Readings

Competition + Commitment = Success

The Competitive Advantage of Nations
by Michael E. Porter
(The Free Press, 1990), 855 pp.

Reviewed by Paul A. Pautler

In *The Competitive Advantage of Nations* Michael Porter tries to give us a theory of industrial advance and decline that captures all the complexities of competition. What he delivers is an interesting, if somewhat long, story of industrial change drawn from case studies from around the world. Porter believes that competition occurs not among nations but among firms and that the best way to attain high per capita productivity and income is to win the battle at the firm and industry level. The battle is won when firms and industries are able to improve continuously in four areas that compose Porter's "diamond": inputs such as worker training and motivation and a technology base; demand conditions (for example, buyers that demand high-quality and cutting-edge products); synergies with (or prodding from) related industries; and firm strategy (for example, commitment to the industry) and rivalry. The four elements work in conjunction with and reinforce each other to produce and maintain competitive advantage. For example, an industry will obtain international advantage if several rival producers can draw upon well-trained labor and state-of-the-art supplier industries to satisfy demanding domestic consumers who push the industry to high quality standards. Continuously upgrading these various elements yields sustained advantage because the process naturally results in barriers to entry by rival industries and nations. The effects of government and chance events are important, but clearly subsidiary, parts of Porter's story.

After 175 pages of theory liberally sprinkled with examples from various nations and industries, the reader reaches a fascinating discussion of several successful industries including printing presses in Germany, patient monitors in the United States, ceramic tiles in Italy, and robotics in Japan. The industry studies are followed by a lengthy description of the development of firms and industries in ten nations. These national descriptions not only include some interesting stories, but also reveal Porter's thinking on several important issues. For example, Porter likes technically trained corporate executives and has little use for finance-types. (This is interesting coming from a B-school professor.) Porter also dislikes capital market "churning." While he praises capital markets that provide funding for innovative firms or allow low-cost access to funds (as the U.S. capital markets did in the 1950s and 1960s), Porter is not very kind to those who would actively trade stocks based on short-term perspectives. He is a firm believer in "buy and hold" strategies and in industry *commitment*. In fact, the commitment theme repeats itself throughout the studies of industries and nations. According to Porter, commitment is the key in several Italian industries where owners and workers would rather die than quit. U.S. commitment, by the way, falls far short of the commitment of Japanese and Korean firms.

After Porter has guided the reader through the countries, he moves on to the theory of national competitive advantage. This draws on his theory of firm-level advantages, and he attempts to answer several questions. Do countries matter? If so, how? And what can a country do to enhance its advantages? Porter identifies four stages of national industrial development: the factor-driven stage (Singapore), the investment-driven

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stage (Korea), the innovation-driven stage (Japan), and lastly the wealth-driven stage (of the nations studied, only the U.K. has fully reached this last stagnant stage). The correct policy for industry and government depends on the nation's developmental stage, with more direct subsidies and central planning activity being tolerated at the earlier stages. For more advanced nations, Porter recommends that, among other things, governments can subsidize the development of highly trained labor, signal (but not "target") important areas for research via their behavior as sophisticated buyers, challenge industry through buyer behavior and forward-looking regulations and standards, discard antiquated regulations, and foster competition.

Readers who are not initially convinced by Porter's story, will not be swayed by the evidence he presents. Part of the problem is that he makes no effort to put the apparently extensive case-study data in a systematic form that would allow statistical analysis. While such an analysis might suffer from the garbage-in-garbage-out phenomenon, there might also be some chance of determining whether any patterns emerge from the case studies. It is also unclear whether the four elements of Porter's theory explain nothing or everything. The theory is so all-emcompassing and the feedback among elements of the theory so diverse that it is hard to pin down the conditions he thinks are necessary or sufficient for an industry or nation to succeed internationally. Virtually any observation could be fit into some niche of his theory.

Although Porter fails to cite much of his evidence, several of the arguments in the book are consistent with research using the Federal Trade Commission's line-of-business data summarized by David Ravenscraft and Curtis Wagner in a paper prepared for a June 1990 Chicago Law School conference. For example, Porter argues that diversification is generally a bad idea, particularly if it is done outside the firms' general core area of expertise by "buying into" an industry rather than through internal expansion. This is consistent with much of the line-of-business research that tends to find that "core skills" matter—firms do better when they diversify into technically related areas rather than into unrelated fields. Thus, the conglomerate merger movement of the 1960s and 1970s was probably a mistake.

Despite the complexity of Porter's four-pronged diamond theory, one factor seems to play a key role in the development and continuation of winning firms and industries. That key element is *rivalry*. Porter argues that the United States was set apart from the rest of the world in the 1950s and 1960s by a "can-do" attitude and a policy of competition. Porter's reading of the case evidence leads him to conclude that competition provides the correct incentives for innovation and advancement. On the basis of this idea, Porter reaches relatively strong policy conclusions. He would allow trade association information exchanges and would foster information exchanges along the chain of suppliers, manufacturers, distributors, and retailers. He would, however, carefully circumscribe cooperative R&D, block all mergers of leading firms, and generally "deconcentrate economic power."

Porter's emphasis on rivalry and competition would make most readers expect an effort to define those terms. But Porter provides no such definition. Indeed, it is difficult to tell whether one domestic competitor is enough (if sufficient foreign rivals exist), whether three major domestic rivals are enough (Coke, Pepsi, and 7Up in softdrinks or AT&T, MCI, and Sprint in telecommunications), whether four or five rivals are required (as is the case in Korea), or whether hundreds of competitors are necessary (as in Italian tile and a few Japanese industries). Maybe competition and rivalry have little to do with the specific number of domestic firms, but it is hard to tell from Porter's discussion or his policy prescriptions. A further conundrum is created because he seems to define markets quite broadly. For example, at one point Porter discusses a broad array of competing technologies for fire protection services including fire detection, sprinkler systems, and security guards. If one used similarly broad definitions for other products, very few markets could be said to be "comfortable oligopolies," as he describes many current U.S. industries.

Porter's affinity for a large number of rivals leads him to chide the Reagan administration in the United States but applaud the Thatcher government in Britain. Given that these two administrations were often viewed as soul-mates, the evaluation seems a bit strained. The contrasting opinions may occur because Porter sees Thatcher's policies as appropriate to move Britain out of its lackluster wealth-driven stage, but similar philosophies are inappropriate for the United States, which remains in an innovation-driven stage. Specifically, Porter criticizes what he

views as Reagan's lackadaisical antitrust policy, while praising Thatcher's policy of privatization designed to enhance competition in previously monopolized sectors.

Unfortunately, Porter's characterization of U.S. competition policy is unconvincing. The Reagan administration seldom allowed mergers to the point where only a very few firms remained in an industry (except possibly in instances where several significant international competitors existed). So the U.S. market cannot be said to suffer from a lack of competition, unless Porter believes that five or six domestic competitors are required to reach the necessary level of rivalry. (Again, the book is quite fuzzy about the specifics of adequate competition.) In addition, Porter dates the U.S. decline in product and process innovation from the early to mid-1970s, well before the Reagan era.

Despite the lack of systematic evidence, Porter offers three intriguing (if unproven) propositions. First, imposing certain cost-increasing regulations (health, safety, and environmental regulations) on firms early is good, because it forces the regulated firms to improve early and thus gives them important technical advantages when the slacker nations catch up and regulate later. Second, selected weaknesses are really strengths. A lack of some important (but apparently nonessential) element often challenges firms and industries to perform better than firms and industries that do not have to overcome such a hurdle. This minimalist idea reappears throughout the book. Porter goes so far as to argue that the United States lost its international lead in large part because it had too few "selected disadvantages." Finally, property rights do not matter very much for innovation. Competition drives innovation, and rights to exploit one's innovation via a patent are relatively unimportant. Each of these three propositions, if supportable, deserves its own book.

Porter's book is more than an expensive paper weight, although it would serve well in that capacity. Porter challenges the reader to think about "industrial policy" in a different way. Unfortunately, he requires his readers to take a lot of his evidence on faith. If Porter is right, however, the nations that will win the fight for competitive advantage and better living standards for their citizens are those that keep lean and hungry industries committed to searching for the most recent technological or marketing innovation with which to ravage their many rivals. I doubt that Porter would care to predict which nation will come up with any particular innovation, but he is sure it will not come from firms or industries that are not pushed to it by the threat of losing out to aggressive competitors.

Injudicious Distortions

Judicial Compulsions: How Public Law Distorts Public Policy
by Jeremy Rabkin
(Basic Books, 1989), 322 pp.

Reviewed by Steve Lenzner

Appeals to the public interest, which in sounder times went by the grander name of "justice and the general good" (*Federalist* #51), are likely to be dismissed today by most people with a disdainful shrug, a wry smile, or a knowing wink. Everyone knows that politics in America is about getting for oneself and his friends what he can, whenever he can. What everyone does not know, and what Jeremy Rabkin describes clearly and forcefully in his new book *Judicial Compulsions: How Public Law Distorts Public Policy*, is how completely this rather vulgar conception of politics is entrenched in judicial activity, particularly, though by no means exclusively, in the field of administrative law.

Rabkin, a Cornell government professor, has two purposes in writing this book. His immediate and practical aim is to demonstrate how contemporary administrative law, by ignoring the logic of our constitutional order, has degenerated into a system in which judges set themselves up as "unaccountable, episodic managers of regulatory performance." Over the past 20 years or so judges have increasingly parceled out to contending interest groups peremptory claims on public policy. Rabkin demonstrates this in his section "Distortions of Practice" by offering detailed case studies of how unwarranted judicial interference has hampered, and in some cases crippled, executive policymaking at the Office for Civil Rights, the Food and Drug Administration, and the Occupational Safety

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and Health Administration. (It is to Rabkin's credit that he can make even OSHA interesting.)

In these chapters Rabkin shows how judges have consistently (and masterfully, in a perverse sort of way) avoided deciding whether a specific individual's rights have been violated and whether he is entitled to a specific legal remedy. That is to say, Rabkin demonstrates how judges have avoided the stuff of judging. What we see instead are judges who irresponsibly blur the distinction between individual rights and the claims of special interest groups.

In practice, this judicial obfuscation leads to a predictable pattern of judicial compulsions. An agency faced with limited resources and great demands is forced to establish regulatory priorities. As it does so, one interest group or another objects in court that its right to regulatory protection has been denied. The judge, accepting the interest group's claim, forces the agency to redirect its resources towards the asserted "right," no matter how trivial it may seem in comparison with the agency's other responsibilities. Inevitably, "as policy decisions become mired in legalism," less vociferous though often publicly more important interests are slighted or ignored.

Consider the example of the Occupational Safety and Health Administration. Rabkin describes a series of misguided cases that effectively rendered almost unimplementable OSHA's rather broad regulatory task—seeing that every worker has a safe working place "to the extent feasible." By refusing to limit who could sue, the courts opened the door to mischief, and OSHA justifiably became "entitled to assume that it would be dragged into court any time it promulgated a new standard that did not satisfy an advocacy group demanding tighter standards." In turn, this development further encouraged OSHA—which had never been an agency overly influenced by economic realities—to ignore whatever costs its standards might impose on a regulated industry. After all, as OSHA told itself (and the rest of us), lives were at stake. Finally, after one egregious standard followed another (including at least one that was estimated to impose costs of over a billion dollars per life saved), the court put its foot down—at least temporarily. In 1980 the Supreme Court determined that whenever OSHA imposed a particularly rigorous exposure standard involving substantial compliance costs rather than a less stringent standard—as in the case of the benzene standard—then OSHA had to show that the additional costs were " 'at least more likely than not' . . . to secure some 'significant' additional health benefit." The very next year, however, the Supreme Court espoused a new doctrine forbidding OSHA from considering costs when lives were at stake unless the costs of compliance threatened the economic viability of the industry.

Rabkin explains: "The results . . . left OSHA exposed to serious challenges from both sides. If its standards imposed heavy costs on particular industries, they were virtually certain to be challenged by industry, which would demand 'substantial evidence' that the stringency of a particular standard was justified by 'significant' health benefits." Given the "paucity and ambiguity of most scientific evidence regarding particular . . . exposure levels," OSHA found it rather difficult to defend particularly strict standards. But if the agency took the opposite tack and tried to balance the costs of compliance against additional safety, unions and advocacy groups were likely to challenge proposed standards. In fact, on occasion OSHA faced lawsuits over the same standard from both business and labor.

Predictably, these conflicting pressures led to administrative paralysis. OSHA felt its credibility was questioned whenever the courts overturned proposed standards, and the agency was "particularly reluctant to commit enforcement resources and staff if it could not be sure the standard would survive judicial scrutiny." In 1978, the year the lower court initially ruled against OSHA's benezene standard, the agency promulgated six new health standards; in the five years following it produced none. From 1979 to 1988 the agency promulgated only four standards. This is not to say that OSHA was completely inactive during those years; it did on occasion propose standards that were never implemented. For example, in 1985 OSHA proposed a new standard for formaldehyde at an estimated cost of $72 billion per life saved. The regulation did not go into effect.

Rabkin's second, larger aim is to remind us of the "grounding assumptions" of American constitutionalism that have been unceremoniously uprooted by the new administrative law. In his section "Confusions of Thought" he attempts to revive the traditional understanding of two ideas central to our constitutional scheme: rights and responsibility. Traditionally a right

was understood to be a specific claim an individual could raise on his own behalf against others—both private individuals and members of the government—which, if valid, a court was obligated to uphold. Under the new administrative law, rights belong not only to individuals but also to groups. Rabkin argues that this shift in meaning is as theoretically unjustifiable as it is practically harmful.

Rabkin views a right as properly individual because it is essentially private. To say that one has a right to something means that that right is his to exercise or assert. Conversely, it also means that he may choose not to exercise or assert it. But in the case of, say, the public's "right to clean air," who can properly speak for or decline to speak for the public? Who is able to responsibly balance the public's desire for clean air with the high costs associated with that end? To say, as courts are wont to do, that one or another environmentalist advocacy group speaks for the public is merely to assign to that group the privilege of speaking "for unknown or indeterminate others to whom it has no meaningful accountability." As Rabkin notes, it is precisely for this reason that American law has traditionally been very uncomfortable with group rights, for there is something most disturbing about rights "over which the right holder has no control."

In practice, this habit of assigning public rights to private groups has the effect of reducing "public policy . . . to the legally protected claims of contending interest groups." The executive branch, whose role has traditionally been to implement the law energetically, is reduced to a minion of the judiciary. The executive branch is no longer supposed to deliberate prudently about the best way to implement the laws by stressing some and deemphasizing others depending on the circumstances. Rather, under the new administrative law, the executive is supposed merely to follow orders. He is required to carry out the law as the judges see it. By "opening the courthouse doors to claimants seeking more or better regulation, contemporary administrative law makes the judge responsible for the implementation of public measures." And this, according to Rabkin, is the crux of the problem. Though they are in large measure to blame for many of our current problems in public policy, judges are not and cannot be in the strict sense responsible because they answer to no one (except perhaps other judges).

"PITY I DIDN'T HAVE A U.S. SUPREME COURT."

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It is important to remind ourselves at this point that the very concept of governmental responsibility is an American invention (the word's first known published use is in *Federalist* #23). Although Publius rarely speaks of judicial responsibility, it is "the central theme in the *Federalist*'s discussion of executive power," as Rabkin notes. The executive branch is politically responsible because it is theoretically unified and publicly accountable. Because all executive decisions, in theory, stem from the president, and because the president will most surely be blamed for inept or foolish administration, Rabkin contends that "the executive must give continual thought to the public interest in deciding how to exercise the powers bestowed by legislation. This responsibility requires the executive to make disputable political judgments, but that is why the executive is made responsible to the people—unlike the judiciary, which can simply claim to be following previously fixed rules with no regard for consequences." Rabkin concludes that "the separation of powers is designed to make one part of government squarely responsible for the actual consequences that flow from the legislative 'intentions' of all of the nation's diverse laws." When judges force executive officials to answer to the regulatory demands of private citizens in the name of the law, this idea of responsibility—"the essential purpose behind the scheme of separated power"—is displaced if not destroyed.

Rabkin's book not only reeducates us about specific principles most of us have apparently forgotten, but, more important, teaches us how we ought to think about courts and constitutionalism in general. Building on Harvey C. Mansfield, Jr.'s work on the forms and formalities of liberty (related in his excellent new book, *Tam-*

ing the Prince), Rabkin persuasively argues that in the American constitutional scheme the form of the judiciary—its insularity and unaccountability—should dictate its function. Or more accurately, Rabkin argues that judges are insulated and unaccountable in our system precisely because we want them to look at rights without regard to larger social consequences: "The point of separating judges from the rest of the political system is precisely to preserve the private or detached character of individual rights." This form is obviously perverted when private rights are fused with the policy demands of interest groups, for regardless of its policy consequences, such fusion encourages forgetfulness about what it means to live in a constitutional regime. As Rabkin demonstrates, forgetfulness is the first step towards decay.

By powerfully reminding us of the principles of constitutional government, Rabkin has rendered us all a service. At the very least, he has written the best book on compulsions since Freud.

Promise of Free Market Environmentalism

Economics and the Environment: A Reconciliation
edited by Walter Block
(The Fraser Institute, 1990), 332 pp.

Reviewed by William C. Dennis

Everyone seems to have discovered "the environment" these days, and commentators from all over are predicting that the politics of the 1990s in the Western democracies will be decidedly green. Many of those interested in environmental questions have other political agenda that they hope environmental advocacy will further—population control, economic redistribution, an end to consumer-driven economic growth, and the development of a more communitarian morality, to name just a few. As the first essay in this book, "The Economics of the Conserver Society," makes clear, all these arguments have been around for a long time and are largely recycled efforts from previous causes. What makes them so politically potent today is that they have been tied to issues of interest to the affluent middle-class West—urban green spaces, park land, wildlife preservation, public health—and to potential public-good problems of global significance. The usual list includes most prominently the greenhouse effect, ozone depletion, acid rain, and species extinction.

It is especially troubling that a market-oriented, minimal government, proliberty approach to all these questions has played so small a part in the public debate. In the United States, at least, every politician wants to be on the side of the environment, and the little political opposition to environmental policy initiatives still seems to be mired, for the most part, in beside-the-point arguments about expense and jobs lost, rather than founded on a defense of the environment of liberty. Despite more than a decade of solid research on environmental questions from a free market or new resource economics perspective, much of which is reflected in the essays in this book, little of this turns up in the popular press, on national television, or in the policy debates in Washington. There have been a few modest successes such as the Coastal Barriers Resource Act, higher user fees for public amenity resources, limited programs of emissions trading, the defeat of the Law of the Sea Treaty, and, until recently, no massive programs to deal with alleged problems stemming from acid rain and increaases in greenhouse gases.

Will this book and others similar to it redress the balance? Will these authors begin to appear on "Nightline"? Will they be quoted in *Time*? Will friendly congressmen ask them to testify at committee hearings? Will the organized environmental groups with their huge budgets (a recent estimate placed the combined budgets of the U.S. nongovernmental environmental organizations at over $400 million annually) begin to include these fine scholars in their conferences and publications? Probably not. Or at least not soon.

Why is this so? The essays of this collection for the most part are careful and moderate discussions of the broad range of current environmental issues—neither overly technical nor (with the exception of the first essay) too general for serious but not expert readers. These arguments deserve wide consideration.

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Chapters 2, 3, 4, and portions of Chapter 10 deal primarily with areas where market-oriented analysis is strongest and most compelling because it can be closely tied to the strength of property rights theory. These chapters demonstrate the transgenerational equity of the market (Thomas E. Borcherding), review the theoretical basis for the new resource economics as the foundation of a political economy of hope (John Baden and Richard Stroup), and develop theory and case studies of the private provision of environmental amenities and wildlife preservation (Terry L. Anderson). All of this is good material, but some of it is at least five years old, and much of it has now been published elsewhere in different forms. A timely presentation of arguments is essential if those in the public policy world are to be asked to take them seriously.

For this reader, the most interesting chapters were those discussing problems of air pollution, both because he was less familiar with the literature and because he has been less convinced by the market-oriented answers. Current technology does not permit air boundaries to be established inexpensively. But such boundaries are, of course, crucial to the development of property rights and, through property rights, laws against air pollution trespass. Policy in this area is complicated further by the fact that a world of zero atmospheric emissions is neither possible nor necessary. The atmosphere is a vast sink into which immense quantities of material can be poured with minimal adverse affects. But at some level, problems do develop. To determine these critical levels, to divide up the rights to produce emissions, and to establish responsibility for reducing existing levels of emissions, particularly in response to possible global environmental problems, would appear to require, even under market-oriented emissions trading rules, vast regulatory schemes and command-and-control-oriented bureaucracies with all the opportunities for rent-seeking that public choice analysis (and recent experience with clean air legislation) would predict—all to the detriment of liberty. Edwin G. Dolan discusses many of these problems in "Controlling Acid Rain," and Jane S. Shaw and Richard L. Stroup are lucid and current in their discussion of "Global Warming and Ozone Depletion." Is there then no good way out of this dilemma?

In this regard "Law, Property Rights, and Air Pollution" by Murray N. Rothbard was the most interesting of the book. Rothbard applies the libertarian homesteading principle to establish property rights to the atmosphere as a sink, and then defends these rights against trespass with a strict liability approach to torts that uses common law procedures where a real plaintiff must prove "a visible and tangible, or 'sensible,' invasion" of his rights against an actual defendant. There is much more to this truly radical essay, which covers such questions as radiation, airspace, class actions, and sophisticated detection of trace pollutants. An article like this should produce long, hard thought, and it suggests as many difficulties with a market approach to air quality as it does solutions. Such an approach is so far removed from the current statist theories of environmental protection, however, that it will probably be ignored by establishment thinkers and many new resource economics theorists as well.

But the great merit of the Rothbard piece, as well as of most of the other essays, is that it is thought-provoking and thoroughly grounded on the ideal of liberty. Those of us who care about both liberty and a high-quality environment should not let any opportunity pass without stating that the environment most favorable to the flourishing of human beings is the environment of liberty. Historically, this environment has been in short supply, and it is easily degraded. Public environmental policies should always be calculated to enhance, not to erode, the institutions of liberty.

Recent Soviet developments have shown that vast state projects cannot produce the promised goods. These lessons need to be applied to public environmental policy, where we also need some *perestroika*. Otherwise government failure will just replace market failure to everyone's disadvantage. A proliberty approach to the environment would be assertive where we know the most, especially in showing how secure property rights in land can provide enhanced environmental quality, and would remain humble and open to learning in the difficult areas of air emissions and long-range global environmental threats. We should insist that environmental policy not be allowed to carry on its shoulders other political agenda that are detrimental to liberty. Thus, for example, if a carbon tax of some sort becomes an attractive policy option, it should substitute for other taxes and not become simply a means for increased government revenue. We should help environmentalists come to understand the idea of economic tradeoffs—that

in a world of scarcity not all good things are possible at once. We should help them choose depoliticized, less expensive, administratively simpler, and where possible market-oriented policy options. Finally, environmental scare tactics should be decried. By historical standards, we in the West live in a relatively good physical environment and a better-than-average environment for liberty. We do not face a crisis on either front, and we have the time to work out improvements in both areas without slighting either.

As some work to make the new resource economics material more a part of the public debate, others need to expand and intensify the careful and thoughtful study of environment and liberty for which a decade of research provides the basis. But the new resource economics theorists are a long way from becoming major players in the public debate. Ten years of maturing should now begin to produce regular free market environmental features in the leading popular press, frequent television interviews, extensive study of the new resource economics in the college classroom, and publication of new resource economics writings by major presses. Good work is in progress, but there is still a lot to be learned about marketing these works and their ideas if they are to make much of a difference.