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REDUCING DEBT AND OTHER MEASURES FOR IMPROVING U.S. COMPETITIVENESS

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ABSTRACT

The United States is at a tipping point: the gross national debt is over $16 trillion, equal to or exceeding the gross national product; unemployment is high; and job creation is low. Our nation's high levels of debt are crowding out private investment, raising costs to private business, and stifling economic growth. To help American businesses remain competitive in an increasingly globalized world, immediate action is required to improve their competitive position and to stabilize the macroeconomic climate in which they operate. While the national debt must ultimately be paid down, there are other competitiveness-enhancing reforms that can be implemented more quickly including tax reform, regulatory reform, and tort reform.

JEL codes: F00, H00, H06

As a society, the United States has moved from a nation of creditors to a nation of debtors, from a nation of savers to a nation of consumers. Nowhere is the consequence of this debtor mentality more profound than in the federal debt. In the wake of two recessions, saving has taken a slight upturn as some consumers seek to protect themselves and build up their retirement savings (see figure 1). Whether this recent return to saving results in a long-term shift, or is just a short-term blip that quickly reverts to a downward slide, remains to be seen. However, the federal government has yet to follow suit. The increase in national saving, the sum of private and public saving, has occurred despite the increase in the national debt. And although greater attention is now focused on the national deficit, the country continues to live beyond its means and the national debt continues to soar.

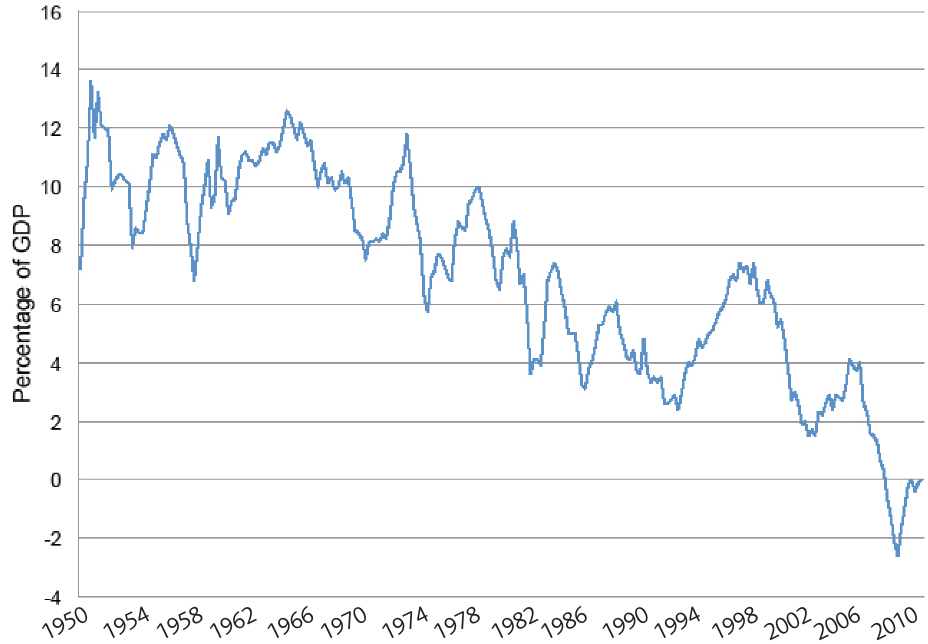
Competitiveness demands that a nation's producers contend within a global marketplace. A nation's ability to compete successfully depends on its ability to employ its resources productively. While some debt-financed spending can be conducive to economic growth, high levels of debt may undermine competitiveness, particularly if a nation's debt becomes so large that servicing that debt redirects resources away from productive activity.

Like most nations, the United States finances its sovereign debt by issuing securities. Therefore, when the government borrows to finance its spending, it competes with private entrepreneurs who are borrowing to finance their own activities. Capital used by government is unavailable to private business. Moreover, when the government borrows, demand for funds increases, thus raising the price of borrowing, or the interest rate, for private investors.[1]

For firms requiring capital, this increases the cost of doing business. As interest rates rise, producers see profits decrease as the cost of one of their production inputs,

1. World Economic Forum, *The Global Competitiveness Report* 2011–2012, http://www.weforum.org/reports/global-competitiveness-report-2011-2012; and Matthew Mitchell and Jakina R. Debnam, "In the Long Run, We're All Crowded Out" (Mercatus Working Paper, September 22, 2012), http://mercatus.org/publication/long-run-we-re-all-crowded-out. This is true even in the presence of international financial markets. The existence of fluctuating exchange rates introduces an additional risk into international lending and borrowing; therefore, international integration of financial markets remains incomplete.

FIGURE 1: U.S. NATIONAL SAVINGS DECLINE

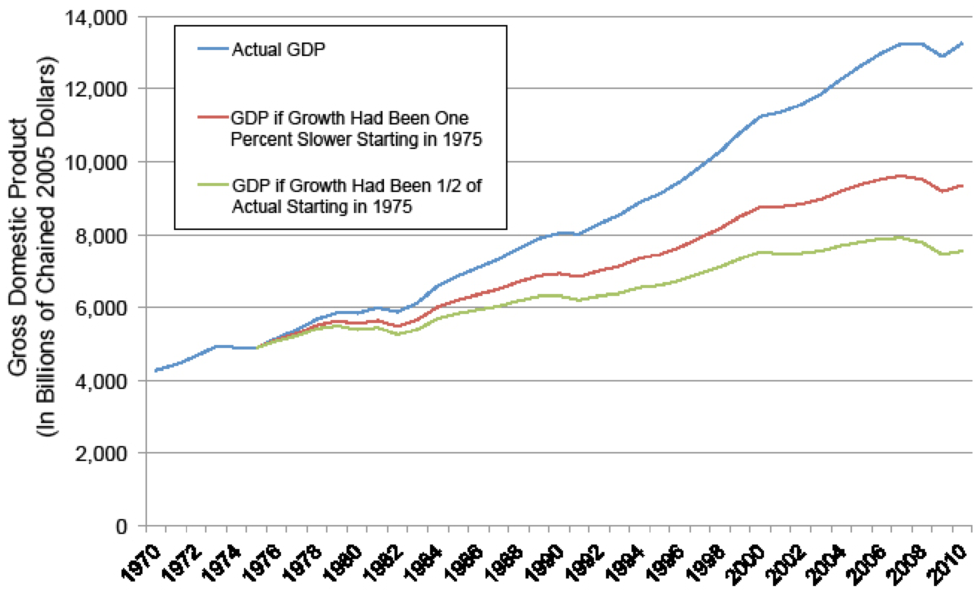


Source: Bureau of Economic Analysis, Table 5.1
http://www.bea.gov/scb/pdf/2011/08 20August/NIPA_Section5.pdf

capital, increases. In this new environment, some producers may choose to exit the market altogether.[2] These individual-level decisions have serious implications for the larger economy. For a nation, this means a decrease in the level of capital it accumulates. Since capital accumulation is at the core of economic development,[3] as the nation's producers accumulate less capital, fewer goods are produced overall.[4]

2. N. Gregory Mankiw, *Principles of Economics* (Mason, OH: South-Western Cengage Learning, 2009).
3. Joseph A. Schumpeter, *Capitalism, Socialism and Democracy* (New York: Harper, 1942); Robert M. Solow, "A Contribution to the Theory of Economic Growth," *Quarterly Journal of Economics* 70, no. 1 (1956): 65–94; and Trevor W. Swan, "Economic Growth and Capital Accumulation," *Economic Record* 32, no. 2 (1956): 334–61.
4. Oliver Jean Blanchard, "Crowding Out," in *New Palgrave Dictionary of Economics*, 2nd ed., ed. Steven N. Durlauf and Lawrence E. Blume (Palgrave Macmillan, 2007). The importance of capital accumulation for economic growth has been emphasized across the literature examining developed countries. Examples include Xavier Sala-i-Martin, Gernot Doppelhofer, and Ronald I. Miller, "Determinants of Long-Term Growth: A Bayesian Averaging of Classical Estimates (BACE) Approach," *American Economic Review* 94, no. 4: 813–35; and Horst Siebert "Debt and Capital Accumulation," *Weltwirtschaftliches Archiv* 123, no. 4 (1987): 618–30. Also, Urquhart finds a strong relationship between capital accumulation and economic growth in Canada, see his "Capital Accumulation, Technological Change, and Economic Growth," *The Canadian Journal of Economics and Political Science / Revue canadienne d'Economique et de Science politique* 25, no. 4 (1959): 411–30. See also Peter Howitt and Philippe Aghion, "Capital Accumulation and Innovation as Complementary Factors in Long-Run Growth," *Journal of Economic Growth* 3 (1998): 111-30; and

FIGURE 2. DEBT AND POTENTIAL ECONOMIC GROWTH



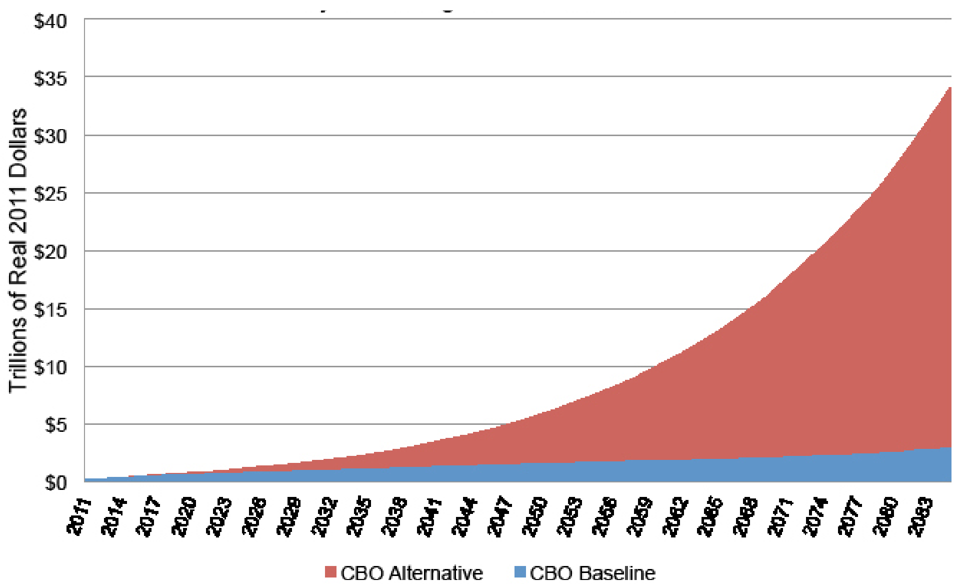
Sources: Bureau of Economic Analysis; author's calculations. Created by Matthew Mitchell, Mercatus Center at George Mason University.
This figure illustrates the impact of slower growth by imagining what our economy would look like if—starting in 1975—we had accumulated the level of debt that we have now accumulated. The graph shows the path of actual (inflation-adjusted) GDP, along with two hypothetical GDP paths: one in which the nation had grown 1 percent more slowly and one in which it had grown at half of its actual pace.[*]
** Matthew Mitchell, "Actual and Alternative Growth Paths for the United States" (Working Paper, Mercatus Center, August 22, 2011), http://mercatus.org/publication/actual-and-alternative-growth-paths-united-states.*

But the effect of a large government debt burden on the economy extends beyond its interaction with interest rates. Debt also undermines our nation's competitiveness by contributing to our real and perceived macroeconomic instability.[5] With high and growing levels of debt, firms and individuals must operate under the uncertainty that taxes might be increased to pay debt servicing costs and/or inflation might sharply increase; this uncertainty is a detriment to overall productivity.

Paul Davidson, "Portfolio Balance, Capital Accumulation, and Economic Growth," *Econometrica* 36, no. 2 (1968): 291–321, who also notes that policymakers should facilitate producers' financing in order to encourage capital accumulation and move the economy toward full employment. In this case, when domestic borrowing is primarily financed through international capital inflows, the federal demand for loanable funds may not compete with domestic demand for lending, therefore interest rates may not increase and domestic production may not decline in the short run. However, national income decreases nonetheless as the nation must eventually repay its foreign debts. (William Gale, "Budget Deficits," *The New Palgrave Dictionary of Economics*).

5. The effect of macroeconomic stability on economic growth is documented in World Economic Forum, *Global Competitiveness Report*.

FIGURE 3. PROJECTED LONG-TERM INTEREST COSTS



Source: Congressional Budget Office, Long-Term Budget Outlook, June 2011

For this reason, fiscal consolidation as well as structural reforms will be needed to increase American competitiveness and growth in the long term.[6]

Figure 2 illustrates the stark impact on what GDP would be today if, starting in 1975, GDP growth had been 1% below what it was and GDP growth had been half of what it was. These imagined GDP growth paths are relevant because of the findings of economists Carmen Reinhart and Kenneth Rogoff, who examined historical data from forty countries over 200 years and found that, when a nation's gross debt exceeds 90% of GDP, real growth slows by 1% in some cases, and in the most extreme cases, real growth was cut in half.[7] This result is true for developing and advanced economies alike. Likewise, economists at the Bank for International Settlements find that when government debt in the Organisation for Economic Cooperation and Development (OECD) countries exceeds a threshold of about 85 percent of GDP, economic growth slows.[8]

The United States gross debt has already exceeded both of these empirical thresholds.[9] While there remains some question as to the generalizeability of international

6. Olivier Blanchard and Carlo Cottarelli, "Ten Commandments for Fiscal Adjustment in Advanced Economies," IMFdirect, comment posted June 24, 2010, http://blog-imfdirect.imf.org/2010/06/24/ten-commandments-for-fiscal-adjustment-in-advanced-economies/
7. Carmen Reinhart and Kenneth Rogoff, "A Decade of Debt" (National Bureau of Economic Research, Working Paper No. 16827, February 2011).
8. Stephen Cecchetti, M.S. Mohanty, and Fabrizio Zampolli, "The Real Effects of Debt" (Bank for International Settlements Working Paper No. 352, September 2011).
9. Gross federal debt includes debt that the government owes to itself through various trust funds.

experiences to the United States, there is no reason to believe that the United States occupies a sufficiently unique position to spare it from the consequences of high levels of debt.

Finally, and perhaps most obviously, the direct financial burden of large and indefinite interest payments will interfere with the nation's ability to provide essential services and make needed investments to improve national productivity and competitiveness.[10] To some extent this has already begun.

The Congressional Budget Office's (CBO's) two long-term projections of the annual costs of servicing the federal debt are shown in figure 3 for the years 2011 through 2085.[11] The blue (bottom) area represents CBO's baseline estimate of interest costs if current law continues. Under this scenario, a number of tax cuts expire. The red (upper) area represents CBO's alternative, which estimates increased interest costs if several provisions under current law do not expire as planned, including the Bush-era tax reductions, an Alternative Minimum Tax patch, and increased payments to Medicare physicians.

In the long term, lowering the debt burden will enhance U.S. competitiveness by lowering costs, because interest rates would be lower and fewer resources would be devoted to servicing the debt as opposed to being invested in more productive pursuits. But there is room for debate about the merits of aggressively lowering the debt through fiscal austerity during a time of slow economic growth or recession. Though efforts to reign in our nation's debt must begin sooner rather than later, how quickly and aggressively to reduce the national debt is open to debate, especially since the nation's economy continues to be weak. From the perspective of an economist, there are solutions to enhance U.S. competitiveness now, regardless of the state of today's economic business cycle. These steps should be taken to improve competitiveness in addition to those that must be taken to reduce the national debt.

10. There is evidence to suggest that investments in health care and infrastructure could improve national producers' competitiveness by transferring costs onto the taxpayer, which are analogously borne in competing nations (in the case of health care), by making production more efficient (in the case of infrastructure investment) or by increasing the productivity of the American worker (in the case of education investment). For specific suggested investments, see Anthony P. Carnevale, "Two Key Actions to Align Postsecondary Education with the Labor Market," chap. 6, and Jack Meyer, "Five Initiatives to Ben the Health Care Cost Curve," chap. 7, both in *Governing to Win: Enhancing National Competitiveness Through New Policy and Operating Approaches*, ed. Charles L. Prow (Lantham, MD: Rowman & Littlefield, 2012).
11. Congressional Budget Office, *Long-Term Budget Outlook* (Washington, D.C.: Government Printing Office, 2011), http://cbo.gov/publication/41486. The CBO's alternative assumes that the 2001 tax cuts will continue to be extended (as they were most recently in 2010) and that the alternative minimum tax will continue to be revised so that middle-income taxpayers are not subject to it.

CORPORATE TAX REFORM

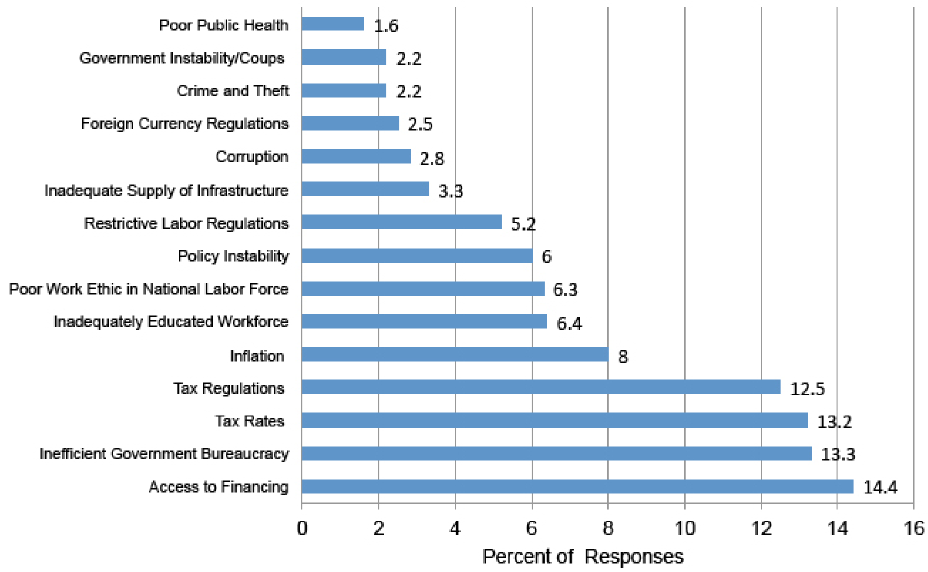
THE U.S. CORPORATE income tax system is riddled with agglomerated attempts to increase fairness, encourage economic growth, and promote favored industries.[12] This system of taxation places domestic producers on an uneven playing field with each other and at a competitive disadvantage abroad. In fact, according to business executives surveyed by the World Economic Forum in 2011, one of the most problematic factors business owners are concerned with is taxes (see figure 4, *business owners' stated concerns*).

The current tax code discriminates between producers according to size and industry. Favored industries receive special deductions and benefits. Smaller companies may deduct their capital expenses all at once but larger companies deduct their expenses gradually, which increases their cost of investment. On the other hand, larger companies, with greater access to financial markets, are advantaged under a tax code that favors using debt rather than equity-financed investments.[13] Such a complex system of corporate income taxes imposes a hefty compliance cost on American businesses, one not borne by many of their competitors in other countries.

Unlike most industrialized countries and all other members of the G7, the United States taxes all corporate income, regardless of where in the world it is generated.[14] It is important to note that, since foreign-source income is only subject to U.S. corporate income tax when it is repatriated,[15] this provides a strong incentive for

12. In the United States, corporate taxes are imposed at more than one level of government. When the average rate of state and local corporate taxation is included, the corporate tax rate in the United States rises from 35% to 39% of profits. The discussion here is limited to the federal level, however, since that is the level at which international competition for business occurs. Additionally, corporate profits are generally subject to "double taxation," whereby firm profits are taxed first at the corporate level and then again at the individual level.
13. This feature of the tax code undermines national economic stability as companies are more prone to seek debt financing and be highly leveraged, thus increasing the risk of being unable to service debt during economic downturns (Cnossen, 1996; OECD 2007b). See Organisation for Economic Co-operation and Development, "Fundamental Reform of Corporate Income Tax," OECD Tax Policy Studies, No. 16 (Paris: Organisation for Economic Co-operation and Development, 2007) and S. Cnossen, 1996, "Company Taxes in the European Union: Criteria and Options for Reform", *Fiscal Studies*, Vol. 17, No. 4, pp. 67–97.
14. However, to minimize double-taxation, qualified income tax paid to the foreign country in which the income is generated is deductible from a corporation's liability under the U.S. tax code up to the domestic corporate tax rate of 35 percent. Internal Revenue Service, *Topic 856: Foreign Tax Credit*, http://www.irs.gov/taxtopics/tc856.html, accessed May 1, 2012.
15. Active foreign-source income is subject to taxation only upon repatriation while passive foreign-source income and royalties are subject to taxation during the tax year they are generated.

FIGURE 4: U.S. BUSINESS OWNERS' STATED CONCERNS



Source: World Economic Forum, Global Competitiveness Report
The survey data presented above were compiled by the World Economic Forum (WEF). According to the WEF, "From a list of 15 factors, respondents (437 U.S. business executives) were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The bars in the figure show the responses weighted according to their rankings." Note that "access to financing," "inefficient government bureaucracy," inflation, and tax-related concerns are cited as the most problematic factors.

corporations to retain earnings overseas instead of paying them out as dividends to shareholders or reinvesting them in America.[16] Evidence suggests that this is precisely what corporations do.[17]

The most obvious reforms are to move the statutory tax rate closer to the Organisation for Economic Co-operation and Development (OECD) average of 26 percent[18] and to eliminate preferential subsidies and credits from the income tax code. This, however, is insufficient, as it leaves many of the structural inefficiencies of the current system in place.

16. C. Fritz Foley, Jay C. Hartzell, Sheridan Titman, and Garry Twite, "Why do firms hold so much cash? A tax-based explanation" (National Bureau of Economic Research Working Paper, No. 12649, October 2006).
17. Kristin Forbes, comment on "The U.S. needs an overhaul of the corporate tax system, not a temporary tax break," MIT Sloan Experts, comment posted May 9, 2011. http://www.mitsloanexperts.com/the-u-s-needs-an-overhaul-of-the-corporate-tax-system-not-a-temporary-tax-break/
18. Organisation for Economic Co-operation and Development, *Tax Reform Trends in OECD Countries* (Paris: Organisation for Economic Co-operation and Development, June 30, 2011), http://www.oecd.org/ctp/48193734.pdf.

Another pro-growth reform would be to transition the U.S. corporate tax code to a territorial basis, with corporations taxed only on income generated in the United States, consistent with the tax policies of other G7 members.[19] The effect of such a proposal on tax revenues is unclear: it would discourage tax avoidance while decreasing the volume of eligible revenue. But the effect of removing this barrier to U.S. producers' competitiveness is clear. Firms will be able to invest their profits in the United States without being penalized for doing so, and American producers will face more equal costs when operating abroad.

CORPORATE TAX REFORM CASE STUDY: NEW ZEALAND

In the early 1980s the New Zealand's corporate income tax system was rife with loopholes and preferences. These distortions were paired with one of the highest corporate income the rates in the OECD: 48 percent.[20] However, when declining oil prices coupled with declining tax revenues placed pressure on public spending, the Lange Douglas Labour Government responded with far-reaching economic reforms designed to improve national competitiveness. These included privatization of certain industries, improved oversight and competition in the financial sector, the introduction of a value-added tax, and the removal of import licensing requirements, export subsidies, and tariffs.[21,22]

Throughout the mid-to-late 1980s, the New Zealand government standardized and simplified the corporate tax code. In order to remove bias in the tax code toward particular methods of corporate financing, in 1988 the government introduced an *imputation system*, which equalizes the tax rate paid on all corporate earnings, whether distributed dividends, retained profits or interest payments.[23] At the conclusion of these reforms the corporate tax rate was 33 percent, then well below the OECD average, and New Zealand's tax system was one of the simplest and most neutral in the OECD.

19. Ruud A. De Mooij and Gaëtan Nicodème, "Corporate Tax Policy and Incorporation in the EU," *International Tax and Public Finance* 15, no. 4 (2008): 478–98.
20. Steffen Ganghof, "Global Markets, National Tax Systems, and Domestic Politics: Rebalancing Efficiency and Equity in Open States' Income Taxation" (Discussion Paper 01/9, Max-Planck-institut für Gesellschaftsforschung, December, 2001), http://www.mpi-fg-koeln.mpg.de/pu/mpifg_dp/dp01-9.pdf.
21. Veronique de Rugy, "New Zealand Should Heed U.S. Tax Lessons," *The New Zealand Daily Herald*, July 4, 2005, http://www.aei.org/article/foreign-and-defense-policy/regional/asia/new-zealand-should-heed-us-tax-lessons/.
22. Organisation for Economic Co-operation and Development, *OECD Economic Surveys: New Zealand* 1998 (Paris: Organisation for Economic Co-operation and Development, 1998); and Organisation for Economic Co-operation and Development, *OECD Economic Surveys: New Zealand 1999* (Paris: Organisation for Economic Co-operation and Development, 1999).
23. For a further definition and discussion of the imputation tax system in New Zealand see Organisation for Economic Co-operation and Development, "Fundamental Reform of Corporate Income Tax," *OECD Tax Policy Studies*, No. 16 (Paris: Organisation for Economic Co-operation and Development, 2007).

These reforms lowered costs for domestic producers and enhanced New Zealand's international competitiveness. The OECD describes the outcome: "Following wide-ranging reforms undertaken from the mid-1980s, output recovered strongly, outpacing growth in most other OECD countries. This resulted in substantial job creation and a rapid fall in unemployment. Furthermore, the budget moved from sizeable deficit to a surplus position."[24]

In this case, corporate tax reform had a positive effect on tax revenues in addition to its effect on competitiveness: from 1982 to 2004, corporate income tax revenue as a percentage of total tax revenue increased by more than 5 percent in New Zealand, one of the highest increases in the OECD.[25]

Unfortunately, while some competitive advantages remain,[26] the competitiveness of the corporate tax code has eroded over time. New Zealand's corporate tax rate (despite the fact that it was reduced to 30 percent in 2010 and decreased further to 28 percent in 2011) is now high relative to its international counterparts because other countries (but not the United States) have lowered their own corporate tax rates, thus placing New Zealand's competitiveness at risk.[27]

REGULATORY REFORM

The U.S. regulatory framework was developed and drastically expanded during the 1970s to suit a manufacturing-based economy with relatively homogenous industries and little international movement of capital and goods.[28] This regulatory mindset is ill-suited to guide the internationally fluid, knowledge-based economy American competes in today.

The cost of this antiquated regulatory framework is decreased economic growth[29] and a bias toward existing technologies. This places domestic producers

24. *OECD Economic Surveys: New Zealand 1998*.
25. "Fundamental Reform of Corporate Income Tax."
26. New Zealand is among the twenty-six OECD member countries that have implemented a territorial tax system. Only eight countries in the OECD continue to use a worldwide tax system: Chile, Greece, Ireland, Israel, Korea, Mexico, Poland, and the United States. Jason Fichtner and Nick Tuszynski, "Why the United States Needs to Restructure the Corporate Income Tax" (Working Paper 11-42, Mercatus Center, November 2011), http://mercatus.org/sites/default/files/publication/Corporate_tax_FichtnerTuszynski_WP1142.pdf.
27. A table comparing corporate tax rates over time is available from KPMG at http://www.kpmg.com/global/en/whatwedo/tax/tax-tools-and-resources/pages/corporate-tax-rates-table.aspx.
28. Bruce Yandle, Henry Wray, Richard Williams, Scott Farrow, Andrew Perraut, and Gary E. Marchant, "21st Century Regulation: Discovering Better Solutions to Enduring Problems" (working paper, Mercatus Center at George Mason University, January 2009), http://mercatus.org/publication/21st-century-regulation-discovering-better-solutions-enduring-problem.
29. Alberto Alesina, Silvia Ardagna, Giuseppe Nicoletti, and Fabio Schiantarelli, "Regulation and Investment," *Journal of the European Economic Association* 7, no. 3 (2005): 791–825; and Giuseppe Nicoletti et al., "European Integration, Liberalization, and Labor Market Performance," in *Welfare and Employment in United Europe*, ed. Bertola Giuseppe, Tito Boeri, and Giuseppe Nicoletti (Boston, MA: MIT Press, 2011).

at a competitive disadvantage relative to their freer foreign counterparts.

At their core, regulations serve to enforce some social or economic constraint on producers for the perceived good of consumers. However, within the current U.S. regulatory framework, this goal must coexist with regulators' dependence on those with the greatest knowledge of industry—the current producers in that industry and the interest groups who seek to influence it. Without sufficient oversight from elected officials, these groups have historically biased regulation toward existing technologies, increased the regulatory burden on new entrants to the sector, and consequently consigned consumers to higher prices.[30]

Despite their far-reaching effects, regulations are currently assessed simply on a direct cost-benefit basis. A better regulatory framework would introduce an auxiliary criterion asking regulators to evaluate the impact of a potential regulation on domestic and global competition.

In addition, the structure of regulations themselves should be modified. Sufficiently flexible regulation would allow firms to comply with the regulators' aims while allowing them to continue to innovate, to find low-cost compliance methods, and to implement new technologies. The simplest and least anti-competitive tool available to Congress is the performance standard approach. This approach specifies the goal to be reached instead of specifying how to accomplish that goal, thereby lessening the influence of industry and interest groups on regulatory outcomes.[31]

REGULATORY REFORM CASE STUDY: THE NETHERLANDS

Following World War II, the Netherlands enjoyed a period of strong GDP growth and full employment, followed by a large expansion in the Dutch social welfare system financed by natural gas revenues. The 1973 oil crisis brought this period of prosperity to a close. This was followed by a severe recession from 1981 to 1983 when exports stagnated, business investment collapsed, and real compensation fell for three years in a row.[32] Unemployment surged from 4 percent to 11 percent between 1979 and 1983.[33] The economic pressures of the early 1980s called attention to an antiqued Dutch regulatory system.

At the time, the Dutch regulatory system was inflexible and reflected producer interests in markets, with organized labor and business playing a major role in

30. "21st Century Regulation."
31. Ibid.
32. Frank den Butter and Robert Mosch, "The Dutch Miracle: Institutions, Networks, and Trust," *Journal of Institutional and Theoretical Economics* 159, no. 2 (2003): 362–91.
33. Organisation for Economic Co-operation and Development, "Regulatory Reform in the Netherlands," *OECD Reviews of Regulatory Reform* (Paris: Organisation for Economic Co-operation and Development, 1999): 20. http://www.oecd-ilibrary.org/governance/oecd-reviews-of-regulatory-reform-regulatory-reform-in-the-netherlands-1999_9789264173774-en.

regulatory policy development.[34] As a result, regulatory policy favored the maintenance of the status quo and the interests of existing producers. The compounded effect of these policies was to suppress domestic competition as well as competition from abroad. In addition, producers faced considerable administrative burdens as they attempted to comply with regulations. Market rigidities and decreased innovation resulting from a lack of competitive forces were particularly costly in a small, heavily export-reliant economy such as the Netherlands.

In response, the Dutch government implemented a series of reforms throughout the 1990s to social security programs, minimum wage laws, and corporate tax systems. The Dutch government also instituted regulatory reforms with the aim of improving the Netherlands' competitive position.[35]

In 1994, policymakers took a decisive step toward improving domestic and international competitiveness, creating the MDW Programme (Marktwerking, Deregulering en Wetgevingskwaliteit, or "Competitiveness, Deregulation, and Legislative Quality" Program) expressly for this purpose. Regulatory reform efforts gathered momentum throughout the 1990s as policymakers pared down regulations to "what is strictly necessary"[36] and reduced the burden placed on consumers and producers by administrative requirements. Regulatory impact analyses (RIAs), which had been performed *ex-post* on select regulations in the Netherlands since 1985, were now used to evaluate the *ex-post* feasibility and enforcement of regulations as well as their environmental, economic, and business impact.[37]

Together, Dutch economic reforms resulted in reduced costs for domestic producers and improved competitiveness in European and global markets. The resulting turnaround was so striking that it is popularly referred to as the "Dutch Miracle."[38] Between 1982 and 2000, unemployment dropped by 11.5 percentage points (while labor force participation increased by 13 percent) and government balance sheets shifted from deficits of more than 8 percent of GDP to surplus.[39]

While the Netherlands currently lacks a formal process to assess the impact of new regulations *before* they are implemented and areas for regulatory improvement

34. Organisation for Economic Co-operation and Development, *Better Regulation in Europe: An Assessment of Regulatory Capacity in 15 Member States of the European Union – Better Regulation in the Netherlands* (Paris: Organisation for Economic Co-operation and Development, 2009).
35. "Regulatory Reform in the Netherlands."
36. *Better Regulation in Europe*.
37. Italian, Irish and Dutch Presidencies of the Council of the European Union, *A Comparative Analysis of Regulatory Impact Assessment in Ten EU Countries*, A Report Prepared for the EU Directors of Better Regulation Group, Dublin, May 2004, https://www.wbginvestmentclimate.org/uploads/9.ReportonRIAEU.pdf.
38. The impact of regulatory reform on macroeconomic performance is difficult to measure, and several explanations exist for the Dutch Miracle of economic growth. Nonetheless, it seems likely that regulatory reform played an important role in the Netherlands economic revitalization throughout the late 1980s and 1990s.
39. "The Dutch Miracle," 363.

remain, the Netherlands remains an exemplar of regulatory reform in the EU and of its potential for stimulating economic growth.

PRODUCT LIABILITY REFORM

THE CODE AND decentralized structure of U.S. product liability laws place domestic business at a competitive disadvantage. Businesses have unlimited liability within a complex system that varies from state to state. As the law stands, U.S. manufacturers, distributors, and vendors are responsible for the compensation of damages suffered as a result of using a product, regardless of fault or negligence.[40] Businesses are responsible for these damages, which are determined by juries of laypersons and can reach into the tens of millions of dollars, regardless of where the product was produced or sold. While some states place time limits on the producers' liability for a product after it is sold or distributed, other states do not; in many states, business responsibility for the safety of a good extends until that good is decades old, even many decades old. And while some states waive producers' liability if the defect was unknowable given the contemporary level of scientific knowledge (known as the *state of the art* defense), in many states this defense is not permissible.

Varying liability laws mean innovation is riskier for producers in some states than in others.[41] Because the application of legal liability can be unpredictable and may result in excessively high punitive damages, businesses face a large, unknown cost that may discourage innovation and business creation, thus putting additional pressure on business competitiveness.

Fearing the monetary consequences of potential lawsuits, some manufacturers may be deterred from introducing new and untested technologies. Domestic producers doing business abroad lose out to foreign producers who face no such litigation threat and are therefore freer to experiment. U.S. global competitiveness suffers as litigation threats bar innovation. In fact, some argue that this has been one force behind the relative decline of the U.S. auto industry.[42]

Product testing and safety measures come at a cost, and companies must weigh this cost against potential benefits to consumers. A competitive firm will then decide to include precisely as much safety as the consumer is willing to demand—no more and no less. American consumers demand an exacting amount of safety from their

40. These cases are litigated on the basis of *strict liability*. If businesses are found to have been negligent or malicious, then additional damages will be imposed. As civil matters, lay juries decide compensatory damages, which are awarded to recoup plaintiffs' pain, suffering, and economic losses, as well as punitive damages, which are awarded to punish businesses' wrongdoing.
41. The Class Action Fairness Act of 2005 expanded the jurisdiction of federal courts to oversee large tort class action cases, in part as a response to the differing standards among the states that existed at the time (http://www.gpo.gov/fdsys/pkg/PLAW-109publ2/pdf/PLAW-109publ2.pdf).
42. Rama Yelkur, Janet Morrison, Erwin H. Steiner, and Ian Schmehl, "Product Liability: Its Impact on the Auto Industry, Consumers, and Global Competitiveness," *Business Horizons* 44, no. 2 (2001): 61–6.

products and, to a certain extent, this preference is represented in our product liability system. However, for the American companies selling abroad that must still operate within this system, the constant specter of litigation imposes an economically inefficient safety standard beyond that demanded by consumers. As a consequence, American companies face an additional cost of production.

Overarching federal legislation could introduce bounds and simplicity into the American product liability system. This legislation should cap the amount for which companies are liable, and it should limit how long a company is liable for the safety of a good after it was produced. Indeed, such legislation was introduced with bipartisan support in the late 1990s but ultimately vetoed by President Clinton.[43]

PRODUCT LIABILITY REFORM CASE STUDY: THE EUROPEAN UNION

U.S. PRODUCERS' COMPETITIVENESS is harmed by the tremendous variety of product liability laws across the fifty states. Before 1985, producers working in the European Union (EU) faced a similar situation, with each member state holding its own unique national system of product liability.

As a step toward harmonizing product liability laws for all consumers in the European Union, and with an eye to the burgeoning product liability crisis in the United States, the European Commission issued a directive on product liability in 1985,[44] which imposed a strict liability regime in all member countries and constrained the types of liability laws which member countries could implement. This system has several important and distinct features that place producers in EU member states at a competitive advantage relative to their counterparts in the United States. First, in the United States, producers may face damages for pain and suffering and punitive damages in addition to compensatory damages. By contrast, non-economic damages are not permitted under the European Directive. Second, product liability claims in the EU must be brought within three years of the time that the plaintiff became aware of the damage, and these claims must be brought within ten years after the product was put into circulation. By establishing these characteristics, among others, the European Commission has given the EU a competitive edge through product liability reform.

43. Product Liability Fairness Act of 1995, HR 956, 104th Congress, 2nd session, Congressional Record H2239-2247.
44. Council Directive 85/374 of 25 July 1985 on the Approximation of the Laws, Regulations and Administrative Provisions of the Member States Concerning Liability for Defective Products, art. 1, 1985 O.J. (L210) 29, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=CELEX:31985L0374:en:HTML.

CONCLUSION

THE UNITED STATES may be at a tipping point: the gross national debt is over 16 trillion dollars, equal to or exceeding the gross national product; unemployment is high; and job creation is low. Our nation's high levels of debt could eventually crowd out private investment, raising costs to private business, and stifling economic growth. To help American businesses remain competitive in an increasingly globalized world, immediate action is required to improve their competitive position and to stabilize the macroeconomic climate in which they operate. While the national debt must ultimately be paid down, other competitiveness-enhancing reforms can be implemented more quickly including tax reform, regulatory reform, and tort reform.