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A Comment on the Deregulation of Industry

DONALD I. BAKER*

The distinguished English jurist Lord Denning, the Master of the Rolls, once said that “the function of lawyers is to find a solution to every difficulty presented to them, where the function of professors is to find a difficulty with every solution.” The politician’s function, however, is different from that of *both* the lawyer and the professor, although the politician provides a great deal of work to both. The politician’s function is to make every problem—actual or imagined—simply go away. If the solution is cheap and painless, then it’s absolutely splendid. Even if the solution is costly, but the cost is inevitable, then that is a quite acceptable second-best.

Moreover, the political world is highly episodic: it can be moved by immediate distress to try almost anything (which it did with much of the 1930s’ regulation), or it can be moved by great public indignation to eliminate something which was highly favored in the recent past (which it did with the seat belt locking system). Also, the political world is particularly unmoved by theory. As a former head of the Justice Department’s Anti-Trust Division noted recently, “One can imagine that the countervailing influence of the members of the American Economic Association and others committed to the goal of allocative efficiency would not much impress Congressmen counting noses.”¹

I stress this reality because it is there. If we academic lawyers ignore it, we may amuse ourselves—but we will not much matter. In fact, we should matter—probably more than the members of the American Economic Association who have produced all those papers showing the various costs of regulation. We should matter, because the hard issues are not so much economic as legal and practical and political. Regulation is maintained today not by economic theory so much as by a mixture of mind-boggling complexity which deters general inquiry, by special interests who are well used to protecting themselves, by a populist prefer-

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¹ Zimmerman, *The Legal Framework of Competitive Policies toward Regulated Industries*, in *PROMOTING COMPETITION IN REGULATED MARKETS* 374 (A. Phillips ed. 1975).

ence for "competitive equality" as opposed to hard-nosed "competition,"² and by general fear that any alternative may be worse. Thus, while to my old friend Jim Liebler³ and many economists deregulation may sound like nirvana, to most politicians and members of the public it sounds more like chaos.

The real question today is not whether we are going to have too much deregulation, but whether we are going to have any meaningful deregulation at all. In this debate, it is important to make clear what the real costs of regulation are, and here we are faced with particular regulatory schemes and with economic work on their operation and costs in particular areas. It is also very important to make clear what practical alternatives exist. Stated another way, what can be done to assure the public *in advance* that all hell will not break loose? This, I submit, requires not a general theory of regulation or of deregulation, but instead requires a hard pragmatic look at specific schemes that may well have outlived their usefulness.

This hard pragmatic look involves several questions. First of all, what exactly are we regulating and why do we think we are doing it in any particular area? Second, what *public* goals are at stake? Are they real? And I think one has to focus on public goals in a very specific way. It is not enough to say, "The goal of regulation here is to protect the public or to perpetuate the medieval notion of a just price." We must be much more specific than that. There are of course some public goals which run across several industries.⁴ One is to protect the public in the real natural monopoly situation from monopoly pricing and arbitrary conduct. A second situation concerns what I will call "common carrier reliability." If you want to be sure that when you pick up the phone you get a dial tone, or when you walk out to the bus stop you find a bus before long, then special duties may have to be imposed. Another public goal may be to avoid unethical dealings or widespread disruption of the financial system. Another set of broad goals may be concerned with health, safety, and the environment. Most of these goals are real; and anyone who proposes a scheme of deregulation that does not meaningfully address relevant public goals will not get anywhere.

² Ralph Nader's support for very stringent branch banking restrictions as a safeguard against "concentration" is a case in point. See, e.g., Smith, *Nader Clash on Wider Branching, Greater Power to Extend EFT Areas*, AMERICAN BANKER, December 9, 1975, at 1. See also *First National Bank in Plant City v. Dickinson*, 396 U.S. 122 (1967).

³See Liebler, *The Deregulation of Industry: How Far Should We Go?*, 51 IND. L.J. 735 (1976), *supra*.

⁴See, e.g., Baker, *Competition and Regulation: Charles River Bridge Re-Crossed*, 60 CORNELL L. REV. 159, 172-75 (1975).

Third, what are the *most efficient* ways of meeting appropriate public goals? Do such goals really require constant day-to-day involvement of bureaucrats in the basic entrepreneurial decisions in an industry? Can the market be used to encourage efficiency, while still using other legal devices to assure safety, honesty, service reliability, or whatever? Obviously, complete deregulation is clear and simple where the regulatory scheme rests on nothing but a poor economic case; then the whole regulatory scheme can be swept away and we will all be better off. If some quality values are at stake, objective licensing can be used as a better alternative to full economic entry regulation. The question is whether this person or firm is fit for a particular activity. If the answer is "yes" he gets in, regardless of how many are in the industry or how well they are serving the public. Full disclosure is also another possible alternative to much more detailed regulation in many non-monopolistic situations. And there are a lot of incremental things that can be fitted into even a "natural monopoly" scheme. For example, requiring peak load pricing of utility services may not fit the label "deregulation" per se, but it can make the regulatory process more efficient and more market-oriented. Another tool is more antitrust enforcement against voluntary practices by regulated firms.

Looking at it in an overall sense, I agree with Professor Schwartz that regulation or deregulation is not an all-or-nothing-at-all situation.⁵ It demands a case-by-case analysis of different regulatory schemes—the way they operate, the goals they serve, and the costs they impose. The process has a definite "nitty gritty" quality.

I had hoped that Jim Liebler and Roger Noll would focus on the cases where the case for deregulation is really strong.⁶ Trucking and airline regulation may not present any interesting theoretical difficulties—but such schemes do involve large costs. I also wish that, if Liebler is going to take on the really heavy health and safety issues (which just scare many "deregulation" supporters on Capitol Hill out of their minds), he would show detailed interest in what would happen if we withdrew FDA regulation. He just says he is "not interested." Unless you are interested, you are not going to get anywhere on reform.

Professor Schwartz does express concern about these regulatory details, but I do not understand his solution in many vital respects. He says that we should separate the *theory* of regulation from the *perfor-*

⁵ See Schwartz, *The Deregulation of Industry: How Far Should We Go? A Built-In Bias*, 51 *IND. L.J.* 718 (1976), *supra*.

⁶ See Noll, *Breaking Out of the Regulatory Dilemma: Alternatives to the Sterile Choice?*, 51 *IND. L.J.* 686 (1976), *supra*.

mance of the regulators. I think this is just wrong. We know what a long-run average regulator looks like, and we even know that a short-run marginal regulator has a still lower performance curve. The average regulator is very average indeed. No theory of regulation that requires a superregulator will work consistently well in the real world over the long run.

Thus, to summarize, I see no clear general theory of regulation or deregulation. I do see some theories of how we can go about deregulating. Its aim should be to simplify the decisionmaking process by structuring it more precisely, while cutting out regulatory inquiries into issues which can be better resolved by customer and entrepreneurial choice. We must dramatize regulatory "horror stories" which nicely illustrate how protectionist and irrelevant much regulation often is. We must also smoke out the defenders of regulation as to their "public interest" justifications and then press for elimination of any regulation that they cannot openly justify. Where the public need is narrow, narrower legal controls should be developed. Search for less anticompetitive alternatives should be undertaken. In coming up with alternatives, we must be more specific and detailed than are most of these papers. To reduce regulation (let alone deregulate an activity), the reformer must present a workable scheme, not some vague general suggestions as to how it *might* work. And, if we really want to make progress, we must begin with those cases where the case for economic regulation is weak. Otherwise we invite more opposition and more confusion.

Of course confusion is nothing new in this field. Ken Jones, in discussing the history of regulation, has noted: "The legal situation, then, in the second half of the nineteenth century was one of complexity and confusion."⁷ What we have a century later is more complexity, more confusion, and a great deal more law.

⁷ W. JONES, CASES AND MATERIALS ON REGULATED INDUSTRIES 29 (2d ed. 1975).