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U.S. COMPETITIVENESS

Assessing the Impact of Government Activities on Productivity and Living Standards

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U.S. COMPETITIVENESS: ASSESSING THE IMPACT OF GOVERNMENT ACTIVITIES ON PRODUCTIVITY AND LIVING STANDARDS

SUMMARY OF STATEMENT BY ALLAN I. MENDELOWITZ, MANAGING DIRECTOR
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Since World War II, the U.S. economy has been transformed by technological and global political and economic changes that have presented opportunities and challenges for businesses, workers, and the government. The ability of the U.S. economy to meet the challenges of these transformations has been subsumed collectively under the popular label of "competitiveness."

The competitiveness of a nation has been defined as its ability to sustain a high and rising standard of living for its citizens in a complex world environment. A nation's competitiveness is determined primarily by productivity growth that allows workers to earn increased wages. Several factors determine productivity, such as the stock of capital, the level of technology, the quality of the workforce, and the quality of management. Private businesses and households, guided by market forces, make the decisions regarding these factors. These decisions are influenced by government laws, regulations, and programs at the federal, state, and local levels.

Today's testimony addresses GAO work both completed and ongoing concerning the impact of government activities on the economy and living standards. The stagnating standard of living for many Americans is a central issue in the current debate over government activities. As such, it is essential that government carefully consider the impact of its actions on productivity and living standards.

Chairwoman Morella and Members of the Subcommittee:

I am pleased to be here today to testify before this Subcommittee on U.S. competitiveness and the impact of government activities on living standards and the economy. Since World War II, the U.S. economy has been transformed by technological and global political and economic changes that have presented opportunities and challenges for businesses, workers, and the government. The United States experienced rapid economic growth during the early part of this period, with significant increases in real incomes and productivity. However, during the last 2 decades, the United States experienced slower productivity growth, declines in real wages, and stagnating median family incomes, as currently measured. For example, Bureau of Census data show real median money income for families in 1993 was essentially the same as its 1973 level.

In the face of these transformations of the U.S. economy, government officials, business leaders, and academic experts have been concerned about the appropriate role of government and the extent to which government hampers or assists private sector responses to changes in the economy. The ability of the U.S. economy to meet the challenges of these transformations has been subsumed collectively under the popular label of "competitiveness." We are all familiar with discussing the competitiveness of a firm in terms of its ability to gain market share while earning adequate returns. In contrast, the competitiveness of a nation has been defined as its ability to sustain a high and rising standard of living for its citizens in a complex world environment. A nation's competitiveness is determined primarily by productivity growth that allows workers to earn increased wages.

A variety of factors determine productivity, such as the stock of capital, the level of technology, the quality of the workforce, and the quality of management. Private businesses and households, guided by market forces, make the decisions regarding these factors. These decisions are influenced by government laws, regulations, and programs at the federal, state, and local levels. Government activities include tax policies; education and training programs; technology policies; trade, health, and safety regulation; macroeconomic policies; and infrastructure investment, among others. Establishing the proper scope for government activities and ensuring efficient government performance is critical if the government is to contribute to, rather than detract from, improvements in living standards.

In today's tight budget environment, Congress is looking carefully at the need and justification for government programs and policies. Additionally, Congress is reviewing the appropriateness of government regulations that can affect productivity and living standards. As such, the relationship between changes in government programs and policies and the competitiveness of the United States is of heightened concern. In assessing the impact of changes in governmental activities on productivity and living standards, there are several issues to be considered.

-- What are the goals of government policies and programs?

-- Are these goals consistent with the competitiveness goals of improving productivity and living standards?

-- Are there opportunities to alter programs and policies to increase their cost-effectiveness, improve the ratio of benefits to costs, and increase their contribution to improvements in productivity and living standards?

Clearly, these questions are Congress' prerogative and central to the political debate of the country. In my statement today, I will provide information related to the last two questions, basing my remarks on GAO work both completed and ongoing concerning the impact of government activities on the economy and living standards.

THE DEFINITION OF COMPETITIVENESS HAS EVOLVED

Over the last 20 years, the issue of U.S. competitiveness has evolved from comparisons of U.S. export market shares to a broader emphasis on the determinants of productivity growth and improvements in living standards. The shift in the definition of competitiveness in the United States can be traced in the presidential and government commission reports on competitiveness and in the interest of Congress.

The competitiveness report President Carter submitted to Congress defined competitiveness in terms of the ability of U.S. exporters to compete in world markets.[1] The study concluded that increasing supplies of human and capital resources and expanding technological capabilities in other nations relative to the United States were the sources of the increased competition facing U.S. producers. In 1985, the commission established by President Reagan defined competitiveness as the "degree to which a nation can, under free and fair market conditions, produce goods and services that meet the test of international markets while simultaneously maintaining or expanding the real incomes of its citizens."[2] The commission found that competitiveness was not a zero-sum game for the world and that all nations can benefit together as the world economy grows. Also, it said that competitiveness was not an end in itself, but a means to achieving higher living standards and

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[1]Report of the President on U.S. Competitiveness, Together with the Study on U.S. Competitiveness, Transmitted to the Congress, September 9, 1980 (Washington, D.C.: U.S. Department of Labor, Office of Foreign Economic Research).

[2]Global Competition: The New Reality, The Report of the President's Commission on Industrial Competitiveness (Washington, D.C.: Jan. 25, 1985).

increasing wealth.

The Competitiveness Policy Council, established by Congress,[3] defined competitiveness as the "ability to produce goods and services that meet the test of international markets while our citizens earn a standard of living that is both rising and sustainable over the long run."[4] The council found that strengthening U.S. competitiveness required a focus on domestic problems to improve the U.S.' economic health and concluded that productivity growth is essential to long-term improvements in living standards. Businesses, especially in industrialized nations, need to increase productivity to remain competitive in the global marketplace, and workers need increased productivity in order to command higher real wages and living standards.

The definition of competitiveness focused on living standards has not been adopted in all studies. The World Economic Forum, of Lausanne, Switzerland, defines competitiveness as the "ability of a country or a company to, proportionally, generate more wealth than its competitors in world markets." The forum has reported that the United States has regained its place as the most competitive economy in the world for the first time since 1985.[5] While the forum includes measures related to productivity achievement in its evaluation, it concentrates on whether a nation's environment is conducive or detrimental to the domestic and global competitiveness of firms operating in the nation, as opposed to concentrated on the living standards of its citizens.

The linkage between the competitiveness of firms and industries to that of a nation is not always a simple one. At the industry or firm level, competitiveness refers to the ability of particular firms to sell products while providing an adequate return on resources employed by the firms. While technological change or trade liberalization can create expanded opportunities for specific firms and industries, it may at the same time force other firms or industries out of business. In this context, some firms or industries experienced "competitiveness" gains while other experienced losses. Yet advances in living standards have historically been tied to technological progress and market

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[3]Congress established the Competitiveness Policy Council in the 1988 Omnibus Trade and Competitiveness Act (Public Law 100-418, Aug. 23, 1988), as amended by the Customs and Trade Act of 1990 (Public Law 101-382, Aug. 20, 1990).

[4]Building a Competitive America, First Annual Report to the President and Congress, Competitiveness Policy Council (Washington, D.C.: Mar. 1, 1992).

[5]World Economic Forum, The World Competitiveness Report: 1994 (Lausanne, Switzerland: IMD International, Sept. 1994).

expansion. Thus, national competitiveness may be advanced even while some firms or industries may see a decline in their competitiveness.

We recognize the interest of Congress in identifying the impact of government activities on the nation's competitiveness. We have defined "competitiveness" as the ability of the nation to achieve a high and rising standard of living in a complex world environment. We chose not to include an international market test because that might lead to a focus on exports as a primary test of competitiveness. Although exports are important, their relationship to living standards can be ambiguous. For example, a country could increase its exports by adopting fiscal or monetary policies--such as currency devaluation--that would lower its population's living standards. Instead, the focus of analysis should be on the standard of living achieved for U.S. citizens.

IMPACT OF GOVERNMENT ON THE ECONOMY

We have increasingly sought to report on how government activities affect the economy and, ultimately the standard of living. We use a diverse set of measures of the standard of living, as no one indicator can give a full picture of how well businesses and individuals are faring. The evidence from the evolution of the competitiveness issue suggests that living standards can only be advanced if U.S. productivity growth increases. This can be accomplished with more capital, better technology, a higher quality workforce, improved management, and a government whose activities have a positive impact on these factors. In our work on competitiveness, we take a broad orientation in assessing government operations to see their bottom-line impact on the economy. In several areas we have sought to specifically link government performance to competitiveness issues, reviewing the efficiency of government operations and identifying adverse consequences of government activities.

More Capital

Economic growth--which is central to almost all our major concerns as a society--requires investment, which, over the longer term, depends on saving.[6] The surest way to increase the resources available for investment is to increase national saving, and the surest way to increase national saving is to reduce the federal deficit. Some progress has been made on deficit reduction, but the long-term deficit outlook remains a pressing national problem. Not taking additional action to reduce deficits remains an

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[6]See Budget Policy: Prompt Action Necessary to Avert Long-Term Damage to the Economy (GAO/OCG-92-2, June 5, 1992); and The Deficit and the Economy: An Update of Long-Term Simulations (GAO/AIMD/OCE-95-119, Apr. 26, 1995).

unsustainable approach in the long term.

Nonfederal saving[7] has declined since the 1970s, while federal budget deficits have consumed increased levels of these scarce savings. The result has been to decrease the amount of national saving potentially available for investment.[8] These conditions--lower nonfederal saving and the large share of this saving absorbed by government deficits--do not bode well for the nation's future productive capacity and future generations' standard of living.

Recently, the Comptroller General testified that continuing large deficits pose significant long-term economic and fiscal consequences for our nation.[9] The aging of America's population threatens to convert today's fiscal commitments into economically unsustainable burdens that may very well undermine the future economic well-being of the nation. Conversely, shifting fiscal policy paths to eliminate these deficits promises to increase the future capacity of the U.S. economy to provide for both the retirement of the baby boom generation and the rising standard of living for the next generation of workers. In addition to the overall level of government deficit or surplus, the proportion of the budget devoted to investment spending will also affect long-term growth. If public resources are devoted to investments that enhance private sector productivity growth, then they will contribute to rising future living standards.[10]

One area of public investment is for infrastructure to move people, goods, and information that U.S. business depends on. Currently, we are studying the link between government investment in transportation infrastructure and competitiveness, including private sector productivity. Infrastructure improvements, for example, enable businesses to employ just-in-time inventory systems, achieve economies of scale, and have access to a larger

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[7]Nonfederal saving consists of the savings of state and local governments and the private sector.

[8]The depressing effect of deficits on growth might have been mitigated had they financed higher levels of public investment. However, as we noted in our June 1992 report, this is not what happened.

[9]See Deficit Reduction: Opportunities to Address Long-Standing Government Performance Issues (GAO/T-OCG-95-6, Sept. 13, 1995).

[10]Given the need to reduce the budget deficit, however, decisions to raise future levels of public investment should be made within an overall fiscal policy emphasizing deficit reduction. This point is discussed at greater length in Federal Budget: Choosing Public Investment Programs (GAO/AIMD-93-25, July 23, 1993) and Investment (GAO/OCG-93-2TR, December 1992).

labor market.

Better Technology

Improved technology is an important contributor to productivity growth and improvements in the standard of living. Historically, the government has been an important source of research and development activities in the United States. However, the direct linkage between specific government programs and productivity improvements has been difficult to establish. GAO has a number of efforts underway to address this linkage. For example, we recently reported on a GAO survey of manufacturers that had received services from manufacturing extension programs (MEP).[11] About 73 percent of the respondents to our questionnaire said that they believed that the MEP assistance in the diffusion of technology had positively affected their overall business performance, and most also believed that it positively affected the productivity of their workers.[12]

In addition to providing these kinds of indicators at the level of the firm, we are also reviewing the extent to which analyses have been able to link government technology programs and productivity. However, the impacts of technology programs are particularly difficult to measure. For example, the technologies may not result in benefits for a number of years after the funding, and some of those benefits may also be captured by firms other than those that received the government funding.

Workforce Quality

Education and training have traditionally been provided by state and local governments, with a limited federal role. Many federally funded employment training programs are designed to assist the unemployed, enhance skills or employability of workers, and create employment opportunities.[13] However, little is known about the

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[11]Manufacturing extension programs are state/federal partnerships that offer manufacturers assistance in modernizing or upgrading their operations.

[12]See Manufacturing Extension Programs: Manufacturers' Views of Services (GAO/GGD-95-216BR, Aug. 7, 1995). In our pretests of the survey, we found that firms were unable to provide quantifiable data on the effect of the service received on other aspects of their business, however, such as changes in productivity, profits, or sales.

[13]The federal government has 163 separate employment training programs scattered across 15 departments and agencies and 40 interdepartmental offices, which in turn channel funds to state and local program administrators.

effectiveness of these programs. Some programs do not meet the needs of job seekers, providing only limited services that may not match the labor market needs. Most of the administering agencies cannot say if the programs are actually helping people to find jobs.[14]

Better Management

Productivity also can advance with improvements in management. Achieving high levels of quality has become an increasingly important element in corporate success. Our 1991 review of 20 companies that were among the highest-scoring applicants in 1988 and 1989 for the Malcolm Baldrige National Quality Award[15] indicated that companies that adopted quality management practices experienced an overall improvement in corporate performance.[16] In nearly all cases, companies that used total quality management practices achieved better employee relations, higher productivity, greater customer satisfaction, increased market share, and improved profitability.

CONCLUSION

Competitiveness is one of the most important issues affecting the United States. The stagnating standard of living for many Americans is a central issue in the current debate over government activities. As such, it is essential that government carefully consider the impact of its actions on productivity and living standards. In assessing impacts, it is important to look at what cannot be quantified as well as what can be quantified. While we recognize that it is difficult to quantify the impact of government activities on competitiveness, the discipline imposed by an approach that focuses on assessing the impact of government activities, rather than just on considering the cost of government operations, may help to ensure that the government activities contribute to, rather than detract from, competitiveness.

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[14]See Multiple Employment Training Programs: Major Overhaul Needed to Reduce Costs, Streamline the Bureaucracy, and Improve Results (GAO/T-HEHS-95-53, Jan. 10, 1995).

[15]The most widely accepted formal definition of what constitutes a total quality management company exists in the criteria for the Malcolm Baldrige National Quality Award. This annual award, given by the U.S. Commerce Department since 1988, recognizes U.S. companies that excel in quality achievement and quality management.

[16]See Management Practices: U.S. Companies Improve Performance Through Quality Efforts (GAO/NSIAD-91-190, May 2, 1991).

Chairwoman Morella, this concludes my prepared statement. I will be pleased to try to answer any questions you or the Subcommittee may have.

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