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# ADVANCES IN COMPETITIVENESS RESEARCH (ACR)

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**Commentary: Threats to Competitiveness in a Political Environment**

Clyde Wayne Crews Jr.

This essay may seem depressing but I hope the reader will appreciate the underlying, if unspoken, optimism. Whatever Washington does, America is nothing if not preoccupied with competition and commerce. No matter how grim things may sometimes seem, optimism has a way of emerging. You might remember that President Bush met with Tony Blair in the Azores that weekend before his fateful speech giving Saddam a 72 hour ultimatum, and recall what a tense time that was. I was watching NASCAR that Sunday, and an alarm sounded and a crawler came across the TV screen that made our national priorities so plain it was a bit scary. I jotted down the exact quote. "President George Bush warns Saddam: 'tomorrow is the moment of truth for the world.' Details after the race."

Apparently, nothing's going to interrupt NASCAR or America's competitive spirit generally!

But that competitive spirit does face challenges. On top of the \$2 trillion in tax revenues the government now collects, agencies issue over 4,000 yearly regulations. Costing some \$800 billion annually, regulations exceed pretax corporate profits and Canada's GDP.

When Washington can't raise taxes to pay for its ends, it regulates. Indeed, according to Americans for Tax Reform's (ATR) new *Cost of Government Day* report, we all worked until July 7—over half the year—to pay the costs of taxes and regulations. This is one day earlier than last year, and good news of sorts in that respect—but what of the future? Is it a promising trend, as ATR wonders?

Now, for perspective, I'm a limited government type, a libertarian, who thinks that apart from security and judicial functions, the role of government ought to be constitutionally limited to picking a state bird. But both parties leap the bounds of their traditional liberal and conservative labels: Republicans signed on to substantial economic regulatory measures, such as financial regulations in the wake of the Enron scandal; while Democrats favor restrictions on free speech spanning campaign finance and the structure of the nation's media firms.

Meanwhile, heavy recent government spending anticipates a regulatory boom that can hamper competitiveness in a number of spheres. For example, Bush's Education bill heralds greater entrenchment of public over private education—and state mandates galore; the Medicare prescription drug benefit means new medical mandates and constraints on doctors and insurers (the ones who remain); Combined with other regulatory attacks on biotechnology and on the few remaining liberalized areas of medicine, such as doctors' prescribing drugs for off-label uses, the prescription drug medicine industries face real threats from FDA.

Not surprisingly, homeland security concerns since September 11, 2001 have generated much of the new spending and attendant regulation. As it stands, 300 of over 4,200 new rules in the works emanate from the new Department of Homeland security. These encompass the obvious such as the Transportation Security Administration's screening of checked bags and bag matching at airports. Meanwhile new Food and Drug Administration (FDA) regulation of food manufacturer and processor shipments, meant to protect against terrorist contamination or disruption, promises real headaches. Over 425,000 Food manufacturers and processors will be required to provide daily updates to FDA on food shipments.

But at least these have a security rationale: contrast those with the new multi-billion "National Nanotechnology Initiative," that President Bush signed into law in December 2003. That move invites vast government regulation of this already threatened frontier industry (EPA) for little apparent reason other than to send government dollars to home congressional districts. The regulatory future of the nanotech industry can easily be sacrificed for the sake of pork and a misguided attempt by Republicans to be regarded as sensitive to safety concerns that the technology does raise.

Of course, it's not that some Republicans haven't tried to reduce the public sphere in favor of the private one. As for the 1994 Contract With America and its approach to reining in federal regulation, the newly Republican House of Representatives successfully enacted H.R. 1022, The Risk Assessment and Cost-Benefit Act of 1995, which included compensation for regulatory takings of property and for costs of federal mandates. But then came the Government shutdown in 1995 in the context of the broader budget debate, a move seen as mean-spirited. The regulatory reform effort suffered. Meanwhile, Republicans' attempt to reform the regulatory process lost the rhetorical debate early: Opponents caricatured the debate in the media and popular mind. As Fred Smith of the Competitive Enterprise Institute summed up their successful spin on Republicans' efforts: "Mad-dog Republican ideologists join with robber-baron capitalists to regain the right to add poison to baby food bottles." The Senate never passed its version of comprehensive regulatory reform.

Some notable Republican-driven reform bills happened under Clinton's watch: For example, legislation dealing with unfunded mandates on state and local governments did pass, and an annual Office of Management and Budget cost-benefit report was made a permanent undertaking by the Regulatory Right to Know Act in 1999 (although these reports tend to accept and rely upon agencies' own estimates rather than critique them). Other limited successes include reforms during the 1990's addressing paperwork, congressional review of regulations, and small business regulatory relief.

The newly arrived Bush Administration relaxed some rules, such as Clean Air Act derivatives and relaxed rules on logging. The Department of Labor's controversial ergonomics rule dealing with repetitive motion injuries was halted by a resolution of disapproval. Meanwhile the OMB's Office of Information and Regulatory Affairs under John Graham required more of agencies in terms of peer review and sound science and scientific review.

As late as May 2004, the House passed H.R. 2432, the Paperwork and Regulatory Improvements Act, to improve regulatory accounting and require that the statement be integrated into the annual budget report, and also set up a pilot project for regulatory budgeting.

Lower numbers of rules can still mask high costs. Perhaps more importantly, growth of government spending and bureaucracy we've seen can mean more rules in the future, and here things are worrisome. In our information/technology based society, more alarming has been intervention driven by an inability to cogently defend the market process from a procession of calls for intervention in the face of crisis or "market failure," like the Ephedra ban and media ownership restrictions and new socialized prescription drug benefits.

Consider recent health and safety rules: these encompass an endless procession of risks from which we presumably can't safeguard ourselves without Washington's guidance: workplace slip and fall hazards; sausage casing labeling; bathroom grout manufacture; smoke alarm location in pre-fab houses; and bans on certain backyard play sets.

The pork-loaded \$270 billion highway bill will usher in numerous car-design safety regulations over the next few years. These will deal with power window safety, rollover-worthiness of roofs and door-lock enhancements. Other automobile rules that have been in the works include proposals covering daytime running-light glare, brake hose reliability standards, radiator safety caps, and Corporate Average Fuel Economy standards for light trucks. The proposed new standard for side-crash protection will cost over \$1 billion.

Some of this is well-intended. But we probably don't need the Agriculture Department dictating the size of holes in Swiss cheese. Nor do we need government fighting over an "official" food pyramid—provision of true information, in almost every respect, is a function that belongs to the private science, health and medical sectors.

Other times, Washington regulates on headlines and impulse. The rapid Ephedra ban—an expansion of FDA's scope into the banning of herbal supplements—was something not authorized by Congress, deserving of more debate.

We're now implementing a vast livestock tracking system, a national identity system for farm animals, initiated after the discovery of a single sick animal, even though the *Washington Post* compared the chance of getting Mad Cow disease to your chances of starring in the next Paris Hilton video (which, on reflection, I realize is a bad example), or being struck by both a bolt of lightning and a meteor while holding the winning Powerball ticket.

The answer to every societal risk cannot be to repudiate the competitive marketplace's disciplinary role in consumer protection, but that's what we often do.

The premise of much regulation is that markets are incapable of conveying word about risks to consumers. But that's surely not true—especially in the age of epinions.com and other online rating services. Markets have a key role to play on behalf of consumer safety.

At the least, competitive markets impose discipline in the form of *reputation* and *disclosure* when those forces aren't replaced by misguided rulemaking. Misguided safety regulation is an unworthy substitute for the competitive process in many respects. Regulations can even make people behave in a more risky manner, or impose more dangerous alternatives on consumers (such as forcing them into smaller cars to conserve oil). A professor of mine poked fun at regulation's unintended effects, noting that if one's goal is increased highway safety, one shouldn't require bigger air bags and seatbelts—which make people feel safer and drive more carelessly, putting others at risk. Instead, require that there be a 6 inch dagger sticking out of the steering column!

#### **Continued economic regulation poses real risks for the competitive economy.**

Properly understood, *laissez-faire* refers simply to a system of limited government whose role is to enforce contracts and protect citizens from force and fraud, whether initiated by individuals or business. For *laissez faire* to be our problem, we would need to live in a *laissez-faire* society. But we do not. Rather than reflexively blame markets for failures, one has to ask whether or not the tax-and-regulate model may bear some responsibility for today's troubles. Indeed, some of our most distressed industries are overwhelmingly directed by Washington central planning, not market forces.

And new industries sometimes aren't even given a chance. In technology, regulatory proposals to ban or mandate appear routinely: online marketing to children? (ban it); porn filtering (mandate it); Internet gambling (ban it); digital copy protection (some say ban, some say mandate—this is huge, an area that needs a talk all its own); cybersecurity (mandate it, even though we can't define it). The regulation of emerging Internet phone calls, called VOIP, is seriously being proposed too.

### **PRIVACY**

Not that long ago, the FTC wanted to regulate Internet privacy. Ironically, programs like the Terrorism Information Awareness office and airline Computer Assisted Passenger Protection that require the handing over to the government of personal information would make it impossible for firms to offer the very privacy guarantees that commerce needs, ironically in an age in which identity theft and cybersecurity concerns are paramount. This has major implications for online commerce and for new industries like biometrics and RFID.

Adding to the confusion have been Health Insurance Portability, and Financial services reforms have also led to new regulatory requirements in the name of protecting privacy, that see information sharing as bad. Bottom line, in the business world, most transactions occur between strangers. Stringent privacy regulations will severely hamper commerce and credit as well, but are likely in the coming years.

Often Government intervention in tech policy entails false short-cut solutions to problems that have no easy answer. Consider costly and ineffective spam regulation: Spam was outlawed as of January 1, by the CAN-SPAM Act, but pours in. But by setting of rules of engagement, for when a commercial email may legally be sent, the law

actually means that you "can spam." The real issues of authentication and pricing still remain to be solved—by the marketplace. And there is no alternative to that.

The FCC's high-penalty Do-Not-Call registry was quickly embraced by Congress and the president. It leads to an \$11,000 fine for each number they call, as well as job losses due to the closing of call centers for which Republicans uniquely shed no tear. Granted, few like getting dinnertime telemarketing calls. But telecommunications is a vibrant industry: If this is a legitimate area for government to regulate—in an age in which we'd best phase out the FCC—then it's hard to argue against regulation elsewhere. If the market can't handle mere phone call screening, then how are policymakers making the case that markets can handle, say, retirement and health care? This is why lack of consistency by policymakers who allegedly understand competitive markets is so damaging.

The stock market and telecom collapse, which aggravated government spending, was in part due to contrived markets created when Washington forced incumbent providers to "share" their infrastructure with opportunistic "competitors" who proceeded to come out of the woodwork following the telecom "deregulation" effort of 1996. It isn't possible for such contrived entities to survive under capitalism: Capitalism wouldn't have (and didn't) create them.

However innocuous-sounding they may seem, calls by a President Bush in campaign mode for "universal broadband" and an end to the "digital divide" invite continued regulation at a time when an aggressive plan for phasing out Federal Communications Commission (FCC) altogether should be pursued

This article is not the venue to explore problems created by the alphabet soup of FCC's telecom programs like TRO, TELRIC, UNE-P. FCC Chairman Michael Powell has taken a pro-deregulatory stance, but was not solidly backed by Bush early in his first term (during which Social Security and education, and subsequently terrorism, dominated). Reasons might be pragmatic—the administration might have expected prices might go up briefly in the short term under full telecom deregulation—but again, this reflects range of the moment thinking that sees telecom networks as a collective resource and willing to sacrifice the gains of full liberalization for political considerations. There are many alternatives available to consumers now, from wireless to VoIP, that dampen any ability to overprice. More importantly, competition in the creation of networks is as important as competition in telecom services sold over them.

Free speech has suffered regulatory incursions as well, and the implications go beyond our individual rights and encompass competitiveness. Apart from the Communications Decency Act, struck down by the Supreme Court, consider campaign finance restrictions, as well as a disappointing showing by Republicans who failed to endorse the FCC's rollback of media ownership rules. Policymakers proved incapable of grasping that media and information cannot be monopolized in a free society whose government does not practice censorship. Misbehaving media in a competitive marketplace face the wrath not just of consumers, but of advertisers, venture capitalists, Wall Street. Upstream and downstream partners regulate monopolizing behavior. And any alleged media monopoly would have to monopolize infrastructure as well as content, a tall order. Yet media ownership regulations remain.

Speaking of antitrust, antitrust regulation is also on the move. It used to be said that in the tech industry, things moved on "Internet time" and Smokestack-era antitrust law couldn't keep up. Many in the free market community warned high-tech antitrust wouldn't stop with Microsoft, and true to form there have been numerous antitrust cases in play. The AOL-Time Warner merger was held up and its Instant Messenger subjected to conditions by regulators. The EchoStar/DirecTV merger was blocked altogether by the Bush FTC, for example.

"Plain vanilla" antitrust cases as well as high tech interventionism are on the move even under Republicans. Washington stopped the Heinz/Beechnut baby food merger in the name of avoiding the monopolization of mashed-up fruits and vegetables. The Phillip Morris/Nabisco merger couldn't go through until the sell-off of the Intense mints business ("Ice Breakers") because of a supposed monopoly in this particular candy market. The FTC has even

considered whether "premium ice cream," and "jarred pickles" are monopolizable markets. The FTC has now put on hold the Lens Crafters-Pearle eyewear merger because of supposed price increases in the "chain store market."

In this environment it's hard to be optimistic about government keeping its hands out of the competitive market process. In the tech and cyber sectors, antitrust impulses often take the form of competitors calling for "open access" to infrastructure and technology, from instant messaging to phone and cable networks. This is a crucial time in business history for policymakers to take a solid stand against such managed competition. Worse than government picking winners and losers, mandating access to infrastructure and networks amounts to picking and choosing among *business models*. It amounts to saying, proprietary is out, open, common carriers burdened with obligations are in. We seriously need to explore implications here.

A consequence is that openness to intervention in commonplace markets leaves policymakers unable to advance major, urgent reforms like electricity deregulation that likely will require industry consolidation. Telecom deregulation would likely result in considerable new consolidation as well, and be good for consumers. But today's policymakers are incapable of defending aggressive industry restructuring against misguided (or cynical and manipulative) antitrust attack and calls for forced access to the networks.

Indeed, the nation's electrical industry is an area where open access has done tremendous damage to the restructuring efforts already tried, and set back genuine electricity reform for years. Yet, rather than abandoning open access models, Republicans, after the massive northeast blackouts of 2003, have called for mandatory reliability rules that would enshrine open access and central management from Washington, D.C..

#### OTHER ECONOMIC REGULATION

Numerous areas face new regulatory intervention, but two that merit final mention are post-Enron accounting regulation and frontier science. With respect to accounting scandals and the Sarbanes-Oxley response, a reasonable case can be made that government regulation interferes with competitive market pressures that would otherwise militate toward full disclosure of internal finances. If there is calamity in the heavily regulated stock market, and in the accounting profession—and elsewhere—then perhaps that very regulatory fallback approach needs to be reexamined. Instead of a market system that forces competing accounting systems to prove their worth, government oversight now dominates. We risk balance-sheet overload: more data is not necessarily the same as more useful information. That's not automatically a good thing, and it has possible negative implications for future disclosure issues with which we grapple today, such as cybersecurity.

Fraudulent business practices must be uncovered and punished. But the economy is already neck-deep in the regulatory approach to day-to-day corporate governance before Enron, and it isn't working.

As for cutting edge science, we are also seeing too much eagerness for government funding and oversight in areas such as biotechnology research, nanotechnology and new private space science, exemplified by the launch of SpaceShipOne. With respect to nanotechnology, our choices, ultimately, are to treat it like software and leave it (substantially) unregulated, or treat it like medical products for which massive oversight by the FDA is standard. The decision will be impacted by government funding, however: the enthusiasm for the \$3.7 billion from the federal National Nanotechnology Initiative seems to forget that spending and regulation go hand in hand. In numerous fields—from finance to cybersecurity to science, and more—the failure of policymakers to move regulatory discipline of industry from the regulatory bureaucracies to the competitive marketplace will cause billions in costs and lost productivity.

#### ANSWERS?

We need to hold the regulatory state to at least the standards of disclosure and accountability that apply to the budget. In fact, no major regulation should take effect until Congress approves it. Granted, that's far off, but intermediate steps should include publishing an annual "Regulatory Report Card" on numbers of rules and their costs, and exploring regulatory cost budgets.



Meanwhile, the existing \$800 billion regulatory state could be targeted with a bipartisan Regulatory Reduction Commission modeled on the military base closure commission

One congressional proposal would sunset obsolete federal agencies, and put an "expiration date" on the rules they issue. Sunset-style proposals deserve more exploration. They can't solve the problems of the regulatory state, but need to be a part of the political debate and the climate within which regulation's costs and benefits are discussed.

On the whole, conservatives seem to be at least as receptive to the regulatory state as progressives by some measures. By delegating sweeping lawmaking powers to the unelected, Congress has created a disconnect between the power to establish regulatory programs, and responsibility for the results of those programs, as legal scholar David Schoenbrod describes. The agency employees typically blamed aren't accountable to voters. Still, accountability doesn't necessarily mean Congress will do right: As noted, we have an enormous spending budget under the Bush administration, and every penny is approved by Congress. And society will always face issues over the tug between freedom and safety in homeland security regulation. Accountability of regulators is a necessary, but not sufficient, condition, due to assumption of powers by Congress beyond its enumerated powers.

We need to push Cost of Government Day back earlier in the year where it belongs. One joke circulating on the Internet puts it, in an essay contest on the theme of good government, the winning essay, in its entirety, was, "Good Government; Good Government. Sit! Stay!"

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