Business–Government Relations

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This chapter focuses on these key learning objectives:

- Understanding why governments sometimes seek to cooperate with business and other times work against business.
- Defining public policy and the elements of the public policy process.
- Knowing the major types of government regulation of business.
- Explaining the reasons for regulation.
- Comparing the costs and benefits of regulation for business and society.
- Examining how regulation affects business in a global context.

William Clay Ford is the fourth generation of Fords to hold the top leadership position at the Ford Motor Company, founded in the early 1900s. He became chairman of the board in 1999 and served as chief executive officer of the family's business from 2001 to 2006. Like each of his predecessors, he faces great challenges as he tries to improve Ford's position as a world-class automobile company. Not the least of those challenges involves dealing with the changing role of government.

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When Henry Ford II, the founder's grandson, became chief executive officer in the 1970s, it was a very different world. Government closely observed how Mr. Ford and his [illegible] had grown into a tangle of laws and court rulings regulating competition, product pricing, mergers, and acquisitions. Labor laws legalized unions and controlled wages, hours, working conditions, safety and health, and employee discrimination. Federal, state, local, and foreign governments levied taxes on company income, plants and equipment, capital gains, auto and truck sales, and salaries.

Over the course of 100 years, the leaders of Ford Motor Company have seen government's role in their business become much more extensive and complex. As chairman of the company, William Ford knows that Ford Motor Company faces new challenges in the 21st century. Foreign competition has increased in the United States, and the company competes in dozens of countries around the world. In many countries, national governments are partners with Ford's competitors and jointly plan how to compete against it; European and Asian competitors loom large. The company's customers and global workforce include people of many races and nationalities. Technological change is transforming many aspects of the business. Today's Ford Motor Company is designing automobiles [illegible] with navigation systems that help drivers avoid traffic congestion. Government-set fuel economy, safety, and emissions standards are important factors affecting automobile design. In all of this, government policy—public policy—plays an increasingly important role in the success and operation of the company.[1]

Why are governments involved in such decisions? How do the government's actions affect businesses and what they are permitted to do? What happens when government experts and industry experts disagree about the best way to achieve the public interest?

Governments create the conditions that make it possible for businesses to compete in the modern economy. Their role is to create and enforce the laws that *balance* the relationship between business and society. Governments become involved when unintended costs of manufacturing a product are imposed on others and government is needed to control or redirect these costs. Governments also hold the power to grant or refuse permission for many types of business activity. Even the largest multinational companies, such as Ford, which operate in dozens of countries, must obey the laws and public policies of national governments.

This chapter considers the ways in which government actions impact business through the powerful twin mechanisms of public policy and regulation. The next chapter addresses the related question of actions business may take to influence the political process.

How Business and Government Relate

The relationship between business and government is dynamic and complex. The stability of a government can be shaky or solid. Even within a stable government, different individuals or groups can acquire or lose power through elections, the natural death of a public official, or other means. Understanding the government's authority and its relationship with business is essential for managers in developing their strategies and achieving their organization's goals.

Government Cooperates with Business

In some situations, government may work closely with business to build a cooperative relationship and seek mutually beneficial goals. The basis for this cooperation may be at the core of the nation's societal values and customs. In some Asian countries, society is viewed as a collective family that includes both government and business. Thus, working together as a family leads these two powers to seek results that benefit both society and business.

In Europe, the relationship between government and business often has been cooperative. European culture includes a sense of teamwork and mutual aid. Unions, for example, are often included on administrative boards with managers to lead the organization toward mutual goals through interactive strategies.

> When faced with the migration of the European pharmaceutical industry to the United States, the European Commission (EC), a governing body of the European Union, adopted a more flexible pricing proposal. Many European countries had previously banned the sale of drugs until the government fixed a price, often much lower than the price found in the United States. The EC proposal permitted companies to market their drugs at whatever price they chose. This created a "framework of action that we believe can help the Europe-based pharmaceutical industry regain its competitive edge," said European Enterprise Commissioner Erkki Liikanen.[2]

Cooperation between business and government, as shown in this example, often occurs when both groups encounter a common problem or enemy requiring a joining of forces. Even traditional adversaries can find grounds for collaboration and support when the need presents itself.

Government Conflicts with Business

In other situations, government's goals and business's objectives are at odds, and these conflicts result in an adversarial relationship. Following the Enron and other business scandals, in which the auditing industry had failed to police itself adequately, the U.S. Securities and Exchange Commission passed new rules, and

Congress passed the Sarbanes-Oxley Act of 2003. This law limited the ability of accounting firms to offer both consulting and auditing services to their clients. (The Sarbanes-Oxley Act is also discussed in Chapters 5 and 15.)

In 2003, with dramatic power shifts occurring in the Middle East and growing uncertainty over the world oil market, business leaders in Russia pleaded with government officials to loosen their grip on Russian oil production. Private industry was ready to invest billions of dollars in new pipelines and ports, but the government was unwilling to relinquish its control over the export infrastructure. Russian officials pointed to concerns over whether there would be sufficient oil supplies for the Russian people and businesses and wanted to retain control over this vital Russian industry.[3]

Governments also may act in an adversarial role against business when negative externalities arise. **Negative externalities**, or spillover effects, result when the manufacture or distribution of a product gives rise to unplanned or unintended costs (economic, physical or psychological) borne by consumers, competitors, neighboring communities, or other business stakeholders. To control or reverse these costs, government may step in to regulate business action.

As further described in a case study at the end of the book, patients taking Vioxx, a prescription pain medication made by Merck, became deeply concerned when evidence emerged of cardiovascular risk. The Drug Safety Oversight Board was established in 2005 to monitor Food and Drug Administration–approved medicines once they were on the market and to update physicians and patients with pertinent and emerging information on possible risks and benefits.[4]

In short, the relationship between government and business can range from one of cooperation to one of conflict, with various stages in between. Moreover, this relationship is constantly changing. A cooperative relationship on one issue does not guarantee cooperation on another issue. The stability of a particular form of government in some countries may be quite shaky, while in other countries the form of government is static but those in power can change unexpectedly or government rulers can change on a regular basis. The business–government relationship is one that requires managers to keep a careful eye trained toward significant forces that might alter this relationship or to promote forces that may encourage a positive business–government relationship.[5]

Legitimacy Issues

When dealing with a global economy, business may encounter governments whose authority or right to be in power is questioned. Political leaders may illegally assume lawmaking or legislative power, which can become economic power over business. Elections can be rigged, or military force can be used to acquire governmental control.

Business managers may be challenged with the dilemma of doing business in such a country where their business dealings would support this illegitimate power. Sometimes, they may choose to become politically active, or refuse to do business in this country until a legitimate government is installed. The military dictatorship

in Myanmar (Burma) is one example of an illegitimate government, as discussed in Chapter 7.

The ability of a government leader or group of leaders to maintain political power can be influenced by businesses' actions. Businesses may boycott economic relations with a country or decide to withdraw operations from that country, as many U.S. firms did in South Africa to protest the practice of apartheid in the 1970s. Some businesses have been ordered by their country to not conduct business with another country due to war or in protest of an illegitimate government, such as the U.S. boycott of Iraq in the 1990s. The United States has imposed economic sanctions on nearly 30 countries due to political and human rights concerns.

Government's Public Policy Role

Government performs a vital and important role in modern society. Although vigorous debates occur about the proper size of programs government should undertake, most people agree that a society cannot function properly without some government activities. Citizens look to government to meet important basic needs. Foremost among these are safety and protection provided by homeland security, police, and fire departments. These are collective or public goods, which are most efficiently provided by government for everyone in a community. In today's world, governments are also expected to provide economic security and essential social services, and to deal with the most pressing social problems that require collective action, or public policy.

Public policy is a plan of action undertaken by government officials to achieve some broad purpose affecting a substantial segment of a nation's citizens. Or as the late U.S. Senator Patrick Moynihan said, "Public policy is what a government chooses to do or not to do." In general, these ideas are consistent. Public policy, while differing in each nation, is the basic set of goals, plans, and actions that each national government follows in achieving its purposes. Governments generally do not choose to act unless a substantial segment of the public is affected and some public purpose is to be achieved. This is the essence of the concept of governments acting in the public interest.

The basic power to make public policy comes from a nation's political system. In democratic societies, citizens elect political leaders who can appoint others to fulfill defined public functions ranging from municipal services (e.g., water supplies, fire protection) to national services, such as public education or homeland security. Democratic nations typically spell out the powers of government in the country's constitution.

Another source of authority is *common law*, or past decisions of the courts, the original basis of the U.S. legal system. In nondemocratic societies, the power of government may derive from a monarchy (e.g., Saudi Arabia), a military dictatorship (e.g., Iraq before the fall of Saddam Hussein), or religious authority (e.g., the mullahs in Iran). These sources of power may interact, creating a mixture of civilian and military authority. The political systems in Russia, South Africa, and other nations have undergone profound changes in recent times. And democratic nations can also face the pressures of regions that seek to become independent nations exercising the powers of a sovereign state, as does Canada with Quebec.

Elements of Public Policy

The actions of government in any nation can be understood in terms of several basic elements of public policy. These are inputs, goals, tools, and effects.

Public policy inputs are external pressures that shape a government's policy decisions and strategies to address problems. Economic and foreign policy concerns, domestic political pressure from constituents and interest groups, technical information, and media attention all play a role in shaping national political decisions. For example, many state and local governments have been asked to ban or regulate the use of cell phones by drivers.

Robert Shelton, executive director of the National Highway Traffic Safety Administration, told Congress that 54 percent of drivers have cell phones in their vehicles or carry cell phones when they drive; 80 percent of those drivers leave their cell phones turned on while driving; and 73 percent talk on the phone while driving. Opponents of the use of cell phones while driving noted that wireless communication and entertainment devices, such as navigation systems, televisions, DVD players and computers, are becoming more common.[6]

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Public policy goals can be broad (e.g., full employment) and high-minded (equal opportunity for all) or narrow and self-serving. National values, such as freedom, democracy, and a fair chance for all citizens to share in economic prosperity, have led to the adoption of civil rights laws and economic assistance programs for those in need. Narrow goals that serve special interests are more apparent when nations decide how tax legislation will allocate the burden of taxes among various interests and income groups, or when public resources, such as oil exploration rights or timber cutting privileges, are given to one group or another. Whether the goals are broad or narrow, for the benefit of some or the benefit of all, most governments should ask, "What public goals are being served by this action?" For example, the rationale for a government policy to regulate cell-phone usage has to be based on some definition of public interest, such as preventing harm to others, including innocent drivers, passengers, and pedestrians.

In a study published in the *British Medical Journal,* researchers estimated that motorists are four times more likely to be involved in a crash requiring hospital admittance when they are using cell phones. A report by the Harvard Center for Risk Analysis suggested that drivers talking on their cell phones are responsible for about 6 percent of U.S. auto accidents each year, killing an estimated 2,600 people and injuring 330,000 others. A California Highway Patrol study concluded that cell phones were cited as a factor in 11 percent of inattention-related crashes, more than any other single factor. "Simply put, this legislation is about saving lives. Just a few seconds of distraction while talking on a cell phone can mean the difference between safety and peril, between life and death. We must make our roads safer," explained Senator Jon Corzine of New Jersey.[7]

Thus, the goals of saving lives, reducing injuries, and eliminating health care costs might justify some form of cell-phone regulation. The policy decision would depend, in part, on whether the benefits of the regulation are greater or less than the costs that would be imposed on the public.

Governments use different *public policy tools* to achieve policy goals. The tools of public policy involve combinations of incentives and penalties that government uses to prompt citizens, including businesses, to act in ways that achieve policy goals. Governmental regulatory powers are broad and constitute one of the most formidable instruments for accomplishing public purposes.

After congressional action limiting cell-phone use stalled, the public looked to state and local governments to ban the use of cell phones by drivers while operating their vehicles. By 2005, 22 states and the District of Columbia had laws governing cell-phone use in the car. Legislators in 39 states, including some states that had adopted weaker forms of legislation, proposed 129 bills

related to driver distraction in 2005. The Cleveland suburb of Brooklyn, Ohio, became the first jurisdiction in the United States to ban using a cell phone while driving. By 2005, 26 municipalities had passed cell-phone restriction laws. And this is not just a public policy issue for Americans. As many as 40 nations, including Australia, Israel, Great Britain, Russia and Japan, ban calling while driving.[8]

Public policy effects are the outcomes arising from government regulation. Some are intended; others are unintended. Because public policies affect many people, organizations, and other interests, it is almost inevitable that such actions will please some and displease others. Regulations may cause businesses to improve the way toxic substances are used in the workplace, thus reducing health risks to employees. Yet other goals may be obstructed as an unintended effect of compliance with such regulations. For example, when health risks to pregnant women were associated with exposure to lead in the workplace, some companies removed women from those jobs. This action was seen as a form of discrimination against women that conflicted with the goal of equal employment opportunity. The unintended effect (discrimination) of one policy action (protecting employees) conflicted head-on with the public policy goal of equal opportunity.

The debate over cell-phone legislation was filled with conflicting predicted effects. The proponents obviously argued that the ban on cell-phone use reduced accidents and saved lives. Opponents of such legislation pointed to numerous other distractions that were not banned, such as drivers reading the newspaper, eating, putting on makeup or shaving. Cell-phone owners cited benefits such as security and peace of mind, increased productivity, privacy, and quicker crime and accident reporting to justify the use of cell phones. A study funded by AT&T found that the cost of lives saved by banning cell phones while driving was estimated to be about $2 billion, compared with about $25 billion in benefits lost, meaning a cell-phone ban would cost society about $23 billion.[9]

As the cell-phone safety examples illustrate, managers must try to be aware of the public policy inputs, goals, tools, and effects relevant to regulation affecting their business.

Types of Public Policy

Public policies created by governments are of two major types: economic and social.

Economic Policies

[illegible] refers to patterns of government taxing and spending that are intended to stimulate or support the economy. Governments spend money on many different activities. Local governments employ teachers, trash collectors, police, and firefighters. State governments typically spend large amounts of money on roads, social services, and park lands. National governments spend large sums on military defense, international relationships, and hundreds of public works projects. During the Great Depression of the 1930s, public works projects employed large numbers of people, put money in their hands, and stimulated consumption of goods and services. Today, fiscal policy remains a basic tool to achieve prosperity. Public works projects (e.g., roads, airports) remain among the most popular means of creating employment while achieving other public goals.

By contrast, the term **monetary policy** refers to policies that affect the supply, demand, and value of a nation's currency. The worth, or worthlessness, of a nation's currency has serious effects on business and society. It affects the buying power of money, the stability and value of savings, and the confidence of citizens and investors about the nation's future. This, in turn, affects the country's ability to borrow money from other nations and to attract private capital. In the United States, the Federal Reserve Bank—known as the Fed—plays the role of other nations' central banks. By raising and lowering the interest rates at which private banks borrow money from the government, the Fed influences the size of the nation's money supply and the value of the dollar.

Other forms of economic policy include *taxation policy* (raising or lowering taxes on business or individuals), *industrial policy* (directing economic resources toward the development of specific industries), and *trade policy* (encouraging or discouraging trade with other countries).

Social Assistance Policies

The last century produced many advances in the well-being of people across the globe. The advanced industrial nations have developed elaborate systems of social services for their citizens. Developing economies have improved key areas of social assistance (such as health care and education) and will continue to do so as their economies grow. International standards and best practices have supported these trends. Many of the **social assistance policies** that affect particular stakeholders are discussed in subsequent chapters of this book.

One particularly important social assistance policy—health care—has been the focus for concern on the international front, as profiled in Exhibit 8.A, and for national and state lawmakers.

> Wal-Mart found itself in the middle of a health care coverage controversy in 2005, when a social watchdog group named WakeUpWalMart reported that 57 percent of the company's 1.39 million workers and their families had no company-paid health insurance. The group estimated that the cost to the U.S. taxpayers to provide health care to Wal-Mart employees and their families, through Medicare and various state public assistance programs, was $1.37 billion annually and would rise to $9.1 billion over the next five years.[10]

Clearly, governments' ability to provide social assistance, for example in the area of health care, is a costly and complex challenge.

Government Regulation of Business

Societies rely on government to establish rules of conduct for citizens and organizations called *regulations*. **Regulation** is a primary way of accomplishing public policy, as described in the previous section. Because government operates at so many levels (federal, state, local), modern businesses face complex webs of regulations. Companies often require lawyers, public affairs specialists, and experts to monitor and manage their interaction with government, as described in Chapter 2. Why do societies turn to more regulation as a way to solve problems? Why not just let the free market allocate resources, set prices, and constrain socially irresponsible behavior by companies? There are a variety of reasons.

Market Failure

One reason is what economists call **market failure**—that is, the marketplace fails to adjust prices for the true costs of a firm's behavior. For example, a company normally has no incentive to spend money on pollution control equipment if customers do not demand it. The market fails to incorporate the cost of environmental harm into the business's economic equation, because the costs are borne by someone else. In this situation, government can use regulation to force all competitors in the industry to adopt a minimum antipollution standard. The companies will then incorporate the extra cost of compliance into the product price. Companies that want to act responsibly often welcome carefully crafted regulations, because they force competitors to bear the same costs.

Natural Monopolies

In some industries, **natural monopolies** occur. The electric utility industry provides an example. Once one company has built a system of poles and wires or laid miles of underground cable to supply local customers with electricity, it would be inefficient for a second company to build another system alongside the first. But once the first company has established its natural monopoly, it can then raise prices as much as it wishes, because there is no competition. In such a situation, government often comes in and regulates prices and access. Other industries that sometimes develop natural monopolies include cable TV, broadband Internet service, software, and railroads.

Ethical Arguments

There is often an ethical rationale for regulation as well. As discussed in Chapter 5, for example, there is a utilitarian ethical argument in support of safe working conditions: It is costly to train and educate employees only to lose their services because of preventable accidents. There are also fairness and justice arguments for government to set standards and develop regulations to protect employees, consumers, and other stakeholders. In debates about regulation, advocates for and against regulatory proposals often use both economic and ethical arguments to support their views. Sometimes firms will agree to self-regulate their actions to head off more costly government-imposed regulatory reform as shown in the following example.

> As Internet technology and applications have become more sophisticated, privacy concerns have been raised. It is unethical, in the view of critics, for

companies to sell private information without customer approval. Faced with mounting government and public pressure, companies such as Cisco Systems, Dell, Intel, Microsoft, and Sun Microsystems, working through the Information Technology Industry Council (a trade association), agreed to a set of principles intended to give consumers confidence and trust that privacy rights will be respected when they engage in electronic commerce.[11]

Types of Regulation

Government regulations come in different forms. Some are directly imposed; others are more indirect. Some are aimed at a specific industry (e.g., banking); others, such as those dealing with job discrimination or pollution, apply to all industries. Some have been in existence for a long time—for example, the Food and Drug Administration was formed in 1906—whereas others, such as those governing state lotteries and other forms of legalized gambling, are of recent vintage in many states. As shown in Exhibit 8.B, regulatory agencies have the challenge of setting rules that are fair and effective in achieving public policy goals.

Just as public policy can be classified as either economic or social, so too can regulations be classified.

Economic Regulations

The oldest form of regulation is primarily economic in nature. **Economic regulations** aim to modify the normal operation of the free market and the forces of supply and demand. Such modification may come about because the free market is distorted by the size or monopoly power of companies, or because the consequences of actions in the marketplace are thought to be undesirable. Economic regulations include those that control prices or wages, allocate public resources, establish service territories, set the number of participants, and ration resources. The decisions of the Federal Communications Commission (FCC) about how to allocate portions of the electromagnetic spectrum, described in Exhibit 8.B, illustrated one kind of economic regulation. Consider the following additional examples:

- Local telephone companies are allowed to offer long-distance service, but only if they open their networks to other service providers. The purpose of this FCC regulation is to promote open competition for long-distance service, giving customers more choices and lower prices.
- The Federal Energy Regulatory Commission, in some situations, controls prices for electricity. For example, the agency capped (placed an upper limit on) wholesale energy prices in California, after prices had spiked upward and blackouts had occurred.
- Regulators at both the state and federal levels set strict rules for when and where commercial fishing boats can operate, as well as rules about what kinds of fish can be caught. One reason for such rules is to divide a common resource (wild fish) among numerous businesses in a fair way.

Certain operations or functions of business have been singled out for special attention by government regulators. Many labor practices, for example, are no longer left to the operation of free market forces. Government agencies set minimum wages, regulate overtime pay, establish the rules for labor union campaigns, and mediate serious and troublesome labor–management disputes, including, in recent years, strikes by airline pilots, flight attendants, schoolteachers, and even professional baseball players. Competition is another business function strongly affected by regulation. Antitrust laws attempt to prevent monopolies,

preserve competitive pricing, and protect consumers against unfair practices; they are further described in Chapter 10.

Economic regulations, like social regulations, sometimes cut across industry lines and apply generally to all enterprises, as they do in the case of antitrust and labor practices. Or they may, as in the case of regulations governing stock exchanges and the issuance of corporate securities, be confined to specific institutions such as the stock markets or the companies whose stocks are listed on those exchanges.

Social Regulations

Social regulations are aimed at such important social goals as protecting consumers and the environment and providing workers with safe and healthy working conditions. Equal employment opportunity, protection of pension benefits, and health care for employees are other important areas of social regulation. Unlike the economic regulations mentioned above, social regulations are not limited to one type of business or industry. Laws concerning pollution, safety and health, and job discrimination apply to all businesses; consumer protection laws apply to all relevant businesses producing and selling consumer goods.

Consider the following examples of social regulations:

- The Consumer Product Safety Commission sets strict rules for children's toys. The reason is to prevent the sale of playthings that could harm youngsters, such as toys with small parts that could come loose and pose a choking hazard.
- The Environmental Protection Agency sets limits on the amounts of sulfur dioxide that can be emitted into the air from the smokestacks of power plants. The government wants to reduce the amount of acid rain that falls on forests, lakes, farms, and cities—and that sometimes travels across international boundaries and causes friction with neighboring countries.
- The National Highway Traffic Safety Administration requires new cars to be equipped with air bags, seatbelts, and other protective gear and to meet strict fuel-efficiency standards.
- Many social regulations are discussed in later chapters of this book that take up the relationship between business and specific stakeholders.

Who regulates? Normally, for both economic and social regulation, specific rules are set by agencies of government and by the executive branch, and may be further interpreted by the courts. Many kinds of business behavior are also regulated at the state level. Government regulators and the courts have the challenging job of applying the broad mandates of public policy.

Figure 8.1 depicts these two types of regulation—economic and social—along with the major regulatory agencies responsible for enforcing the rules at the federal level in the United States. Only the most prominent federal agencies are included in the chart. Individual states, some cities, and other national governments have their own array of agencies to implement regulatory policy.

There is a legitimate need for government regulation in modern economies, but regulation also has problems. Businesses feel these problems firsthand, often because the regulations directly affect the cost of products and the freedom of managers to design their business operations. In the modern economy, the costs and effectiveness of regulation, as well as its unintended consequences, are serious issues that cannot be overlooked. Each is discussed below.

The Effects of Regulation

Regulation affects many societal stakeholders, including business. Sometimes the consequences are known and intended, but at other times unintended or accidental consequences emerge from regulatory actions. In general, government hopes that the benefits arising from regulation outweigh the costs.

Costs of Regulation

The call for regulation may seem irresistible to government leaders and officials, but there are always costs to regulation. An old economic adage says, "There is no free lunch." Eventually, someone has to pay for the benefits created.

An industrial society such as that of the United States can afford almost anything, including social regulations, if it is willing to pay the price. Sometimes the benefits are worth the costs; sometimes the costs exceed the benefits. The test of **cost-benefit analysis** helps the public understand what is at stake when new regulation is sought. For example, when the U.S. Congress debated the Clinton administration's national health care proposals in the 1990s, opposition increased when it was shown that the plan would impose large regulatory costs. Congress realized that the American public did not want the benefits of a national health care plan at any cost; they wanted them at little or no cost. On the other hand, when it became known that the National Highway Traffic Safety Administration (NHTSA) had received information about defective Firestone tires more than one year before their recall, the public was outraged that NHTSA's budget was not large enough to enable it to analyze the data and protect lives.

Figure 8.2 illustrates the increase in costs of federal regulation in the United States since the 1960s. Economic regulation has existed for many decades, and its cost has grown more slowly than social regulation. Social regulation spending reflects growth in such areas as environmental health, occupational safety, and consumer protection. The rapid growth of social regulation spending that occurred from 1970 until the late 1990s has slowed considerably during the George W. Bush era of the 2000s.

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The growth in regulatory programs is not a new phenomenon. As scholars at the Center for the Study of American Business have documented, staffing regulatory activities in the United States took off during the 1960s and 1970s, as shown in Figure 8.3. In 1960, fewer than 40,000 federal employees monitored and enforced government regulations. Two decades later, in 1980, nearly 100,000 federal regulatory employees did so. In the early 1980s, President Reagan led a campaign to cut government regulation. This campaign continued during both of the Bush presidencies and the number of full-time federal employees dedicated to regulatory activities has modestly increased since the 1990s.[13]

Although the costs of regulation continue to climb, some argue that the benefits outweigh these costs. In the United States, regulatory agencies seek to protect employees from discrimination, sexual harassment, and unnecessary workplace hazards. Consumer interests are likewise the concern of regulatory agencies. Protection of the natural environment may require increasing staff and other associated costs, but many claim that preserving our air, land, and water is worth the expenditures. Small-business owners are able to compete in the marketplace

and are protected from economic abuses by other firms due to regulatory oversight. Many of these benefits cannot be measured by dollars and cents, but the need for regulation must be balanced against both its costs and assessments of whether it will accomplish its intended purpose.

The United States has experimented with different forms of government regulation for more than 200 years, and experts have learned that not all government programs are effective in meeting their intended goals. Thus, government is called on from time to time to regulate certain types of business behavior and, at other times, to deregulate that behavior if it is believed that the industry no longer needs that regulation or that other, better means exist to exercise control (e.g., market pressures from competitors).

Continuous Regulatory Reform

The amount of regulatory activity often is cyclical—historically rising during some periods and declining during others. Businesses in the United States have experienced a lessening of regulation—*deregulation*—only to observe the return of regulatory activity—*reregulation.*

Deregulation is the removal or scaling down of regulatory authority and regulatory activities of government. Deregulation is often a politically popular idea. President Ronald Reagan strongly advocated deregulation in the early 1980s, when he campaigned on the promise to "get government off the back of the people." Major deregulatory laws were enacted beginning in 1975 when Gerald Ford was president and continued through the administrations of Jimmy Carter, Ronald Reagan, and (the first) George Bush. Deregulation has occurred in the following industries, among others:

- *Commercial airlines:* removed government-set rates and allowed domestic airlines to compete and more easily make mergers and acquisitions.
- *Interstate trucking companies:* permitted to charge lower prices and provide services over a wider area.
- *Railroads:* given the freedom to set rates in some parts of their business and to compete in new ways.
- *Financial institutions:* allowed to be more flexible in setting interest rates on loans and to compete across state lines.

Deregulation has also occurred in Europe, especially in the arena of social regulation. In the United Kingdom, for example, the Approved Code of Practice (ACoP) governing various employee safety and health issues was downgraded to a "Guidance," a weaker form of regulatory control. In the Netherlands, the Ministry of Social Affairs proposed the deregulation of the Work Environment Act.[14]

Proponents of deregulation often challenge the public's desire to see government solve problems. This generates situations in which government is trying to deregulate in some areas while at the same time creating new regulation in others. **Reregulation** is the increase or expansion of government regulation, especially in areas where the regulatory activities had previously been reduced. The scandals that rocked corporate America in the early 2000s brought cries from many stakeholder groups for reregulation in the area of securities law. Clearly, businesses had not effectively regulated themselves, and the market had not deterred business misdeeds. A flood of regulatory reforms were proposed, to an extent unseen in America for decades, leading some to call this a "New Reform Era." The target was clear: the overhaul of the financial reporting practices in America. Government and society must constantly strive to achieve the right balance between market freedoms and government oversight of business behavior.

Regulation in a Global Context

International commerce unites people and businesses in new and complicated ways, as described in Chapter 7. U.S. consumers routinely buy food, automobiles, and clothing from companies located in Europe, Canada, Latin America, Australia, Africa, and Asia. Citizens of other nations do the same. As these patterns of international commerce grow more complicated, governments recognize the need to establish rules that protect the interests of their own citizens. No nation wants to accept dangerous products manufactured elsewhere that will injure its citizens, and no government wants to see its economy damaged by unfair competition from foreign competitors. These concerns provide the rationale for international regulatory agreements and cooperation.

Regulation of Imported Products

Every nation has the power to set standards for products to be sold in the country. For example, toys made abroad but sold in the United States must meet U.S. safety standards, so long as domestic manufacturers must also meet them. However, governments are often under pressure from other interests, including local companies, labor organizations, and communities, to close local markets to foreign sellers. These stakeholders may feel threatened by foreign competitors and seek to block the importation of their products. An example of such a situation is presented in the discussion case about imported steel at the end of this chapter. In other examples, businesses have tried to block imports, if they would undercut their own pricing policies.

> Responding to pressure from U.S. insurance companies, the Food and Drug Administration issued a warning to third parties, such as the UnitedHealth Group, Inc., that they might be violating the law by making it possible for Americans to buy drugs from Canadian firms. The price of some prescription drugs had risen dramatically, a burden on many senior citizens in the United States who did not have adequate insurance to cover their prescription drugs. Senior citizens were crossing the U.S.–Canadian border in the thousands to purchase cheaper but equivalent drugs in Canada, or ordering the drugs online from Canadian Internet companies, causing a flood of pharmaceutical imports into the United States.[15]

In this case, drug companies lobbied for laws that would make importation of cheaper Canadian drugs illegal or more costly. The economic loss to the U.S. insurance and pharmaceutical industries, and the focus of American regulatory policy, was pitted against U.S. consumers seeking to purchase needed prescription drugs on the international market.

Regulation of Exported Products

Governments have an interest in knowing what products their businesses are exporting to the rest of the world. The federal government is understandably concerned that products that say “Made in America” are of good quality. U.S. companies have sometimes exported products to other nations that were banned from sale at home because of safety concerns. Although such practices may not be illegal, they are almost always unethical. The government is also concerned that U.S. companies not sell military technology to unfriendly nations. In recent years, a number of cases arose in which U.S. businesses illegally sold sophisticated technology with potential military applications to Libya, Iran, and Iraq. These

transactions violated U.S. laws that restrict the sale of classified military technology to only those customers approved by the Defense Department.

In 2003, the U.S. Treasury Department fined nearly 60 firms, including Amazon.com, Bank of New York, Caterpillar, Citibank, ExxonMobil, the New York Yankees, and Wal-Mart, a collective $1.1 million for exporting goods and providing services to nations in violation of federal trade sanctions. The fines ranged from a slap-on-the-wrist $9,000 fine to Chevron Texaco to a $244,250 fine assessed against GRE Insurance Group and Albany Insurance Company, which insured seven cargo shipments from Iraq to Libya between 1991 and 1995.[16]

Regulation of International Business Behavior

Nations have sought to standardize trade practices through various international organizations. As described in Chapter 7, the world's nations have formed specialized institutions, such as the World Trade Organization, to define the rules under which international trade is conducted. These rules can be considered multinational regulations. To cite another example, the World Health Organization, an agency of the United Nations, has worked with the pharmaceutical industry to create databases on the side effects of drug products, establish quality standards, and develop conforming manufacturing and marketing practices that might harm the public. As shown in Figure 8.4, the creation of bilateral or multilateral regulation causes elaborate consultation between leaders of business, governmental, and nongovernmental organizations (e.g., consumer groups). This interaction is required because of the vast number of stakeholders involved. The World Health Organization's international marketing code for infant formula products, for example, required nearly three years of meetings and consultations before a suitable code was ready for adoption by national governments.

Nations also cooperate to establish standards for the use of global resources not owned by any nation. Multilateral international agreements govern ocean fishing, protection of sea mammals such as dolphins and whales, chemical emissions affecting the earth's ozone layer, and dumping of hazardous chemical waste in oceans. In each case, governments acknowledge the problem cannot be solved through one nation's actions. The result is a framework of international agreements, standards, and understandings that attempts to harmonize business activity and the public interest.

- Government's relationship with business ranges from cooperative to adversarial. This relationship often is tenuous, and managers must be vigilant to anticipate any change that may affect business and its operations.
- [illegible]
- Regulation can take the form of laws affecting an organization's economic operations (e.g., trade and labor practices, allocation of scarce resources, price controls) or focus on social good (e.g., consumer protection, employee health and safety, environmental protection).
- [illegible]
- Although regulations are often very costly, many believe that these costs are worth the benefits they bring. The ongoing debate over the need for and effectiveness of regulation leads to alternating periods of deregulation and reregulation.

- Regulation in a global context affects business because nations recognize their need to cooperate in controlling business activities that cross national borders. International regulations focus on imports, exports, and business practices.

Discussion Case: *Protecting the U.S. Steel Industry*

Between 1997 and 2002, America's steel industry was under attack. Foreign companies had allegedly dumped large amounts of cheap steel into the American market, sending 35 companies into bankruptcy and costing 54,000 industry employees their jobs. Dumping is the practice where a product is exported to another country at a low price, sometimes below the cost of production.

Recognizing that the domestic steel industry faced a crisis that threatened its very existence, President Bush asked the U.S. International Trade Commission (ITC), an independent, bipartisan government agency, to investigate whether the U.S. steel industry had been injured by the unprecedented surge of foreign imports. After a seven-month analysis, the ITC made a unanimous determination that the industry had suffered serious injury as a result of the surge of imports and strongly encouraged President Bush to take significant steps to remedy this situation.

In 2002, President Bush proposed a 30 percent tariff, an import tax, on most steel sold in the United States by foreign companies for three years. The outcry in reaction to Bush's plan was immediate. From Beijing to London, governments threatened a serious international trade fight and retaliatory action. The European Union said the tariffs would cost European steelmakers as much as $2 billion a year in lost trade. Russia computed its losses at $500 million annually. Officials in South Korea and Brazil also expressed their dismay at the proposed tariffs, but made it clear that they had little desire to pick a fight with the United States over this issue.

The European Union accounted for approximately 37 percent of all steel affected by the tariffs, and thus the EU response was viewed as the most critical in determining if Bush's plan would succeed. Other significant steel exporters to the United States included South Korea, Russia, and Japan. Bush did not have to wait long for a response from the international community. Less than two months after Bush's tariff proclamation, the EU threatened retaliatory actions against $300 million of U.S. goods within two months as a political counterattack to impose additional costs on U.S. exports to the EU if Bush did not withdraw or seriously modify his tariff plan. The next day Japan joined the EU by announcing its intentions of slapping tariffs on some imports of U.S. steel. The Japanese action would be imposed the same day that the EU tariffs on U.S. products took effect.

A few weeks later, President Bush began to back down from his aggressive plan. He excluded about 136,000 tons of annual steel imports from the tariffs, representing about 1 percent of the steel that would have been affected. Two months later the administration excluded an additional 178 products from the tariff proposal. The last exclusion was mainly aimed at reducing barriers to steel exports from the EU and Japan.

By the end of 2002, Bush's tariff proposal had been significantly watered down. Once the

key to his 2000 presidential campaign, the tariff plan was designed to bring an end to international steel wars, provide time for U.S. steel manufacturers to modernize their plants, and give hope to thousands of unemployed steelworkers. Things did not turn out the way Bush had planned. By the end of the year, steel prices had risen more sharply than Bush and his advisors had anticipated. Lured by higher prices, steel mills around the world began to produce more than they had two years ago, worsening the global glut of steel. Brazil produced 36 percent more steel in July 2002 than a year earlier. Production in Russia, the EU, and Japan rose about 3 percent over this period.

Nonetheless, Bush's supporters maintained that the steel tariff plan, even the modest effort that was finally implemented, was necessary. "We live in a world that isn't always about living on a free-trade basis. It's about moving the process in the right direction. And I truly believe that this action [Bush's tariff proposal] has done that," said Grant Aldonas, undersecretary for international trade at the U.S. Commerce Department.

Bush's saga with the tariff proposal was not over. In early 2003, the World Trade Organization (WTO) determined that the United States had acted illegally when it raised tariffs on imported steel in 2002. The WTO said the U.S. decision to raise tariffs had been based on bogus information (that unfair prices were undercutting U.S. businesses and imperiling the nation's steel industry). Rather than being flooded by cheap foreign steel, on the contrary, the United States had actually witnessed declining steel imports. Therefore, the consequent tariffs were illegal. The WTO authorized the European Union, Canada and five other countries to impose nearly $150 million in trade sanctions on the U.S. in retaliation from Bush's steel tariffs.

Eventually, President Bush lifted all tariff restrictions on steel imports well before the protections were to expire, bowing to economic and political pressure from within and outside the United States. Critics of Bush's tariff plan argued that the critical blow occurred when the WTO fought back and confronted Bush by authorizing European and Asian nations to impose retaliatory tariffs against the United States, just 11 months before a presidential election. The Europeans went so far as pulling out an electoral map and proudly announced they would single out products made in states Bush most needed to win a second presidential term. Industry analysts claimed that the tariffs had hurt the U.S. manufacturing sector and cost more jobs than they saved. One of Bush's senior aides said, "Defiance had real costs. It was going to cost us exports and export jobs. It was going to cost us credibility around the world."

Source: Information for this case was drawn from "U.S. Steel Industry Progress Report: The President's Steel Program," American Iron and Steel Institute, March 2003; "Europe Parries U.S. on Tariffs," *The Wall Street Journal,* June 11, 2002, p. A10; "Backing Down on Steel Tariffs, U.S. Strengthens Trade Group," *The New York Times,* December 5, 2003, *www.nytimes.com;* "Bush Set to Lift Tariffs on Steel," *The New York Times,* December 4, 2003,

www.nytimes.com; and "WTO Authorizes Trade Sanctions against the United States," *The New York Times,* November 27, 2004, *www.nytimes.com*. Quotations are from "So Far, Steel Tariffs Do Little of What President Envisioned," *The Wall Street Journal,* September 13, 2002, pp. A1, A12; and "Bush Abandons Steel Tariff Plan," *The Wall Street Journal,* December 5, 2003, pp. A3, A6.

[1] William Clay Ford's leadership of the Ford Motor Company has drawn many commentaries. See, for example, Danny Hakim, "William Clay Ford, Jr.: Just Another Short-Sighted Auto Executive," *The New York Times,* March 18, 2002, *www.nytimes.com*; and "Ford Did Indeed Have a Better Idea," Mackinac Center for Public Policy, July 7, 2003, *www.secure.mackinac.org.*

[2] "EU Body Moves to Ease Curbs on Drug Pricing to Aid Sector," *The Wall Street Journal,* July 2, 2003, p. B3.

[3] "In Russia, Politics vs. Pipelines," *The Wall Street Journal,* January 30, 2003, p. A22.

[4] "FDA to Establish New Drug Oversight Board," *SFGate,* February 15, 2005, *www.sfgate.com.*

[5] See George Lodge, *Comparative Business–Government Relations* (Englewood Cliffs, NJ: Prentice Hall, 1990).

[6] "NY Passes Law: Hands off Cell Phones While Driving," *WirelessNewsFactor,* June 26, 2001, *www.wirelessnewsfactor.com*; and *Cell Phones and Highway Safety: 2005 State Legislative Update*, National Conference of State Legislatures, *www.ncsl.org.*

[7] "Cell Phone Road Hazard Target of U.S. Lawmakers," *WirelessNewsFactor,* May 23, 2001, *www.wirelessnewsfactor.com/perl/story/9956.html;* and 2005 National Conference of State Legislatures report, *www.ncsl.org.*

[8] 2005 National Conference of State Legislatures report, *www.ncsl.org.*

[9] "Hello? Cell Phones Cause Crashes," *Wired News,* December 2, 2002, *www.wired.com/news/wireless.*

[10] "Stop the Wal-Mart Health Care Crisis," *www.wakeupwalmart.com.*

Health care is the most essential of social services, in part because public health problems affect every person in every nation. Two recent health crises point to the need for a global, not just national, response to health care.

The first crisis involved the outbreak of SARS (Severe Acute Respiratory Syndrome) in 2003, in which nearly 3,000 cases were reported and more than 100 people died. This was a dramatic example of how important it is for countries around the world to take care of their citizens' health. The United States, Canada, Germany, Japan, and United Kingdom all invest heavily in providing health care to their populations. Many nations emphasize meeting basic health care needs through local clinics, community education, and reliance on locally available medicines. Investment in such primary health care tends to produce significant improvement in indicators such as infant mortality, illness rates of small children, and vaccination of the population against disease.

The second crisis was known as the Avian (or Bird) Flu Pandemic. Researchers have determined that all strains of influenza virus can be traced back to their origins with birds. Typically these viruses mutate each year, requiring the development of new strains of vaccine to protect humans. The avian flu virus was first detected in southeast Asia in 2005 and spread along the migratory flyways of birds to China and Russia before moving westward to Europe. By February 2006, the avian flu had infected 170 people in southeast Asia and Turkey, killing 90 people.

President George W. Bush, fearing that the avian flu was heading toward the United States, announced in October 2005 a commitment to "keep the American people safe" from this spreading virus by pledging to "detect outbreaks when they occur . . . and be ready to respond at the federal, state and local levels in the event that a pandemic reaches our shores." Yet, a national response to a global problem was quickly seen as insufficient. President Bush also promised $334 million to support a global campaign against the avian flu virus. This amount represented the largest single nation contribution and was used to improve surveillance and response systems, train local rapid-response health teams and medical personnel, and support public awareness campaigns to minimize the spread of the avian flu virus.

Other responses by various nations gave rise to the "International Partnership" to combat avian influenza and to deal with the threat of a possible human pandemic. Over 90 nations and international organizations banded together to elevate the political and financial profile of the avian flu pandemic crisis. Robert Egge, project director for the Center for Health Transformation said, we need "to emphasize 21st century strategies such as building electronic health record and biosurveillance networks, capitalizing on genomics and other breakthroughs to create new diagnostics, vaccines, and therapies" in order to meet and defeat global health crises such as the avian flu pandemic.

Source: Quotations are from "Safeguarding America against Pandemic Influenza Fact Sheet," *www.whitehouse.gov/news/releases/2006/01/20060118-6.html*; and "Avian Flu Virus Requires Calm, Educated Concern," Health Care News, *www.pacificresearch.org.* Additional information from "Update 83—One Hundred Days into the Outbreak," World Health Organization, June 18, 2003, *www.who.int/csr/don/2003_06_18/en*; and "UK to Buy Bird Flu Vaccine Stock," BBC News, news.bbc.co.uk.

[11] For a complete description of the Information Technology Industry Council's mission, activities, members and press releases, see *www.itic.org.*

The Federal Communications Commission (FCC) announced in 2000 that it would auction off 422 licenses in 195 geographic markets across the United States. The auction would enable private parties (organizations, businesses) to use portions of the electromagnetic spectrum that had been kept out of commercial public use. The decision to license the right to use more of the spectrum, which has been called "the most precious natural resource of the information age," was made by the FCC after extensive debates about whether the public interest would be served by making more frequencies available.

The FCC is responsible for regulating and promoting the communications industries. Companies engaged in wireless communications need electromagnetic frequencies on which they can transmit messages. Many of the bidders for the new licenses were major players in the communications business such as AT&T Wireless, Sprint PCS, and Verizon Wireless. They needed to fill in holes in their networks, enter new cities, increase overall capacity, and gain the national "footprint" that has eluded them. Other bidders included second-tier firms such as Nextel Communications, VoiceStream Wireless, and Cingular, a joint venture of SBC Communications and BellSouth, all of which were looking to expand.

In setting the rules for the auction, the FCC commissioners decided that the public interest required that some of the licenses be reserved for small businesses, minority enterprises, and rural companies. These licenses would enable small niche players to develop services for particular cities or regions. The auction rules therefore set aside some of the licenses for companies with assets less than $500 million and gross revenues of less than $125 million in each of the last two years.

Among the interesting bids received were those from three Alaskan companies owned by 38,000 natives. These companies were working with AT&T Wireless Group. The Native American companies, created by a special act of Congress in 1970, negotiated a deal with AT&T Wireless wherein cash from the no. 3 wireless-service provider would help them win valuable airwaves in the auction. In return, AT&T has a chance to gain access to some restricted frequencies and for less money.

After 101 rounds of bidding and the sale of all 422 licenses, the FCC announced that it had taken in nearly $17 billion. Verizon Wireless spent nearly $9 billion for 113 licenses. AT&T Wireless paid close to $2.9 billion for licenses through Alaska Native Wireless, including one of the three prized New York licenses. Some firms, such as Nextel and Sprint PCS, dropped out of the bidding early.

Source: "[illegible]" "AT&T, 3 Native Alaska Companies Seek U.S. Airwaves," *Bloomberg News,* December 8, 2000; and "U.S. Auction Ends, Raising $16.85 Billion," *Mobileinfo,* January 5, 2001, *www.mobileinfo.com/news_2001/Issue05/US_Auction.htm*.

FIGURE 8.1 Types of Regulation and Regulatory Agencies

FIGURE 8.2

Spending on U.S. Regulatory Activities

Source: Susan Dudley and Melinda Warren, "Moderating Regulatory Growth: An Analysis of the U.S. Budget for Fiscal Years 2006 and 2007," *Regulatory Budget Report 28*, Mercatus Center, *www.mercatus.org*.

[12] "Paying for Regulation," *The Wall Street Journal,* February 4, 2003, p. A4.

[13] See Susan Dudley and Melinda Warren, "Regulatory Response: An Analysis of the U.S. Budget for Fiscal Years 2005 and 2006," *Regulatory Budget Report 27,* Mercatus Center, *www.mercatus.org/pdf/materials/1246.pdf.*

FIGURE 8.3

Staffing of U.S. Regulatory Activities

Source: Susan Dudley and Melinda Warren, "Moderating Regulatory Growth: An Analysis of the U.S. Budget for Fiscal Years 2006 and 2007," *Regulatory Budget Report 28*, Mercatus Center, *www.mercatus.org*.

[14] [illegible]

[15] "The FDA Begins Cracking Down on Cheaper Drugs from Canada," *The Wall Street Journal,* March 12, 2003, pp. A1, A2; "FDA Bid to Halt Drugs from Canada Stirs Uproar," *The Wall Street Journal,* March 13, 2003, pp. A3, A7; and "FDA Defends Tougher Stance on Drug Imports," *The Wall Street Journal,* April 4, 2003, p. A6.

[16] "U.S. Firms Fined for Trading with Sanctioned Nations," Institute for Global Ethics, *Ethics Newsline,* April 21, 2003, *www.globalethics.org/newsline.*

FIGURE 8.4

Forms of International Regulation

Unilateral Regulation

Country A

- All companies doing business in Country A.

National Government Country B	regulates	• Country A companies doing business in any other nation. • All companies doing business in Country B.
National Government	regulates	• Country B companies doing business in any other nation.

Bilateral Regulation

Country A and Country B	Agree to mutually accepted rules of doing business in both nations (e.g., no government subsidies for certain agricultural products).

Multilateral Regulation

Country A Country B Country C	Agree to common rules governing use of common resources (e.g., oceans, Earth's atmosphere) or to impose sanctions on Country D, which fails to comply with international standards (e.g., boycotts, human rights violations).

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Key Terms

cost-benefit analysis, *173*
deregulation, *176*
economic regulation, *171*
fiscal policy, *168*
market failure, *170*
monetary policy, *168*
natural monopoly, *170*
negative externalities, *164*
public policy, *165*
regulation, *169*
reregulation, *177*
social assistance policies, *168*
social regulation, *172*

Internet Resources

www.federalreserve.gov	Board of Governors of the Federal Reserve System
www.cato.org	Cato Institute
www.ncpa.org	National Center for Policy Analysis
www.mercatus.org/regradar	-RegRadar.org, Mercatus Center, George Mason University
www.regulations.gov	Regulations.gov

Discussion Questions

1. Which relationships (between the WTO, national governments, and business industries) would you characterize as cooperative and which were adversarial, and why?
2. What public policy inputs, goals, tools, and effects can be found in this discussion case?
3. Why wasn't Bush's tariff proposal more effective? Did it achieve any of the effects he intended?
4. Should there be some sort of international regulation of steel imports and exports? If so, who should administer and enforce such international regulation?