Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

Health-Care Competition

TO THE EDITOR:

The article by Clark Havighurst and Glenn Hackbarth (*Regulation*, May/June 1980), attests to the need for reexamining regulations periodically to ensure that they remain consistent with society's aims. The specific regulatory program they question applies to health-care financing and dates back to the 1965 enactment of Medicare and Medicaid.

The 1980 health debate focuses on ways to bring to the health system some of the more salutary effects of "competition" as we understood it in Economics I. But this debate must be placed in the context of the benefit and service expansions of the 1960s, the cost pressures of the 1970s, and five decades of health insurance expansion. The challenge now facing those who propose complete deregulation of health-care financing is not just to outline an ideal, but rather to help us believe that we can, in fact, move closer to the ideal. So far, the debate has revolved around theories, limited experience, and rather vague savings estimates. What is needed, I suggest, is more attention to the following kinds of issues:

(1) What is competition in the health industry and each of its discrete sub-industries? What are the critical elements? Are we trying to institute a perfectly competitive system? Competition in health insurance may mean one thing to public policy analysts, and quite another to private insurers who engage in rigorous price competition with each other in order to generate and retain business.

(2) What do consumers really want? To what extent should public policy allow people to exercise their own choices, whether with before- or after-tax dollars? Recognizing the current financing structure for health care, who would bear the cost of any changes?

(3) What is the objective of the deregulator? More specifically, how would the two objectives of the health planners—facilities planning and cost containment—be served in a "pro-competitive system?"

(4) How do you make operational the "pro-competitive double play" financing to reimbursement to delivery? Private insurers will respond to changed regulatory or financial incentives, but they have limited ability to change reimbursement without putting policy holders at risk. Even if companies could change payments, physicians control the ordering and delivery of services, and even HMOs in the limited experience to date have had spotty results in affecting physician practices.

(5) Finally, how do you turn a philosophy into a strategy for reform, given the existing participants, their historic roles, and economic and political realities? How can we get to a better, more economical, more effective health-care system, with minimal disruptions along the way?

I hope that the authors will begin to address issues such as these in order to enrich the debate and help foster development of a health industry that better serves the needs and wants of the American people.

Joseph Eichenholz,
Director of Health Policy Analysis,
Connecticut General
Life Insurance Company

CLARK HAVIGHURST
and GLENN HACKBARTH respond:

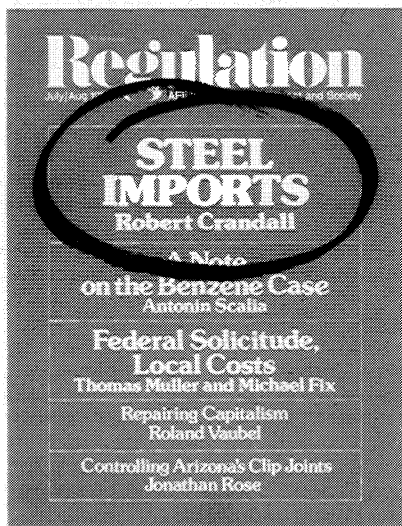
Mr. Eichenholz urges advocates of competition to "begin to address the issues." The fact is, however, that all of his issues have been extensively explored by market advocates. In light of this growing body of literature, those who would portray the market strategy as a simplistic effort to apply the theoretical models of "Economics I" would seem to be the ones ignoring what are true issues.

Obviously, we cannot in this space answer Mr. Eichenholz's many questions without inviting still more charges of oversimplification. We would only note that market advocates have made a careful diagnosis of the causes of the health-care market's past failures and have concluded that the major culprits are poorly designed subsidies, vicarious or collective purchasing of health insurance through employers and unions, anticompetitive regulation, and private restraints of trade. These features of this market have aggravated its one inherent flaw—the externalities caused by paying medical bills through insurance—until that manageable problem has become unmanageable. Market advocates have therefore formulated a detailed agenda for ameliorating the market's secondary flaws. On that agenda are changes in existing regulatory statutes (the topic of our article), changes in Medicare and Medicaid and the tax treatment of employer-financed health benefits, and vigorous antitrust enforcement aimed at the undue control the medical profession has exercised over the private financing system and other features of the industry. In short, very extensive work has been done on how to "turn a philosophy into a strategy for reform, given the existing participants, their historic roles, and economic and political realities."

Admittedly, we cannot predict the precise effect of the various elements of the market strategy. Unlike the proponents of regulation, however, we do not find that alarming, since we do not believe that policy analysts can ever predict with precision how a complex system will respond to basic changes in incentives. Of course, we have ideas about how existing arrangements might be improved, and we have shared them liberally. But we do not claim to know the best way to complete Mr. Eichenholz's "pro-competitive double play," or even that there is a single "best" way. Ultimately, we are prepared to defer to the decisions of doctors, hospitals, insurers, and of course consumers, when those decisions are made by people facing the economic costs of their choices in a relatively free market. Indeed,

the greatest strength of the market as an institution is that it eliminates the need for omniscient policy analysts and instead relies on decentralized decision making by those who best know their piece of the system or their needs.

Our goal is not to institute "a perfectly competitive system," whatever that might mean. It is instead to remedy some obvious problems with the market so that cost-conscious competition might increase the efficiency of a now imperfect system. If the externalities attendant to third-party financing prove an insurmountable obstacle to workable competition, there will be ample opportunity to resort to more drastic regulatory measures, like caps on hospital revenue and regional health budgets. On the other hand, if we submit now to such unprecedented government intervention—or allow ourselves to be consumed by idle and repetitious debate until the political pressure for such drastic action becomes irresistible—the opportunity for applying competitive principles may be lost for good.


Regulation

STEEL IMPORTS
Robert Crandall

A Note on the Benzene Case
Antonin Scalia

Federal Solicitude, Local Costs
Thomas Muller and Michael Fix

Repairing Capitalism
Roland Vaubel

Controlling Arizona's Clip Joints
Jonathan Rose

Steel Imports

TO THE EDITOR:

Robert Crandall obviously cherishes the purely competitive ideal, and has carefully groomed his data to support that ideal for international trade in steel ("Steel Imports," July/August). I would like to present an alternative view.

Approximately one-half of the world's steel comes from government-controlled steel companies, with a substantial additional proportion from companies constrained to government-directed motivations. In economic downturns, such companies exaggerate the typical reaction of capital-intensive industries (that is, price cutting to maximize capacity utilization) and, as a virtual extension of government policy, seek to export unemployment at whatever price. It is a well-known fact that if everyone cut prices, little additional steel would be sold. Thus, only by taking someone else's market, can "government-motivated" producers expect to maintain employment. Despite Crandall's rationale, this is *predatory* behavior. It is naive to imply that beggar-thy-neighbor policies are "fair" and to advocate that U.S. producers and workers pay the unemployment premiums other countries attempt to avoid by exporting unemployment.

Since 1974 no major world producer has been able to cover opportunity costs. The Japanese are the low-cost major producers, but this production cost advantage is largely offset by importation charges to U.S. and European markets. U.S. and European producers are, as a rule, the low-cost producers for their respective home markets, with transport costs a major barrier to bilateral trade. One would think, and certainly the author must believe, that producers who remain in business must eventually cover their opportunity costs.

In comparative advantage terms, the United States' abundance of capital and raw materials, including coal, should foster industries such as steel. Japan's current advantage, which results largely from newer plant and equipment (eleven years old on average, versus seventeen-and-a-half years), would largely disappear if the United States were at a similar stage in the application of new technology. Based on estimated costs of building and operating new steel plants, Japanese producers would have a home production cost advantage, but not one sufficient to cover transport costs to either the United States or Europe. Thus, in the long run, based on comparative costs, the U.S. industry could make opportunity profits while at the same time enabling consumers to buy steel at much lower prices from domestic rather than foreign suppliers. In this context the U.S. industry, which cannot meet current home market demand, is far from overbuilt.

Dumping (predatory pricing) delays or destroys the normal evolution along lines of comparative cost advantage. Consumers may receive a temporary bonus, but only at their long-range expense. Most foreign steel producing countries have attempted to secure their markets against predators while "funding" losses their producers incurred through the same practices (a fact the author downplays). Thus, "open markets" in the United States become the target of foreign attempts to delay adjustment to new economic circumstances. It is naive to assert that the United States should ignore "unfair" trade in order to be an "example" of what trade policy should be.

Undoubtedly, the modernization of the American steel industry—so that it can compete more effectively, earn opportunity returns, and ensure long-term benefits to U.S. consumers—will cost in the short term. However, Crandall's analysis of the costs and benefits to the economy as a whole from maintaining a domestic steel industry is highly misleading. For example, in comparing short-term costs and benefits, the author cites a cost to U.S. consumers of $1 billion for the TPM anti-dumping program (a temporary program) versus a benefit of $60 million to steelworkers. Assuming $1 billion is the correct short-term cost to consumers, then (based on the author's own data) short-term benefits could be well over $1 billion: $0.4 billion from the "redistribution effect" (consumers are also workers, taxpayers, and shareholders) of higher prices, and approximately $1 billion from the "production effect" (assuming that in the short term, resources would be otherwise unemployed so that most of the revenue from increased domestic sales constitutes a benefit to the economy). Similar assessments of short-term costs and benefits lead foreign countries to encourage beggar-thy-neighbor policies in recessions.

In the longer term, of course, resources have alternative uses and the "production effect" is substantially reduced. However, in his longer-term comparison of costs and benefits, the author says that consumers would have to pay $4 billion, or $110,000 per job created, annually, to make our industry look profitable. Again, he ignores the fact that this cost is not a net loss—but largely redistributed to taxes, dividends, or salaries. Further, he omits the fact that the cost of creating jobs in the types of industry (for example, capital intensive) where the United States presumably has a

comparative advantage probably differs little from those in steel. Finally, he does not point out that, because of technical changes in steel production and the benefits to be derived from unexploited economies of scale, the American industry would appear to have a downward sloping long-run marginal cost curve. Thus, any short-term cost to society could be more than repaid in the longer term with lower-cost domestic versus foreign steel.

I, too, cherish the economic efficiency and equity inherent in the competitive ideal. However, correcting only one departure from the purely competitive ideal without addressing others may result in greater rather than lesser distortions in efficiency and equity. This is precisely what would happen without effective enforcement of anti-dumping laws as, for example, they pertain to steel.

Donald F. Barnett, Ph.D.,
Vice President and Economist
American Iron and Steel Institute

TO THE EDITOR:

If U.S. steelmakers have lost competitive advantage, as Robert Crandall claims, how can he account for the phenomenal success of Canadian producers, the most profitable in the world? The well-documented explanation is that the Canadian producers enjoy the benefits of benign government policies. The United States retains a large measure of inherent comparative advantage in steelmaking, but this advantage has been nullified by our government. Indeed, the government has come to recognize that fact, as is illustrated by the Carter administration's recently proposed remedies.

Dr. Crandall believes there is no hope that the domestic industry will become efficient, competitive and profitable until it has "adjusted fully"—meaning a drastic reduction of size. We agree that some marginal tonnage must, and no doubt will, be abandoned. Where we differ with Dr. Crandall is on the costs and potential returns of "brownfield" modernization projects. Quite frankly, we think we know our business better than he does.

Protectionism, especially for such bellwether industries as steel, is endemic around the world. The measures the U.S. industry advocates (including enforcement of statutes that Dr. Crandall criticizes so vehemently) are mild by the standards of other countries.

Dr. Crandall responds that American consumers benefit from low-priced imports—and indeed they might, but only in the short term. As our present plight illustrates so vividly, however, the steel industry cannot be revived overnight. Inadequate domestic production capability in a time of strong worldwide demand will surely mean extortionate import prices, possibly for a long and painful period.

And what about the possibility of curtailments in foreign steel supplies, a possibility that Dr. Crandall ridicules? Considering the troubled state of geopolitics, it hardly seems prudent to become any more dependent than is necessary on foreign sources of essential materials. After all, the desire for a large degree of self-sufficiency in steel supply accounts for the growth of steelmaking in so many other countries.

Dr. Crandall quite correctly emphasizes the importance of *competition* to hold down prices and meet the needs of the marketplace. He's right. All the more reason to maintain a large and fully competitive domestic steel industry.

Finally, Dr. Crandall implies that steel producers believe "trade protection" is the crucial key to whether the industry will, in his words, "collapse or prosper." He's wrong. Imports may be the decisive factor for plants in certain especially vulnerable areas (such as the Pacific Coast). But for the industry in general, other issues—such as tax policies, price jaw-boning, and regulatory strictures—are equally significant. We have said so time and again.

Richard F. Schubert,
Vice Chairman,
Bethlehem Steel Corp.

TO THE EDITOR:

Robert Crandall's article addresses the key issue of the present steel trade debate, the extent to which imports have contributed to the difficulties of our steel industry. The steel companies and the United Steelworkers of America claim that the government's failure to enforce U.S. trade laws has been largely responsible for the industry's poor performance in the past two decades. Critics tend to blame the companies and the union, criticizing them particularly for some less-than-optimal investment decisions, diversion of funds into nonsteel activities, far-above-average employment costs, and (until 1974) strike threats in years of contract negotiation.

Dr. Crandall holds out little hope that the application of trade laws will bring major benefits to the industry and its union. He also predicts continuing troubles for American steelmakers until they decide to adjust to the "new world competitive reality." I agree with the first point, but remain skeptical about the second, especially the postulate that the domestic industry adapt its pricing policy to the cyclical price movements of the world steel market.

Application of the antidumping section of the U.S. trade act could be compared to punishing truckers, who are caught speeding on a long downslope, by blasting them off the road with a howitzer. The cost test of dumping, if applied during a severe downturn of the market, has the potential of completely closing off the U.S. market to large foreign export industries. Enforcement of the price-discrimination test could similarly affect the exporters from those nations whose currencies rise steeply against the U.S. dollar.

Protecting the domestic manufacture of textiles, shoes, and television sets results in greater inflationary pressures in these markets. The burden of keeping some U.S. firms in business and their workers employed is borne by the consumer and the export sector. In the case of steel, there are more subtle adverse effects. Protection of the steel industry will affect the international competitiveness of many U.S. manufacturing firms. The final outcome of such a policy is likely to be an increase in the importation of steel-containing goods and a decline in total manufacturing employment, including employment in the steel industry itself. A further consequence will be intensive, and in some cases successful, lobbying for protection conducted by several steel-using industries.

Apart from having a considerable inflationary effect, such a development would threaten the entire international trade system that has been established over the past three decades. For what purpose, one should ask? To defend the market share of integrated steel producers with a mediocre performance record and the jobs of workers receiving total compensation in excess of $20 per hour worked?

On the question of adjusting the price of U.S.-made steel to world market fluctuations, I have severe doubts that American producers

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could live with that practice when the world market remains depressed for an extended period. Considerable differences exist in the cost structure of steel firms around the world. Burdened by rigid capital and labor costs, some of those firms sell their products at less than half of their total cost in a recession. Ultimately, those enjoying support from profitable non-steel operations or low exchange rates will manage to continue on their own while many others will be driven into public receivership. Without the European (Davignon plan) and U.S. (trigger-price mechanism) interventions, the bloodletting would probably have affected even the Japanese industry, as well as the more efficient among the U.S. and German steel producers. The result might well have been an even stronger (and more lasting) projection of government influence into the international trade of steel products.

I also have some doubts about the degree to which steel industries are "overbuilt." As recently as 1974 the world market suffered from a shortage of steelmaking capacity. Predictions abound at the present time of a renewed tightening of the market a few years from now. Can anyone really predict at this time which countries will find themselves with too much steel capacity five years from now, or whether the entire world market will suffer from an overhang or a shortage of capacity?

Hans Mueller,
Middle Tennessee State University

ROBERT CRANDALL responds:

The discussion of trade policy in the United States is generally one part economics and three parts theology. Protectionists criticize economists for invoking "competitive theory" in explaining the real world, while economists shake their heads at the protectionists' search for the medieval "fair price" in a world very unlike that of Thomas Aquinas. We do not seem to join the issue.

Barnett and Shubert say the U.S. steel industry has not lost comparative advantage. In the presence of "fair trade," U.S. firms would be thriving if only Washington left them alone. Unfortunately, neither Barnett nor Shubert mentions that the industry's loss of position in the world has paralleled its general loss of cost competitiveness. The U.S. industry has not broken ground on a new plant since the early 1960s and apparently will not do so in the next decade or two.

Since 1960, the Japanese industry has built as much steel capacity as the U.S. industry currently owns. And it is still in a position to build additional mills and operate them profitably, while the United States has not been able to do so since the 1960s. How then can Barnett and Shubert argue that steelmaking is our "comparative advantage." Compared to what?

Neither Shubert nor Barnett mentions the U.S. industry's wage rates. The industry has granted wage increases so large that many companies now have difficulty competing with the Japanese, Koreans, or other low-cost countries. Our labor-cost disadvantage vis à vis the Japanese is at least $50 per ton and rising. No wonder that Japan's automakers can buy steel at about $50 a ton less than Detroit and still provide a comfortable profit margin for their steel industry.

The theology of volatile pricing and government ownership permeates every discussion of steel trade policy. Even Mueller seems to worry about this problem. The notion that nationalized steel industries create more volatile pricing patterns than would a competitive market of privately owned companies is difficult to substantiate. The price cutting that emerges in recessions is no worse in steel than for many other industrial commodities. Prices rarely fall by more than 20 perecnt in even a severe slump. In the sharp two-year slide from the dizzying height of the 1974 speculative boom for steel, U.S. import prices fell by only 18 percent. Also some of the sharpest price cutting was done by small, privately held Italian mini-mills. Government-owned steel companies pose a threat to consumers for quite a different reason: they are more likely to trundle off to Paris to fix prices than will a multitude of private sellers.

Nor can we say that flexible prices equal "dumping" and predatory intent. Japanese steelmakers certainly have no illusions of monopolizing our steel market by means of predation. We now limit them to 6 million metric tons a year of our market—about 5 to 6 percent of the total. Some monopoly! More important, the average prices of imported steel over the entire business cycle are lower than average domestic prices. This should surprise no one. If large fabricators were inviting future price-gouging by purchasing steel at "predatory" prices, they would not be foolish enough to consummate such deals. General Motors and Ford can be left to handle these problems themselves. They do not need government warnings about the dangers of being held hostage by Japan, Inc.

One often hears that the theology I share with my fellow economists on the benefits of free trade is irrelevant in a world of "unfair" trade with its many government restrictions. Even if every other steel-producing nation were to erect prohibitive barriers to imported steel, it can still be shown that we would be better off allowing our borders to remain open to foreign steel. I do not deny the usefulness, even the necessity, of using our steel market as a bargaining chip in gaining access to Japan, Germany, or Korea for our export industries; but this is not the same thing as saying that our steel industry needs protection because their *steel* industries do not feel the pressure of external competition.

Finally, the national-defense theology should be laid to rest once and for all. We do not need a 150-million ton steel industry to protect ourselves against the threat of disruptions of imports.

I agree with Shubert that we must remove government impediments to sound business decision making in steel and other industries. Simplifying environmental policy, reforming work-place health and safety policy, eschewing jawboning, and ending "trigger prices" would be part of such a plan. I might even support a ten-year moratorium on corporate income taxes for steel firms, just to test Shubert's theory that there are enormous opportunities for "brownfield" expansion of the industry. Given the small sums the Treasury now receives from the steel industry in coroprate taxes, this experiment would cost little.

We all long for a healthy U.S. industrial base, one that can propel us into a new era of economic growth. But steel will not and cannot lead this thrust. Indeed, we might be much better off with a somewhat smaller, but healthier, industry than with one that needs periodic loan guarantees from the Department of Commerce or that must become a regular supplicant before the administrator of the Environmental Protection Agency. ■