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## **Rules of the Road: Governing Principles for the New Economy New Economy Task Force Report**

### Introduction

The U.S. economy has undergone a profound structural transformation in the last decade and a half. The information technology revolution has expanded well beyond the cutting-edge high-tech sector. It has shaken the very foundations of the old industrial and occupational order, redefined the rules of entrepreneurship and competition, and created an increasingly global marketplace for a myriad of new goods and services. In short, a New Economy has emerged. Yet while economic reality is fundamentally changing, much of our public policy framework remains rooted in the past.

This mismatch between public policy and economic reality is not sustainable. On one side of the political spectrum, policymakers advocate across-the-board tax cuts, a dramatically reduced role for government, and elimination of social regulations. This does nothing to support the underlying factors propelling growth in the New Economy: technological innovation, e-commerce and digital transformation, higher education and skills, open trade, and a balanced budget. An every-man-for-himself ethos risks leaving behind Americans who are struggling to cope with the dynamism of the New Economy. On the other side of the political spectrum, policymakers advocate increased spending on top-down social programs geared toward income redistribution, coupled with a focus on command-and-control regulation through bureaucratic institutions, ignoring just how entrepreneurial, fast moving, and flexible our economy has become. Furthermore, resistance from both ends of the political spectrum to open trade, global integration, and technological and organizational change threatens to slow the economic changes that hold great potential to yield higher standards of living for American workers.

Over time, policy frameworks must adapt to changing underlying economic and social realities.

Turn-of-the-century industrialization triggered the development of new institutions and policies in the Progressive Era. Likewise, the rise of a national mass production, industrial economy in the 1940s led to the emergence of the post-New Deal, Keynesian policy framework. But during the rocky and turbulent transitional period from the mid-1970s to the mid-1990s -- when the old economy was collapsing but the New Economy had not yet emerged -- that consensus broke down. Too often, one side devoted its energies to preserving rather than reforming existing policies and programs, while the other side fought to tear down the institutions of government entirely, guided largely by economic views that made more sense in the pre-mass production economy of the turn of the 20th century.

Now that the New Economy has emerged, we must foster a new consensus around a new framework for government and public policy. This framework must be consistent with the unique properties and logic of the New Economy. These characteristics include an increase in knowledge-based jobs, higher levels of entrepreneurial dynamism and competition, reduced delays between design and production, faster times to market, increased product and service diversity, constant technological innovation, the advent of the Internet and the information technology revolution, globalization, the replacement of hierarchical organizational structures with networked learning organizations, and relentless economic churning. These are more than economic fads or passing trends; they go to the heart of how the New Economy works.

The Progressive Policy Institute formed the New Economy Task Force to weigh these issues and to develop a set of guiding principles for rethinking the role of government in the Information Age. Here, the New Economy Task Force lists ten key "rules of the road" to guide

that cannot be breached in any situation. These rules are not tailored to suit any particular technology, nor should they have to evolve to keep pace with each new innovation. Rather, they are signposts intended to guide policymakers at the local, state, and federal levels as they craft a policy framework for the New Economy.

#### Rule #1: Spur Innovation to Raise Living Standards

New economic research shows that innovation plays a central role in productivity growth in the New Economy. Innovation and productivity are the prerequisites for higher wages and expanded opportunity for American workers and are critical to addressing a host of social needs, from averting a future Social Security crisis, to improving human health, to solving global warming. As a result, government must be on the side of policies that boost innovation and foster higher productivity and against policies that seek only to divide a slowly growing pie, protect or reward special interests at the expense of overall economic progress, or slow down the process of change. But at the same time, government must play a key role in providing workers and communities with the skills and tools they need to successfully navigate turbulent waters and prosper.

Innovation and change are disruptive. They displace workers; they cause firms, and even entire industries, to fail; they lead to industrial and economic restructuring in cities and sometimes even whole regions; and they upset traditional ways of doing things, making some skills obsolete. There is every reason to believe that this will be just as true, if not more so, in the New Economy. Because innovation and change are disruptive, they tend to spark strong political demands to insulate affected segments of the economy and slow down economic change.

Such demands, while understandable, inherently deny opportunities to less politically powerful interests in the guise of "protecting" those with clout. As a result, to effectively promote growth in the New Economy, government must facilitate, rather than resist, the processes of economic change and modernization as these changes create new opportunities and increased incomes for all Americans. A key lesson of American economic history is that the broad benefits of innovation and change vastly outweigh the short-term costs associated with disruption. This is particularly true in the New Economy, where innovation and change are creating more jobs than they are eliminating and are driving productivity and wage growth.

#### Rule #2: Expand the Winners' Circle

Ensuring that the benefits of innovation and change are spread broadly will require that all Americans, including those not yet engaged in or benefitting from the New Economy, have access to the tools and resources they need to get ahead and stay ahead.

As the economy has become increasingly volatile and knowledge-based, success for people, organizations, and entire communities is more than ever determined by the ability to learn and adapt. Government needs to counterbalance the tendency toward a new division of society around learning and skills.

As the economy churns--destroying some jobs while creating others--government needs to ensure that employee benefits are portable, that workers can access a state-of-the-art system of rapid re-employment, and that all workers have

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expanded opportunities for capital ownership. In a skill and knowledge-based economy, government must provide every American with access to continuous and affordable life-long education.

As information technology becomes an increasingly important driver of the economy (and a determinant of worker skill requirements), and as it becomes an increasingly vital tool for accessing information and participating in civic life, government needs to enable widespread access by ensuring that public libraries, schools, job centers, community centers, and all regions of the nation are connected to the Internet and that individuals have the skills they need to use these technologies.

### Rule #3: Invest in Knowledge and Skills

To spur innovation and equip citizens to win in the New Economy, government should invest more in the knowledge infrastructure of the 21st century: world class education, training and life-long learning, science, technology, technology standards, and other intangible public goods. These are the essential drivers of economic progress today.

In the new knowledge-based economy, over two-thirds of economic growth stems from technological innovation. But the knowledge economy is not only about expanding the frontiers of knowledge; it is about more effective use and implementation of all kinds of knowledge in all kinds of economic activity. In short, our competitive success stems from our capacity to innovate. Moreover, skills and learning not only drive economic growth, they increasingly determine individual opportunity.

But a global, hyper-competitive, fast-paced economy has made it increasingly difficult for the private sector to maintain its investments in these kinds of public goods, especially training

and mid- to long-term research. Moreover, publicly supported research is a key driver of economic growth. (Over 30 percent of U.S. patents are based on research supported by the public sector, and that share is increasing.) Therefore, government investments in science and technology should be increased, and private sector research should be encouraged through the R tax credit and support for collaborative R. In addition, in an economy where competitive success stems increasingly from shared industrial standards, government needs to support standards setting.

Finally, investments in education and training, including science and engineering education, are critical to ensuring that companies have the skilled workers they need to be productive, and that workers have the skills they need to navigate, adapt, and prosper in the New Economy.

#### Rule #4: Grow the Net

The Internet is a critical component of the emerging digital economy. In the old economy, the key driver of economic growth was mechanization of production, particularly in manufacturing and agriculture. In the New Economy, the key driver will be digitization (using digital information technologies to produce goods and services), particularly using the Internet and other information technologies in the service sector, which employs more than 80 percent of working Americans. The information technology revolution is transforming virtually all industries and is central to increased economic efficiency and productivity, higher standards of living, and greater personal empowerment.

Governments must avoid policies and regulations that would inhibit the growth of the Internet or slow progress by protecting business interests threatened by the digitization of the economy. Policymakers should craft a legal and regulatory framework that supports the

widespread growth of the Internet and high speed "broadband" telecommunications, in such areas as taxation, encryption, privacy, digital signatures, telecommunications regulation, and industry regulation (in banking, insurance, and securities, for example). However, they must do so in ways that are fair and responsible. Government can also help spur future growth of the Internet by co-investing in the information infrastructure, including the Next Generation Internet (NGI), a collaboration among more than 100 U.S. universities to develop networking and advanced applications for shared learning and research. The importance of the Internet also means that we must expand its reach to all Americans.

#### Rule #5: Let Markets Set Prices

In the old economy, government often regulated prices when national markets were dominated by oligopolies or monopolies. In those cases, the economic costs of government intervention were manageable, and sometimes necessary. But in the new, more competitive global economy, distorted prices are much more likely lead to economically inefficient decisions by consumers and producers and to unfair, politically driven resource allocation. Therefore, in the absence of clear market failures, markets, not governments, should set prices of privately provided goods and services.

In this critical transition period, as the old economy gives way to the New Economy, policymakers must embrace forward-looking, innovation-producing investments (e.g., industry-university collaborative R) while at the same time, distinguishing between programs that address legitimate market failures and industry subsidies that foster economic inefficiency. Government must focus on increasing investment in the foundation areas of the New Economy: technological innovation, education, and skills. At the same government must strive to reduce or eliminate the tariffs, unnecessary price regulations, and the array of

government protections that protect entrenched interests without increasing the economy's innovative or productive capacity.

Markets are a means, not an end in themselves, and they do not always work as intended.

Government has a responsibility to address the problems stemming from market failures, through such mechanisms as emissions taxes to reduce pollution or the R tax credit to boost research. Government must also safeguard democratic values of equal opportunity. Along with establishing rules to ensure fair competition, it must also support policies to ensure citizens have access to the information they need to make informed choices.

#### Rule #6: Open Regulated Markets to Competition

Economists have long acknowledged that competition keeps prices down. The New Economy creates another critical reason for competition: competition drives innovation, and ultimately provides the greatest benefits to consumers and citizens. Of course, government must continue to provide commonsense health, safety, and environmental regulations. However, government should move away from regulating economic competition among firms and instead promote competition to achieve public interest goals of lower costs, new products and greater consumer choice. For example, competition in the long distance telecommunications market has driven down costs and improved the quality of service for consumers. Likewise, the Federal Communications Commission's goal is to set rules to open telecommunications markets to robust competition and then step back and ensure network interoperability, universal service, and consumer protection. Through minimalist, yet consistent rules, public policy should also ensure that consumers have the information they need to make educated choices and provide a backstop to protect consumers and citizens from abuse in markets.

## Rule #7: Let Competing Technologies Compete

In the New Economy, technology is not just the province of Silicon Valley; it is the catalyst for profound change throughout the economy and society. Technological innovation has now become central to addressing a wide range of public

1 | 2 | 3

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to a

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Friend

Economy Task

About the New

Force

Economy Grow:

Making the New

An Action Agenda

Index

The New Economy

(Continued)

policy goals, including better health care, environmental protection, a renewed defense base, improved education and training, and reinvented government. For example, technology provides doctors and patients with state-of-the-art health information systems that improve the quality of care. Similarly, new generations of cleaner technologies can dramatically reduce pollution generated by industrial processes.

We should look for technology-enabled solutions to public problems, but not so that today's winners are frozen in place at the expense of tomorrow's innovators. As a case in point, in the 1980s the French government decided to provide free "Minitel" terminals to all French households. However, because the Minitel systems are incapable of supporting modern Internet technology, France now lags significantly behind in Internet usage. Similarly, some U.S. states have passed legislation locking in particular technical standards for the digital

signatures that allow individual authentication in electronic commerce. Given today's rapidly changing technological capabilities, locking in any particular technology through regulation or massive public investment would run similar risks.

**Rule #8: Empower People With Information** In the old economy, information was a scarce resource to which few outside of large corporations and governments had access. In the New Economy, constant innovations in ever-lower-cost information technologies have enabled increasingly ubiquitous access to information, giving individuals greater power to make informed choices. Governments should encourage and take advantage of this trend to address a broad array of public policy questions by ensuring that all Americans have the information they need as consumers and citizens.

For example, policymakers have required TV manufactures to install technology such as the V-chip to give parents tools to block objectionable programming from children. But the application of the principle of providing people with tools and information to make informed choices goes far beyond gadgetry. Policymakers could improve the quality of the health care in the United States by enabling consumers to have ready access to their own health records and more information about health care providers' track records. That type of transparency has long been one of the core strengths of our financial markets, where the Securities and Exchange Commission requires publicly traded companies to open their books so people can make educated investment decisions. Publishing on-time airline performance data has spurred an increase in airline efficiency, while requiring long distance telecommunications companies to publish information on pricing plans has helped consumers make better choices in a competitive telecommunications market. Similarly, publishing real-time environmental emissions information could lead to reduced pollution. Finally, making a wide range of

government information available over the Internet could lead to more open and accountable government.

#### Rule #9: Demand High-Performance Government

Government should become as fast, responsive, and flexible as the economy and society with which it interacts. The new model of governing should be decentralized, non-bureaucratic, catalytic, results-oriented, and empowering. In some cases government agencies should be transformed into Performance-Based Organizations (PBOs) that have both the accountability and flexibility to achieve publicly defined goals. In other cases, governments should let organizations, both public and private, compete to deliver public services.

When designing solutions to compelling public concerns, such as reducing industrial pollution or delivering world-class public education, government should hold organizations and individuals accountable for meeting goals, while allowing them flexibility to achieve those goals. In many cases, industry self-regulation can achieve public policy goals in ways that are more flexible and cost effective than traditional command-and-control regulation, while also enabling technological innovation.

For example, in the case of pollution, the government should set clear standards that protect health and the environment, but where appropriate, government should encourage companies to devise their own ways of meeting prescribed standards while maintaining credible monitoring to ensure that standards are indeed being met. Similarly, to improve the quality of public education, government should create incentives for schools to set high standards of achievement. But it should also give schools flexibility in how they implement programs and hold schools accountable for reaching standards, while encouraging parental

and community involvement in the education process.

Procedurally, governments should use information technologies to fundamentally reengineer government and provide a wide array of services through digital electronic means to increase efficiency, cut costs, and improve service. Digitizing government is the next step in re-engineering government.

#### Rule #10: Replace Bureaucracies With Networks

In the old economy, bureaucracy was how we addressed many major public policy problems.

In the New Economy, we must rely on a host of new public-private partnerships and alliances.

In the New Economy, boundaries of all sorts have blurred. In what has been described as "coopetition," companies are entering into partnerships and alliances of all forms. Direct competitors in one market may well collaborate on research and development in another market. Similarly, rather than acting as the sole funder and manager of bureaucratic programs, New Economy governments need to co-invest and collaborate with other organizations -- networks of companies, universities, non-profit community organizations, churches, and other civic organizations -- to achieve a wide range of public policy goals.

Compared to government, these organizations have a number of advantages. They are usually closer to the customer and tend to have greater capacity to solve problems because they can be more flexible, leverage additional resources, and face bottom-line pressures to boost performance. Yet public policy has only begun to explore the potential of bottom-up, decentralized networks assuming the lead role in solving pressing societal problems.

In short, many problems in the New Economy cannot be solved without government, but

government alone can't solve problems. Relying on collaborative networks does not mean that government should abdicate its policy responsibilities. It is dangerously naive to hope that private sector voluntary efforts alone will emerge in a sufficient scale to meet public needs. Rather, government needs to co- invest in these efforts and foster continuous learning through the sharing of best- practice lessons. Most importantly, the collaborative network model requires government to relax its often overly rigid bureaucratic program controls and instead rely on incentives, information sharing, competition, and accountability to achieve policy goals.

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1 | 2 | 3

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[Making the New](#)

[An Action Agenda](#)

[Index](#)

[The New Economy](#)