Currents

Déjà Vu

Oh my, here we go again. My latent optimism that people learn from prior mistakes has again been shaken by the domestic reaction to the recent increase in oil prices.

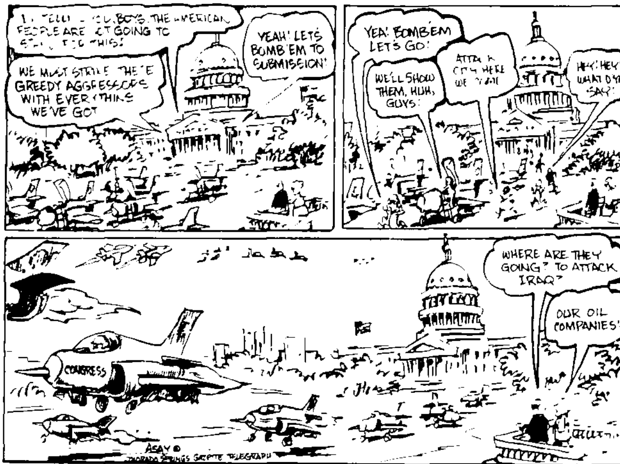
Politicians and the media were quick to charge the oil companies with "price gouging," even though the average price of gasoline did not increase as much as the spot price of oil. Several states are considering gasoline and oil price controls, which would cause selective shortages and pressure for national controls. Assistant Attorney General (for Antitrust) James Rill summoned oil executives to Washington to determine whether there was some conspiracy to raise domestic prices. Former President Jimmy Carter and Sen. Lloyd Bentsen, for different reasons, have revived proposals for mandated energy conservation, an oil import tariff, and targeted subsidies for energy development and alternative fuels. Congress nearly approved a large increase in the mandated corporate average fuel economy (CAFE) of new cars and light trucks, although this measure would seriously harm the domestic automobile producers without reducing the short-run demand for gasoline. (See the following Current by Robert Crandall.) The Department of Energy initially refused to release any oil from the Strategic Petroleum Reserve, without acknowledging that it has yet to formulate and announce a release policy. And even President Bush, a former oil entrepreneur, made some mushy Carteresque noises, counseling restraint by the oil companies and conservation by consumers. All of this energy policy rhetoric had the effect of a time warp; I fully expected some 1970s sitcom to follow all this news.

Our political community seems to have learned nothing about energy policy in the meantime. The apparent rationale for reviving these proposals is that an increase in the explicit or implicit price of energy caused by the government is desirable, but an increase in the price by the oil companies (to reflect the current replacement cost of oil) is undesirable. Each of these proposals would compound the problems of the recent Iraqi-provoked crisis. Let me count the ways:

- The August spike in oil prices was the result of the U.S.-imposed embargo on oil exports from Iraq and Kuwait. The Iraqi invasion of Kuwait, however deplorable, did not reduce the world supply of oil.
- Price controls on gasoline would increase the sum of cash payments, queuing in gas lines, and driving to find an open station.
- An oil import tariff would cost American consumers and industry about two and one-half times the tariff revenue, would seriously damage the petrochemical industry, and would accelerate the depletion of domestic oil reserves.
- Targeted subsidies for energy development and alternative fuels, by prior experience, would probably cost taxpayers at least twice the value of the energy produced.
- Mandated energy conservation measures, such as CAFE, would cost consumers of new products more than the value of energy saved and would reduce the replacement of older, less energy-efficient products.
- Adding more oil to the Strategic Petroleum Reserve would be a waste until both consumers and producers are confident about the conditions under which this oil would be released.

And so on. This list would have been longer if Congress and the state legislatures had not been on their summer recess.

What explains the revived demand for a pervasive energy policy? A part of the explanation is the politicans' compulsion to be perceived to be doing something in response to every crisis. As individuals, they can do nothing about Saddam Hussein, so they pillory the domestic oil com-



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pany executives. A more enduring explanation is an unholy alliance of puritans and the greedy, rather like the alliance of Baptists and bootleggers that supported prohibition. The puritans maintain that it is morally wrong for Americans to consume so much energy. The greedy are those who promote government favors to serve the owners of domestic energy resources and the army of underemployed energy consultants. And both groups seem ready to use any currently fashionable rationale to serve their interests. Alas!

W.N.

The Changing Rationale for Motor Vehicle Fuel-Economy Regulation

Fifteen years ago, Congress enacted the corporate average fuel-economy (CAFE) program that required each producer of automobiles for sale in the United States to achieve by 1985 a sales-weighted average of at least 27.5 miles per gallon (MPG) for new cars sold. Furthermore, each automobile manufacturer had to achieve this average for its domestic cars and for its imported cars separately; imports could not be used to offset less fuel-efficient domestically produced vehicles.

The CAFE policy was enacted in the aftermath of the Arab oil embargo. At the time, world oil prices were peaking, but U.S. prices were being held artificially low by government regulation. Fuel economy regulation was thus "necessary" because another set of government regulations kept market forces from operating. This was also the period during which U.S. crude oil prices were being kept artificially low so that the rents from U.S. production could be transferred to the Arab oil producers through an "entitlements" policy.

The presumed rationale for CAFE after the first OPEC oil shock subsided was that the United States needed protection against future oil shocks, although this case has never been explained very well. Is the United States less vulnerable to, say, a 20 percent reduction in oil supply if it is consuming only 16 million barrels instead of 20 million barrels each day? Is the required adjustment or the national-security threat any less severe?

Whatever the original case for CAFE, it has now changed considerably. The Arab OPEC states are in disarray. In the past few months real oil prices have been gyrating between $8 and $15 per barrel in 1974 dollars—a far cry from the $50 to $100 per barrel predictions that were common in the 1970s. True, imports are rising once again—oil exploration and production is not very attractive in the United States at recent prices, and U.S. environmental policy is not conducive to developing new offshore reserves—but few in Washington today are pressing for tight fuel economy standards simply to protect us from an OPEC conspiracy to drive up the price of oil.

This is the year of the environment, and the case for CAFE is now an environmental one. Recent concerns about the accumulation of carbon dioxide, CFCs, and other greenhouse gases in the world's atmosphere have created an entirely new reason to mandate strict new-car fuel economy standards. Global warming is the new concern; CAFE is still the instrument. Unfortunately, it is a very blunt instrument, likely to cause more harm than good.

The consumption of motor fuel depends on the types of vehicles driven, the price of motor fuel, and the level of overall economic activity. In the absence of fuel efficiency regulation, the fuel efficiency of *new* passenger cars sold will depend in large part on the current price of gasoline and the manufacturers' expectations of that price in the prior several years. Between 1979 and 1981, CAFE was largely irrelevant as automobile companies scurried to introduce new fuel efficient cars in the aftermath of the Iranian Revolution. As real motor fuel prices plunged after 1981, fall-

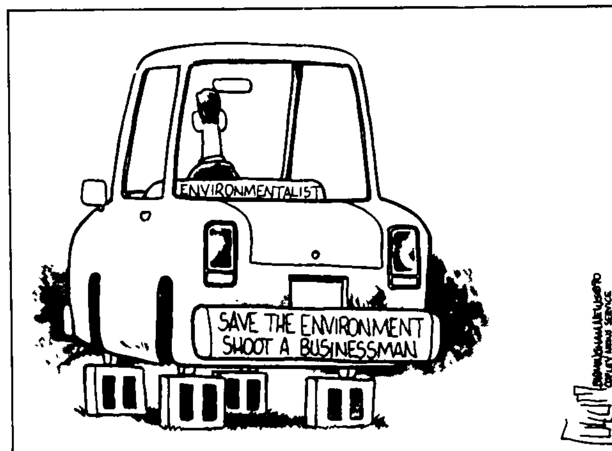
ing by 1986 to their lowest levels since World War II, Americans understandably began to demand larger and more powerful cars once again.

In 1985 Ford and General Motors found themselves in a very difficult position with gasoline prices falling to these very low levels, but CAFE pegged at 27.5 MPG. They raised large-car and large-engine prices to avoid fines of $50 per MPG for each car sold that did not meet the 27.5 standard. But it was very difficult to sell fuel efficiency in the face of sharply falling gasoline prices. Cars designed for gasoline prices expected to reach $1.50 to $2 per gallon are not the ones that consumers want when the price of gasoline falls below $.80 per gallon.

It surprised no one when in 1986 Ford and General Motors petitioned the Department of Transportation for relief from CAFE. The Reagan DOT responded by lowering CAFE to a 26 MPG standard for the 1987–1988 model years and 26.5 MPG for 1989. This year, however, in an obvious surrender to the environmentalists, Transportation Secretary Skinner has raised the CAFE standard back to 27.5 MPG. It is once again popular to preach frugality in energy consumption, and Secretary Skinner was not one to buck this trend.

The irony of mandated fuel economy standards is that they may actually *increase* fuel consumption. First, it must be understood that CAFE is an exercise in reducing the attractiveness of new cars to consumers. CAFE standards are met in three ways—by reducing weight, by reducing engine displacement, and by spending money on new design and engineering. When gasoline prices are low, the first two strategies (which have contributed about 60 percent of the improvement in fuel economy) simply reduce the demand for new vehicles as older, heavier, more powerful cars are kept in use longer with these lower gasoline prices. The third strategy raises vehicle prices by more than it raises vehicle *value* because consumers do not desire these increases in fuel economy.

Proponents of CAFE would have us believe that the country is made better off by having producers offer a mix of cars to consumers that is less desirable than they would otherwise be offered. These advocates fail to understand that consumers will react by buying fewer new cars and keeping old gas-guzzlers longer. It is hardly surprising that in the face of the emissions, safety, and fuel-economy regulatory requirements that have been piled on new cars, the average age of cars on the road has increased by two full years since the mid-1960s. Peak demand for new cars in the 1980s was no higher than in the early 1970s, despite higher real GNP and the larger population.



Drawing by Cullum; Copley News Service.

The second reason why CAFE may actually increase total fuel consumed is that producers faced with a CAFE constraint may reduce the price of small cars to meet CAFE and thereby offset some of the deleterious effects of regulation of new car sales. If these inexpensive, smaller cars induce increases in vehicle miles travelled, the improvement in CAFE will be partially offset.

Third, if the overall mix of new cars sold is more fuel efficient, those new cars sold may be driven more miles because their greater fuel efficiency reduces the marginal cost of a vehicle mile.

In summary, CAFE has had much less effect on total fuel consumption than a simple examination of new-car fuel-economy trends might suggest. Unfortunately, no one has conducted a definitive empirical study of CAFE's effects that would give us a respectable estimate of the fuel saved. As in most environmental issues, this absence of evidence on the effects of policy simply allows proponents to press for even more stringent regulation.

Why, one might ask, do those who would defend us from Arab oil embargos, greenhouse warming, or other assorted prospective disasters not simply lobby for higher gasoline taxes? Surely, the real culprit in stimulating consumption of motor fuel is not Detroit engineering but low real gasoline prices. A sharp increase in the tax on gasoline would reduce fuel consumption,

induce producers to design more fuel-efficient cars, and cause consumers to scrap their remaining pre-1980 cars at record rates. New-car sales would probably increase for several years even though higher gasoline prices would ultimately reduce the desired vehicle stock.

There are three arguments—now two arguments—against using a gasoline tax to reduce U.S. fossil-fuel consumption. The first is Bush's "read my lips" pledge, which obviously is no longer a binding constraint. The second is the fear that gasoline taxes are regressive, but surely CAFE is also regressive. It reduces economic welfare by an amount that rises less than proportionally with income. (Automobile-related expenditures do not rise proportionally with income.)

The third reason energy-regulation advocates may wish to avoid increasing gasoline taxes is that such taxes are simply too visible to consumers who will understand that government is forcing them to pay for a social objective with which they may or may not agree. Proponents of CAFE correctly perceive that it would take a large increase in gasoline taxes to achieve 27.5 MPG. It is not surprising, therefore, that they prefer to place the onus on the automobile companies and to pretend that consumers will not have to pay for this policy in terms of higher car prices or reduced vehicle performance.

As the drive to reduce fossil-fuel consumption heats up in the drive to combat global warming, advocates of fuel-economy regulation are now proposing new and more virulent forms of CAFE in the name of "carbon dioxide" regulation. These new proposals also generally include a subtle form of trade protection under which Japanese car companies would be forced to achieve a higher standard than U.S. companies.

Under the current CAFE program, full-line vehicle manufacturers are more constrained than those that specialize in smaller cars. Since there are no American small car specialists, it is easier for importers—principally Japanese companies—to meet CAFE requirements than it is for U.S. domestic producers.

Under the CAFE program, companies are permitted to carry forward any excess they achieve over the 27.5 MPG as potential offsets against future shortfalls. They are also permitted to carry back any excesses to make up for past shortfalls. At present, the Japanese companies have large carry-forward credits, while GM and Ford have deficits to make up from future surpluses. This situation has encouraged the Japanese companies to compete in the U.S. market for large cars, because U.S. manufacturers have to compromise on their large-car designs to meet and even exceed CAFE, while the Japanese do not even have to meet the standard for three years because of their accumulated credits.

Because a company's import and domestic fleet are regulated separately under CAFE, a company may not import small cars to offset its domestic production of gas guzzlers. (A domestic car is defined as one with 75 percent domestic content.) Because Ford has had difficulty achieving 27.5 MPG and is successful in marketing large cars, such as the Crown Victoria and the Lincoln Town Car, it is now moving to import slightly more than 25 percent of the value of its Crown Victoria line so that this low MPG car can be counted as an "import" for CAFE. This will reduce Ford's import CAFE rating—which is already far above 27.5—but raise its domestic rating.

The Japanese, meanwhile, are producing more of their small to midrange cars in the United States while using their credits on their imported vehicles to develop sleek, powerful new luxury cars for production in Japan and export to the United States. These cars have V-8 engines and much lower CAFE ratings than the usual Japanese car. The U.S. companies—particularly GM and Ford—cannot respond freely with more powerful versions of their own cars because of CAFE. Thus, the Japanese are being invited to compete in the highly profitable large and luxury car segments of the market by our own "conservation" policies.

The answer from U.S. politicians, obviously encouraged by U.S. producers, is to recast CAFE as a program that demands *proportional improvements* in fuel economy by all producers, not a flat standard. Japanese companies would then be forced to improve their fuel economy from their current average of about 30 to 31 MPG while Ford and GM might have to show a similar proportional improvement from about 26 to 27 MPG. Trade lawyers are now busy studying such an idea to determine whether it is consistent with the General Agreement on Tariffs and Trade.

Other proposals for extending fuel economy regulation of new cars are also being considered. Producers could be given credit for producing cars that use alternative fuels—particularly if those fuels, such as ethanol, are produced by

U.S. farmers for automobile technologies that are unique to U.S. automobile companies. Or credits could be given for other greenhouse-gas savings activities, such as forest preservation, company car pools, or the repurchase of older cars for scrap.

There is yet another irony in the evolution of CAFE policy. The Department of Transportation is responsible not only for setting CAFE policy but also for regulating automobile safety. Since CAFE induces producers to offer more small cars and to reduce the weight of all of their models, CAFE increases highway fatalities. In its recent decision to raise CAFE back to 27.5 MPG, DOT found it expedient to reject claims that smaller cars are less safe, but in earlier proceedings involving safety regulation it had acknowledged just such a relationship. DOT's only defense in 1990 was that *"regulatory-induced"* reductions in automobile size do not increase highway fatalities, but apparently market-induced reductions do. John Graham and I have estimated that at its current level, CAFE could be responsible for a 14 to 27 percent increase in highway fatalities at current gasoline prices, once these CAFE-constrained cars fully penetrate the vehicle fleet. These findings have been disputed, of course, because government could not possibly be guilty of generating unintended consequences. Could it be that only markets fail, not legislators and regulators?

Robert W. Crandall
The Brookings Institution

P.S. In the last days of the 101st Congress, the CAFE bill died, and the gasoline tax was increased by five cents per gallon.

A Century of Antitrust: The Lessons, The Challenges

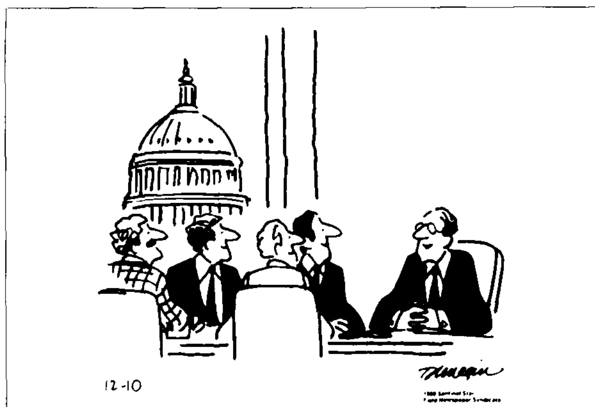
On July 2, 1990, the United States observed the 100th birthday of antitrust law, an occasion that led to a number of conferences and seminars at economics meetings and law schools across the country. Antitrust scholars would have been busy this year anyway. The key Bush antitrust officials—Janet Steiger at the Federal Trade Commission and James Rill at the Justice Department—spent their first year in office sending a clear message that the Bush antitrust "philosophy" is different from that of the Reagan administration. Economic efficiency in the creation, production, and delivery of goods is no longer the primary concern. Kevin J. Arquit, director of the FTC bureau of competition has been quoted as suggesting instead that "the idea is to prevent wealth transfers from consumers to producers."

On April 11 and 12, 1990, the Cato Institute sponsored its first annual *Regulation* conference, "A Century of Antitrust: The Lessons, The Challenges." The conference offered an opportunity to evaluate the history of antitrust, to consider current enforcement practices and points of controversy, and to look to the future of antitrust. Unfortunately, space limitations make it impossible for us to reprint here all the worthwhile papers and comments presented at the conference, but a sampling of the papers forms the basis of this issue.

The opening panel looked to the origins of antitrust and the historical enforcement record. Thomas DiLorenzo, whose article appears in this issue, opened the conference by arguing that, from the beginning, the antitrust laws were intended to protect favored producers.

In the Winter 1990 *Cato Journal*, Robert Bradley suggested another political motive for the Sherman Act. According to Bradley, Senator John Sherman's drive to become the 1888 Republican presidential nominee was blocked at the convention by Russel Alger, head of Diamond Match Company, an organization destined to become the target of a government investigation soon after the Sherman Act became law. Indeed, upon signing the Sherman Act, President Benjamin Harrison observed, "John Sherman has fixed General Alger." So much for protecting the little guy.

At the April conference, Dominick Armentano recounted a history of antitrust enforcement that has systematically undermined competition and efficiency. Armentano blamed this record of policy failure on the acceptance by antitrust enforcers and judges of the "perfect competition" model as a desirable policy goal. Armentano's Austrian-based critique of the "structure-conduct-performance" paradigm charged that the resulting models are too static, that they fail to make adequate allowance for the dynamic nature of market processes and adjustments. Armentano concluded that "the essence of the 'monopoly problem' is not to be found in free market



"SMALL BUSINESSES ARE THE BACKBONE OF THIS COUNTRY, GENTLEMEN... AND IT HAS BEEN OUR REGULATIONS THAT HAVE MADE THEM SMALL!"
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agreements, but in government *legal* impediments to rivalry (entry) or cooperation. Legal barriers to entry and prohibitions on interfirm cooperation prevent the market from generating, disseminating, and using information that traders require for efficient plan coordination."

George Bittlingmayer considered the macroeconomic impact of antitrust policy. Bittlingmayer presented evidence indicating that during the late nineteenth and early twentieth centuries, increases in antitrust enforcement tended to drive capital investment offshore: "Swings in antitrust enforcement caused major fluctuations in the economy during the first 25 years of the Sherman Act." Bittlingmayer noted, "Regardless of one's view of Standard Oil and the other larger firms and cartels, the periods of aggressive antitrust enforcement can be viewed as attacks on the existing organization of business." Bittlingmayer concluded by urging politicians to pay closer heed to the fallout from politically charged economic policies in the future.

The historical analysis of antitrust law and politics was concluded by luncheon speaker, James C. Miller III. Miller described and defended the goals and accomplishments of the Reagan administration's antitrust policies.

The second and third conference panels examined questions of current policies and areas of controversy. Steven Calkins and Frederick Warren-Boulton described how the Bush administration's approach to antitrust differed from that of the Reagan administration. In describing Bush's "kinder and gentler" antitrust policies, Calkins and Warren-Boulton observed that "part of the explanation is in the appointments. Jim Rill and Janet Steiger are less ideological than Bill Baxter and Jim Miller. Neither Rill nor Steiger is an economist. . . . Rill is a conservative with a litigator's heart, quite unlike his predecessors." The result is more active and potentially innovative antitrust policies. The Justice Department's new perspective was made apparent this past spring when Rill announced that he would consider prosecuting U.S.-based subsidiaries of firms engaged in anticompetitive actions overseas. (Michael DeBow discusses Rill's extraterritorial antitrust policies in a following Current.)

More specific issues were then addressed. Thomas Jorde and David Teece, whose paper is included in this issue, analyzed the impact of antitrust laws on innovation. After examining the innovative process, Jorde and Teece concluded that recent antitrust revisions designed to facilitate cooperative research and development ventures have not gone far enough.

The whole area of horizontal agreements is becoming more important, not only in research and development, but also for industries in which customers benefit from networking. Travel agents and their customers gain from access to a single source of information about competing flights and prices. Banking customers profit from shared ATMs that allow access to their money through other banks' machines. But the arrangements necessary to provide this kind of information and access also raise traditional antitrust concerns about possible agreements on prices and available services.

James Langenfeld described the FTC's approach to the gray area of horizontal agreements that on their surface are neither legal nor illegal per se. Langenfeld outlined the sequential analytical filters that the FTC uses in its attempt to determine whether specific horizontal agreements are likely to have important anticompetitive consequences. He then used as a specific example of the FTC process the decision to press the case against Detroit automobile dealers who had agreed on hours and days of operation. Langenfeld concluded, "Some agreements will usually be procompetitive, and those that would challenge such agreements should bear the burden of proof under a rule-of-reason standard. Other agreements may be better left illegal per se. Between these two extremes exists a 'gray area' where judicial efficiency suggests the need for a systematic approach to agreements among competitors. . . . The FTC's methodology focuses

the inquiry on an efficiency rather than a market power screen."

Fred McChesney charged Chicago-school economists and lawyers with inconsistency in their continued support for limited antitrust. He argued that the Chicago school's "positive approach to antitrust as public-interest government intervention intended to correct market failure squarely contradicts the now-dominant economic theory of regulation that Chicago itself popularized. That is, the Chicago school of antitrust regulation runs counter to the Chicago school of regulation more generally." McChesney noted that antitrust regulation is no more likely to be used in consumers' interest than any other form of economic regulation, and he challenged Chicago-based opponents of repeal to reevaluate their positions.

William Shughart, in an article appearing in this issue, examined the role played by private litigants in the enforcement of the antitrust laws. Shughart concluded that the potentially substantial benefits that are possible through pursuit of private antitrust suits may often make litigation a profitable alternative to more traditional competition.

Rick Rule discussed antitrust policies toward vertical agreements. Rule concluded that vertical agreements are very often driven by efficiency concerns and that it is "not clear that in and of themselves, vertical restraints should ever be illegal." At worst, they may be evidence of some other antitrust violation that can be dealt with separately. (For a similar discussion, see Frank Mathewson's Current in this issue on legislative attempts to outlaw resale price maintenance.)

Donald Boudreaux, whose paper also appears herein, examined emerging theories of nonprice predation and raising rivals' costs. He argued that such theories, though interesting, appear to have little basis in fact if one accepts that the "perfect competition" model has little to say about real-world rivalry.

William Kovacic considered how Reagan's judicial appointments would affect antitrust policy in the 1990s. Kovacic began by noting that "since 1890, the comparatively open-ended language of the principal antitrust statutes has given federal judges a crucial role in determining the content of the statutes' competition commands." In fact, a growing judicial appreciation of economic criticisms of past antitrust policies aided Reagan appointees Bill Baxter and Jim Miller in their efforts to change the direction of antitrust in the early 1980s. Kovacic concluded that Reagan's impact on antitrust may continue to be felt long into the future through his judicial appointments: "Amid signs of a limited revival of antitrust approaches the Reagan administration disfavored, [judicial] appointees of the Reagan and Bush administrations will play a major role in determining how far the antitrust pendulum swings back toward its pre-Reagan equilibrium."

A similar viewpoint recently appeared in the *Wall Street Journal.* In an August 6, 1990, article entitled, "Bush's Plan to Prosecute Antitrust Cases Could Fail Because of Reaganite Judges," reporter Paul M. Barrett began, "Fans of old-time aggressive regulation of corporate mergers celebrated the Bush administration's early declarations that the antitrust cops were back on the beat. . . . But free-market rumblings from two influential federal appeals courts may foreshadow hard times for antitrust enforcers who back their rhetoric by bringing lawsuits." Barrett continued, "Legal scholars observe that Reaganite hostility to the very idea of merger enforcement has become increasingly fashionable among sitting federal judges." As an example he quoted Judge Alex Kozinski, who wrote in a recent decision, "The market has its own fail-safe mechanisms. . . . More fundamentally, in a free economy the market itself imposes a tough enough discipline on all market actors, large and small."

Henri Lepage broadened the context of the American debate by providing a description of evolving European competition policy. European "antitrust" policies have been strengthened of late. Lepage identified several reasons for this. For example, the EEC Commission seeks to help Europe improve the productivity of its industries. Lepage noted that the commission believes this can be achieved "by a policy that will discriminate between mergers that allow more economies of scale to be captured and mergers whose aims are only to strengthen monopolistic market positions." But, Lepage warned, "This is precisely the kind of knowledge that no one can obtain without the discovery process of an unhampered market." Lepage concluded that while the fall of communism in Eastern Europe was to be applauded, "many journalists are too quick to proclaim the final victory of

capitalism. The next few years may bring about an unexpected revenge of statism under two guises: that of 'saving the earth' and 'saving competition.' Statism will change its traditional clothes, but it will still be statism."

Finally, Judge Douglas Ginsburg responded to earlier charges that Chicago-school adherents are inconsistent in their approach to antitrust regulation. Ginsburg framed his remarks by identifying the types of business behavior that should be prohibited from an efficiency point of view. He concluded that price-fixing and a few mergers are undesirable in a free-market economy.

The speakers at the conference generally agreed that past antitrust enforcement has often worked to the detriment of consumers and undermined the competitive process. But there was disagreement about whether the proper response was reform or repeal. There is little doubt, however, that antitrust scholars of all stripes will have much to study and debate in the coming decade. Even the gains from the Reagan administration seem by no means assured as the Bush administration's policies begin to take hold in the markets. Kevin Arquit of the FTC has declared, "I hope [the Sherman Act] lives on for another 100 years." Unfortunately, it probably will.

C.E.

Do Not Use U.S. Antitrust Enforcement to Promote U.S. Exports

The Antitrust Division of the U.S. Department of Justice is considering an important change in its international enforcement policies. The proposal is that the division should sue foreign firms that may have violated U.S. antitrust law through activities conducted outside the United States when those activities have adversely affected the ability of U.S. firms to export products to the country in question. If adopted, this practice would represent a dramatic and mistaken departure from Reagan administration policies, as it would reinstate the announced policies of the Carter administration Justice Department concerning extraterritorial antitrust enforcement.

The Reagan legacy, as applied to questions of international antitrust, is embodied in the "Guidelines for International Operations" adopted by the Antitrust Division in 1988. The guidelines describe the situations in which the division will exercise its prosecutorial discretion and bring suit over alleged antitrust violations in international trade. The guidelines are consistent with the Chicago-school view that the only legitimate goal of the antitrust laws is the protection of *consumer* welfare (as opposed to the protection of *producer* welfare). At the time of their adoption, then-Assistant Attorney General Charles Rule explained that the guidelines sought to "condemn only those practices that threaten to raise prices or reduce output to U.S. consumers." The guidelines themselves make this point repeatedly, as in the declaration that the Antitrust Division "is concerned about transactions and conduct" that have adverse "effects on competition, rather than competitors."

The proposed international enforcement policy now under consideration by the Antitrust Division would scrap the consumer welfare orientation of the current guidelines.

This extraterritorial antitrust proposal arose out of the Structural Impediments Initiative (SII), a series of talks between the U.S. and Japanese governments about the removal of alleged barriers to U.S. export penetration of Japanese markets. U.S. negotiators encouraged the Japanese government to take steps to remove or reduce such barriers, and in the June 1990 final report from the SII, the Japanese government pledged stricter enforcement of its own antitrust laws (themselves a U.S. export). The proposal now under consideration at the Antitrust Division apparently developed from a concern that the Japanese government will not do so much in the antitrust area as the U.S. government would like. The idea seems to be that if the Japanese government will not act, the U.S. antitrust authorities should.

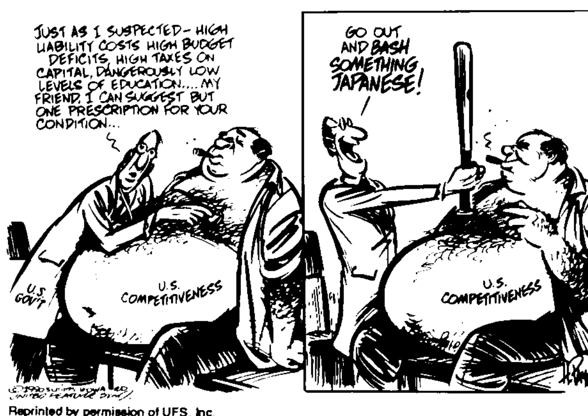
The application of U.S. antitrust laws to actions taken largely (or entirely) in other countries has long been a complex issue, and it has, from time to time, generated much opposition from the United States' trading partners. The U.S. view of its courts' jurisdiction in such matters—which was codified by the Foreign Trade Antitrust Improvements Act of 1982—employs

the "effects test." If actions taken overseas have a "direct, substantial, and reasonably foreseeable effect" on U.S. interests, then a U.S. court may properly exercise jurisdiction to hear the case. The flaws in the proposal now under review do not revolve around jurisdictional puzzles or questions of international law, however. The real problems with the extraterritorial antitrust proposal stem from the type of U.S. interests that would be protected through such lawsuits.

The proposed policy would be applied in situations where, by definition, the welfare of American consumers would not be the primary goal of antitrust litigation. This portion of U.S. antitrust enforcement, instead, would be engineered to protect the interests of U.S. *businesses.* (Indeed, as discussed below, antitrust suits designed to help U.S. exporters could well threaten U.S. consumers' interests.) At best, the extraterritorial antitrust policy under consideration would convert a portion of federal antitrust enforcement into a new type of export promotion program. At worst, it would undermine the Antitrust Division's domestic enforcement activities and lend support to those individuals in Congress, on the bench, and at the bar who wish to see antitrust used to pursue multiple goals. Two major points support this latter claim.

First, it would be difficult for the Bush administration to jettison the consumer welfare standard in the international realm and to adhere to it in the domestic realm. The problem is not merely one of logical inconsistency. Such a posture would likely be attacked both politically and judicially.

In antitrust politics a new export-promotion goal in international enforcement would undercut the administration's credibility and effectiveness in making consumer welfare-based arguments against alternative antitrust policies. For example, the administration has, to date, successfully opposed congressional efforts to reverse several recent Supreme Court decisions in the vertical restraints area that displease some retailers. The consumer-welfare-based analysis that informs the current administration's opposition—as well as the opposition of the Reagan administration—is the most intellectually coherent defense of the doctrines that some in Congress wish to overturn. (See the following Current by Frank Mathewson.) The Bush administration's opponents are not likely to accept the



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position that the antitrust laws mean one thing (promoting the welfare of U.S. consumers) when applied in a domestic setting while they mean quite another (promoting the welfare of U.S. producers) when applied to foreign defendants.

By embracing producer welfare in the international realm, the Antitrust Division would undermine the concept that consumer welfare is the sole appropriate goal of antitrust in domestic antitrust litigation. This is so, in part, because of the structure of the Foreign Trade Antitrust Improvements Act. This act is explicitly a jurisdictional statute; it does not define substantive offenses, but refers instead to the substantive offenses defined in the Sherman and Clayton Acts. Thus, an international antitrust enforcement regime that reads the Sherman and Clayton Acts as advancing producer welfare would, of necessity, read these acts as also protecting producer welfare when domestic behavior and defendants are involved.

There is a second way in which pursuit of an extraterritorial antitrust policy would undermine the remainder of the Bush administration's antitrust policies. If export promotion is a goal of federal antitrust enforcement, the Antitrust Division could attack foreign business methods that *promote* U.S. consumer welfare. Consider, for example, the case of U.S. firms that fail to make sales to Japanese manufacturers. Such failures are often blamed on the Japanese *keiretsu*—alliances of firms centered around either a bank or a major manufacturer. Fear of *keiretsu* recently led Rep. Jack Brooks to direct the FTC to investigate the purchasing practices of the Japanese auto manufacturers—and their failure to buy from U.S. suppliers. In the SII talks, the U.S. representatives (including Assistant Attor-

ney General James Rill, head of the Antitrust Division) were clearly suspicious of the *keiretsu*, and the Japanese government promised to study antitrust compliance questions regarding *keiretsu* members.

Keiretsu can serve legitimate purposes, however. According to an article by Marie Anchordoguy in the July-August 1990 *Harvard Business Review*, a *keiretsu* led by a large bank "enable[s] companies to share risk and provide[s] a mechanism for allocating investment to strategic industries." "Supply *keiretsu*," on the other hand, "are groups of companies integrated along a supplier chain dominated by a major manufacturer." *Keiretsu* members typically engage in "mutual shareholding," the "purchase of a small amount of each other's shares, usually 2 percent to 5 percent," combined with a promise not to sell the stock. Accordingly, interlocking directorates are common. Also common, according to the U.S. representatives to the SII talks, is the refusal of firms that are members of *keiretsu* to buy from American suppliers. They prefer instead to deal with their *keiretsu* brethren.

Should the Antitrust Division seek to attack the Japanese *keiretsu* system through antitrust litigation? The supply *keiretsu* are a form of vertical integration, to many forms of which U.S. antitrust law was long hostile. Indeed, in the mid-1960s, the Supreme Court threatened to declare per se illegal nonprice vertical restraints, such as a supplier's territorial constraints. Recent decisions by the Court in this area have adopted a much more defensible approach to questions of vertical restraints, but these recent decisions rest primarily on a consumer-welfare standard. If this standard is jettisoned in the international arena, what standards would then be applicable, domestically or internationally?

Unfortunately, if antitrust is viewed as promoting producer welfare as well as consumer welfare, then the welfare of U.S. consumers would most likely suffer. Suppose that the Antitrust Division's hypothetical challenge to the *keiretsu* succeeds. If firms in a Japanese industry choose to organize in this fashion, and if they also gain a larger share of world markets, it is reasonable to conclude that this is a superior, more efficient way of organizing production.

Indeed, just such a conclusion is reached by Charles Ferguson of the MIT Center for Technology, Policy, and Industrial Development. In an article titled "Computers and the Coming of the U.S. *Keiretsu*" in the *Harvard Business Review*, Ferguson argues that the recent successes of Japanese computer firms can be traced in substantial measure to their *keiretsu* form of organization. He goes on to suggest that U.S. and European firms must emulate this example if they are to compete effectively. If the Japanese system is a superior form of organization, then attempts to protect U.S. suppliers through an antitrust assault on the Japanese computer *keiretsu* would risk serious damage to the interests of U.S. buyers of computers and other information-technology products. Clearly, U.S. suspicion of "foreign" forms of business organization combined with an antitrust policy that makes them targets of government-sponsored litigation may well prove counterproductive from the standpoint of U.S. consumers' welfare.

Private plaintiffs may also attempt to make the same arguments that the Antitrust Division is now considering. One hopes that the Antitrust Division would oppose the private suit if U.S. consumers' welfare would be harmed by interfering with foreign business practices. The Antitrust Division's ability to oppose such suits would, however, be diminished if it adopted the policy now under consideration. This is so largely because the policy would have the effect of legitimizing the private plaintiff's claim that the antitrust laws protect producer welfare.

The Antitrust Division's specialists in international enforcement are reviewing the proposal to use U.S. antitrust laws to promote U.S. exports. A decision will likely be announced before the end of the year. The decision will have a profound effect on the future of the idea that consumer welfare is the single legitimate goal of antitrust. This idea is invaluable in confining the law to its proper, limited role in the U.S.—as well as the international—economy. Although the past decade has seen federal antitrust enforcement policy and much case law based on the consumer welfare norm, it is still an open question whether this view is politically viable. The resolution of this seemingly narrow issue of international enforcement should give us some indication. The administration should decline this proposed new venture in U.S. antitrust enforcement.

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Resale Price Maintenance Revisited

Among other pieces of potential legislation percolating in the U.S. Congress are bills that will transform current U.S. common law on resale price maintenance into statutory law. Dissatisfaction with the Supreme Court's decisions in two recent cases, *Spray Rite* and *Sharp Electronics,* appears to be the catalyst for the current legislative push, championed in the past by Sen. Howard M. Metzenbaum and others. Whether the catalyst will prove sufficient to press the legislation through the Senate as well as the House remains to be seen. But the push seems to be stronger now than before. From the perspective of antitrust economics there are two questions of interest: Does the legislation promote economic efficiency? If not, what specifically accounts for the legislation? Or "whose ox is being gored"?

Recently, economic and legal scholars have written extensively about resale price maintenance (RPM) and the host of other possible vertical contractual restrictions between manufacturers or wholesalers and their downstream operators such as retailers or franchisees. A considerable body of learned opinion argues cogently that these practices, when observed, are likely to be efficient. In any case, it seems reasonable to apply to RPM the same rule-of-reason approach accorded to other possibly substitute instruments such as exclusive territories.

There is more than one possible role for RPM. The classic explanation involves a "free-ride" among retailers where point-of-sale information and service at the retail level are important to the sale of the product. The story is simple enough.

In a market where consumers require relatively extensive information before making a purchase or before using the product, a "free-rider" problem can develop if consumers go to a full-service store to obtain the necessary information but then purchase the product from a discount outlet that provides no information but offers a lower price. In the extreme, if the provision of information at the retail or wholesale level is essential to the development of a market or product, the failure of the full-service store to recover the cost of providing the information could lead to the collapse of the market. Manufacturers who can eliminate discounters by imposing price floors can guarantee a return to the full-service retailer and thus allow the market to develop. Whether RPM is necessary to ensure that valuable information is available in any particular case should be decided on the facts of that case. RPM would seem to make the most sense for complex products just introduced to or relaunched in the market.

In the case of *Spray Rite,* for example, Monsanto had responded to a drop in its market share of farm herbicides by initiating a program of point-of-sale information to farmers on the application and uses of its farm products. Monsanto claimed that Spray Rite did not adhere to the Monsanto plan, did not employ technically trained employees, and sold the product at discount prices. Other dealers complained to Monsanto. If the information program was important to the sale of the product, the associated disincentive created for other retailers by the discounter's failure to provide the information could jeopardize the market for Monsanto. The court upheld Monsanto's right to establish a price floor if Monsanto's decision were unilateral, but in this case the Court supported the district court jury's finding of a "common scheme" to set resale prices.

But RPM can enhance efficiency even when the apparent role for retailer information would appear to be minimal. For example, jeans have frequently been subject to RPM, yet retailers of jeans provide no important information role. Realistically, consumers do not try on jeans at high-service stores and then buy the jeans at discount stores. The interest of manufacturers in imposing RPM in such cases can be explained without the free-rider argument.

Retailers offer many nonprice services that encourage consumers to buy products. They display them for consumer inspection in pleasant and perhaps spacious surroundings. They offer demonstrations of the product's capabilities and attributes. They engage courteous sales people to accommodate consumers' search for products that meet their needs. And retailers affect the consumers' costs of purchasing a product by the length of the lines at cashiers' stations.

Manufacturers are interested in setting price *and* nonprice instruments to encourage consumers to purchase their products rather than those of their rivals. Manufacturers are less interested in which specific retail outlet the consumer chooses. Retailers, however, use both price and nonprice competition to encourage consumers to purchase a particular good at their outlet rather

than at a competing outlet. The differences between the objectives of the manufacturer and the retailer or wholesaler in using price and nonprice instruments can lead to the use of RPM to align the interest of both parties.

The consumers that one retailer attracts away from another retailer have low average opportunity costs of time and search costs. (Busy people buy jeans from the nearest store and are less price conscious and more service conscious.) From the manufacturer's perspective, the retailer is overly concerned about consumers who have low search costs when it makes its pricing and nonpricing or service decisions because these consumers are overrepresented among consumers on the margin of buying between two retailers. The manufacturer focuses instead on consumers on the margin of buying his product instead of another product. These consumers are more concerned with the "nonprice" costs of buying the product. The manufacturer can help realign the retailers' incentives by constraining the extent of their price competition, which encourages more service competition.

The earlier example of point-of-sale information is one example of a retailer service, but it is not the only one. The use of RPM by a manufacturer in its retail contracts is by itself, no indication of a substantial lessening of competition. Subjecting virtually all such agreements to rules of per se illegality, which would be the case if the bills under current scrutiny become law, could therefore substantially reduce overall consumer welfare.

If RPM were per se legal, not all manufacturers would instantly choose to eliminate all discounters. Discounters could serve other roles, such as servicing the more price-sensitive segments of the market.

To serve consumers, then, competition policy must move away from the excessively rigid position associated with the type of bills currently being considered in Congress. The tests for the courts should be the facts in a particular application and the possible motivations for the practice.

In the *Spray Rite* and *Sharp Electronics* cases, the U.S. Supreme Court seems to be inching toward this position in an extension of the Colgate doctrine. Under this doctrine, manufacturers are free to select the type and nature of competition for their products at the retail level, provided that there is no conspiracy between the manufacturer and an existing retailer to eliminate a price-cutting retail competitor.

If the proposed legislation would lead to lower economic efficiency, why are the bills before Congress? One suggestion is that the recent advocacy position by the Antitrust Division of the Department of Justice (beginning with William Baxter's term as Assistant Attorney General) has incensed Congress, and the enhanced chances of the bills in Congress reflect increased congressional hostility toward the Antitrust Division's policies. Of course, this does not identify whose interests the bills would protect. If RPM did signal a horizontal price conspiracy across retailers or manufacturers, there is already obvious and ample legislation to protect economic efficiency. Those who would benefit from per se illegality of RPM do not appear to be so numerous or so important politically as to warrant this kind of attention.

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Stop Giving Away Airline Routes

Federal lands hold enormous deposits of oil, natural gas, silver, and other minerals. If the government one day were to announce that it would give an oil field to some private company without requiring any payment, the American people would react with outrage, and rightly so.

Now, let us turn the lens to international air services. International air passenger and cargo services are regulated by the national governments of the countries touched by the respective routes. Government regulation often results in high fares that in turn are supported by limits on capacity and frequency of flights. These high fares translate into substantial profits for airlines fortunate to receive the right to operate. Some measure of these profits may be gleaned from the price of $750 million paid by United Airlines to Pan American's Pacific Division for aircraft and route authorities in 1985, and Eastern Airlines' recent sale of its Latin American routes to American Airlines for $349 million.

Clearly, international air routes can be as profitable as oil, gas, or silver deposits. But the fed-

eral government chooses to treat them very differently. Companies must pay to extract oil from federal lands. In contrast, no airline has ever paid a penny to the federal government for rights to international air routes.

A simpler, fairer, and more efficient method would be to allocate rights to new routes by open tender. The airline that believes that it can provide the most competitive product—in terms of service and price—would bid highest and win the auction. If market forces prove management wrong, or if competitive conditions change, the airline should be allowed to sell the route authority to another operator. Put simply, the federal government should not treat international air routes differently from other federal property such as undeveloped land, timber, or vehicles seized from drug traffickers.

Under the present system, the initial recipient of route authority pays nothing to the government. This means, of course, that airlines compete for the rights in other ways. I do not doubt that airlines have spent large sums on lawyers, lobbyists, and influence to obtain routes. Last November, the federal government concluded a new air services agreement with Japan that Secretary of Transportation Samuel Skinner hailed as providing "the most dramatic expansion of air services to Japan since the original bilateral aviation agreement was signed in 1952." The agreement triggered a scramble among U.S. airlines, including American, Delta, Northwest, and United, for new routes, which Assistant Secretary of Transportation Jeffrey Shane estimated would take *twelve months* to allocate. Without doubt, an abundant harvest for Washington lobbyists!

And they are not the only beneficiaries. It is said that the Department of Transportation prefers airlines to serve long international routes with Boeing 747s. Should the airlines not be allowed to decide such questions?

The current system also engenders other inefficiencies. Presently, DOT must approve all transfers of routes between airlines. The department is said to question whether routes should be sold by one carrier to another.

Inefficiencies arise wherever property rights are not well defined or secure. Livestock farmers systematically overgraze common pasture; Hong Kong residents are transferring their assets to avoid expropriation by the Peoples Republic after 1997. Similarly, an airline whose claim to a route is uncertain will be discouraged from long-term investment. American managers are often criticized for being myopic. International air services are an example where short-term thinking results directly from ambiguity in government regulation. The remedy is simple—remove the regulator's discretion.

DOT might argue that assignment of routes by administrative fiat allows the department to prevent any one airline from building up monopoly power over international air services. The auction method that I propose does not prevent DOT, or the Justice Department for that matter, from regulating which airlines should be allowed to participate in an auction. If either agency judged that market competition might be jeopardized, it could, of course, disqualify particular airlines from bidding. Likewise, the federal and state governments could review all subsequent transfers of routes, just as they do under existing antitrust laws in many other markets.

Allocation by auction, however, does force all government decisions out of the recesses of dimly lit corridors and smoke-filled rooms into the clear light of day. It forces airlines to compete for rights to a valuable asset in the most efficient way possible, and moreover, to use the asset efficiently. Finally, the auction method clearly defines the property right and thereby fosters long-term investments.

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Higher Budgets for Federal Regulators

When former President Reagan came to office nine years ago, he promised to get the government off the backs of Americans. One of the tools applied to this ambitious task was to tighten the purse strings of the federal regulatory agencies.

But the first solo budget of President Bush sends a different message—"happy days are here again" for federal regulators. Much can be inferred about President Bush's view of the federal regulatory apparatus from an analysis of his proposed 1991 budget.

Bush Budget Breaks from the Recent Past

Spending by the federal regulatory agencies will reach a record high in 1991—both in current dollars and in real terms. Expenditures will total nearly $12.25 billion, up 9 percent in nominal dollars and 4 percent after adjusting for inflation.

Last year's budget (primarily prepared by Reagan holdovers), by contrast, called for only a 2 percent nominal increase in regulatory spending. After adjusting for inflation, real spending was slated for a 1 percent cut. Interestingly enough, after Congress and the Bush administration massaged the 1990 budget, federal regulators gained a great deal of purchasing power. Spending plans increased from $10.98 billion to $11.26 billion, thus changing a proposed cut in real spending to an actual increase.

Similarly, President Bush appears more inclined to allow the federal agencies to increase their employment than was his predecessor. Regulatory staffing is estimated to rise by 4,300 people from 1990 to 1991—a 4 percent increase. Nonetheless, the total of 113,300 is still well below the peak of 118,800 reached in 1980 at the end of the Carter years.

Reagan's regulatory reform strategy included hefty personnel reductions. Regulatory staffing dropped by 15 percent from the 1980 high to 101,300 in 1985. In his second term, Reagan allowed modest staff growth—about 1 percent a year. In addition to planning for a much larger increase in 1991, Bush is permitting the agencies to add 2,000 more staffers in 1990 than the previous administration had planned. Thus a 3 percent growth in federal regulatory personnel in 1990, followed by a 4 percent increase in 1991, signals a significant departure from the game plan of the past.

In short, President Bush appears less skeptical about the role of federal regulators in the U.S. economy. He is willing to provide more resources—dollars and staffing—to these efforts than was Reagan. Indeed, he has proposed a growth path for regulatory budgets and staffing that looks similar to the budget trends of the Carter years.

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Focus on the Environment

Bush's pledge to be the "environmental president" and the continuing high level of public support for environmental controls virtually assures the Environmental Protection Agency its place at the top of the federal regulatory agencies for the foreseeable future. The EPA budget (excluding construction grants) accounts for nearly one-third of the total expenditures for 1991 at the federal regulatory agencies. EPA is slated for a $360 million budget increase in 1991, following a $310 million rise in 1990. This 20 percent boost over two years is substantially above the average 16 percent increase in total regulatory expenditures.

EPA staffing has also grown dramatically during the past twenty years. The head count has increased from 3,900 in 1970 to 15,300 in 1990. The new Bush budget allows for an additional 900 employees, which will bring the total to 16,200. By the end of 1991, EPA staffing will account for 14 percent of the total for federal regulatory agencies. The two Bush budgeting periods have resulted in an overall projected staffing increase of 16 percent at EPA, well above the 7 percent overall increase in federal regulatory personnel.

A Rising Tide Lifts (Nearly) All Boats

Tables 1 and 2 provide summary information from the 1991 budget as well as some historical figures to put the new numbers in perspective. Table 1 shows that budgets are growing in real terms in every subcategory except energy. This does not mean that every agency is growing, but it does indicate that many different types of regulatory activities are expanding.

Overall, budget gainers in the 1991 budget outnumber losers by 32 to 19. Growth in real spending is a widespread phenomenon. Our re-

Table 1: Summary of Administrative Costs of Federal Regulatory Activities (fiscal years, dollars in millions)

Agency	1970	1980	1989	(Estimated) 1990	1991	% Change 1990–1991	1970	1980	1989	(Estimated) 1990	1991	% Change 1990–1991
	Current Dollars						Constant 1982 Dollars					
Social Regulation												
Consumer Safety and Health	710	2,354	3,185	3,476	3,804	9	1,524	2,730	2,513	2,637	2,770	5
Job Safety and Other Working Conditions	128	753	959	998	1,060	6	274	873	757	757	772	1
Environment	214	1,651	3,904	4,185	4,485	7	459	1,915	3,081	3,175	3,267	3
Energy	64	550	449	484	501	4	137	638	354	367	365	−1
Total	1,116	5,308	8,497	9,143	9,850	7	2,394	6,156	6,705	6,936	7,174	3
Economic Regulation												
Finance and Banking	87	362	1,067	1,073	1,218	13	187	420	842	814	887	8
Industry-Specific Regulation	91	279	301	321	346	7	195	324	238	244	252	3
General Business	115	354	693	723	832	15	246	410	547	548	606	10
Total	293	995	2,061	2,117	2,396	13	628	1,154	1,627	1,606	1,745	8
Grand Total	1,409	6,303	10,558	11,260	12,246	9	3,022	7,310	8,332	8,542	8,919	4

Source: Center for the Study of American Business, Washington University. Derived from the Budget of the United States Government and related documents, various fiscal years.

port for the Center for the Study of American Business—*Regulation's Rebound*—provides detailed data on individual agency spending and staffing. A few highlights from this more detailed analysis are worth sharing in this brief overview.

A general principle, borne out by the 1991 budget, is that regulatory growth often follows salient news events. Coast Guard budgets benefit from oil spills; Food and Drug Administration spending rises to handle increased pressure for new AIDS drugs and charges of alleged quality problems for generic drugs; financial regulators are added to respond to concerns about instability in the financial markets; and Federal Aviation Administration budgets climb in the face of concerns about airline equipment and personnel readiness.

"Consumer safety and health" is receiving an added boost due to large increases at the FDA,

Table 2: Staffing Summary for the Federal Regulatory Agencies (fiscal years, permanent full-time positions)

Agency	1970	1980	1989	(Estimated) 1990	1991	% Change 1990–1991
Social Regulation						
Consumer Safety and Health	41,613	54,591	44,888	46,040	47,973	4
Job Safety and Other Working Conditions	7,472	18,201	14,768	14,705	14,899	1
Environment	4,241	14,318	17,840	19,441	20,258	4
Energy	688	5,303	3,380	3,293	3,301	0
Total	54,014	92,413	80,876	83,479	86,431	3
Economic Regulation						
Finance and Banking	6,219	9,681	10,881	10,747	10,884	1
Industry-Specific Regulation	6,072	7,365	4,708	4,770	4,798	0
General Business	7,070	9,390	9,392	10,015	11,198	11
Total	19,361	26,436	24,981	25,532	26,880	5
Grand Total	73,375	118,849	105,857	109,011	113,311	4

Source: Center for the Study of American Business, Washington University. Derived from the Budget of the United States Government and related documents, various fiscal years.

FAA, and the Agricultural Marketing Service. This category of regulatory activity shows a 9 percent growth in the Bush budget. Staffing levels are also growing substantially. The FDA and FAA personnel totals will increase in 1991 by 9 percent and 6 percent, respectively.

Budget increases for the Patent and Trademark Office and the Securities and Exchange Commission cause the largest subcategory growth in "general business." Spending in this area is increasing by 15 percent in nominal terms and staffing is going up 11 percent. Once again, these increases are not surprising. The concern about protecting intellectual property rights is helping the Patent and Trademark Office to increase its budget by 21 percent and its staffing by 22 percent. The frequent Wall Street scandals and the junk bond crisis are leading to changes at the SEC that justify a 16 percent budget increase and personnel growth of 6 percent.

Many smaller agencies also show significant budget increases on a percentage basis that indicate growing concern for specific issues. The Drug Enforcement Administration, Labor-Management Services Administration, Farm Credit Administration, Commodity Futures Trading Commission, and the Copyright Office are examples.

The Changing Composition of the Regulatory Pie

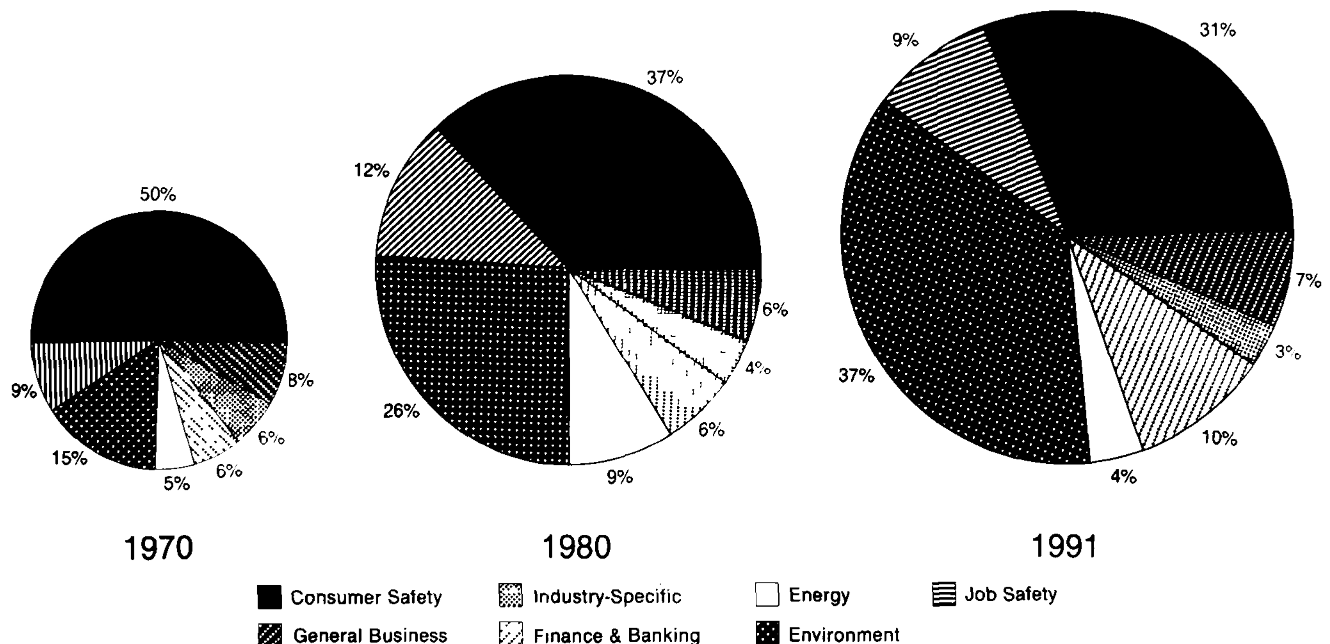
Figure 1 shows how the division of the spending pie has changed over the past 20 years. The size of the "pies" in the figure are also proportional to real spending totals. Clearly, spending priorities have undergone significant changes during the past two decades.

First, environmental expenditures (excluding EPA construction grants) accounted for only 15 percent of federal regulatory spending in the inaugural year of the EPA. A decade later, environmental administrative costs claimed 26 percent of total expenditures. The Bush budget for 1991 would give environmental concerns 37 percent of the total.

On the other hand, spending for "consumer safety and health" has been shrinking in relative terms over this period. Half of federal regulatory expenditures were in this area in 1970, declining to 37 percent in 1980 and falling further to 31 percent of the 1991 budget.

This declining share of the spending pie is primarily the result of lower than average spending growth at the old-line agricultural inspection services within the Department of Agriculture. In real terms the Consumer Product Safety Com-

Figure 1: Changes in Real Spending Shares



Source: Center for the Study of American Business, Washington University. Derived from the 1970, 1980, and 1991 Budgets of the United States Government.

mission budget has declined nearly 50 percent since 1970. Higher growth rates at the FAA and FDA have failed to balance below-average increases at the other agencies included in "consumer safety and health."

Economic deregulation has had a mixed effect. As Figure 1 shows, "industry-specific" regulation (primarily in the transportation industry) is steadily shrinking. This area went from 6 percent of the pie in 1970 to 4 percent in 1980 to 3 percent in 1991. But deregulation in finance and banking has actually led to a *larger* share of regulatory spending in this area—from 6 percent of the 1970 budget to 10 percent in 1991. The continuing federal insurance of deposits and an active role in assuring confidence in financial markets explain this apparent anomaly.

Energy market regulation has grown and then contracted during this period—a reflection of changing views of the effectiveness of the marketplace vis-à-vis direct government controls. Energy regulation in 1970 consisted of Nuclear Regulatory Commission (Atomic Energy Commission) restrictions on nuclear power plants. With the establishment of the Department of Energy, the proportion of regulatory expenditures going to this subcategory grew from 5 percent to 9 percent in 1980. Deregulation of petroleum and natural gas since then has shrunk "energy" spending to 4 percent of the total.

Conclusion

Analyzing the spending and staffing plans for the 51 major federal regulatory agencies is admittedly an exercise in reading tea leaves (or perhaps the entrails of a goat). The figures provide a crude measure of the ebb and flow of federal intervention in various areas of the private sector. Of course, it is not the administrative cost of regulation that reflects the primary impact on the economy but rather the multiplier effect of regulatory agency activities on compliance costs borne by business firms and ultimately by consumers.

Analysts are on firmer ground when inferring meaning from two decades of data than they are when analyzing just two budget periods. The rising importance of environmental issues is a clearly established phenomenon. Apparent across-the-board support for federal regulations shown in President Bush's 1991 Budget may or may not prove to be an enduring feature of administration budgets, however. But for now it seems safe to conclude that regulation is on the rise in the U.S. economy.

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