1984

Review of Studies in Public Regulation, by G. Fromm

Frank J. Navratil
John Carroll Univ, navratil@jcu.edu

very nicely. However, an econometrical model developed to quantitatively test the de-industrialization hypothesis, while confirming it, finds that the absolute effect is very small (p. 132). Beenstock feels that the model may not be sophisticated enough to make a full evaluation, but he concedes that the results do not "rule out the importance of other theories either as complements or substitutes" (p. 129).

In some ways the last half of the book is the more appealing part, especially to those with a bent toward economic history. It is here that the author provides a marvelous critique of alternative theories to explain changes in the structure of the world economy. The contributions of Kondratieff, Schumpeter, Kuznets, Rostow, and the Club of Rome are all found to be inadequate explanations for the observed facts. An excellent chapter on the British Climacteric, 1860–1900, applies the transition theory to what the British call their Great Depression, and the evidence is supportive. Thus, the present structural developments, it is argued, are not new. There is precedent in the past for these current changes. In a sense, the present finds its microcosm in the core British economy of the 19th Century and the periphery of development in the U. S., France, and Germany. Still another good chapter examines the relatively poor economic performance of the U.K. since 1950 and concludes that the transition theory is useful in predicting the secular trends. The author, however, grants that labor institutions, monetary policy, North Sea oil, and other short run developments might have provided a mix of the truth along with the structuralist theory.

This book accepts de-industrialization in the west as a fact and offers a theoretical explanation for why and how it occurred. There are a number of prominent American economists, however, who have recently argued that de-industrialization is not a significant aspect of the U.S. economy. Charles Schultze [2], Barry Bosworth and James Tobin [1], among others, have pointed out that the nation's manufacturing sector typically declines proportionally more than the economy as a whole during a slump, and that recovery of this sector needs merely a vigorous expansion. These economists make an impressive case for the fact that the condition of the U.S. industrial sector is quite understandable in terms of inappropriate monetary and fiscal policy, and, thus, that an "industrial policy" designed to cope with a sick sector is not necessary. Beenstock obviously has a different perspective — one that suggests that the industrial changes of the last decade are likely to be permanent and far reaching.

Clair E. Morris
U.S. Naval Academy

References

1. Bacon, Kenneth H., "Industrial Policy: More Smoke Than Fire." *The Wall Street Journal*, Sept. 12, 1983, p. 1.
2. Schultze, Charles L., "Industrial Policy: A Dissent." *The Brookings Review*, Fall 1983, 3-12.

Studies in Public Regulation.
Edited by Gary Fromm. Cambridge, Massachusetts and London: The MIT Press, 1983. *Pp. xii, 393. $15.00 paper.*

Market failure is the economic rationale for regulation of business. Traditionally, market failure was caused by scale economics which led to natural monopolies; the response was price and/or quantity regulations that restricted the monopolist's ability to fully exploit market power. In those markets where casual observation suggested large potential scale economies, franchise monopolies were awarded, prohibiting effective competition. Recently, business regulation has been rationalized increasingly because of market failure due to externalities (such as pollution problems) and information costs (as in the case of consumer protection regulations).

This book is a collection of eight articles and accompanying comments presented at a 1977 Conference on Public Regulation sponsored by the National Bureau of Economic Research. The goal of the conference was to advance the theory and practice of regulation. The articles generally present new approaches to the traditional problems, rather than focusing on the issue of competition versus regulation where there may be externalities or substantial information costs.

Paul Joskow and Roger Noll begin the volume with an uneven review of the theoretical and empirical analysis of regulatory issues. Discussant George Stigler criticizes them for devoting pages to experimental economics and the dynamics of pricing, while saying relatively little about the incomeredistribution aspects of regulation. Neither the editor's remarks nor this article attempted a thematic review of the diverse articles that follow. Only Sam Peltzman's excellent summary attempts such an integration. It is surprising that Joskow and Noll ignore the voluminous studies on price and entry restrictions imposed on American depository institutions.

Richards Levin's article, "Regulation, Barriers to Exit and the Investment Behavior of Railroads," is impressive. Levin finds that a railroad's return on total assets is negatively correlated with the percentage of low-volume trackage (referred to as "low-density lines" or LDLs). Because of ICC regulations, cross-subsidization takes place between high-density lines (HDLs), where price exceeds marginal cost, and the unprofitable LDLs. Further, investment has been stifled through higher than necessary freight rates on HDLs, as well as the lower profitability associated with the need to maintain LDLs. Levin claims that abandonment of LDLs would have increased 1975 railroad profits by $1.4 billion and increased investment in trackage by $160 million annually.

Melvyn Fuss and Leonard Waverman use the translog cost function to analyze economies of scale and economies of scope in three aggregated services (local services, toll services and "competitive" services) provided by Bell Canada. Their estimates ignore rate-of-return constraints and the attendant Averch-Johnson effects, although the last section of the article gives a theoretical model for treating these problems. Fuss and Waverman find that the overall scale elasticity has been rising over time, although the imprecision of their estimates does not allow them to make definitive conclusions. Their results yield weak evidence of cost complementarities among the services, suggesting that there may be economies of scope in their provision. Further, incremental cost pricing would increase local service prices while lowering the others. Taken together, their findings call into question the assumption that, given today's technology, the telecommunications industry should be treated as a natural monopoly.

Robert Leone and John Jackson present an interesting analysis of the 1972 Water Pollution Control Act. The authors first analyze the Congressional voting process that led to passage of the Act. They hypothesize two different models of paper industry lobbying efforts, and accept the "naive" model that firms view any controls as cost-increasing and requiring unspecified changes in their production processes. Hence, the industry lobbies against any controls because of the uncertainty involved with them, even though certain firms may actually benefit competitively from controls. Through a detailed analysis of tissue mills, the authors estimate these distributional effects, and show that the competitive position of many producers is shifted when controls are implemented.

Kenneth Baseman's contribution is a theoretical analysis of the effect of cross-subsidization between a monopoly market and a (potentially) competitive market. Baseman studies the case where the two outputs of the monopolist are cost-superadditive (i.e., the total cost of producing a given amount of each product is greater for the monopolist than it would be for two separate firms). The monopolist might control both markets by pricing below his incremental costs in the competitive market, subsidizing this output from his allowed return in the regulated market. As discussant William Baumol points out, it appears that Baseman's article deals primarily with franchise (as opposed to natural) monopoly, a case where governmental grant of monopoly cannot be justified in the first place. It appears that the case of cost-subadditivity, first analyzed by Gerald Faulhaber and recently embedded in the contestability theory of Panzar, Willig and Baumol, remains the more interesting area of research.

Patricia Munch and Dennis Smallwood present a theoretical analysis of solvency regulations in the insurance industry which is motivated by the question, "Under what conditions are the interest of owners sufficient to provide policyholders with an adequate level of protection?" (p.119). They conclude that, in an unconstrained environment, only one of two levels of capital is optimal: either none or an infinite amount. Like the discussants, I find these results hard to accept.

Robert Willig and Elizabeth Bailey develop the concept of "social-welfare dominance" to analyze the optimality of any policy that would change the income distribution. It contains three criteria that social-welfare dominant policies must achieve. In addition to being Pareto optimal, dominant policies should be "anonymous" (policymakers should not know whose income is affected) and policymakers should be averse to regressive income transfers. The pragmatic significance of this theory may be similar to that of Arrow's Impossibility Theorem, in that its criteria are rarely, if ever, satisfied, particularly in light of the "capture" theory of regulation.

This book is unlikely to be read in its entirety by many economists because of its diverse material.

While there is much to be garnered from a meticulous perusal of its pages, this book is best regarded as a research reference volume.

Frank J. Navratil*
Federal Home Loan Bank Board
and John Carroll University

*The views expressed are those of the author and do not reflect the opinions of the Federal Home Loan Bank Board.

U.S.-Latin American Trade Relations: Issues and Concerns.
Edited by Michael R. Czinkota. New York: Praeger Publishers, 1983. *Pp. xvii, 297. $35.95.*

This book contains 15 papers presented at a conference sponsored by the National Center for Export-Import Studies of Georgetown University, the Centro Interamericano de Comercializacion, and the Fundacao Centro de Estudos de Comcercio Exterior held in Rio de Janeiro in 1982. There are three parts to the book. Part I deals with macroeconomic issues in Latin American trade policy. Part II deals with corporate issues of U.S. and Latin American trade. Part III explores new forms of trade and development between the U.S. and Latin America. The topics are certainly timely in view of the rising trend of "new protectionism" and the world debt crisis which sees Brazil, Mexico and Argentina as the principal actors. The book's twin aims (1) to examine the close relationship between U.S. financial institutions and the Latin American Debt structure and (2) to demonstrate the need of strategic planning for export development are only partially fulfilled.

There are six papers in part I on macro-issues in Latin American trade policy. The paper by William A. Dymsza presents a comprehensive model of national export strategy that each country needs to adapt to its socioeconomic and business circumstances. The paper by Robert T. Green examines the changes that have occurred in the trade in manufactured goods between the United States and Argentina, Brazil, Colombia, and Venezuela from 1963 to 1978. He finds that Brazil was the most successful in developing competitive export industries, while Venezuela was the least successful. Frank G. Vukmanic points out that the performance requirements that Latin American countries have imposed on foreign direct investments have not been in the direction of comparative advantage and have led to massive inefficiencies.

In the fourth paper, Thomas Kwako examines the cost and benefits of tax schemes for exports and recommends that Latin American nations review their tax laws to get the maximum benefit from international trade without violating the Subsidies Code. On the other hand, Nicolas Rivero and Manuel Diaz Franjul examine the great benefit that Latin American countries would derive from developing a large scale fuel industry from alcohol produced from sugar cane. They find that the major obstacle is not technological but financial. Frankly, I thought the opposite was the case. Finally, Mary Barry points out that Latin America should grow into a major supplier of textile to the United States. However, with the growing trade restrictions in textiles and the strong competition from the more efficient Asian countries, I doubt that this is feasible or even to be recommended.

There are four papers in part II on the corporate issues of U.S. and Latin American Trade. The paper by Troncoso and others is down-to-earth and candidly blames the lack of success in the Mexican export promotion effort on the lack of an export mentality. They recommend that more help be provided to individual firms in their day-to-day export operation. Marylyn L. Liebrenz and John K. Ryans found that U.S. firms are losing their traditional advantage of doing business in Latin America to Japanese and German firms, but that good opportunities still exist, particularly in Chile, Brazil, Venezuela, and Colombia. Michael Czinkota and Bernard LaLonde conclude that management should devote as much attention to the service component as to the product component of the commodity. Red tape should be reduced and customer service programs should be implemented. This, however, is more easily said than done. Finally, Juan Luis Colaiacovo presents a model stressing training programs and technical assistance for governments to use to strengthen the negotiating hand of small and medium sized firms in their export promotion efforts.

In the first paper of part II, Ilkka Ronkainen and Daniel McConville find that, strangely, only Mexico (I would add Brazil) seems to have aggressively tapped tourism as a source of foreign exchange