officials' demands. Small-business people have always grumbled about government regulation, but their mood had turned especially sour

after the Clinton administration strengthened regulatory programs and raised the possibility of mandated health care. Mr. Cremeans tried to turn the tables. In 1994, he was elected as a freshman member of the new Congress, swept in with a Republican landslide.[67] However, after 2 years, he lost his seat to Ted Strickland, the Democrat he had unseated in the previous race.

In addition to the induced effects described above, several others affect managers especially. These include stress on managers, modified decision processes, and alterations of corporate structure. To be sure, these kinds of effects are seen and experienced by managers as costs of government regulation, although they are typically overlooked in most calculations.

DEREGULATION

Quite frequently, trends and countertrends overlap with one another. Such is the case with regulation and its counterpart, deregulation. There are many reasons for this overlapping, but typically they include both the economic and the political. From an economic perspective, there is a continual striving for the balance of freedom and control for business that will be best for society. From a political perspective, there is an ongoing interplay of different societal goals and means for achieving those goals. The outcome is a mix of economic and political decisions that seem to be in a constant state of flux. Thus, in the economy at any point in time, trends that appear counter to one another can coexist simultaneously. These trends are the natural result of competing forces seeking some sort of balance or equilibrium.

This is how we can explain the trend toward deregulation that evolved in a highly regulated environment. Deregulation represents a counterforce aimed at keeping the economy in balance. It also represents a political philosophy that was prevailing during the period of its origin and growth.

Deregulation may be thought of as one kind of regulatory reform. But, because it is unique and quite unlike the regulatory reform measures discussed earlier, we will treat it separately. Deregulation has taken place primarily with respect to economic regulations, and this, too, helps to explain its separate treatment.

Purpose of Deregulation

The basic idea behind deregulation has been to remove certain industries from the old-line economic regulations of the past. The purpose of this deregulation, or at least a reduced level of regulation, has been to increase competition with the expected benefits of greater efficiency, lower prices, and enhanced innovation. These goals have not been uniformly received, and it is still undecided whether deregulation will work as a method of maximizing society's best interests.

Deregulation of certain industries has been basically a phenomenon of the past 20 years, although some big steps toward deregulation took place in the late 1960s and throughout the 1970s. Most of the landmark decisions in the move toward deregulation have occurred in the following fields: telecommunications (for example, the

breakup of AT&T), finance (for example, phasing out of interest rate ceilings), energy (for example, decontrol of gas/petroleum products), and transportation (for example, deregulation of the trucking, railroad, and airline industries).

Trend Toward Deregulation

The trend toward deregulation, most notably exemplified in the financial industry, the telecommunications industry, and the transportation (trucking, airline, railroad) industry, represents business's first major redirection in 50 years.[68] The result seems to be a mixed bag of benefits and problems. On the benefits side, prices have fallen in many industries, and better service has appeared in some industries along with increased numbers of competitors and innovative products and services.

Several problems have arisen also. Although prices have fallen and many competitors have entered some of these industries, it appears more and more that these competitors are unable to compete with the dominant firms. Thus, they are failing, going bankrupt, or being absorbed by the larger firms. Experts are now seeing that entry barriers into some industries are enormous and have been greatly underestimated. This has been shown to be the case in airline, trucking, railroad, and long-distance telephone service.[69] In addition, many of the problems that arose with savings and loan associations and banks have been attributed to deregulation.

Concerns are being expressed about what may be growing anticompetitive side effects as key industries increasingly are dominated by a few firms. This trend is obvious in transportation, where the major railroad, airline, and trucking companies boosted their market shares considerably during the 1980s. The top six railroads went from about 56 percent of market share to about 90 percent during this time. The top six airlines went from about 75 percent of market share to about 85 percent. The top ten trucking firms went from about 38 percent of market share to about 58 percent. In long-distance telephone service, AT&T still enjoys about an 80 percent share of the domestic market and a virtual monopoly in the huge toll-free, big-business, and overseas markets.[70]

To guard against the growing concentration in these major industries, greater vigilance will be needed in the antitrust area. Many of the experts who advocated deregulation during the 1970s knew that anticompetitive side effects would be likely. However, they expected the regulatory agencies to do a better job of actively supervising the transition to free markets. If this close supervision does not take place, the regulatory pendulum could readily swing back in the other direction.[71]

Dilemma with Deregulation

The intent of deregulation was to deregulate the *industries,* thus allowing for freer competition. The intent was not to deregulate health and safety requirements. The dilemma with deregulation is how to enhance the competitive nature of the affected industries without sacrificing the applicable social regulations. This is the second major problem with deregulation that needs to be discussed. Unfortunately, the dog-eat-dog competition unleashed by economic deregulation can force many companies to cut corners in ways that endanger the health and/or safety of their customers. This pattern, which seems to occur in any deregulated industry, was apparent in the trucking and airline industries.[72]

Trucking Industry

To survive in a deregulated industry, many truckers delayed essential maintenance and spent too many hours behind the wheel. According to some industry experts, as many as one-third of the long-haul drivers turned to illegal drugs to help them cope with the grueling hours on the road. Others turned to alcohol. Statistics showed a sharp increase in the number of truck accidents from 1980 to 1986, and roadside inspections in one year turned up serious problems in 30 to 40 percent of the trucks inspected.[73]

Airline Industry

The changes in the airline industry also had various experts concerned. Numerous accidents in the 1980s have been traced to poor maintenance or increased congestion at airports. Although the major airlines have historically maintained safety and maintenance standards higher than the minimum prescribed by the FAA, continuous price wars forced the best and largest firms to cut costs by abandoning previous standards. FAA-imposed fines for safety violations increased 20-fold over a recent 3-year period. Other cost-cutting measures that compromised safety include the widespread use of unapproved parts and a reduction in the number of flight attendants.[74]

Almost two decades after the trucking and airline industries were deregulated, the outlook appears brighter. In the trucking industry, the Federal Highway Administration (FHWA) has turned up the heat on truck safety, with some evidence of success. For instance, the percentage of fatal accidents in which the drivers' blood level alcohol content exceeded legal limits dropped by 25 percent from 1984 to 1994.[75] In the airline industry, concerns over deregulation have also lessened. Since 1929, accidents have been on a downward trend that was unaffected by deregulation, and recent research has shown no correlation between airline profitability and air safety.[76] Nevertheless, concerns about "underserved" small communities and low-cost carrier survival have prompted members of Congress to consider legislation that would reregulate part of the industry by redistributing airport slots and limiting predatory behavior.[77]

Overall, the trend toward deregulation continues globally. Around the world, industries that were once considered public goods are now being opened to market forces. In the United States, attention is being devoted to deregulating the telecommunications industry and electric utilities.

Telecommunications Industry

Since the breakup of AT&T in 1984, telephone rates have been cut in half and aggressive competitors, such as MCI and Sprint, have moved quickly to adopt fiber optic cable and other service improvements.[78] The Telecommunications Act of 1996, however, has yet to achieve its promise of lower rates and better service. In fact, 2 years after the Act's inception, thousands of rural phone subscribers are without phone service. Before the Act, cross-subsidization (urban subscribers and major long-distance carriers paid extra) ensured universal service. Although the new law proposed a new subsidy system, legal battles have slowed its implementation.[79] In contrast, business and urban customers are expected to be the first beneficiaries of the new broadband services.[80]

Electric Utilities

Since 1996, various states have passed electric restructuring initiatives, and Congress has been considering a range of bills all geared to bring competition to the electric

utilities. As has been true with telephone deregulation, consumers are likely to save money, but those savings have inherent trade-offs.[81] Power companies have traditionally provided special programs to aid the community and people in need. As was true of telephone companies, these programs were financed by spreading the cost over the customer base. Following deregulation, only those programs that can be used to enhance image or advertising are likely to remain.[82]

REGULATORY REFORM

The 1970s witnessed a surge of regulatory initiatives unprecedented in the history of the United States. Ironically, at almost the same time, or at least during the same decade, a surge of second thoughts about the wisdom of these initiatives occurred. Many questions began to be asked: Had we gone too far? Had our best intentions gotten the better of us? Had our idealism reached beyond the bounds of practicality?[83]

By the mid- to late 1970s, the calls for regulatory reform were begun by President Gerald Ford and were quickly embraced by President Jimmy Carter. President Ronald Reagan interpreted his 1980 election as a mandate to further the efforts at reform and to get the government off the backs of the people. President George Bush reactivated some of the attentiveness the regulatory agencies had given their missions. President Bill Clinton's record is somewhat more difficult to interpret. There is significant evidence of a resurgence in government regulation. At the same time, however, President Clinton and Vice President Al Gore have pledged to make the federal government more efficient through their "reinventing government" initiative.

Approaches to Regulatory Reform

Three broad kinds of regulatory reform proposals surfaced during the past 15 years. One approach was to *streamline the process* and to *review justifications* for existing and proposed rules. The idea here was that a rule should not be developed unless its benefits clearly outweighed its costs. President Carter promoted this idea with Executive Order 12044. This order requires agencies to justify new rules with cost-benefit analysis. President Reagan embraced the cost-benefit idea enthusiastically, as did many members of Congress. President Clinton and Vice President Gore have pushed the government agencies into developing streamlining plans, but it is too early to see the effects of this initiative.

A second approach to regulatory reform advocated that *regulators be more accountable* to Congress, the courts, and the executive branch. In this connection, the controversial legislative veto was proposed that would allow Congress to void proposed rules. The courts would be given power to review regulations under another proposal. The president's powers would be expanded under another proposal. Picking up on this, the Reagan administration sought and received from Congress the authority to enlarge the power of the Office of Management and Budget (OMB) to review independent regulatory commissions. Along these lines, President Clinton, in keeping with a previously announced Gore theme, has been encouraging agencies to measure program performance—getting the government focused on results so taxpayers can see what they are getting for their money.

A third approach to regulatory reform held that these procedural reforms were superficial and what was needed was a *broad-based attack on the regulations* themselves and the statutes that gave the agencies power. This approach was brought up during the lengthy controversy over renewal of the Clean Air Act and the reauthorization of several regulatory commissions.[84]

No single approach to regulatory reform is likely to cure all the problems we have with government regulations. The important consideration is that policy makers be sensitive to the problems that bring about regulatory failure and be prepared to address these problems when regulations are proposed and, later, when it is evident that reform is necessary. In some cases, generic reforms will be adequate. In other cases, a regulation-by-regulation examination may be necessary.

Regulatory Trends: A Decade of Experience

In late 1986 and in 1987, there was some evidence that a regulatory revival was beginning. A *Wall Street Journal*/NBC poll showed that 38 percent of the public still believed there was too much government regulation of the economy, 32 percent thought there was about the right amount, and 23 percent said there was not enough. These results indicated a major swing in public opinion in favor of regulation since polls taken in the early 1980s.[85]

Although President Reagan pursued a deregulation strategy during the period 1980 to 1985, in his second term he allowed modest growth in regulatory agencies' budgets and staffs. Similarly, President Bush was more inclined to allow the federal agencies to increase their budgets and staff levels. Economists from the Center for the Study of American Business at Washington University concluded that regulation was rebounding under the Bush administration. The 1991 budget, which was President Bush's first, showed spending levels at the federal regulatory agencies reaching record highs both in current dollars and in real terms. President Bush seemed to be less skeptical about the role of federal regulators in the economy, and his first budget suggested a growth trajectory similar to the budget trends from the Carter years, just prior to Reagan.[86]

In addition to stepping up enforcement of existing regulations and expanding budgets and staffing of the regulatory agencies, Congress passed costly laws in the early 1990s that will increase the focus on regulation. In 1990, Congress passed two significant pieces of legislation: the Clean Air Act amendments and the Americans with Disabilities Act. Some estimates suggest that the new air pollution laws may turn out to be the costliest regulations in the nation's history. Estimates of the annual costs of the law range from $25 billion to $40 billion. This sum would amount to an annual cost of about $300 to $400 for each U.S. household. Economists were alarmed because of the fear that these regulatory expenditures threaten needed U.S. economic expansion and could lead to a diminishment of productivity, an undermining of competitiveness, and significant numbers of lost jobs in the U.S. work force.[87]

Another significant factor that may have brought about public concern for more regulation was the stock market crash in October 1987. It is clear that the public was greatly unsettled by this event. Moreover, this event may have precipitated renewed interest in tighter government regulations. To this must be added the Savings and Loan Association bail-out by the federal government and the increasing numbers of

bank failures, both of which are at least in part attributable to careless or inadequate government regulation.

In his book *Putting People First,* then Governor Clinton pledged to reduce the federal bureaucracy and budget.[88] Since entering office, his administration has reduced the federal work force by 332,000 people, presented the first balanced budget in 30 years, and reformed welfare. Yet, anecdotes of regulatory zeal suggest an increased level of activism by such agencies as OSHA, the FDA, and the EPA.[89] Only time will tell whether the Clinton administration will meet its goal of creating a government that works better while costing less.

Professional economists will continue to debate the pros and cons of government regulation, but in the final analysis the outcome of the political process will prevail. It can be readily seen by these trends, countertrends, and examples that the public does, indeed, see government as one major mediator of its relationship with business. This is how the system works, and the changes we continue to see and sense in the business/government/public relationship are constantly evolving; they cannot be pinned down for any significant period. The best judgment at this point is that there will be some moderate interest in social regulation but that the trend toward economic deregulation will not be reversed anytime soon. Part of the reason, of course, is that the economic decisions are of such a large magnitude and, once made, are not easily changed.

SUMMARY

Business cannot be discussed without considering the paramount role played by government. Although the two institutions have opposing systems of belief, they are intertwined in terms of their functioning in our socioeconomic system. In addition, the public assumes a major role in a complex pattern of interactions among business, government, and the public. Government exerts a host of nonregulatory influences on business. Two influences with a macro orientation include industrial policy and privatization. A more specific influence is the fact that government is a major employer, purchaser, subsidizer, competitor, financier, and persuader. These roles permit government to affect business significantly.

One of government's most controversial interventions in business is direct regulation. Government regulates business for several legitimate reasons, and in the past two decades social regulation has been more dominant than economic regulation. There are many benefits and various direct, indirect, and induced costs of government regulation.

A trend of the 1980s was deregulation. However, bad experiences in key industries, such as trucking, airlines, savings and loans, and banks, have caused many to wonder whether the government has gone too far in that direction. Although regulatory reform was a central issue throughout the 1980s, there has been some amount of talk about *reregulation.* This has occurred for a variety of reasons, but the stock market crash in October 1987 made the general public quite anxious about the private sector and its stability. Obviously, these perceptions of the business sector come and go, but they often assume much more weight in determining government's role than do theoretical economic arguments.

KEY TERMS

accelerationists (page 216)

adjusters (page 216)

bankers (page 216)

central planners (page 216)

cybersquatting (page 217)

deregulation (page 232)

direct costs of regulation (page 229)

economic regulation (page 225)

indirect costs of regulation (page 229)

induced effects of regulation (page 230)

industrial policy (page 216)

natural monopoly (page 222)

privatization (page 218)

regulation (page 222)

social regulation (page 225)

targeters (page 216)

DISCUSSION QUESTIONS

1. Briefly explain how business and government represent a clash of ethical systems (belief systems). Go through the list of characteristics of each belief system in Figure 7–1. With which do you find yourself identifying most? Explain. With which would most business students identify? Explain.
2. Explain why the public is treated as a separate group in the interactions among business, government, and the public. Doesn't government represent the public's interests? How should the public's interests be manifested?
3. What is regulation? Why does government see a need to regulate? Differentiate between economic and social regulation. What social regulations do you think are most important, and why? What social regulations ought to be eliminated? Explain.
4. Outline the major benefits and costs of government regulation. In general, do you think the benefits of government regulation exceed the costs? In what areas, if any, do you think the costs exceed the benefits?
5. The airline and trucking industries were cited as examples of problems with deregulation. What is the current mood of the country regarding deregulation? What evidence can you present to substantiate your opinion?

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