The Benefits of Deregulation

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by Murray Weidenbaum

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The deregulation of American transportation, telecommunications, energy, and financial markets over the past 10 years has been a triumph of ideas over entrenched political interests. For 90 years—from the establishment of the Interstate Commerce Commission in 1886 to the passage of the Toxic Substances Control Act in 1976—government regulation of American economic activity continuously expanded, and created in its wake powerful constituencies who benefited from the regulation.

Yet this trend in government rule-making has changed dramatically and perhaps irrevocably during the past decade, resulting in remarkable benefits for the American economy. Deregulation has lowered the cost of producing goods and services. It has offered a wider array of choices to the American consumer. And it has substantially bolstered the international competitiveness of our economy.

What caused the shift toward deregulation was not a realignment of political forces. The most significant developments were supported by a bipartisan coalition in both the legislative and executive branches of the federal government. Consumer activists such as Ralph Nader offered support at vital points, as did leaders of both political parties, including Presidents Ford and Carter and Senator Edward Kennedy. But the most important role was played by a very unusual

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set of actors in the public policy arena: economists, political scientists, legal scholars, and similar purveyors of ideas.

Intellectual Support

Three streams of economic research and policy analysis dealing with different aspects of regulation reached a confluence in the early 1970s. The first, and most substantial, focused on the heavy and widely distributed burdens that economic regulation imposed on the economy, especially in the field of transportation, and the smaller and far more concentrated distribution of any resulting benefits. The second research effort dealt with the fundamental nature of the regulatory process, especially the relationships between regulators and those regulated. The third area of research focused on the general costs of regulation, especially to the consumer.

It is difficult to pinpoint the exact start of the influential research that led to transportation deregulation, but *The Economics of Competition in the Transportation Industries,* written by John R. Meyer, et al. in 1959, was a landmark study. Important work followed on each of the major modes of transportation, notably George W. Douglas and James C. Miller, III on airlines, and Thomas Gale Moore on trucking.

The airline industry provided the clearest examples of the heavy cost of regulation, particularly the price differences for trips on regulated and non-regulated airlines. Interstate travel was under the jurisdiction of the Civil Aeronautics Board (CAB); intrastate travel was beyond the CAB's purview. Research found that a traveler could fly 500 miles from San Diego to San Francisco in the unregulated California market and pay less than someone flying 300 miles from Portland, Oregon to Seattle, Washington under the CAB's control.

Most American economists writing in this field also had concluded during the 1970s that Interstate Commerce Commission (ICC) regulation was protecting the carriers (railroads, truckers, and their unions) while increasing costs to shippers by billions of dollars a year. Comparable studies were made of other regulated industries, such as radio, television, and utilities.

A consensus gradually emerged. Transportation regulation in the United States did not protect its purported beneficiaries, consumers, but instead was designed to benefit the employees, executives, and shareholders of the companies being regulated. Government rule-making shielded entrenched firms from potential new competitors and kept a high price umbrella over the regulated industry.

Transportation regulation did not protect consumers, but instead benefited the employees, executives, and shareholders of the companies being regulated.

The second, and related, stream of research focused on the political efforts of interest groups that benefited from regulation. Political scientist Marver Bernstein presented in 1955 a basic "capture" theory of regulation. As the only political force in the regulatory agency's environment with any stability, the industry eventually forced the agency to accommodate its needs. George Stigler and Sam Peltzman generalized this theory, contending that regulatory policy reflects the interests and the power of the concerned groups, not necessarily the consumer's. In 1982, Stigler was awarded the Nobel Prize in Economics for his seminal articles on the theory of regulation and his empirical studies of the effect of regulation on specific industries.

The third line of research—focusing on costs to consumers—saw the topic move from the business pages and academic journals to the front pages and the nightly news. The American Enterprise Institute (AEI) led the way in the mid-1970s with several widely cited reports on the high cost of regulation, among them my own *Government-Mandated Price Increases*, Sam Peltzman's *Regulation of Pharmaceutical Innovation*, John P. Gould's *Davis Bacon Act*, and Rita Ricardo-Campbell's *Food Safety and Regulation*. In 1977, AEI began publishing a bimonthly journal, *Regulation*, that is devoted entirely to government rule-making. The issue hit a responsive chord with the media, influential policy groups, and finally the Congress.

Deregulation gave policy-makers an opportunity to curb escalating inflation without trading off jobs.

A few simple concepts made the issue attractive. Deregulation presented policy-makers with an opportunity to curb escalating inflation in a way that did not involve a tradeoff with jobs. Indeed, reduced regulation would cut both costs and barriers to production and employment.

The burdens of regulation were characterized as a hidden tax on the consumer ($63 billion in 1976 for a sample of federal regulatory programs, according to estimates by Robert De Fina and me). This cost increase was buried in the form of higher prices but it was very real and often regressive.

Cost-benefit analysis—which had been used to screen out clearly uneconomical expenditure projects for decades—also proved to be useful when applied to regulation. Although the implementation required dealing with many difficult conceptual and statistical problems, the general notion of weighing costs against benefits generated a positive reaction.

Carefully researched examples of regulatory silliness brought these concepts to the public's attention. Perhaps the first was the dead haul—the numerous requirements that resulted in trucks returning empty from delivery even though there was ample opportunity to fill them with cargo. The public needed no great expertise in industrial organization to resent the waste that resulted.

This unusual form of applied research concentrated increasingly on the Occupational Safety and Health Administration. OSHA jokes (based on that research) became a staple of business conversation. Is it true that OSHA made one company build separate "his" and "her" toilets even though the only two employees of the firm were married to each other? Did OSHA really issue a bulletin to farmers telling them to be careul around cows and not to step into manure pits? Both of those questions could, quite accurately, be answered in the affirmative.

By the late 1970s, support for regulatory reform had become widespread. It included business executives who found themselves inundated with a flood of rules to follow and reports to file, lawyers and political scientists who thought that the regulatory agencies often were captured by the regulated industries, and economists who believed that regulation reduced competition and increased costs. Congressional hearings on the subject yielded support for less regulation from such disparate groups—and surprising allies—as the American Conservative Union and the Consumer Federation of America.

Ten Years of Progress

Progress on deregulation built up slowly but gathered strong momentum in the mid and late 70s. In 1968, the Supreme Court decision permitted non-AT&T equipment to be hooked into the Bell telephone system. In the following year, the Federal Communications Commission (FCC) allowed a non-Bell company to connect its long-distance network with local phone systems. Although these two actions attracted little attention at the time, they triggered the forces that led to the breakup of the Bell system.

In the 1970s, interest rates on deposits of $100,000 and over were deregulated. Again, one move toward deregulation ultimately led to another. As securities firms took advantage of that "loophole," banks responded. A process was set in motion that has resulted in the lifting of interest rate ceilings, the payment of interest on consumer demand deposits, and greater competition among financial institutions.

Two important regulatory changes took place in 1975. The Securities and Exchange Commission (SEC) ordered an end to the practice of fixed brokerage fees for stock market transactions, and the ICC prohibited rate bureaus for both trucking firms and railroads from protesting independent rate filings by members. Clearly, the regulatory ice was breaking.

In 1977, the Civil Aeronautics Board (CAB), led by two economists, chairman Alfred Kahn and member Elizabeth Bailey, instituted several changes that ultimately led to deregulation. The CAB gave airlines increased freedom in pricing and easier access to routes not previously served. The results were spectacular. Fares for tourists fell sharply, planes filled, and airline profits soared. The CAB experiences provided a striking example of how regulation had been hurting the traveling public; in response, a bipartisan coalition in Congress passed legislation in 1978 that phased out the CAB and its authority to control entry and prices.

The year 1980 was an eventful one for deregulation. The FCC eliminated most federal regulation of cable television. Economist Darius Gaskins became chairman of the ICC and economist Marcus Alexis was appointed a member of the Commission. That, in turn, "encouraged" the trucking industry to support congressional leadership of reform in this field, in the expectation that the results would be less

LANDMARKS IN DEREGULATION

1968	Supreme Court permits non-AT&T equipment to be hooked up to Bell System.
1969	MCI is allowed to connect its long distance network with local phone systems.
1970	Interest rates on deposits of $100,000 and over are deregulated.
1972	FCC sets domestic satellite open skies policy.
1975	SEC ends fixed brokerage fees for stock market transactions.
	Rate bureaus for trucking firms and railroads are prohibited from protesting independent rate filings.
1977	Air cargo is deregulated; airlines are given more freedom in pricing and easier access to new rates.
1978	Congress partially decontrols natural gas.
	OSHA revokes 928 "nitpick" rules.
	CAB is phased out, ending its control over airline entry and prices.
	EPA begins emissions trading policy.
1980	FCC eliminates most federal regulation of cable TV and of consumer premises equipment.
	Motor Carrier Act removes barriers for new entries and lets operators establish fares and routes with little ICC interference.
	Depository Institutions law phases out interest rate ceilings and permits S&Ls to offer interest-bearing checking accounts.
	Staggers Rail Act enables railroads to adjust rates without government approval and to enter into contracts with shippers.
1981	President Reagan decontrols crude oil prices and petroleum allocations.
	FCC eliminates much radio regulation.
1982	New bus regulatory statute allows intercity bus companies to change routes and fares.
	Garn-St. Germain Act allows S&Ls to make more commercial and consumer loans and removes interest rate differentials between banks and S&Ls.
1984	AT&T agrees to divest local operating companies as part of antitrust settlement.
	Individual ocean shipping companies allowed to offer lower rates and better service than shipping conference.

drastic than desired by the ICC. Later in the year, a new trucking law provided much more pricing freedom to individual truckers, made entry into the market much easier, and eliminated many costly ICC restrictions—but the ICC presence was retained. Also passed in 1980, the Staggers Rail Act gave the railroads new pricing freedom.

In 1981, the executive branch took the lead on regulatory reform. Building on the groundwork of the Ford and Carter Administrations, President Reagan issued a new executive order directing the regulatory agencies under his jurisdiction to perform cost-benefit analyses prior to issuing new rules. A formal review process was placed under the auspices of the Office of Management and Budget. Also, a hold was placed on the numerous "midnight" rules that the Carter Administration had tried to rush through in its final weeks. As a result of these efforts, the rapid rate of regulatory issuances in the 70s substantially decelerated in the 80s.

Progress toward deregulation was made in other areas as well. The FCC eliminated much regulation of the radio industry. President Reagan decontrolled crude oil prices and petroleum allocations, and quietly terminated the Council on Wage and Price Stability.

But the pace of deregulation slowed significantly after 1981. Although regulatory reform was one of the four original pillars of Reaganomics (along with tax reduction, budget cutting, and anti-inflationary monetary restraint), it never received as high a priority as the other three. A backlash in the environmental area (fueled in part by the controversial personalities of some of the Administration's appointees) put the entire regulatory reform movement on the defensive.

Nevertheless, progress continued to be made. Banking legislation enacted in 1982 allowed savings and loan associations to make more commercial and consumer loans.

The interest rate differentials between banks and thrift institutions also were removed.

The Bus Regulatory Reform Act of 1982 permitted bus companies to change routes and fares. In 1984, the Shipping Act enabled individual ocean shipping companies to offer lower rates and better service than shipping "conferences." Also in that year, AT&T agreed to divest local operating companies as part of its historic antitrust settlement in the Justice Department.

In one key area—the regulation of foreign trade—substantial backsliding has occurred. Since 1981, the Reagan Administration has renewed or extended restrictions on the import of automobiles, meat, motorcycles, sugar, steel, textiles and many other products. Simultaneously, control over exports—often justified on foreign policy or national security grounds—has been tightened. The Administration does not seem to understand fully that deregulation is a concept as relevant to foreign trade as it is to the domestic economy.

In environmental and safety rule-making, wholesale deregulation has not been the reformers' goal. The emphasis here has been on relating the costs of regulation to their benefits and thus reducing the economic burdens of the regulatory process. Responding to the critics of its regulatory approach, OSHA eliminated or modified 928 of its "nitpicking" rules. EPA experimented with "bubble" and "offset" policies designed to give companies more flexibility in complying with environmental standards.

In the case of OSHA and EPA policies, the courts have often been barriers to the adoption of more economically efficient regulations. For example, in 1981 a federal court ruled out cost-benefit tests performed for a proposed cotton dust standard because it held that the law did not provide for basing OSHA rulings on economic criteria. Nevertheless, the increasing support for reviewing the costliness and desirability of proposed new regulations—an approach started by

President Ford, continued under President Carter, and expanded under President Reagan—has clearly slowed down the pace of federal rule-making.

Consumer Protection

The general impact of deregulation on the American economy has been extremely positive. Diminished government intervention has expanded the role of competition and market forces. Virtually every study of the changes has concluded that the results have been lower costs, increased demand, and new opportunities for both producers and consumers of the previously regulated activities.

In the case of airlines, competition has been especially rigorous; 26 new carriers entered between 1978–85 and 19 have exited. This has exerted great downward pressure on labor and overhead costs. Airline productivity has risen, average air fares have declined and volume is sharply up. The number of city pairs served by more than one airline increased by 55 percent from 1979 to 1984. While some passengers no longer have direct flights, the proportion of passengers changing planes actually decreased from 27 percent in 1978 to 25 percent in 1984.

Moreover, despite several highly-publicized crashes and near-misses, the overall record of airline safety has improved since deregulation. The accident rate declined 26 percent—from the average during 1972–78 of 2.35 accidents per 100,000 flight hours to 1.73 per 100,000 hours during 1979–86.

A few negative results have also occurred. The recent tendency for airline consolidation was not expected by many advocates of deregulation. As of the middle of 1987, a handful of the major trunklines was coming to dominate air traffic and passenger complaints about flight delays and lost luggage were rising. The structure of the industry is still evolving, and the long-term effects of the

merger movement on price and service have yet to be determined by the newly-unleashed competitive forces. Moreover, airlines remain subject to the scrutiny of the federal government's antitrust authorities.

For the railroads, revenue per ton-mile (a good measure of unit cost) has been declining in recent years while volume (total ton-miles) and operating income have increased. In the case of trucking, comprehensive data are harder to come by. Nevertheless, 65 percent of a large sample of shippers recently reported lower trucking rates and improved services. The number of new firms entering the industry has far exceeded the loss of older companies. The number of ICC-authorized carriers increased from 18,000 in 1980 to 33,000 in 1984.

Reduced regulation—ranging from outright deregulation to simplification and streamlining of rule-making—has enabled the competitive process to work better. Depositors in financial institutions have been receiving higher returns on their money, as a greater variety of companies compete for their business. Long-distance telephone users find that greater competition has resulted in lower rates, while subsidies to local service have been eliminated.

Inevitably, the wrenching changes brought about by deregulation have generated counter-pressures from interest groups that have lost government protection. Managers of many deregulated firms have seen their pay and perquisites decline to the competitive norm. Some companies have been unable to survive in the new competitive environment and have gone bankrupt or have been acquired by stronger firms.

But, clearly, the economy as a whole has benefited. All economic reform involves transitional costs, which often seem to outweigh the benefits at first. Deregulation's scorecard, however, has shown nothing but pluses from the start.

The public interest would be served by another wave of economic deregulation and by renewed emphasis on reducing the burden of social regulation. In the area of economic deregulation, the Interstate Commerce Commission and the Federal Maritime Commission should follow the CAB into the graveyard for regulatory commissions. The consumer would be far better protected by competitive forces in the marketplace. Also, the remaining vestiges of energy price regulation should be repealed, along with the various quotas on imports. Restrictions on exports should be reduced only to instances that truly involve the national security.

Simultaneously, a fundamental revision of the statutory framework for social regulation should be undertaken. Unreasonable goals (such as "zero discharge") and unrealistic timetables (such as those governing gasoline usage) should be modified or, better yet, eliminated. Much more use should be made of market-based approaches, such as effluent fees in lieu of detailed "clean" water regulations.

Perhaps the most fundamental need is to help the public understand the limits of government rule-making. Even if it were staffed entirely with Newtons and Einsteins, the Consumer Product Safety Commission could not effectively regulate the 2 million companies producing the 10,000 products within its jurisdiction—nor could the Environmental Protection Agency clean any significant portion of the water, air, and land in and around the United States. The need is not for greater compassion, commitment, or technological expertise—those we have in abundance. What is required now is the willingness and the courage to make difficult choices among the many alternative demands for government regulation of private activity.