Readings of particular interest

Regulatory Agency Structure—Cause for Optimism?

Governance of Federal Regulatory Agencies by David M. Welborn (Knoxville, Tenn.: University of Tennessee Press, 1977).

This study, undertaken in response to growing public concern about the performance of regulatory agencies, examines the inner workings of the Civil Aeronautics Board, the Federal Communications Commission, the Federal Maritime Commission, the Federal Power Commission, the Federal Trade Commission, the Interstate Commerce Commission, and the Securities and Exchange Commission—known as the "Big Seven."

According to David M. Welborn, political scientist at the University of Tennessee, not enough is known about how a regulatory commission (as distinct from an agency headed by a single official) functions, and this may explain some of the recent criticism of the performance of these commissions and the attendant proposals for reform. Nonetheless, Professor Welborn emphasizes that his intention is not so much to evaluate these criticisms and proposals as "to explore the relationship between agency governance and those characteristics of performance identified as problems." Specifically, the lines of inquiry of this study are drawn in terms of the finding of the 1971 President's Advisory Council on Government Organization, headed by Roy Ash: that regulatory commissions are ineffective because of their independence of the President and their collegial character.

Professor Welborn's conclusion, based principally on interviews with present and former regulators, is that "systems of governance have developed [within the so-called Big Seven] so that the commission form is not a barrier to achieving performance aims, such as those put forth by the Ash council, or to achieving the diverse objectives sought in economic regulation." This conclusion rests on the determination that the commission chairman, partly because of legislation and executive orders in the 1950s and 1960s, has become the key to an agency's operations. The chairmen "stand apart from other regulators in scope of activity, engagement in regulatory processes, and in imprint on regulatory determinations." They have wide discretionary powers over such disparate matters as staff appointments and what issues are brought before the commission for collective consideration. Furthermore, they have a much larger public role than their colleagues since it is they who speak in behalf of their agencies before Congress and other organizations. The extensive role of the chairman in agency governance is, in sum, "secure in its underpinnings, stable in at least broad outline, and typically free of substantial, overt conflict."

Thus, in contrast to the Ash council's assertion that regulatory commissions suffer from "splintered management," the author describes their structure as consisting of "a fairly high level of integration around the chairmanship." In other words, suggestions that regulatory commissions need a single dominant executive instead of a collegial executive miss the point, since this is already what they have to a large extent. Moreover, just as the term collegiality no longer describes relations among fellow commissioners, the term independence no longer accurately describes relations between the regulatory commissions and executive branch agencies and departments. Indeed, according to the author, chairmen who accept appointments today often see themselves as part of the President's administration. In effect, these developments, along with the constraints embodied in the appointment process, the congressional appropriations process, and existing statutes and precedents, make it clear that regulatory commissions are not so

independent as to be politically unaccountable.

Having suggested that the Big Seven as constituted can do what they are supposed to do—albeit, at times, with much difficulty because of the enormously complex task of trying to reconcile competing economic interests—Welborn presents suggestions for improving regulatory performance. Consistent with his theme of the expanded role of commission chairmen, he emphasizes ways to make fuller use of this position without diminishing "the working concept of collegiality." First, the President should try to appoint as chairmen individuals who can deal with both broad substantive issues and the myriad details of day-to-day regulatory business. Second, chairmen should use the skills and abilities of their fellow commissioners more effectively. Third, "innovative ways" for handling the multiplicity of regulatory tasks must be found. Finally, means for facilitating systematic coordination between regulatory agencies and other governmental bodies and organizations are needed.

The Burger Court and Mr. Bakke

"The High Court's Road in the Bakke Case" by A. E. Dick Howard, in *The American Oxonian,* October 1977, pp. 225-234.

In this review of *Regents of the University of California* v. *Bakke,* A. E. Dick Howard of the University of Virginia Law School traces the evolution of the Supreme Court's views on race since 1896, analyzes the arguments on both sides of the case, and gauges the likely responses of the Burger Court. Allan Bakke, a disappointed white applicant, is challenging the constitutionality of a special admissions program of the medical school at Davis, under which sixteen out of one-hundred places in the entering class are set aside for minority students.

According to Professor Howard, if the Court should choose to decide the case on the grounds of constitutionality, then "the central issue becomes one of deciding whether the 14th Amendment's guarantee of 'equal protection of the laws' permits a person's skin color alone to influence or determine his admission to a professional school."

The author finds it difficult to accept arguments that the Fourteenth Amendment does apply to "benign" race-specific acts, for these acts are certainly not benign toward those who are displaced and may also have the deleterious effect of undermining the self-respect of minority students. Moreover, the notion of race preference raises perplexing questions: "How many places in an entering class may be earmarked for members of a given race?" If race is simply one factor among many, how is it to be weighted? May all minorities be given preference, including those like the Asian-Americans who are already generously represented in regular admissions? At any rate, the author argues, to provide racial preference is to "risk exacerbation of racial resentment."

The Court's approach to racial issues has shifted, Howard notes, from the view that the Constitution is colorblind (stated in Justice Harlan's famous dissent of 1896) to support for racially based remedies to past injustices. Yet, according to Howard, the recent precedents justifying preferential treatment of minority applications as a means of remedying previous discrimination may not be applicable in the Bakke case, because there is no evidence that Davis has ever discriminated. Moreover, in cases where the Court has allowed the use of racial considerations, the situation has not been one of scarcity (a limited number of places), and the remedy has merely required shifting students or voters from one place to another, not denying some a place altogether.

The author does not expect the Court to disregard entirely its rule of "strict scrutiny" of racial considerations simply because those considerations are now being used to favor minorities instead of to discriminate against them. Nor does he expect the Court to "endorse the notion that minorities are entitled to something like a proportionate share of the country's doctors and lawyers" simply because their numbers are so low in these professions.

Indeed, the justices may wish to reject in principle the notion of race as a criterion for admission; but if they do they will be likely, in Howard's view, to consider the social impact of their decision. He suggests three ways for the Court to resolve the dilemma. (1) It could decide to substitute the concept of "disadvantage" for the concept of race. Though this remedy might end up helping mostly poor

whites, this result cannot be predicted because few, if any, law or medical schools have tried out this approach. (2) The Court could decide to leave admissions policy to the universities themselves, just as it has kept its hands off other social issues it considers better left to local experimentation or to the political process. Finally, (3) the Court could outlaw "quotas" (Howard recognizes the difficulty of defining this word) but let the universities "use race as one factor in admissions."

Although Professor Howard believes the Court could easily duck the constitutional issue, the problem would remain. Thus he concludes: "As with the Brown ruling in 1954, there is a special need for a decision that is seen to rest on principle."

A Counterproposal for Containing Health Care Costs

"Health Care Cost-Containment Regulation: Prospects and an Alternative" by Clark C. Havighurst, in *American Journal of Law and Medicine*, Fall 1977, pp. 309-322.

Clark C. Havighurst of the Duke University School of Law argues that regulation of health care for the purpose of containing overall costs is, in fact, a form of rationing. It is also, he says, a particularly difficult form of rationing for political institutions to undertake, because the public expects a high standard of health care and because that care has a symbolic value—health care is a "right"—as well as an economic value.

Necessarily, according to the author, cost-containment regulation would prevent patients from receiving, and professionals from providing, the care that both believe would be beneficial. The regulators "have been asked to say 'no' " in circumstances where everyone immediately concerned "is inclined —because they do not face the costs—to say 'yes.' "

Professor Havighurst argues that regulation sometimes seems advantageous because it is compared not with alternative policies but with doing nothing at all. Because the providers of health care have failed at self-regulation in their professional standards review organizations and will not perform the rationing function, there is a movement toward arbitrary forms of regulation or, in the author's words, "escalating arbitrariness." The proposal to establish a cap on health care costs and then allocate the permitted costs by political processes would deprive some consumers of care they wanted and give others care they would not purchase if they could. The natural tendency of regulation in health care is "toward narrowing consumers' range of choice, enforcing a false consensus, and obscuring the wide variations that exist in both consumer preferences and medical practice."

Havighurst suggests a market alternative. He would (1) reduce "excessive subsidization" of health insurance by changing the federal tax treatment of health insurance premiums, (2) encourage active competition between and among insurers, health maintenance organizations, and "new models of health care financing and delivery," (3) enforce antitrust laws in the health care professions to encourage experiments in cutting costs to consumers, (4) allow Medicaid and Medicare beneficiaries some choice between more health care and cash by giving them vouchers—or refundable tax credits—to cover their payments under those programs. In other words, he argues for a competitive market in the provision of health care, one that is free of government-instituted

'Boy, hospital costs are really getting out of hand. They charged me $385 and I only visited a friend in Room 212!'

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rigidities. In that kind of market it would be the patients and the providers, not the government cap, that would contain costs.

Folklore and the FDA

"Regulating Pharmaceutical Innovation: An Economist's View" by J. E. S. Parker, in *Food Drug Cosmetic Law Journal*, April 1977, pp. 160-181.

The author, an English economist now senior lecturer at Otago University in New Zealand, here compares the regulation of new drugs in the United States and the United Kingdom, taking into account the (1) folklore of a regulatory agency's operations, (2) the agency's terms of reference, administrative structure, access to scientific knowledge, methods of communication, procedures, incentive structure and attitudes toward risk, and (3) the basic underlying model of innovation.

He notes that American folklore counsels that delaying the introduction of new drugs is a benefit, while in Great Britain the folklore counsels that new drugs are good and "the regulatory agency is not considered fair game for parliamentary comment." Moreover, in the United States, drugs must be proved effective before they are used, while in Great Britain (at least by law) they need only be proved safe.

In the United States, the regulatory agency in question—the Food and Drug Administration—is a part of the executive branch (in British terms, "a full-blown department of State"), whereas its British counterpart—the Committee on Safety of Medicine—was, until 1968, quasi-independent and quite small. But now the CSM is an agency of the government and is, moreover, requiring retrospective review of drugs already introduced for effectiveness as well as safety. Nevertheless, even now, the British have not quite reached the U.S. situation where "the patient is protected from drug hazard and not from disease."

A further contrast is the fact that the FDA relies on in-house personnel, the CSM on outside experts—the latter being more likely to be acquainted with the frontiers of medical knowledge and, therefore, more likely to understand the nature of new drugs. Tied to this is the formality of procedure: the FDA needs all things in writing, while the CSM encourages person-to-person contact. On the question of risk, the U.S. system embodies a concern with "absolute risk," the U.K. system with "relative risk," in Parker's terms. U.S. drugs are to be "risk free," while in Great Britain the risk of using a new drug is to be measured against the risk of not using it.

Finally, the implied model of innovation in the U.S. scheme of things is one in which advances are made in predictable little steps, "where a compound is identified as having possible therapeutic value for a specific disease, and a highly directed routine is then followed from testing in animals through to evaluation in man." The British model implies a more sophisticated innovation process than the FDA's "disease specific potential drug" model—a process in which there may be more complicated and indirect paths to innovation.

With all this set out, Mr. Parker turns to the observed decline in new drug introductions in the United States, the decreasing productivity of R & D expenditures in the United States, the concentration of innovational output in the United States in larger established companies, the contrary trends in Great Britain, and the—so far, modest—export of U.S. resources to avoid FDA regulation. He suggests that, to reverse these trends, a new model of innovation is needed, a new attitude toward risk, new procedures, new use of outside experts, and—underlying all of this—a new folklore and political environment for the regulation of pharmaceutical innovation in the United States.

Weidenbaum on Government and Business

Business, Government, and the Public by Murray L. Weidenbaum (Englewood Cliffs, N.J.: Prentice-Hall, 1977), 336 pp.

Murray L. Weidenbaum, director of the Center for the Study of American Business at Washington University (St. Louis), designed this book for "future generations of business executives" as well as "government officials and members of various interest groups." Though the benefits of regulation are noted, and though all seven case studies come from gov-

ernment sources, Professor Weidenbaum emphasizes the costs of regulation—to business and, through business, to the public. The book describes "far-ranging regulatory activities, which impinge on almost every business executive . . . in industries that are not ostensibly 'regulated' as well as those that are."

Part I on "Regulation by Government" deliberately adopts "at times an unconventionally critical view of federal intervention," designed to provoke discussion. The author considers consumer safety, automobile safety, job safety, environmental controls, and job discrimination, before turning to regulation via government procurement and government as financier. The chapter on procurement points out that the question of social responsibility has largely been settled for companies doing business with the federal government: they do what the government wants or they do not get government contracts. Many of these government-oriented corporations have taken on the characteristics of government bureaus, and the consequent loss of the "advantages of innovation, risk-bearing, and efficiency" is a high possible cost to the society as a whole. The chapter on the government as financier argues that government-guaranteed credit reduces the "amount of credit that can be provided to unprotected borrowers, mainly consumers, state and local governments, and private business firms."

Part II on "The Adaptation by Business" discusses passive, anticipatory, and active business responses to government controls. It appears to Weidenbaum that large firms are able to respond more actively and positively than small firms, though trade associations may help small firms in their response.

Part III on "Shaping the Business Environment" begins by examining the means by which business adjusts to increasing government involvement in its day-to-day activities—lobbying, trade associations (including their lobbying), and participation in the political process (the data suggest that some businessmen do not fully understand that process). Then, as a kind of capstone to the entire volume, Professor Weidenbaum examines the rising government presence in business management. This rising presence, he suggests, represents a "second managerial revolution." Just as the first managerial revolution transferred the locus of business decision-making from the firm's owners to the firm's managers, the second is transferring it from the firm's managers to the "vast cadre of government regulators."

As a case in point, the author focuses upon the proposal of the Initiative Committee for National Economic Planning to create a formal system of national economic planning, whereby the government would forecast demand for goods and "induce" industries to meet the demand forecast (the means of "inducing" being laws, as specific as necessary). Proposals for federal chartering of corporations and a requirement for public members (including labor representatives) on boards of directors, if enacted, would also help bring about a basic change in the nature of corporations and in the relationship between business and government.

The present relationship, in Professor Weidenbaum's words, appears to be "basically adversary in nature." Rather than continuing along this line or embracing a government-business partnership on the European or Japanese model (which would submerge the public interest, especially the interests of consumers), he suggests a third alternative—"peaceful coexistence" made possible by "a sensible division of labor between the public and private sectors in achieving basic national objectives."

Regulation by Litigation

Decision to Prosecute: Organization and Public Policy in the Antitrust Division by Suzanne Weaver (Cambridge, Mass.: MIT Press, 1977), 196 pp.

The form of economic regulation practiced by the Antitrust Division of the Justice Department is an instructive alternative to regulation by commission, according to political scientist Suzanne Weaver of Yale. *Decision to Prosecute* examines the structure, personnel, and policies of this division during the years 1971–74 in order to learn about the "consequences of this court-oriented form of policy making."

Since the beginning of the twentieth century the Antitrust Division has been chiefly responsible for prosecuting violators of the Sherman and Clayton antitrust acts. The Sherman act (1890) prohibits attempting, conspiring, or

combining to monopolize any line of commerce or to restrain trade in any line of commerce. The Clayton act (1914) prohibits specific monopolistic practices and acquisitions that have the effect of lessening competition measurably or creating a monopoly in any line of commerce.

Professor Weaver finds that the very organization of the division reflects the much-criticized ambiguity of American antitrust policy, an ambiguity that is related to the original legislation. For example, the Sherman act fails to define "unlawful restraint of trade"; and Senator Sherman's own speeches stress the political and social, as well as a modern economist's view of the consequences of monopolies and monopolistic behavior. Further, the Antitrust Division is shaped by the "imperatives of prosecution" and by the desire to bring and win as many cases as possible. The decision whether to prosecute is based largely on the likelihood of success, rather than on a theory of antitrust policy. But there are some situations in which most staff lawyers are reluctant "to bring a case they think they can win," for example, where prosecuting would have an anti-competitive result, where harm would be done to a small businessman, or where prosecution would "prevent or slow" the distribution of an "important commodity."

Staff lawyers in the division possess, and jealously guard, their considerable independence. This is so much the case that "where executives have actually tried to exercise authority in behalf of goals different from those of the staff, they have found that staff resistance and the outside opinion that supports it can make the exercise futile in the long run." But this same professional outlook serves as the major protection against improper influence by businessmen or politicians. That is, the concept of legal craftsmanship (which is the admired hallmark of the Antitrust Division) and the intimate relationship between the division and the private antitrust bar are, in the author's opinion, fundamental to the division's reputation of incorruptibility.

Various assistant attorneys general (AAG) who have headed the division have attempted organizational or public policy initiatives, but with mixed success. In general, straightforward reorganizations, such as AAG Lee Loevinger's move in 1961 to place all of the division's transportation-industry work in one section, are successful. On the other hand, policy innovations, like AAG Donald Turner's attempt to improve the economic quality of the division's work, encounter resistance and resentment. In the case of Turner's initiative, the "criteria of review" were changed by adding standards that were "alien" to the lawyers and "repugnant to their notions of good prosecution." Also Turner drew up guidelines for mergers that heavily emphasized economic-structural data and that tried to make the work of the division in this area, for the first time, predictable. Opposition from the staff to whatever restricts its short-run prosecutorial "reach" (in spite of possible long-range benefits) ended many of the Turner innovations as soon as he left the post.

Professor Weaver points out that some of the organizational arrangements now being proposed to reform regulatory commissions—such as "enabling courts to intervene more energetically"—already can be found in the Justice Department's methods of enforcing antitrust policy. She concludes that the division appears to be able to maintain a "faithfulness to legislative intentions" and that it has "escaped massive corruption by other interested parties." At the same time, however, the path of regulation by prosecution resists antitrust policy-making. One consequence in the division has been a strong preference for one version of competition with little recognition of possible complexities in the idea or of competing economic and social goals.

Perspectives on the 4-R Act

Railroad Revitalization and Regulatory Reform, edited by Paul W. MacAvoy and John W. Snow, Ford Administration Papers on Regulatory Reform (Washington, D.C.: American Enterprise Institute, 1977), 246 pp.

This collection of analyses and other documents was assembled by two economists, Paul MacAvoy of Yale and John Snow of the Chessie System (who is also a lawyer), as background for the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act). One important question addressed, according to MacAvoy, is, can a regulatory agency "effectively implement

a basic reduction of its own powers?"

The volume begins with a 1973 report in which the Task Force on Railroad Productivity reviews what went wrong in the rail industry, emphasizing property taxation, passenger deficits, rail technology, regulation, the "fractured" corporate structures and labor-management problems. Then a 1973 paper by the U.S. Department of Transportation outlines the northeast rail problem and recommends that these railroads be restructured rather than nationalized, that the existence of a crisis as well as substantial northeast rail freight traffic must be recognized, that the system be streamlined (which would reduce jobs and service), and that regulation be reformed.

The United States Railway Association, in a 1975 paper making up the third chapter, discusses intermodal and intramodal competition and suggests that the former (competition between different modes of transportation) "may not be capable of producing some of the benefits associated with rail-rail competition" but that these benefits may be provided by "indirect rail-rail competition."

In Chapter 4, which is a 1975 memorandum from then Secretary of Transportation William Coleman, the railroads' problems are defined as redundant facilities and excess competition, outmoded regulation, archaic work rules, lack of capital, and preferential treatment of other modes of transportation. Secretary Coleman proposed two pieces of legislation, one of which, the Railroad Revitalization Act of 1975, became the basis of the 4-R Act. This is followed by John Snow's summary of the main elements of the Ford administration's proposal for rail regulatory reform—improvements in ratemaking, restriction of anticompetitive practices by rate bureaus, loan guarantees, and system restructuring. Mr. Snow's summary leads to a Department of Transportation staff paper in which the rail industry's benefits from regulatory reform are estimated at $985 million to $2 billion.

In Chapter 7, economic consultants Stephen Sobotka and Thomas Domencich suggest that the cost standards for rail pricing should be the standards of variable cost pricing until rail property wears out. Since "it has not been demonstrated" that there is any greater social value to railroads than to other kinds of economic activity, the authors are not convinced that society should subsidize railroads.

In Chapters 8 and 9, first an economist and then a lawyer address the question of rail-barge competition and predatory pricing. David Qualls of the University of Maryland concludes that the proposed water-carriers' amendments to the 1974 Transportation Improvement Act would not be in the public interest, because they might prevent technological innovation and lead to higher rates and prices. Law Professor Glen Weston of George Washington University opposes the water carrier amendments as unnecessary.

In Chapter 10, the U.S. Department of Transportation examines the question of rail abandonments outside the northeastern region, noting that there might be substantial impact on agriculture, milling, mining, and logging if they should occur.

In Chapter 11, John Snow (at that time deputy undersecretary of transportation) and Mark Aron of the Department of Transportation assess the regulatory reform provisions of the 4-R Act, noting that the results "are significant but not as extensive as those recommended by the administration." Chapter 12 is made up of ICC and Department of Transportation reports on the implementation of the 4-R Act.

In Chapter 13, economic consultant Norman H. Jones, Jr., discusses the concept of market dominance as it affects the pricing flexibility (especially upward flexibility) intended by the 4-R Act. He concludes that "intermodal competition pervades the transportation markets in which railroads participate" and that "rail market dominance can be considered the exception rather than the rule in virtually every market." On the other hand, as the Department of Justice brief that concludes the book argues, the ICC has defined market dominance in such a way as to avoid this conclusion. This brief criticizes the ICC for refusing to consider evidence of geographic and product competition even in rebuttal, for using an unreliable accounting system to compute costs, and for assuming market dominance based on a standard of investment that "is so vague as to be irrational." The effect of all this has been to contradict the intent of Congress that "railroads be free to adjust their rates without extensive litigation where effective competition exists."