Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

Auto Safety

TO THE EDITOR:

In the November/December issue of *Regulation* ("Auto Regulation"), William Niskanen calls for an end to NHTSA regulations requiring passive restraints (air bags or automatic seat belts) in new cars. He states: "No public purpose is served by protecting people who choose not to protect themselves." I would like to know what he considers a public purpose to be? Does he think that children who do not use their seat belts somehow deserve to die? Does he think that people who forget to buckle up because they are in a hurry deserve to be paraplegics or quadriplegics? Does he think that people who would use seat belts except for their poor design and erratic functioning deserve to lie for months in comas in our nation's hospitals? How about all the independent types who read *Regulation* and decide that they are not going to have big brother/big government make them wear seat belts? Do they deserve to join the 50,000 who die on our nation's highways each year?

If, in addition, Niskanen is also suggesting that people who do not choose to buy air bags deserve the same fate, he is ignoring the fact that unless the government requires air bags (at least as an option), consumers will not be able to purchase these life-saving devices. No U.S. manufacturer is currently offering them, and none is planning to do so in the future, with the possible exception of Ford, which may offer them on 1983 Continentals. Mercedes will offer them on all 1982 models and Volvo too on some lines. While it is nice to know that the rich will have the option of obtaining air bags on their Continentals and Mercedes, this fact does little to reassure the average American who cannot afford a luxury car.

Finally, while Niskanen seems to have high regard for cost-benefit analyses that place some sort of value on human life, his article studiously ignores the benefits air bags will bring in lives saved, reduced hospital costs, et cetera—benefits which will greatly outweigh the cost of air bags.

Matthew H. Finucane,
Attorney,
Washington, D.C.

WILLIAM NISKANEN responds:

Auto safety is one of those issues that often seems to defy rational discourse. Matthew Finucane suggests that any opposition to the passive restraint standard indicates indifference to injuries and deaths from auto accidents. Since there is no way to value the life of a specific individual, his position seems to dismiss the use of any form of calculation as the basis for evaluating safety issues.

At a minimum, I would value his understanding of the several considerations that have led me to oppose the adoption of the passive restraint standard:

(1) The government must use some criterion to determine which conditions, among the many affecting safety, merit government intervention. In general, I suggest, government action should be limited to those conditions where the actions of one person injure another. This provides the rationale for mandatory auto insurance, tort law, and criminal penalties for unusually irresponsible behavior.

The passive restraint standard does not meet this test. Most of the expected benefits and costs of passive restraints would accrue to auto owners. They may not, in some sense, deserve the injuries they might suffer if they fail to buy passive restraints, but they deserve to make this choice. A requirement that autos include passive restraints, moreover, may reduce the safety of others, if the increased perception of personal safety induces people to drive more aggressively.

(2) Whatever the rationale for government intervention on personal safety issues, and whatever the value of increased safety, the passive restraint standards do not meet a cost-effectiveness test. These standards would impose costs of around $2 billion a year, more than the sum of all auto safety regulations to date. NHTSA's own studies indicate that the cost of passive restraints per life saved (or more accurately, since we will all die sometime, per additional life-year) is far higher than several types of changes in highway conditions. For any level of investment in safety conditions, our shared concern for saving lives implies that we use these resources in the most efficient way. The relevant alternative to the passive restraint standard is the *higher* level of safety that could be achieved by other measures.

Federal Maritime Commission

TO THE EDITOR:

I must confess exasperation with Thomas Moore's brief piece on the Federal Maritime Commission (*Regulation*, November/December). But let me first make it clear that I am no protector of the status quo: I am a Republican member of less than a year's standing who has been critical of the FMC for some time. The commission *needs* constructive, informed criticism; unfortunately it did not receive this from Mr. Moore.

In the first place, Mr. Moore's whopping errors of fact damage his credibility as a knowledgeable critic of the agency. For example:

• He states that the FMC "regulates . . . rates . . . in foreign commerce. . . . It approves or disapproves rates filed by the merchant marine and U.S. flagships and establishes maximum and minimum rates." Wrong. The FMC does not have any ICC-type ratemaking authority over ocean carriers in foreign commerce. Such rates are freely determined by the carriers. The commission's few powers in this area are to prevent discrimination between shippers or localities and to prevent rate activity so gross as to affect the flow of commerce (the

latter power has seldom been exercised).

• Moore also says the commission should encourage "substantial price flexibility by establishing very low minimum rates and very high maximum rates." Since the commission does not establish *any* foreign commerce rates, it is hard to see how the present flexibility could be much improved upon!

• Moore claims the FMC spends "most of its time on such activities as investigating rebating and rate-cutting." While the FMC does of course enforce the laws requiring carriers to charge the rates set forth in their tariffs—a task that consumes relatively little of its time—it does *not* investigate rate-cutting. Carriers in the foreign trade can cut their rates all they want, save for the limited restrictions previously mentioned, as long as they publish the cuts in their tariffs. Substantial rate wars are going on this very moment in both Atlantic and Pacific trades.

• Moore says that the commission requires "U.S. carriers to abide by rates set in international rate conference agreements." This is true only for carriers that have joined those conferences. But the commission has always insisted that carriers be free to join or not to join conferences and, if they join, be free to leave. If anyone is restricting "the ability of our carriers to meet price competition from non-U.S. firms," it is the carriers who have voluntarily joined those rate-making bodies.

However, more regrettable than its factual errors is the article's failure to come to grips with issues that *are* basic to federal maritime regulation. Mr. Moore does not seem to understand that the FMC's principal function is to act as a buffer between the full application of U.S. antitrust laws to carriers operating on our international trade routes, on the one hand, and a complete laissez faire system where carriers could freely engage in joint anticompetitive activity, on the other.

Congress has maintained a U.S. agency in this role for sixty-five years for good reason. Before the Shipping Act, carriers joined together in cartels to restrict service to communities, to penalize shippers patronizing noncartel carriers, to force out a new carrier competitor, to charge higher rates to one type of customer than to another, and the like. These abuses are held in check by the FMC, which provides a forum for claims of abuse and keeps joint carrier agreements within the bounds of fairness. The principal questions facing the FMC are where and how should the United States draw the line between U.S. antitrust philosophy and foreign laissez faire policies toward shipping services — keeping some control of this international activity, without massive confrontations with foreign, maritime governments.

The challenge in U.S. carrier regulation today is not, as Mr. Moore apparently assumes, to establish a completely free market in our ocean shipping services, for that market is already relatively free of entry and price controls. It is instead to protect the market from growing assaults by industry interests. There was heavy pressure in Congress last year to weaken the FMC's control over conferences and to give carriers greater latitude for joint anticompetitive activities. And there is pressure now to have the United States adopt the UNCTAD Liner Code, which would in effect divide up the cargo moving in and out of our country among carriers on a national flag basis. . . . Unfortunately, Mr. Moore offers no help on these crucial problems. . . .

Peter N. Teige,
Federal Maritime Commission

THOMAS MOORE responds:

Commissioner Teige asserts that I was wrong to write that the FMC "regulates the services, rates, practices, and agreements of common carriers by water . . ." and that it "approves or disapproves rates filed by the merchant marine and U.S. flagships and establishes maximum and minimum rates." Let me quote from the FMC's *Fourteenth Annual Report* (1975): "The statutory authorities and functions of the commission embrace the following principal areas: (1) Regulation of services, practices, and agreements of common carriers by water and certain other persons engaged in the foreign commerce of the United States; (2) acceptance, rejection, or disapproval of tariff filings of common carriers engaged in the foreign commerce of the United States; (3) regulation of rates, fares, charges, classifications, tariffs, regulations, and practices of common carriers by water in the domestic offshore trade of the United States; (4) [omitted] . . . ; (5) investigation of discriminatory rates, charges, classifications and practices in the water-borne foreign and domestic offshore commerce . . ." (page 1). The report also asserts that "[t]ariffs and amendments thereto are critically examined by the staff . . ." (page 36) and that some 3,650 tariffs were rejected during the fiscal year (page 38). I believe that these quotes substantiate my claim. Clearly, the authority to disapprove rates permits the FMC to establish de facto maximum and minimum rates.

Moreover, the report goes on to assert that "[i]n the domestic offshore trades . . . the commission has authority to suspend a rate prior to its effectiveness and embark upon hearings to determine the reasonableness of the proposed rate or practice" (page 39). This is very similar to the practices of the Interstate Commerce Commission. Also reminiscent of the ICC is the fact that some 8 percent of the tariff papers were rejected (page 39).

The FMC's *Annual Report* illustrates the anticompetitive effects of the FMC with a discussion of a proposal to amend the tariffs of the United States Lines for foodstuffs between the West Coast and Hawaii. When these lower rates were protested by Matson, USL's major competitor, the commission ordered an investigation to determine whether they were unlawful, unreasonable, discriminatory and/or preferential (page 44). No doubt the law requires such an investigation, but that point simply explains why the FMC is inherently anticompetitive.

My chief problem with Commissioner Teige is that he fails to understand the harm that the FMC does to competition. He asserts in his rejoinder that the "FMC's principal function is to act as a buffer between the full application of U.S. antitrust law to carriers operating on its international trade routes . . . and a complete laissez faire system where carriers could freely engage in joint anticompetitive activities. . . ." What is wrong with subjecting the carriers to our antitrust laws? If such laws help maintain competition within the United States, why should they not be fully applied to our carriers in ocean commerce? The anticompetitive nature of the FMC can be clearly demonstrated by quoting again from the *Annual Report*: "The Commission has continued its efforts to bring some order to . . . the destructive effect of rebating and other malpractices" (page 3). Rebating is clearly a method of price competition and is not illegal in unregulated markets. Dur-

ing 1975, the FMC levied fines on twenty-seven firms for such "crimes" as "operating without a tariff, charging rates different from those filed, carrying out unapproved understandings or arrangements" (page 66). "Shipper-consignee penalties were [levied] for accepting unlawful rebates . . ." (page 66). Furthermore, while admitting the bilateral pooling and equal access cargo sharing agreements are anticompetitive, the commission has approved some twenty-one of them (page 103).

The thrust of my short piece was that the Federal Maritime Commission is anticompetitive. These quotes demonstrate that. I hope that Republican Commissioner Teige will agree. Regulation is no more needed in the maritime industry than in airlines or trucking. It is not that the commissioners themselves are anticompetitive, but that the statute makes them act as if they were.

Rate-of-Return Regulation

TO THE EDITOR:

Nina Cornell argues persuasively that price-earnings regulation cannot control monopoly under dynamic conditions (*Regulation*, September/October). Furthermore, she believes that such regulation places a substantial indirect burden on society, and that there are superior alternatives for dealing with monopoly power.

It would be premature to dismiss price-earnings controls without considering three fundamental issues at greater length. The first is whether such controls are inherently unworkable, or whether they have been misapplied in the past. Ms. Cornell appears to believe the former. But it is incorrect to reject price controls simply on the ground that the concept cannot be applied when demand and technology change. Much of the recent literature in public utility economics is premised on the belief that price regulation can readily accommodate changes in the slope and position of demand functions as well as shifts in cost functions over time if marginal-cost criteria are adopted. Ms. Cornell does not deal directly with the issue of whether marginal-cost pricing can make the transition from theory to practice and still serve as a regulatory tool. Instead she concentrates on the large data requirements needed to implement price-earnings controls and the difficulties of deriving unit prices. In view of the amount of data and information gathered in compliance with section 133 of the Public Utilities Regulatory Policies Act of 1978, the task of collecting data may not be an insurmountable barrier.

If price control is theoretically feasible and empirical support can be assembled, then the fault with price regulation may lie in implementation. The answer would not be found in abandoning price-earnings controls, but rather in applying them in a more meaningful fashion. Along this line, a major deficiency lies in the reluctance of commissions to recognize that regulated firms may employ price strategically to foreclose entry and maintain market shares. The recent Datran, MCI, and Florida Power and Light cases illustrate this type of behavior, and abandonment of price regulation can hardly be expected to mitigate such practices.

A second area of concern is the need for a better perception of the indirect consequences of price-earnings regulation. Ms. Cornell has shown clearly that rate-based regulation can have an adverse effect on innovation and efficiency. Nevertheless, for the period 1900–68, the rate of growth in average annual total factor productivity for public utilities (electricity, gas, and communications) was more than twice that of domestic manufacturing. Perhaps the adverse impact of regulation during a period of growth is far less than we anticipate. On the other hand, ceiling price regulation may serve to protect consumers whose supply options are limited. For example, 90 percent of residential customers have monthly interstate message toll telephone bills that are so low as to preclude their reliance on non-Bell suppliers such as MCI.

Finally, I question the superiority of three of the four alternatives to price-earnings control suggested by Ms. Cornell. She correctly notes that franchise bidding has limited value where there are rapid changes in technology and the output is sold at multiple prices. Yet these are the conditions most apt to characterize the public utility industries when the firm serves a number of customer classes and when costs vary according to peak/off-peak usage. In such a setting, bidding might conceivably control monopoly profits, but it would not eliminate the possibility of price discrimination. Further, bidding is a poor alternative when it is difficult to select a single bargaining agent to act on behalf of the public because of conflicting regional interests. The process is also apt to be burdened with the same problems as commission regulation when the franchise recipient has to contend with strong inflationary pressures.

The alternative of relying on intermodal rivalry also suffers from significant shortcomings. The most obvious is that such rivalry is a poor proxy for intra-industry competition in ensuring that the firm will perform efficiently. As for the antitrust alternative, it is difficult to be sanguine about the effectiveness of this form of intervention. One need only cite the abortive efforts of the Department of Justice to apply the antitrust laws to the Bell system over the past seventy years. Too often remedies were sought many years after the fact, and the resulting consent decrees and informal agreements did little or nothing to diminish corporate power.

Ms. Cornell's fourth alternative holds great promise for promoting competition. This is the argument for mandatory interconnection between utility systems. Such interconnection could be a major step toward the establishment of competition in wholesale power sales, "white" market transfers of natural gas, and intercity common-carrier telephone service. Employed in this fashion, mandatory interconnection could neutralize monopoly focal points where economies of scale still prevail. The difficulty is that interconnection alone is not sufficient.

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It must be complemented by the establishment of prices that negate the ability of the firm to employ predatory or limit-entry pricing. This, of course, reintroduces price-earnings regulation. In addition, such interconnections may require new investment that will not benefit the customers or shareholders of a specific firm. Mandatory interconnection under these circumstances reintroduces equity and distributional considerations.

One can understand Ms. Cornell's frustration with price-earnings regulation as applied by regulatory agencies. But this should not foreclose efforts to improve regulation and introduce more competition as a stimulus to greater efficiency wherever possible. The alternative may be only a shift from imperfect regulation to a reliance on the corporate conscience.

Harry M. Trebing,
Professor of Economics,
Michigan State University

NINA CORNELL responds:

Professor Trebing offers three objections to my fundamental thesis that price-earnings regulation is an inherently unworkable method of keeping monopolies from charging monopoly prices. First, he argues that I should have discussed marginal cost rather than fully distributed cost formulas. Second, he alleges that the problems result more from poor implementation than from a faulty model. Finally, he is skeptical of my suggested alternatives to price-earnings regulation. While he devotes much analysis to each of these criticisms, I do not believe that any of them alters my earlier conclusion.

Professor Trebing argues that recent analysis has allowed for the possibility of changes in both demand and cost functions by suggesting that regulators watch marginal rather than average cost data. Unfortunately, regulators may find the former even more difficult to acquire than the latter. Average costs, after all, can be computed by taking total costs, deciding on a formula for allocating them among products, and then dividing up the costs for one product by the units produced. To compute marginal costs, one must guess how a change in output would affect the utility's choice of production technology. Moreover, despite his assertion that significant data is being collected under section 133 of the Public Utilities Regulatory Policies Act of 1978, it is hard to understand how the problems of timeliness and knowability have been resolved. It is easy to generate large quantities of data; one needs large quantities of accurate and timely data. I argued that this could not, by definition, be produced.

Our second major area of disagreement concerns the question of whether price-earnings regulation fails because it is not being implemented properly. Professor Trebing here correctly notes the failure of regulatory agencies to recognize that regulated firms may use prices strategically to foreclose entry and preserve market shares, using the Datran and MCI cases among his examples. But he fails to recognize that the agencies are unable to prevent such manipulations even when they recognize them. A prime example is the long and so far unsuccessful attempt by the FCC to establish a cost-based WATS tariff. In this case the commission has recognized the strategic use by AT&T of the WATS tariff, yet the very problem of acquiring accurate and timely cost data has left the commission unable to prevent the company from using a tariff that diverges from cost. Just as the commission cannot be certain that prices correspond exactly to cost without the kind of data discussed in my article, so it cannot prescribe a new rate itself without the same data. The problem is not poor implementation but an unworkable mandate.

Professor Trebing notes that public utilities have made above-average strides in total factor productivity since 1900 and thus questions whether the impact on innovation is as severe as I suggested. My comparison, however, was not of utilities and other domestic manufacturing, but of utilities with regulation and utilities without. Professor Trebing's knowledge of energy utilities greatly exceeds mine. But it is disquieting to compare the rate of innovation in telecommunications with the rate of innovation in data processing, an industry whose technological base has now become the technological base of telecommunications as well.

Perhaps most chilling of all, however, is Professor Trebing's belief that 90 percent of residential interstate telephone customers are somehow protected by the regulatory system. If their interstate phone bills are so low as to preclude them from using competitors, the reason seems as likely to be that high prices have forced conservation as that they are enjoying protection from overcharging.

Professor Trebing is right when he notes the limits of my suggested alternatives to price-earnings regulation. With the exception of my fourth alternative, mandatory interconnection, I would only quibble with some of his points. Franchise bidding may not be as academic a proposal as he makes it out to be: both the distribution of water and of gas to homes by pipes are utility functions that have not undergone any significant changes in technology. Present antitrust policy does concentrate on formal collusive arrangements, but makes an explicit exception in the case of regulated industries.

Professor Trebing, like me, seems to believe that mandatory interconnection is the most useful approach wherever it can be applied. It is the approach that allows the greatest infusion of short-run competition using a given technology. He apparently believes, however, that for it to work a regulatory agency would need to set a cost-based interconnection tariff. One of the benefits of a mandatory interconnection rule, if properly structured, is that the authorities ordering it can also require that the price for interconnection be the same for all users. Thus they could require all firms connecting to a toll switch in Chicago to pay the same tariff, whether they are part of the Bell system or not. This renders the cost problem far less important. If the company owning the toll switch charges far more than its costs, and thereby lowers the overall demand for the service, the effects of that lower service usage will be shared by all firms in the industry. (If entry is open and if intermodal competition is allowed, such above-cost pricing may attract either competitive entry or innovation that allows some firms to dispense with the overpriced toll switch altogether.) If the toll switch interconnection tariff is below cost, the firm would be subsidizing its competitors.

Despite my differences with Professor Trebing over whether the problem with price-earnings regulation is an inherently flawed model or simply a very poor execution of an otherwise workable one, we seem to agree on two points: the need to introduce more competition wherever possible, and the need to continue to find ways to improve the overall functioning of the markets involved. ■