Department of Justice

THE DEREGULATION OF GOVERNMENT ENTERPRISE --

THE NEXT FRONTIER FOR REGULATORY REFORM

Remarks by

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Regulatory reform--"deregulation" to its strong proponents--and, more generally, the government's role in the economy is my topic. The past and present of deregulation must be ranked as one of Washington's best and brightest political topics. Today I would like to share with you some thoughts about new directions in regulatory reform.

Virtually all once and future social engineers seem to have written extensively on deregulation topics. Flushed with their recent air cargo and air passenger deregulation victories, critics of regulation are now zeroing in on other "federal protectorates." And many now wearing the golden chains of what former President Ford labeled "regulatory bondage"--the American Trucking Association, for example--are for their part reportedly marshaling their forces to convince the Congress that their particular regulatory briar patches--replete with institutionalized price fixing and market allocation--should most appropriately be viewed, Professor Galbraith has recently suggested, as a "particularly advanced form of free enterprise capitalism." 1/

Deregulation is a long-standing interest of the Antitrust Division. Until about five years ago, however, changing regulatory systems to permit more effective competition was not something that too many politicians took seriously. We were accused by our critics of trying to remodel the Alhambra with a blunt, indiscriminate steam shovel.

Deregulation gained substantial respectability when former President Ford in August, 1975, declared as a presidential objective getting the federal government "as far out of your business, out of your lives, out of your pocketbooks, and out of your hair as I possibly can." 2/ What gave this presidential statement special importance were its timing and context. For at the same time that more elected and appointed officials than just the head of the Antitrust Division began talking about deregulation, the country was undergoing substantial economic and political and sociological changes.

Five years ago, for example, the country's unhappy and very expensive Vietnam experience was coming to a close. That was also the era of the great Arab Oil boycott. After a period of energy abundance, the first glimmerings of dependence confronted consumers who wheeled their two-ton, 400-horsepower Chevrolet Impalas up to the gas pump only to discover that the energy cornucopia was ms momentarily--they hoped--quite empty. Late 1974 and early 1975 also saw the resurgence of apparently ineradicable inflation. We began to count the costs of an expensive war, and at the same time adopted dozens of new social and regulatory programs, most of them very worthy, most very well-meaning, but none of them being very inexpensive. Federal, state and local tax levies rose, along with prices across the board. And public disenchantment with traditional institutions grew geometrically as the political scandals of the era unfolded.

Professor Kissinger has talked of how an essential part of growing up is learning one's limitations. 3/ Don McLean's song "[b]ye bye Miss American Pie," summed up the new realism, with its lines about driving Chevies to the levee "but the levee was dry," and catching "the last train for the coast, the day the music died."

In short, a lot of traditional music and conventional wisdom died very quickly in late 1974 and 1975. Understandably, in those years, criticism of so familiar and, frankly, so easily criticized an institution as traditional economic regulation, struck responsive chords.

The election of President Carter in 1976 was in part attributable to considerable public enthusiasm for new political leadership with ideas grounded in the new realism. The Carter Administration was elected on a platform that included reasonable and achievable goals on the regulatory front, a commitment to reduce the level, intensity, cost, and confusion evident in many regulatory programs.

Where are we now in respect of deregulation? I think that a fair reading of the record over the past two or so years will demonstrate that at least four important things have been accomplished, offering hope for a meaningful future for deregulation.

First, we have at least capped trends that until 1976 were proliferating new federal and usually regulatory agencies.

Congressman Lee Hamilton of Indiana has estimated, for example, that between 1960 and 1975, more than 50 new regulatory agencies and programs were created. 4/ Important laws were passed to promote consumer product safety, to improve environmental quality, to regulate commodities future trading, to ensure highway safety, to govern the hunting of marine mammals, to protect endangered species, to regulate the disbursement of copyright royalties, and so forth.

Americans like to boast of this country as being the last bulwark of competitive free enterprise. But by 1976, about 46 percent of the entire economy had, according to various estimates, become subject to direct federal regulation of varying degrees of intensity. In terms of direct out-of-pocket costs, this proliferation of new regulatory programs in part accounts for the rapid growth of federal expenditures, from $110 billion in 1963 to about $500 billion by 1978.

Second, the Administration proposed and then strongly and persistently supported legislation that actually rolled back economic regulation to a significant extent. The air cargo and air passenger deregulation acts passed in 1977 and 1978 were major accomplishments.

The Carter Administration, as a third accomplishment, then pushed through necessary, if not always popular, requirements that at least Executive branch regulators make some effort to consider the economic impact of proposed regulations. The

Council of Economic Advisers and the Council on Wage and Price Stability recently have come under criticism, unfairly I think, for, among other things, asking regulators do what every family in this country does already and without giving it much thought: ask how much something new will cost and consider whether there may be less costly availble alternatives.

Fourth, the Administration, by proposing what is in fact something of an austerity budget, has succeeded in persuading the public and the Congress, as well as the bureaucracy, to start thinking in terms of priorities. Setting priorities means that not everyone and everything will simultaneously be invited to the budgetary dinner. A new sense of fiscal responsibility will clearly affect the extent to which and the ways in which government involves itself in new activities.

I said at the outset that in some senses Republican Gerald Ford was responsible for making regulatory reform a bipartisan and respectable political topic. In addition to backing up some of this rhetoric with solid accomplishments, Democratic Jimmy Carter has managed to make it easier for liberals to talk about fiscal responsibility without feeling uncomfortable.

In summary, then, the deregulation movement has some solid progress to show for its effort, and considerable Administration and congressional momentum now exists.

If this is where we are now, then we must examine where, or as Mr. Lincoln put it, "whither are we tending?" As for traditional forms of "single line" economic regulation, I think the most accurate appraisals project some continuing regulatory reforms. Justice Brandeis wrote in 1914 that "Sunlight is said to be the best of disinfectants; electric light the most efficient policeman." 5/ I expect that in the surface transportation field existing truck, train, and maritime regulation will simply have to change to allow more effective competition given that we now have the light, and the positive experience, of the air transportation reforms.

Cartels and their management are fragile institutions in many ways. Cartel members rarely miss the chance "to chisel" on each other--a phenomenon also known as price competition. Rigid regulatory systems usually have a hard time adapting when confronted with technologically diversifying supply and increasingly pluralistic demand forces. The one thing that is not good at all for cartels or their management is the emergence of competitive yardsticks by which their performance can be readily measured. In line with our traditions in this area, the Antitrust Division will be trying to encourage, indeed, to accelerate, existing trends to more competition in all of these surface transportation sectors.

Another long-standing and conventional system of economic regulation whose present form will surely be substantially modified is the system set up by the 1934 Communications Act. The present regulatory and, indeed, private cartel arrangements familiar to most students of the telephone and television markets do not appear to be very stable or very sustainable for the future. This probability of change to facilitate more free play of existing competitive forces has to be enhanced by the fact that now both Senate and House Communications Subcommittees have committed themselves to enacting new, procompetitive legislation.

If we now have a realistic and efficiency-oriented White House; and a progressive Congress; and the deregulation building blocks for the future assembled--does this mean that we have reached the deregulators' free-market Nirvana? Is it just a matter of time? Not quite. There are some trends that point in the opposite direction--toward more, not less, government involvement in the economy.

Professor Walt Rostow, for example, has predicted increased government intervention, both because of the nature of some of the problems we confront, and because of the increasing politicization of important economic issues. 6/

For more than a decade now, or really since early Rachel Carson, environmentalists have been arguing that our economic calculus must take into account externalities, particularly environmental impacts and costs. There is no basic disagreement among policymakers that air and water pollution, for example, should be contained and reversed. There is substantial disagreement, however, whether this should be achieved by conventional kinds of regulatory directives, as well as, of course, whether conventional approaches are most cost-effective. Professor Alfred Kahn and others have argued that there are alternatives to conventional approaches in this area. Pollution taxes are one alternative. Whatever the merits of the debate, it is important to remember at least the basic point--the kind of regulation we choose to pursue important social goals has significant implications for the efficient operation of our economy.

Another factor puts the issue of less governmental involvement in doubt. One must take into account the reality that basic resource allocation and economic issues are becoming increasingly political issues. Senator Patrick Moynihan has suggested that this is the inevitable consequence of an already large and intrusive government establishment. As the government is increasingly the dispenser of all desirable goods and benefits, he has argued, groups within society will coalesce at a geometric rate, basically for the purpose of lobbying the government to secure their rightful share of federal goodies.

Professor Robert Lekachman has advanced a parallel, perhaps reinforcing explanation for the increasing politicization of economic issues. There are, of course, two parts to the traditional economic equation: first, the overall size of the economic pie, and second, the distribution of particular slices. In the post-World War II era of some seemingly inexhaustible economic abundance, economists of virtually all political persuasions tended to focus their attention on simply keeping the economic pie--the Gross National Product--steadily and rapidly growing. When the economic pie, however, ceases to grow or to grow as quickly; or the available pie either does or is perceived to be actually shrinking; at that time, of course, distributional economics tend to move from second to first place as a matter of priorities.

Whether we are currently in a growing, static or shrinking economic pie situation politically may be less significant than how the public perceives the situation. There is little question but that a significant portion of the public in fact perceives the United States as having achieved or exceeded the limits of economic growth. As a consequence, more attention has been paid to ensuring that "the public" will continue to be able to get all that it wants, often at administered, not market-determined prices. Much of the controversy that has swirled about the energy field for the past decade provides ample evidence of this political phenomenon.

If the nature of certain problems, too ready acceptance of direct regulatory "solutions," and the growing politicization of resource allocation decisions do not drive the government to intervene more actively in the general economy, there is yet another trend that may tip the balance. That is the trend toward straight government enterprise, the government as businessman in the marketplace. This phenomenom would seem to be a next logical step for deregulatory attention.

Robert Heilbroner has argued that there are three relatively distinct stages observable in government policies toward the economy, always tending toward greater government responsibility, and it has been suggested that we are moving toward or have already entered the last of these stages. Initially, of course, the federal government tended to follow a policy of actively promoting certain kinds of presumptively desirable private sector activities. In 1862, for example, Congress gave some 131 million acres of public lands, not to mention substantial subsequent loan guarantees, to the railroad industry. The explicit purpose of these very substantial public subsidies was to promote the wider availability of rail transportation services.

Following the active promotion efforts, the government undertook to secure the reasonableness of the terms under which these presumptively desirable "quasi-public" services were made available to the public. The manifestation of this second stage is the Interstate Commerce Commission, established in 1887, and that regulatory agency's familiar and abundant New Deal progeny.

Heilbroner calls the third stage of federal economic involvement the "guarantor" stage--also known as the "bail-out" imperative of Lockheed, New York City, Conrail, and Amtrak experience. Because the services involved are quasi-public and provided by virtue of public grants, the argument is advanced, the government must affirmatively act to ensure the reasonable availability of services. This should be accomplished, it is argued, through loan guarantees, direct subsidies, special statutory "trust" or other forms, public corporations, and so forth.

At this point, we must confront a basic question. The chief rationale buttressing reliance on the profit motive is that profits are a necessary compensation for competitive market risks. If there is little or no competition, and, by virtue of federal guaranty programs, firms are shielded from market risks, the justification for profits tends to evaporate. Or, put differently, the question tends to arise as to whether the shielded and guaranteed firm should not just be nationalized, as responsible economists including Professor Galbraith have quite candidly suggested. 7/

At present, some 40 percent of the electrical generating and distribution enterprises in the country function under some kind of public ownership. The Department of Agriculture currently has some $3 billion in subsidized loans outstanding to the Nation's telephone industry, and a substantial number of the "Rural Telephone Bank" customers are not eleemosynary cooperative ventures. The U.S. Postal Service, a wholly owned federal service "establishment" has annual revenues of about $18 billion, or slightly above those of IBM. This organization, which has yet to adapt its commercial operations to accommodate cash registers, incidentally, is currently considering spending some $2 billion in public monies to diversify into electronic computer-related communications.

In addition to the $70 billion in interstate highways--an expenditure that has inured to the benefit of the motor carrier and bus industries--the federal government in 1974 approved some $2.2 billion in grants and guaranteed loans to the railroads--Amtrak and Conrail essentially. Parallel to the almost _de facto_ nationalization of significant parts of the rail business, the government has made something like an $11.8 billion commitment to urban mass transit--services that until fairly recently were largely private sector offerings.

Exact figures respecting the Defense Department's "non-appropriated fund" activities tend to be fairly obscure. It has been suggested, however, that through a nationwide network of grocery, variety, and liquor stores, supplemented by night clubs, golf courses, and miscellaneous leisure activities, sufficient revenues are aggregated to rank the Defense Department as something between the fourth and seventh largest of the country's retailers.

That the federal government is heavily into what we all thought was "private enterprise" should come as no great surprise. But much more surprising is the intensity with which the trend toward more government involvement in the marketplace is fostered by private business itself.

For example, in arguing for reform of traditional economic regulatory schemes, the Antitrust Division and others increasingly are confronted with a sort of "buy-out" proposition. That is, the industry will acquiesce in "deregulation" if, for its part, the government will afford the industry various special funds to, in theory, cushion the transition to a fully competitive marketplace environment. Usually, this "buy-out" is advanced only after the industry has perceived that deregulation is inevitable. Prior to that time, various "equities"--essentially capitalized monopoly rents--are advanced as reasons for doing nothing.

In the case of some regulated industries, obviously, these equities can be very substantial. In 1977, for example, the Council on Wage and Price Stability submitted to the ICC an economic analysis of the dollar value of trucking certificates. In one instance surveyed, certificates bought for $770,000, when they were then sold an average ten years later, yielded $3.8 million. 8/ Even more flamboyant dollar amounts commonly are advanced by the National Broadcasters Association at the first whiff of possible FCC licensing policy changes, or potential cable television competition.

The enormous dollar volumes apparently secured by the regulatory status quo in many industries helps explain why deregulators traditionally have had to fight primarily with the regulatees as we endeavor, as President Ford suggested, to "free them from regulatory bondage." Professor Stanley Besen at Rice has even postulated his own "transitional equities" rule, "that the more screwed-up any given regulatory system, the less likely legislation to reform it, since the costs of moving to an economically sound system will be the highest."

Viewed in the context of what appears to be steadily encroaching government enterprise, the policy implications of the present "guarantor" convention are fairly obvious. To the extent that such "equity" arguments may find political acceptance, the role of the government in the economy--given the other factors that I have mentioned--seems at least potentially likely to increase.

From the standpoint of antitrust policy, the implications of potentially expanded government enterprise are also relatively clear. We depend on the price and profit systems, for example, to stimulate the flow of investment in the "right" directions. The traditional assumption has been that in an effectively competitive market, price will tend to align--more or less--with marginal cost. Firms in the market will be assisted by consumers' signals--the prices they are willing to pay--in making their resource allocations. Similarly, firms outside a market but considering potential competitive entry will tend to be guided by their comparing prevailing prices to what they believe will be the costs of new entry.

The pricing signals generated in many businesses are imperfect signals at best. We rely on them generally, however, to accurately reflect, for example, the underlying scarcities associated with an offering, and thus to encourage private acts of investment, conservation, and the generation of new technologies.

Pricing signals can be skewed by government actions as in energy, where prices have been driven to artificially low levels.

Or as in ocean shipping, where demand appears to have been artificially suppressed by government actions aimed at maintaining overly high prices.

While traditional regulation _may_ affect the integrity and accuracy of pricing signals, the presence of substantial _de facto_ or _de jure_ government enterprise in an industry almost certainly _will_ result in skewing the signals. This is because it has proven exceedingly difficult for politicians and bureaucrats, when the government owns a particular enterprise, not to manipulate the prices charged by such an enterprise for a variety of usually well-meaning purposes. It is because government enterprises either cannot, or are not allowed to determine prices based on commercial realities that what have been labeled "islands of chaos" tend to materialize and persistently throughout centrally planned economies.

The companion loss which government enterprise typically entails is the loss of the discipline inherent in private, effectively competitive markets. Promises, special institutional arrangements, and public commitments notwithstanding, it is a fact of present life that even the most inefficient and wasteful of government enterprises will never lose. For such enterprises have access, of course, to sources of capital and day-to-day financial nourishment quite independent of their commercial operations. Indeed, as OMB Director James McIntyre has noted, there are apparently only two known examples of government enterprise that ever actually went out of business. First, we no longer manufacture rum in the Virgin Islands. And, second, we no longer run horse-breeding farms for the U.S. Cavalry. In short, government enterprises generally appear to have adverse impacts on the pricing mechanisms we ordinarily depend on for resource allocation, impacts similar to those associated with "simple" regulation. In respect of the government enterprise alternative, however, the skewing effects are much more probable, and when they appear, probably more severe.

A long-run loss associated with government enterprise is a decrease in public accountability. Precisely because a particular public authority is acting on behalf of a generalized "public interest," it may cease to be subject to laws that govern the rest of the marketplace--disclosure, antitrust, sometimes even health and safety measures. Service of the public interest at large leads to avoidance of public responsibility.

In critizing government enterprises as a concept, I do not mean to slander those enterprises that we already have. Many of these serve valuable nonmarket-related purposes. One can without being inconsistent, however, acquiesce in the face of existing enterprises and still be strongly opposed to many more.

To summarize--whither are we tending on the deregulation front? First, we have made significant strides in cutting back traditional forms of economic and related regulation, and in the process, we have secured very real consumer dividends. I expect that there will be in the nearer term significant changes in the ways in which we now regulate surface transportation and telecommunications, for example.

Second, however, while we appear to be winning the war against traditional forms of economic regulation, we may not be doing so well when it comes to new multipointed regulatory systems. In those sectors, we seem to be seeing more government involvement. Those special forms of involvement that entail government enterprise have very substantial policy implications and provide, I believe, new opportunities for constructive deregulatory activity.

What should we be doing in these new areas? In more traditional regulation, the literature is comprehensive, the case for deregulation, compelling. Yet we still only dimly know the implications of government enterprise as a form of involvement in the marketplace. In this new area, much of the basic analytical work has yet to be done. We at the Division are beginning that effort to focus the Brandeis sunshine on the uncharted phenomenon of the government as a direct participant in the marketplace.

The bottom line lesson of regulation is that we should be exceedingly careful before leaping forward with new and innovative regulatory solutions, especially those that too easily discard the benefits of an efficiently functioning marketplace. The best ideas today may prove inadequate or debilitating in much less than a single generation. As policy-makers examine new regulatory systems and their cost effectiveness, and consider in particular the competitive implications of more government enterprise, they ought to take to heart the words of Jeremy Bentham, not usually thought of as one of your leading free enterprise proponents. His advice--when it is suggested that the government affirmatively displace the private sector to make things better, perhaps the guiding rule for government should be to "Do nothing, keep quiet."

FOOTNOTES

1/ See J. K. Galbraith & N. Salinger, Almost Everyone's Guide to Economics (Boston: Houghton Mifflin & Co., 1978) at p. 67.

2/ Remarks of the President Before the American Hardware Manufacturers Association, August 1975, quoted in Duffy, Domestic Affairs, supra at p. 272.

3/ Bill Moyers' Journal, "An Interview with Henry Kissinger," telecast Thursday, January 16, 1975, WETA, Washington, D.C.

4/ See 123 Congressional Record H9809-10 (1977), quoted in Duffy, Domestic Affairs, supra, at pp. 269-70.

5/ Other People's Money, (1914) at p. 92.

6/ See W. W. Rostow, Getting from Here to There--America's Future in the World Economy (New York: McGraw-Hill Books, 1978) at p. 36.

7/ See, e.g., J. K. Galbraith & N. Salinger, Almost Everyone's Guide to Economics (Boston: Houghton Mifflin Co., 1978) at pp. 57-63.

8/ See Stephen M. Aug, "ICC Policy Called Costly to the Public," Washington Star, June 7, 1977, p. B-5.