Book Review

The Regulated Industries and the Economy

Paul W. MacAvoy

New York: W. W. Norton & Co., 1979. Pp. 160. $3.95.

This small book is a fine survey of the literature dealing with the costs and benefits of regulation. One chapter deals with regulation of public utilities, airlines, and surface freight transportation, and another focuses on environmental and safety regulation. MacAvoy extends the research on the costs of regulation by comparing prices, investment, and rates of return for regulated industries with unregulated. It is to be hoped that this book will have extensive sales in Washington. My only regret is that a number of small inaccuracies and overstatements subtract from the general excellence.

MacAvoy starts with a broad description of the spread of regulation. Even though he does not make it clear, his emphasis is on federal controls; state regulation has usually preceded federal regulation but remains practically unmentioned in this volume. The author attributes the growth in regulation basically to the government's attempts to control prices and qualities in markets where competitive forces were absent or small. This is the traditional view of the causes of regulation, but it is a view increasingly questioned. Perhaps he has oversimplified the factors involved in the establishment of regulation to keep down the size and cost of the book.

The author in earlier works has written extensively of the reasons behind the establishment of the Interstate Commerce Commission. In these works MacAvoy has shown that the railroads themselves were supportive of the concept of federal control, yet he writes, "For instance, they [regulatory commissions] gained jurisdiction over railroads in response to public antagonism toward oligopolistic pricing practices" (p. 19).

Chapter 2 deals with price and entry control in the traditional regulated industries. In discussing regulation of such industries as electric power, gas retailing, telephone, and airlines, the author argues that during the 1950s and early 1960s "regulation could produce either (1) lower prices by constraining monopoly power, or (2) the same price level because of ineffective procedures, or (3) higher prices in order to expand investment and capacity so as to provide subsidized services" (p. 35).

But his third possibility is not logical. The most profitable position is the unconstrained monopoly. Regulation might be able to force monopolists to dissipate some of their rents on certain desired goals, but that would not mean that prices were higher. It is true that regulation might also force up costs such

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that prices were higher than at the unconstrained monopoly level, but that would not produce more profits. Profits under the circumstances would be smaller and there would be less to spend on investment.

With the exception of natural gas regulation, the author shows that this type of regulation has failed during periods of relative price stability to prevent monopolistic pricing and during inflationary periods has squeezed the industries reducing investment and growth. The regulation of natural gas did hold prices down, albeit not from monopoly levels but from competitive ones. The results, however, were the same by the early 1970s: falling investment, reduced capacity, and lower growth.

In a series of tables on various aspects of these regulated industries, MacAvoy shows that profit margins, prices, and rates of return declined in the regulated industries during the early 1970s compared with other industries. He attributes this to regulatory lag and to the reluctance of regulatory commissions to permit higher charges. While these factors may explain the results for such regulated utilities as electric power, telephone, and gas distribution, they are more questionable for airlines. During the early 1970s, the Civil Aeronautics Board was very sympathetic to the airlines and usually approved all requests. It is likely the poor performance of the airlines was due more to market conditions than to regulation.

Nevertheless, the author attributes the reduced rate of output growth in energy, transportation, and communications to regulatory constraints that held prices and profits down. But reduced investment and lower prices should have resulted in shortages. Only for natural gas were there measurable shortages. In fact, for airlines, load factors were down in the late 1960s and early 1970s, according to table 2.16. MacAvoy claims that this is a decline in service quality, but, to the contrary, a higher ratio of empty seats is an improvement in service from the point of view of passengers.

Chapter 3 discusses the costs and benefits of health and safety regulation. Again the author takes the popular view of the origin of these regulations. He uncritically accepts the view that "fundamental to government action in these areas was the awakening of public awareness that action was necessary" (p. 81). But was government action necessary to provide for job safety or product safety? There is certainly room for doubt.

In a variety of tables the author compares the performance of the industries most affected by environmental and safety regulation with that of other relatively unregulated industries. MacAvoy finds that the affected industries have experienced higher price increases than are typical or than the industry had in the unregulated periods. He also reports that economic studies have failed to find any significant improvement in safety or reduction in on-the-job accidents from Occupational Safety and Health Administration (OSHA) regulation. Regulation of automobile safety also has failed to lower car related fatalities. Environmental benefits from The Environmental Protection Agency's (EPA) controls are either small or negligible. The author reports that "although positive effects of environmental controls have appeared at certain locations, on the whole they have not been significant or widespread" (p. 100).

The last chapter of the book discusses the possibilities for regulatory reform. I believe that MacAvoy is much too pessimistic. He discusses airline deregulation and natural gas deregulation, but seems doubtful that full decontrol will be implemented. While it may not have been clear when he wrote this book, deregulation is much more extensive than just these two industries indicate. The President acted to decontrol crude oil prices in the United States by 1981. Congress will very likely pass a trucking deregulation bill this year. A reduction in railroad regulation is also under consideration by the Congress. The FCC has acted to decontrol much of the communications industry and Congress is rushing to catch up. The SEC decontrolled brokerage commission several years ago. The Congress just acted to eliminate regulation of interest rate ceilings and to permit savings and loans to offer checking services while commercial banks will be permitted to pay interest on demand deposits.

On the other hand, MacAvoy's pessimism on environmental and safety regulation may be warranted. While there is increasing evidence that this type of regulation is quite costly and that results have not been significant, there seems to be little movement in the government to consider abolishing it. Perhaps this slim volume will promote the goal he is so pessimistic about achieving.

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