Perspectives on current developments

Antitrust Rulemaking at the FTC

On October 18, the comment period closed on the petition pending before the Federal Trade Commission for issuance of a rule banning oil company ownership of certain classes of petroleum pipelines. The commission's staff will consider the comments and then recommend "appropriate action"—including, presumably, whether to commence a rulemaking proceeding. Yet prominently missing from the specific questions set forth in the commission's request for comment was the central issue the proceeding presents—an issue with implications far beyond a ban on vertical integration in the oil industry. By entertaining the proceeding, the FTC is threatening to use a power never before significantly exercised—and, until the 1960s, never before claimed: the power to promulgate legally binding rules in the antitrust field.

The basic powers and authorities of the commission, with respect to both its original antitrust responsibilities and its subsequently added consumer protection responsibilities, were set forth in the Federal Trade Commission Act of 1914. For a half century, the exclusive means by which the commission established legally binding prescriptions under the act in both fields was the conduct of adjudicatory, trial-type proceedings against individual companies. The commission did not assert any substantive rulemaking authority—and there were indeed some official disclaimers of such authority.

In 1962, however, the commission adopted procedures for "trade regulation rulemaking" and, within a few years, began to issue substantive rules in the consumer protection field. Its authority to do so was brought to a court test in the *National Petroleum Refiners* case, involving a rule that required gas stations to post gasoline octane ratings. The U.S. District Court for the District of Columbia held the rule invalid in 1972, but the next year the court of appeals reversed, finding in Section 6(g) of the Federal Trade Commission Act the necessary rulemaking authority. The Supreme Court declined to accept discretionary review.

While *National Petroleum Refiners* was making its way through the courts, there was significant activity on the legislative front. In 1971, the commission supported a bill that would specifically confirm rulemaking authority in the consumer protection (but not the antitrust) field. Needless to say, the FTC's ardor for the bill (which soon acquired some restrictive features—notably, the addition of trial-type procedures to the simple rulemaking process permitted by the Administrative Procedure Act) cooled considerably, once its long dormant 1914 authority had been confirmed by the courts. By the same token, however, the zeal of many who had opposed the bill likewise cooled—or, rather, reversed direction, since they now found the restrictive features essential. The ultimate result was the Magnuson-Moss Act, passed in 1975, which established what might be termed a quasi-adjudicative procedure for consumer protection rulemaking. It did not delete (as some of the legislative proposals put forward at the time would have done) the language in the 1914 statute that assertedly authorized substantive antitrust rulemaking. Instead, it provided (quite ambiguously) that the new rulemaking provisions it contained "shall not affect any authority of the Commission to prescribe rules . . . with respect to unfair methods of competition." In other words, Magnuson-Moss left the antitrust rulemaking issue to be fought out in the courts on the basis of the 1914 legislation.

If the Magnuson-Moss Act were not in the picture, the chances of the Supreme Court's invalidating FTC antitrust rulemaking authority would seem slim indeed. Though the *National Petroleum Refiners* decision pertained to a consumer protection rule, the court of

appeals' reasoning, and the statutory provisions upon which it relied, apply with equal force to antitrust rulemaking; and the Supreme Court's denial of discretionary review, while technically not of any precedential effect, would, in a case of such importance, normally connote agreement with the court of appeals. It would be disruptive to strike down at this late date an important authority which the Supreme Court was unwilling to stay six years ago and which has been the basis of much agency action since then.

But the point is that Magnuson-Moss has wiped the slate clean. Because of the consumer protection rulemaking authority conferred by that legislation, the Supreme Court can now agree with the district court's view in *National Petroleum Refiners* without destroying the commission's consumer protection rulemaking authority, and without even upsetting any individual rulemaking commenced after 1975. Or to put the matter another way, by reason of Magnuson-Moss the Court can now be selective in its invalidation of rulemaking authority, striking it down as to antitrust rulemaking (under the 1914 act) while leaving it intact as to consumer protection rulemaking (under Magnuson-Moss).

That leaves, of course, the question whether the Court *should* reach such a result. Perhaps so. Insofar as pure interpretation of the 1914 act is concerned—confirmed by half a century of practice—the district court opinion in *National Petroleum Refiners* has much the better of the argument. But with respect to consumer protection activities, one can at least plausibly argue that the failure of Congress to advert specifically to substantive rulemaking authority in an era that knew very little of that device should not be interpreted to deprive a modern agency of what has become a standard and (many believe) indispensable means of regulatory prescription. That pragmatic argument has less force with respect to antitrust rulemaking, for several reasons. First, antitrust enforcement authority has been conferred not only upon the trade commission, but also upon the Justice Department, through the authority to bring injunction actions and criminal prosecutions. Such an arrangement, together with the provision for private, treble-damage suits, assumes (what has always been the case) a greater degree of control *by the courts* than is compatible with the existence of substantive rulemaking authority. In other words, the "discovery" of a latent antitrust rulemaking authority would not only accord the FTC a technique already possessed by all major regulatory agencies. It would also drastically alter the division of substantive responsibility between that agency and the Justice Department, and between the executive branch and the courts. Another factor weakening the pragmatic case for antitrust rulemaking authority is a belief on the part of many experts (including, in the past, at least one chairman of the FTC) that the economically disruptive device of antitrust proscription does not lend itself to wholesale use, but requires a consideration of particularized circumstances and a flexibility which only case-by-case application can provide. Finally (and closely related to both of the previous points) there is the fact that the authority to govern pricing practices, and indeed to restructure industries, involves a massive degree of power over the economy, and therefore may demand a more explicit legislative expression of authority to act by rule than would suffice for the prescription of trade practices.

Thus it may well be that the Supreme Court would strike down any rule adopted as a consequence of the present proceeding. But the matter is not likely to get that far. Apart from a monumentally unimportant rule on advertising and promotional allowances in the men's and boy's tailored clothing industry (adopted in 1967 with the general support of the industry), the commission has rattled the antitrust rulemaking sabre once before, in a 1966 hearing looking toward rules governing vertical mergers in the cement industry. The world never learned whether there was anything but a sabre-handle in the scabbard, since the hearing produced no action. The same result seems likely in the present case. Six years ago, when the Magnuson-Moss proposals were under consideration, Chairman Engman assured Congress that he would not contemplate using rulemaking powers in the antitrust field. From a political standpoint, the commission chose a good target for departing from that assurance (the oil industry); but, as matters turned out, its timing could not have been worse. Even as the assertion of rulemaking authority in the antitrust field is being contemplated, Chairman Pertschuk is fighting a life-

and-death struggle on Capitol Hill to retain those rulemaking powers explicitly conferred by Magnuson-Moss. A proposal to subject all such rulemaking to legislative veto seems likely to pass, and there is substantial support for proposals excluding all rulemaking for particular industries (to wit, most of those industries in which the commission has held rulemaking hearings). It hardly seems a propitious time for new adventures at the FTC.

On the other hand, the oil industry is currently in no better odor than the commission, and there have been at least a few occasions in the past when Congress has not permitted popular measures to be deterred by generalized considerations of principle as incomprehensible to the general public as the FTC's antitrust rulemaking authority. And there is another factor whose impact upon the FTC and the Congress may be of increasing importance in the coming months and (perhaps) years: the petition that is the subject of the current comments was filed by Senator Edward M. Kennedy.

Reforming International Airline Regulation

With the battle for domestic airline deregulation now largely over, the Civil Aeronautics Board and the still reform-minded aviation subcommittees in Congress have, in apparently unrelated actions, turned their attention to the international arena. Both are moving in the direction of more competition in international aviation—Congress through legislation and the CAB in a Show Cause proceeding that affects the future of the International Air Transport Association (IATA). Their decisions may also have an impact on other U.S. policies, determining how a nation that is moving fast to place more reliance on the market can get along in a world still committed to government regulation.

On the legislative side, the Senate and House of Representatives recently passed their respective versions of the proposed International Air Transportation Competition Act of 1979. Despite important differences between the two bills, it is clear that the result will provide a push toward free trade in international aviation. U.S. carriers, for instance, would for the first time be allowed to "wet lease" (lease with crew, et cetera) aircraft from foreign carriers; U.S. negotiators would be encouraged to drop restrictive "Fly American" provisions (which force government employees to fly on U.S. carriers when traveling abroad, even if this involves detours or delays) in return for similar concessions from our trading partners; and foreign carriers would be allowed to fly U.S. passengers on U.S. domestic routes under certain "emergency" conditions (for instance, when a strike closes down a U.S. carrier). A fourth provision, and the major source of disagreement between the House and the Senate, concerns the CAB's authority over international air fares. Though the board already has substantial authority to disapprove fares under certain conditions, it wants the additional power to set "benchmark" levels above which no fares would be approved. U.S. carriers are lobbying hard against this increase in the board's regulatory authority.

The question of international fares is even more directly at issue before the board itself, in the Show Cause proceeding concerning IATA that commenced in June 1978. There the board contemplates withdrawing the antitrust immunity granted to U.S. and foreign carriers that makes possible IATA's "tariff coordination" activities with respect to traffic between U.S. and foreign points.

IATA came into being at a time when U.S. carriers enjoyed a dominant competitive position in international air passenger service. In 1944 governments of fifty-four nations met in Chicago and agreed that each country's carrier should have a "fair and equal" opportunity to participate in international carriage. Though the Chicago Convention was not ratified by the United States, the "fair and equal" clause led directly to the creation of IATA at a meeting in Havana in 1945 and to "tariff coordination" under IATA. Carriers would meet to determine the fare levels necessary to keep *all* carriers operating at a profit, or at a subsidy their governments could afford; all agreements on fares and service standards would be made unanimously, meaning that no carrier would have to accept a fare too low to cover its costs. The IATA mechanism was given official recognition in the 1946 Bermuda Agreement between the United States and Britain, which specifically refers to IATA as

the primary means of determining fares between the two countries.

In its 1946 deliberations on IATA, the CAB showed concern over the antitrust implications of allowing de facto price-fixing by the airlines. It was persuaded by several factors, however, that IATA was the best alternative available. First, if IATA constituted a cartel, as some alleged, it certainly was an imperfect one. Under the Bermuda Agreement, and the Bermuda-type agreements negotiated between the United States and most of its other trading partners, IATA has no control over either capacity or entry, two of the three ingredients essential for a perfect cartel. Moreover, IATA agreements are, nominally at least, subject to approval by the governments of the countries to which they apply. So, arguably, the antitrust implications were not as bad as they appeared on the surface. Second, all international air service, U.S. carriers included, was then subsidized anyway—so its was not a matter of purely competitive markets. Third, foreign policy considerations made it difficult to take any action that would have appeared unreceptive to foreign needs. Finally, and probably of greatest importance, the CAB did not have an alternative means of influencing international fares. It could grant antitrust immunity for agreements among carriers under sections 412 and 414 of the Federal Aviation Act, and it could disapprove discriminatory fares under section 1002(f), but it could not generally influence fares submitted by individual carriers. If it failed to approve IATA, the board said in its 1946 opinion, international fares would "be subject to no control by our Government, thereby provoking unilateral control by other governments." So the board approved IATA and simultaneously asked Congress for more general authority over international fares.

But this situation changed in 1972, when the board's request for greater control over international fares was granted. Suddenly, there was an alternative to IATA. There are several possible reasons why the CAB did not act at that time to investigate, and possibly disapprove, its policy of granting antitrust immunity. One is the pro-regulation bent of the board's membership in those days. Another is the fact that IATA seemed to be functioning reasonably well. This is not to say that it was setting rates at efficient levels, for that is not what it was intended to do. Rather, IATA was generally preventing conflicts between governments over fares and setting fares at levels that allowed all carriers, the less efficient as well as the more, an opportunity to participate in the international air travel market.

By 1978 both of these reasons for inaction had disappeared. The CAB was moving forward with domestic deregulation, displaying its willingness to rely on the market. And there were changes in the fundamental character of the market to which IATA was having a difficult time adjusting.

By 1978 the North Atlantic and South Pacific markets had developed to the point where, without question, high-density low-cost services could be operated at a profit. Charters in the North Atlantic and illegal rebating in the South Pacific were giving the traditional IATA carriers competition to which they were not accustomed. The stress in the North Atlantic became so great that in September 1977 the carriers were not able to reach agreement on a new fare structure, and the task of setting fares fell on the governments. Though the two events were not directly related, IATA's inability to reach agreement followed soon after the conclusion of the Bermuda II agreement between the United States and Britain, which provided for increased government control of both capacity and fares. (See "Carter Administration Stumbles at Bermuda" by John W. Barnum, *Regulation*, January/February 1978.) That was only one of many restrictive agreements which had begun to appear (generally in "letters of understanding" and *not* involving the United States) and which were increasing the regulatory component in the aviation market.

In issuing its Show Cause Order of June 1978, the CAB did not list all of these factors as important considerations. Rather, it emphasized the more general differences in circumstances between 1946 and 1978, noting especially that U.S. carriers were no longer the only ones capable of taking part in price competition and that its authority to disapprove rates meant that there was now an alternative to the conference method of rate setting.

In any event, the June order provoked a strong response from IATA itself and from many foreign governments. The People's Republic of China expressed concern that the market, in the event of IATA's demise, would fail to

In Brief–

All for the Consumers—Again. A special ceremony was held in the White House on September 26 to mark the signing of an executive order that administration officials claimed would work toward the same ends as the proposed independent consumer protection agency, several times defeated in Congress. Advocates of the independent agency are unlikely to regard the new program as an adequate substitute. It calls for placing consumer representatives in each federal agency, supervised in some way by a Consumer Council whose members are drawn from all Cabinet departments. Neither the council nor the new consumer units within the agencies will have the authority to contest new regulations in court, nor the visibility and resulting clout, that the independent agency was supposed to possess. The council's role, it appears, will be limited to ensuring that agencies do establish the consumer representation procedures laid down in the order, though its powers and resources even for that are uncertain.

Opponents of the original proposal, by the same token, have no reason to see this as an end-run around congressional resistance to a radical new scheme. Back in September 1976, President Ford issued a memorandum requiring federal agencies to assign personnel to respond to consumer complaints and to facilitate consumer participation in rulemaking proceedings. Carter administration officials claim their effort is different because the new order (three pages in all) is more "specific" about the responsibilities of these in-house consumer representatives and requires that at least some of them serve full-time in this role. Otherwise it differs only by the decorative addition of the Consumer Council. One other difference: President Ford established his program to assist in defeating the independent agency proposal in Congress, whereas President Carter acted to assuage supporters after his administration's efforts to achieve such legislation failed. The in-house consumer rep appears to be a scam for all seasons—serving political ends equally well, whether coming or going.

Hurdles for a Different Race. It is often charged that "slow growth" regulatory policies tend to favor established groups while imposing disproportionate hardships on minorities. A recent case in Hawaii illustrates the phenomenon—and also suggests the interesting question of when reverse discrimination is not reverse discrimination. Two dentists from the mainland charged in federal court last year that the State Board of Dental Examiners in Hawaii—six of whose seven members are of Asian descent—was systematically discriminating against newcomers to Hawaii, and against Caucasians generally, in the grading of dental licensing exams. A federal judge upheld the charge and ordered extensive changes in the way the licensing exams are administered.

Evidence submitted in the case indicated that from 1974 to 1977, more than 90 percent of the Japanese-Americans taking the state dental exams were given licenses to practice, compared to only 33 percent of the Caucasians. Prior to 1974, more than three-quarters of the Caucasians were regularly successful. It was in 1974 that Governor George Ariyoshi, an advocate of limiting Hawaii's population growth, was sworn into office. Japanese-Americans currently constitute about 42 percent of the islands' registered voters, but the white population, now 26 percent of the electorate, has been growing steadily for a decade. The decision in the dentistry case may presage further judicial vetoes of Ariyoshi's programs for discouraging immigration by burdening new residents with special taxes and curtailed opportunities for employment.

Flying Dust. Regulations designed to protect textile workers from cotton dust—a prime source of "brown lung" disease—were upheld by the Court of Appeals for the District of Columbia on October 24. In protesting these regulations of the Occupational Safety and Health Administration, the textile industry had argued that mill workers could enjoy the same degree of safety, even at higher levels of cotton dust exposure than allowed by the OSHA standard, if they were simply required to wear respirators while in certain factory areas. OSHA decided, instead, to require textile plants to install millions of dollars worth of special equipment on the grounds that respirators would be uncomfortable for workers and so unlikely to be worn. Industry advocates got nowhere with the argument that the textile firms could be expected to control the performance of their employees at least as well as the performance of their equipment. The Court held that OSHA's decision was not so unreasonable as to warrant reversal, however, and noted: "Even if a few firms are forced to shut down, the standard is not necessarily economically infeasible."

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set a "standard of prices." Other countries, along with IATA, echoed the sentiment. Many countries, moreover, expressed the understandable concern that their home carriers would not be able to survive unrestricted competition.

The Department of State, responding to these foreign complaints that the CAB's order amounted to "unilateralism" on the part of the United States, submitted a plea that the board either tone down or terminate its investigation, a position with which the Department of Transportation agreed. The Department of Justice, on the other hand, sided with the sentiment expressed in the Show Cause Order.

Finally, during the week of October 22, 1979, the board heard testimony on a "toned-down" version of its original order. Whereas the original proposal considered removing antitrust immunity for all of IATA's functions, the new version would disapprove only those activities relating to fare-setting and would allow certain "facilitation" agreements to stand (for example, agreements to use standardized baggage tickets). More important, the new version would limit the removal of antitrust immunity to traffic originating or terminating in the United States. No longer would it be possible for the Department of Justice (or a private citizen) to pursue an antitrust suit against carriers that collectively set rates for routes between foreign points. This latter change, though it did not satisfy IATA, goes most of the way to meet the original criticism that the United States was trying to make the world conform to its antitrust laws. It still permits, however, prosecution of foreign (as well as domestic) carriers that cooperatively set rates to and from U.S. points. At the hearings, CAB members asked witnesses about ways of further weakening the initiative, possibly by granting IATA continued immunity on a conditional basis.

With the CAB having general control over fares and with only two U.S. carriers (National and Flying Tiger) still participating in IATA fare setting, the outcome of the Show Cause proceeding is not likely to have any appreciable, immediate effect on the level of fares. It could have some effect in the future—if, for example, the board decided to continue granting antitrust immunity and U.S. carriers rejoined IATA's fare-setting conferences (a possibility suggested, in fact, in IATA's argument). If U.S. carriers did this and if the board's consumer-oriented philosophy changed, a return to more restrictive competition and higher fares would probably result.

The CAB's initiative and the legislative proposals discussed earlier exemplify an interesting phenomenon. As the United States moves domestically toward less regulation and more reliance on the market, it will display a similar tendency in the international arena. This is partially a matter of institutional dynamics: a CAB and a Congress which have been disposed to deregulate the domestic market and are satisfied with the effects of deregulation will naturally be inclined to advocate competition in international markets as well. But it is also a matter of economics: regulation and competition are uneasy bedfellows, and competitive domestic markets place pressures on regulated international regimes.

It would be premature, however, to regard the United States as an acknowledged champion of free trade. The IATA debate in fact contained repetition of the old charge that we support free trade only when it is in our narrow and immediate interest to do so. Our apparent readiness to open up international aviation certainly does not disprove the charge, since in that field we appear to have a marked competitive advantage. But in ocean shipping, for example, where the competitive edge is elsewhere, we have made no effort to push deregulation. In other areas as well—so-called orderly marketing agreements for shoes and TV sets, cartel-like arrangements in steel and textiles—the United States is substantially involved in regulating international commerce.

A Drug on the Export Market

In 1975 a report by the United Nations Conference on Trade and Development charged that the greed of multinational pharmaceutical companies was depriving Third World nations of the full range of drugs they need to treat indigenous diseases. Last year a report by the United Nations Industrial Development Organization made substantially the same charge (unsurprisingly, since it was written by the same man). This spring, Senator Edward Kennedy's health subcommittee approved a bill implicitly acknowledging that the U.S. government is partly to blame for this situation.

Under existing law, the Food and Drug Administration cannot approve a new drug for domestic sale *or for export* (in official parlance, cannot grant an approved new drug application, or NDA) until the drug passes an elaborate series of tests for safety and efficacy. Furthermore, drugs cannot in fact be exported for investigative purposes without the FDA's granting an investigational new drug exemption, or IND. Yet even though the United States is the only country requiring approval for such export, the matter, while a hassle, seems not to represent an insurmountable problem.

The largest problem is that the FDA judges

new drug applications by essentially the same criteria no matter what market the drugs involved may be aimed at. Thus a drug for schistosomiasis would probably not receive an NDA if the drug posed some risk of dangerous side effects, because the risks would seem excessive for treating a disease that is almost nonexistent in the United States. But refusal of the NDA would then bar export of the drug to a country like Brazil, which might be willing to accept the same risks in order to provide effective treatment for a disease that attacks up to 100 percent of the population in its vast Northeast Province. Moreover, the process leading to the NDA requires testing on human subjects on a fairly broad scale and the FDA has historically been unwilling to accept as grounds for approval the results of tests carried out anywhere but in the United States. In the United States, however, tropical diseases are so rare that testing here (except for leprosy) is impossible. Which means that drugs for these tropical diseases are unlikely to receive the NDA necessary for export.

Such considerations have discouraged U.S.-based firms from developing drugs for tropical diseases. Rules designed to ensure the quality of drug testing and to protect Third World countries from becoming dumping grounds for dangerous drugs have actually worked against the health needs of the Third World.

The export provisions of the proposed Drug Regulatory Reform Act of 1979 (S. 1075) are designed to remedy this situation. They would permit the export of a drug without the NDA if that drug has the approval of the country of destination and is not "contrary to public health and safety." At the urging of Senator Jacob Javits, however, Senator Kennedy's health subcommittee has altered the bill so that the effective date of the proposed changes would be delayed until a Task Force on Drug Export Policy (with a six-month life) can develop more detailed ground rules for the licensing of new drugs destined for overseas. The task force's recommendations should be able to deal with residual concerns about using Third World peoples as guinea pigs. But there is some fear that these recommendations may let the FDA take away with one hand what has been granted with the other. After all, the FDA has previously promulgated a rule to the effect that the results of foreign tests can in some cases be accepted for the NDA—but has only accepted them as pivotal evidence in a couple of very recent cases.

In any event, a change in U.S. regulatory policy, though welcome, would still make only a small contribution to the underlying health problems of the underdeveloped nations—even though it might remove some of the disincentives for drug companies to work on Third World diseases. In that work, as in the development and testing of any new drug, pharmaceutical researchers must be able to compare the drug's effects on a sample group of subjects with its effects on a comparable control group in nearly the same state of health. But in the less-developed countries where tropical diseases are most common, the victimized populations often have so many different diseases that it is hard to isolate appropriate sample and control groups. Moreover, wide-scale poverty and isolation, shortages of doctors and health-care workers, inadequate transportation and communication networks—in short, the array of economic problems implied by "underdeveloped"—make it difficult for these countries to deliver even currently available drugs to the people who need them. And it is also this condition of economic underdevelopment, of course, that makes these tropical countries so dependent on the pharmaceutical research capabilities of foreign—including American—drug companies in the first place. U.S. regulation can hardly be blamed for these problems. But it would be a welcome change, at least, if it no longer exacerbated them.

Large Changes for Small Business

Committees in both houses of Congress began to labor in earnest last month on two bills that may herald a far-reaching change in federal regulatory policy. The measures amount to a mandate for the creation of a special protective niche for small business enterprise and would, if passed, force agencies throughout the federal government to alter existing regulations accordingly. There is by now broad recognition in Congress that the cumulative burdens of federal regulation and tax policy have had a severe impact on the start-up and development of small firms. It is a testimony to the depth of the problem—and to its disturbing implica-

tions for the economy as a whole—that the sweeping measures now under consideration have already gained strong support in Congress.

Concern about the problems of small firms is by no means a matter of nostalgia for the simpler economy of the past. For it turns out that small business has played a disproportionately important role in developing new technologies and creating jobs. Perhaps small firms are highly innovative because, with less to lose, they tend to be less risk averse than corporate giants—or because small entrepreneurs are typically more free to pursue daring hunches, more assured of reaping the financial rewards, or simply more lean and hungry than their counterparts in larger organizations. In any event, a recent study by the National Science Foundation concluded that, in the period since World War II, firms with less than 1,000 employees were responsible for half of the "most significant new industrial products and processes" and that firms with fewer than 100 employees produced almost a quarter of these innovations. Equally important, small new-technology firms often grow with startling rapidity, creating more and more new jobs along the way: a study done at the Massachusetts Institute of Technology found that, between 1969 and 1974, the number of jobs in a sample of "young, high-technology companies" grew faster than 40 percent a year compounded annually, compared with barely half a percent for a sample of major "mature" corporations. Studies recently brought together by the Small Business Administration suggest a strong connection between the staggering decline in the creation and development of small businesses in the last decade and the steady fall-off in industrial innovativeness—as reflected, for example, in sharp decreases in productivity improvement. This in turn suggests that the troubles of the small business sector may have a very important relation to the larger problems of the American economy.

The most severe difficulty faced by small entrepreneurs has been a drastic reduction in capital sources. By the late 1970s, the capital that small firms (those with less than $5 billion in net worth) acquired annually from public markets was barely one-tenth of what it had been in 1969. In large part, undoubtedly, this reflected the sharply increased tax rate on capital gains enacted in 1969, which made investors less willing to risk their money on new ventures and reduced the incentive for salaried executives of established corporations to start firms of their own. Not surprisingly, then, reductions in the capital gains tax rate voted by Congress in 1978 have already stimulated a considerable increase in the start-up of new small businesses.

But federal regulation has also posed sizable obstacles for small business development—even in the area of capital formation. Securities and Exchange Commission rules have imposed highly disproportionate costs on the public offerings of small firms, by requiring them to meet the same elaborate registration and disclosure standards as large corporations. This problem was also eased last year, when the ceiling for abbreviated registration requirements was raised from offerings of $500,000 to $1,500,000. But the SEC concedes that some of its regulations (like those affecting private offerings) may present special difficulties for small firms. Similarly, provisions of the Employee Retirement Income Security Act imposing stringent but vaguely worded standards of "prudent investment" have made pension fund managers fearful of risking even a small portion of their enormous funds on the growth potential of small firms. Here, too, the problem has recently been lessened via a Labor Department interpretation applying the prudence test not to each separate investment but to the state of the overall portfolio.

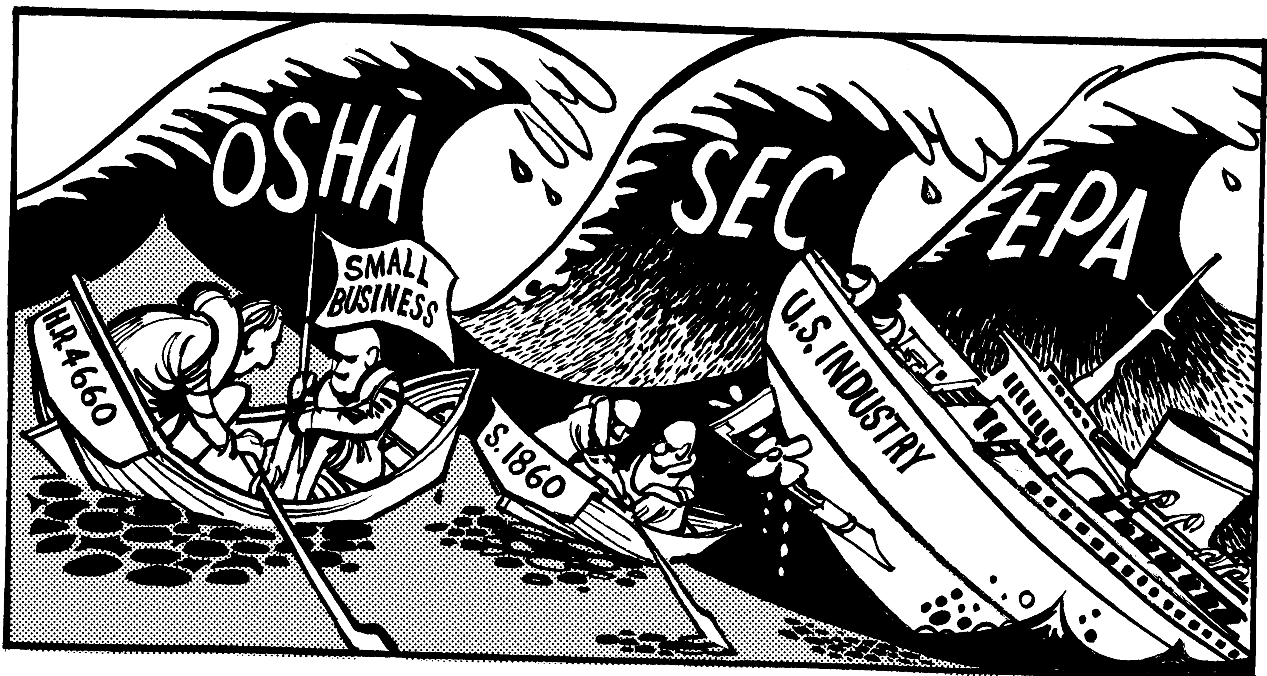
In addition, the newer social regulatory agencies established in the last decade have, in various unforeseen ways, created specially onerous problems for small businesses. This is often the case simply because small firms have fewer resources, less experience, and less ability to apply economies of scale to regulatory compliance costs. Thus, for example, the small business participants in a recent Domestic Policy Review on industrial innovation, prepared at White House request, were so incensed by the costs associated with regulations of the Occupational Safety and Health Administration that they urged a presumptive exemption for small business from *all* OSHA jurisdiction.

The proposed Smaller Enterprise Regulatory Improvement Act (H.R. 4660) rests on the premise that much of the regulatory burden on small business is, in fact, unnecessary. Un-

der this bill, all federal agencies would be required to publish analyses of the effects of each new regulatory proposal on small business. When such analysis indicates that it is "lawful, desirable and feasible" to do so, the agency would have to exempt small businesses from the regulation in question (if their compliance would be of "minimal value" in achieving the regulatory purpose) or at least would have to establish "appropriate differing and less burdensome requirements" (including modifications in performance standards, compliance timetables, and routine reporting requirements). The bill would also require agencies to apply the same process of analysis and modification to all their existing regulations over the next ten years. Though the bill defines "small business" by reference to the Small Business Act, it would allow agencies to establish different definitions as appropriate to their own circumstances (while also requiring them to consider special regulatory status for unincorporated businesses, sheltered workshops, small and independent "not-for-profit enterprises," and other "small organizations").

The Senate version of this proposal is similar in language and structure (though cast as an amendment to the Administrative Procedure Act and not, like the House bill, to the Small Business Act). Essentially the same bill that passed the Senate last year, it has now been incorporated as Title IV of the proposed Small Business Innovation Act of 1979 (S. 1860). It differs from the House version principally by including "small governmental jurisdictions" (defined as local governments, school districts, or special service districts serving populations of less than 100,000) and "individuals" (except in their capacities as members of business or governmental organizations). It is also somewhat more specific about the procedures the agencies would have to follow in considering regulatory modifications and more emphatic about their obligation to seek out suggestions and advice from small business in doing so.

Since these bills essentially mandate procedures for reconsideration rather than specific changes in regulations—and since their abstract directives to the agencies are qualified by numerous cautionary phrases—it is hard to predict how soon or to what extent they might produce the sort of "two-tiered" regulatory system envisioned by their sponsors. In trying to take on reform of the whole regulatory system at once, Congress leaves it entirely to the agencies themselves, in the first instance, to distinguish essential regulatory aims or requirements from those that can be prudently compromised in the interest of lessening the burdens on small business. It is the legislative course of least resistance—and also, perhaps, of least effect—to endorse the elimination of inessential burdensome requirements on small business, while remaining noncommittal about



what is inessential. If the bill is passed, one can expect this problem to join the many other political determinations now being pressed upon the courts.

These proposals also raise larger questions. The objective of relieving the disproportionate regulatory burden on small businesses can easily deteriorate into the objective of handicapping big business—and it is hard to tell where the one begins and the other ends. This consideration prompts reflection, not only on abstract questions of fairness, but also on some basic issues of economic policy and political balance. In many industries, there are undeniable economies of scale, and in many areas large research units are vital to innovation—so that a policy of systematically favoring small business can often amount to a policy of systematically penalizing the consumer. Moreover, the larger movement toward deregulation may be seriously weakened if small business is split away from the reform coalition by special regulatory exemptions. Is it foolish to fear that small business interests may even come to champion more stringent and inflexible regulation for their larger competitors?

In its eagerness to do something dramatic to help small business, Congress does not seem to be giving much thought to the considerable potential for trouble in the new regulatory approach. It is not reassuring, for example, that the Senate version of this proposal has been attached to a bill that accords special benefits to small businesses in tax code provisions, procurement policies, patent procedures, and research funding—all of which rather clearly goes beyond eliminating special burdens on small firms, and would confer substantial subsidies on their activity.

Rum, Federalism, and Regulation

Within the last decade or so, most of the traditionally regulated industries—transportation, banking, even public utilities — have been opened (more or less) to competition by legislated regulatory reform. Contemporaneously, the Supreme Court has steadily broadened the reach of the federal antitrust laws by cutting back upon antitrust exemptions, including most importantly the so-called state-action exemption, which protects those enveloped by state regulatory schemes from antitrust liability (see "Antitrust Comes to City Hall" by Joe Sims, *Regulation*, July/August 1979).

Until recently, the liquor industry has been safe from antitrust attack, and has stood as one of the last bastions of private market stabilization. A major reason is the Twenty-first Amendment (repealing prohibition), which has been viewed as an impediment to federal disruption of state liquor regulation schemes. Now, however, that view has been challenged, and the industry is fighting to preserve its regulated way of life. The issue has come to the Supreme Court in the case of *California Retail Liquor Dealers* v. *Midcal Aluminum.*

In *Midcal*, the California Alcoholic Beverages Control Board cited a retailer for selling wine below the minimum price posted by the manufacturer. Under California law, wine manufacturers were required to file minimum price schedules with the state, and retailers were prohibited from selling at less than those posted prices. Only a year ago, in *Rice* v. *Alcoholic Beverages Control Board*, the California Supreme Court had invalidated a similar regulatory scheme for liquor and beer. In *Midcal*, the California Court of Appeals followed the *Rice* rationale and set aside the citation. The California Supreme Court declined appeal, and the California Retail Liquor Dealers Association (which had intervened on the side of the ABC Board in order to present the industry view) filed a petition for review by the U.S. Supreme Court. That petition has now been granted.

Although the Twenty-first Amendment has been perceived as delegating to the states the right to regulate the sale of liquor within their respective boundaries, that is not what the amendment actually says. It provides that "the transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." Of late, some federal courts have concluded that the amendment applies *only* to "the transportation or importation" of alcoholic beverages, reasoning that it was intended to allow "dry" states to keep the stuff out, but not necessarily to give the states carte blanche over liquor regulation.

The California Supreme Court adopted this view and concluded that the state scheme was not protected by the Twenty-first Amendment

because its effectiveness in achieving the state goals of fostering temperance and protecting smaller sellers was outweighed by its destructive impact upon federal antitrust policy expressed in the Sherman Act. This "balancing test," reminiscent of that used by the U.S. Supreme Court in commerce clause and federal preemption cases, was applied by the California Supreme Court in the portion of its opinion treating the Twenty-first Amendment; but had that issue not been in the case, the same balancing would presumably have been undertaken in the portion dealing with Sherman Act preemption.

If the U.S. Supreme Court disposes of the *Midcal* appeal by deciding that the traditional, expansive interpretation of the Twenty-first Amendment is correct, committing liquor regulation absolutely to state control, the case will be important to imbibers and purveyors of strong drink, but not terribly significant otherwise. If, on the other hand, the Court agrees with the more limited view of the Twenty-first Amendment or if it chooses (as is sound judicial practice) to take up that constitutional issue last, it must then confront the question of much more general consequence: whether the Sherman Act preempts state regulatory laws.

The California Supreme Court disposed of this issue by finding that preemption can occur, at least where the particular anticompetitive action required by state law (in *Midcal*, the establishment of the *specific* posted prices) is not actually directed or approved by a state agency, but is left within the discretion of private entities. In pursuing this analysis, the California court relied heavily upon its reading of the U.S. Supreme Court's opinions in cases involving the state-action exemption. To connoisseurs of federal antitrust law, this may seem strange. For the state-action exemption, as its name implies, relates to the dispensation of private entities from civil or criminal liability under the Sherman Act. It has never been used by the U.S. Supreme Court directly to confront the issue involved in *Midcal*—whether a state regulatory scheme has been preempted. But at bottom the state-action exemption does rest upon preemption considerations, since it essentially answers the question whether Congress intended private conduct to be controlled exclusively by the Sherman Act or, in the case of conflict with a regulatory statute, by state law.

It is clear, then, that if the U.S. Supreme Court adopts the California courts' view with respect to the preemption issue, the scope of the state-action exemption will be substantially constricted. Though recently narrowed in other respects, it has been thought to accord immunity to all private action *required* (even if not to all private action *permitted*) by state regulation. Such a view is obviously incompatible with *Midcal*'s principle that state regulatory requirements leaving substantial discretion to private entities are invalidated by the Sherman Act.

But the real novelty of *Midcal* is the latter principle itself—the use of the Sherman Act not merely to impose prohibitions upon private action, but directly to override state business regulation. The enormity of the difference is apparent from the nature of the *Midcal* lawsuit itself. Unlike the standard state-action exemption case, *Midcal* is not a Sherman Act prosecution or civil suit, but a direct attack upon the California liquor scheme.

If the U.S. Supreme Court were to agree with the California courts, the consequences would be far-reaching. Many state regulatory schemes flatly inconsistent with the policy of free competition would presumably be stricken down. But a Supreme Court affirmance seems unlikely. It is contrary to reasonable principles of federalism to discover in the ninety-year-old Sherman Act at this late date an implicit intent incidentally to overturn vast areas of traditional state legislation. And it is positively perverse to do so when a large number of federal laws are at least equivalently inconsistent with the supposed pro-competitive absolutism.

A similar issue (though not in the extreme context of self-operative Sherman Act displacement of state law) is involved in the Federal Trade Commission's announced intention to preempt various state statutes by issuing trade regulation rules. That matter is also in litigation, and probably on its way to the Supreme Court; so the FTC among others will be watching *Midcal* closely. While the thrill of uncertainty accompanies any litigation, it seems likely that the Court accepted this case to correct what might be good public policy but is probably bad law, rather than to announce a new national rule of wider mandatory competition. The answer should come sometime around June 1980.