

Government *in Your* Business

Regulation is back, but you won't see a return to FDR-style controls. Instead, expect a new set of tools designed to coax, not curb. | **by Robert B. Reich**

IF YOU FEEL AS IF GOVERNMENT OFFICIALS are breathing down your neck, get used to it. For the foreseeable future, governments are going to take an especially keen interest in how you're managing your business. Executives should look for tighter scrutiny than we have seen for decades and new, indirect forms of intervention. Managers in the private sector, accustomed to ducking behind corporate- and government-relations professionals, will need to develop a new mind-set and skill set that will allow them to partner with government rather than fend it off.

This is not the first era of government ascendancy. The pendulum of public trust has swung back and forth between business and government for more than a century. Confidence in one drops, leading the other to take prominence – until prominence leads to excesses that erode confidence and push the pendulum back. In the United States, business was ascendant between the end of World War I and the start of the Great



Depression, which called into question the capacity of the private sector. Government was ascendant between the election of Franklin D. Roosevelt in 1932 and the late 1970s, by which time its excesses had become apparent. Regulation was stifling growth, federal spending had led to double-digit inflation, and taxes were deterring innovation. And so, beginning with the presidency of Ronald Reagan, public sentiment moved against government, unleashing the influence of business and finance.

Now the pendulum is swinging sharply in the other direction. All told, industries and sectors representing more than a third of the U.S. economy are being reshaped by government. In Europe and Japan, the percentage is likely to be even higher, given a greater tradition of and tolerance for behaviors Americans might consider meddling. But we won't see the return of government as intruder; old-style regulation would stifle the level of innovation we sorely need to revive industry. Executives should instead expect a new type of working partnership, where governments will offer incentives for desirable business behavior, and executives will work more directly with administra-

tion agencies to tap into those incentives. The particulars will vary by nation, but the United States is the world's biggest economy and at least for now the most influential, so events in other countries are likely to echo the actions of U.S. officials.

The Economic Meltdown, and More

Many of the current government initiatives were triggered by the worldwide economic meltdown that commenced in 2008. When the economy recovers, some will cease to exist; stimulus packages and industry bailouts are temporary measures by design. But in the United States as well as Europe and Japan, government oversight will not return to what it was before the recession. Change has been on the horizon for years; it will be the culmination of several long-term trends. These include:

Deepening distrust of business. The recent malfeasance in financial services is only the latest in a se-

ries of scandals that have eroded public confidence. Over the past decade, several U.S. corporations came to symbolize betrayals of public trust – Enron, Adelphia, Global Crossing, Tyco, HealthSouth, Sunbeam, WorldCom, Waste Management, and ImClone, to name a few. Every major U.S. accounting firm either admitted negligence or paid substantial fines without admitting guilt. Nearly every major investment bank played a part in defrauding investors, largely by urging them to buy stocks that the banks' own analysts privately described as junk.

According to a poll taken at the end of 2008 – the annual Edelman Trust Barometer – just 38% of self-described informed adults in the United States trust businesses, a decline of 20 percentage points from the previous year and the lowest level of trust in a decade. In another survey, conducted online by Public Strategies and Politico, 61% of respondents said they believe federal regulation of business should be increased.

Greater ties between the interests of business and society. Business stands at the center of many of our most pressing public policy challenges – the need to reduce carbon emissions, for instance, and (at least in the United States) the urgency of health care reform. The financial crisis has also brought to a head issues related to the availability of credit, the adequacy and safety of private pensions, and access to affordable housing, all of which involve business enterprise. Other emerging public concerns – the development of renewable energies, access to broadband, infrastructure repair and upgrades, and workplace education and training – necessarily influence how companies operate and how they design goods and services for their customers.

Decreasing control across national borders. National regulatory systems have proven inadequate to the task of overseeing global enterprises. It's easy to circumvent tough banking regulations at home when you can find more-lenient rules elsewhere. It's just as easy for corporations in higher-tax jurisdictions to park profits in lower-tax nations. Stringent health and safety regulations become irrelevant when companies can source from anywhere around the globe. And so on.

Less Regulating, More Coaxing

The heavy-handed, command-and-control regulatory systems that dominated U.S. corporations during the middle decades of the twentieth century were appropriate to an industrial structure populated by large oligopolies, each itself an organization that commanded and controlled a large em-

IDEA IN BRIEF

» **The massive failure of world economies that began in 2008 has paved the way for government action on a scale not seen since the Great Depression. Managers accustomed to dodging officials will now have to collaborate with them.**

» **The changes afoot have been on the horizon for some time, thanks to long-term trends such as deepening public distrust of business.**

» **New regulations will be designed to promote, not impose, desired behaviors. For instance, watch for government to change how Wall Street traders get paid, set up guaranteed loans for small businesses investing in alternative energies, and require employers to either insure workers or pay into a national pool.**

ployee base. Top-down management worked well when production was relatively stable and predictable, and companies didn't rely on ongoing innovation to survive. But today, regulations that seek to dictate behavior run the risk of either blocking innovation or shifting it into the shadows.

Current systems in other parts of the world won't set the course, either. Europe and Japan have something of a tradition of negotiation between business and government over regulations, but the process is often opaque. In developing economies, where government and business are even more intertwined, regulations are sometimes inconsistent, depending on which companies are favored.

Over time, economies worldwide will settle on versions of the system that's beginning to emerge in the United States, relying less on regulations that limit or replace free-market transactions and more on incentives that push markets to address public needs. That is, government will be less interested in barring corporate actions that might possibly harm the public and more inclined to reward actions that will almost certainly help. Call it coaxing rather than regulating. It will involve a close working relationship between government and business, but one sufficiently consistent and transparent to maintain public trust while addressing the challenges at hand.

How to revive the auto industry, for instance, while giving small businesses a shot in the arm and helping students get a college education? The U.S. Federal Reserve is providing subsidized loans to investors who acquire new securities backed by auto loans, student loans, and small-business loans. How to get renewable-energy projects off the ground while encouraging innovation? The U.S. Department of Energy is guaranteeing loans to small businesses that want to implement alternative-energy projects but would otherwise have trouble financing them; their lenders will be repaid even if the projects go belly-up, as some inevitably will.

Governments will make use of taxes and tax credits to promote wanted behavior, such as investing in renewable energy or hiring veterans, and to discourage unwanted behavior, like emitting excess carbon. Through a cap-and-trade system, governments are starting to allow would-be polluters to bid for rights to emit carbon dioxide up to a certain level, and then permit them to trade such rights with one another. Rights to pollute thereby become a form of property available to firms that need it most, and every company has an incentive to devise ways to avoid carbon pollution.



Governments will also give companies more choices for how to achieve desired outcomes. Rather than mandate that businesses provide specific employee benefits in particular ways – health care and pensions, for example – they will allow businesses over a certain size to pay a minimum amount per employee into a common fund accessible to people who do not receive such benefits.

We can also anticipate that governments will take a more active role in coordinating public and private interests through rules on how businesses and individuals are compensated. For example, credit rating agencies have long been paid by the issuers of the very securities they rate rather than by those who use the ratings. Wall Street traders have been paid according to the size of the bets they place rather than the long-term outcomes of those bets. Expect governments to mandate changes to such payment systems – not just in the United States but in major financial centers around the world. By better aligning the incentives of executives and traders with the needs and goals of investors, we'll avoid rigid regulations that tie the hands of executives with regard to all sorts of more specific decisions.

Finally, governments will move to harmonize their coaxing mechanisms across borders. The global meltdown has starkly illustrated the interconnectedness of global capital and unleashed demands for more uniform and rigorous international standards for financial reporting and auditing, and for corporate taxes. The additional necessities of addressing climate change and ensuring the safety of food, drugs, and other products moving in international commerce will spur further efforts toward uniform

Regulations that dictate behavior run the risk of blocking innovation or shifting it into the shadows.

rules. The United States, Europe, Japan, and China are likely to lead the way with agreements and treaties, backed by systems for getting accurate information from businesses operating worldwide.

Managing in a New World

No one should anticipate a return to the industrial statesman of the 1950s and 1960s, the CEO whose job was to “maintain an equitable and workable balance among the claims of...stockholders, employees, customers, and the public at large,” in the words of Frank Abrams, former chair of Standard Oil, in his 1951 HBR article, “Management’s Responsibilities in a Complex World.” Maximizing shareholder returns will continue to be the primary responsibility of managers, but to achieve that goal, they will work with government more directly than we have witnessed at any time since World War II.

Lately, most managers have regarded government officials as intruders who lie outside the perimeters of their businesses. To the extent that CEOs have thought about government at all, it’s mostly

been to keep regulators at bay, gain favorable treatment relative to competitors, or attract government contracts. So the typical CEO has been encircled by people whose primary goal is to insulate the business from government intrusion. Precise labels vary from company to company, but people with the word “relations” or “affairs” in their job title have understood implicitly that their real job is to ward off costly interventions and keep executives from being impeded by outside demands.

But today, the imperative is *engage*, not *shield*. Managers must understand government concerns, and leaders in major companies should expect to help resolve them. For example, it is no longer sensible for executives in the health care industry to dedicate vast amounts of time, money, and energy to blocking government efforts at reform. It’s far more productive to help make the system more efficient and affordable – which will greatly benefit not only millions of families but also most businesses.

Managers will also need to devote more attention to public concerns about business practices

An Era of Government Activism

Government’s role in business is still emerging, but it’s clear that companies worldwide can no longer operate independent of regulatory concerns. Consider the following industries:

FINANCIAL SERVICES Governments in the United States, Europe, and Japan have become major lenders and equity holders in banks. In some cases, they have taken ownership stakes. New regulations will reshape lending and bank investing to better align financial institutions’ interests with the public’s. Look for higher minimum capital requirements, more disclosures of risk, and sharper restrictions on off-balance-sheet derivatives.

HOUSING The U.S. government is now underwriting, guaranteeing, or taking over a large percentage of outstanding mortgage loans. It is also providing incentives for mortgage lenders and borrowers to refinance their loans at subsidized rates. Expect more oversight of lenders, especially when long-term interest rates fall below a certain level.

INSURANCE With its controversial bailout of ailing insurance giant AIG, the U.S. government has become a major investor and participant in insurance markets. In addition, it is planning to subsidize lower-income individuals and families to help them afford private health insurance and will be offering its own health insurance plan.

AUTOMOBILES The United States, Canada, Germany, Sweden, and Japan are providing their automakers with tens of billions of dollars in loans and equity infusions. The U.S. is also supplying funds for the development of fuel-efficient cars. Watch out for beggar-thy-neighbor policies that favor domestic automakers over foreign ones.

ENERGY The United States, Europe, and Japan are subsidizing the development of non-carbon-based energies. The U.S. has committed \$40 billion over 2009 and 2010. The Obama administration has pledged to double within three years the country’s capacity to generate wind, solar, and geothermal power. Govern-

ments are also modernizing systems for transmitting electricity.

HEALTH CARE This sector has long been nationalized in various countries and highly regulated in the United States. The U.S. is developing a plan that will require all companies over a certain size to either insure their employees or pay into a national health care pool from which individuals and families will draw. Uninsured people will probably be required to obtain coverage, with extra subsidies over and above the health care pool available to those with lower incomes.

PHARMACEUTICALS U.S. legislation is being written to allow the government to use its leverage as the largest purchaser of pharmaceuticals to negotiate lower prices.

TELECOM AND IT The U.S. government is subsidizing greater broadband coverage, especially for rural areas. Government will also influence intellectual property, privacy, and intelligence gathering in the industry.

and try to advance solutions even before those concerns crystallize into political action. For example, it's less important now for energy firms to convince the public that they are model citizens – born-again as “green” companies – than it is for them to help citizens reduce reliance on expensive and environmentally hazardous fossil fuels. Working in tandem with government, energy companies will become energy-conserving companies.

Managers will be called on to ensure that the business is responding appropriately to government coaxing – that is, making the most of federal loans, subsidies, tax breaks, liability protections, “play or pay” requirements, new property rights, and other mechanisms. Managerial responsibilities will entail working with government auditors, investigators, and lawyers to track taxpayer money and assess the consequences of tax incentives; developing internal controls to ensure that government resources are applied correctly; and training company personnel to maximize the value of government incentives.

To lead effectively in this new era, managers must pay particular attention to three issues they've previously been content to delegate: public finance, the relationships between coaxing mechanisms and business strategy, and how to collaborate with, rather than duck, government officials.


Dangers and Possibilities

There are risks here, both for governments and for businesses. To begin with, as governments shift away from regulating and toward coaxing, big businesses may capture the lion's share of the subsidized loans, loan guarantees, tax breaks, new property rights, and other incentives. These firms are large enough to discover and obtain governments' largesse and to hire specialists to assure officials that the money is not being wasted.

A second, related risk is that these twin roles – government as the coaxer, business as the coaxed – may invite subtle forms of corruption. Too many government incentives might line the pockets of intermediaries who advise both government and business or who move through a revolving door between the two realms. Or government largesse might be distributed in ways that do not serve public interests, and without adequate public accountability – as arguably happened with the first tranche of money provided by the U.S. government under the Troubled Asset Relief Program. In that case, the criteria for funds were unclear. Citigroup and insurer AIG got fabulous sums that dwarfed other deals and enraged taxpayers.

When it comes to international coaxing arrangements, governments will be tempted to give preferential treatment to homegrown firms, even though that could lead to beggar-thy-neighbor strategies that harm the global economy. Tax credits or loan guarantees that favor businesses headquartered in the country that dispenses them invite recrimination by other nations. Moreover, the long-term interests of governments and businesses lie in gaining and keeping the trust of global consumers and investors. Societies will pay a price when unsafe food and drugs make their way into international commerce or when businesses and governments play fast and loose with tax rules.

There is no simple way to guard against these risks; it will take continued vigilance on the part of public policy makers, businesses, and the media. One important check against business and government becoming too cozy is transparency. To the extent feasible, the business beneficiaries of coaxing mechanisms, along with whatever changes in behavior the mechanisms are intended to induce, should be made public – perhaps even posted on the internet by government accountability offices – so that parties can be held broadly accountable. Governments, in partnership with the World Trade Organization, must also work hard to ensure that countries don't use coaxing mechanisms to impede the flows of international trade and capital.

The new business-government relationship also offers a rare opportunity. Current events are setting precedents and high expectations for what government can and should do for at least the next generation. We may witness the start of a new form of capitalism that meets public needs without constraining innovation or growth in the private sector. Events may also bring to bear the best insights of the private sector on solving heretofore intractable public problems. These developments could allow us all to break out of the tired ideological debate about whether we want more or less government and focus instead on what we need business and government to achieve together. 

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To order, see page 158.

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