

# Michigan Law Review

---

Volume 81 | Issue 4

---

1983

## Rationalizing Regulatory Reform

Ernest Gellhorn

*Case Western Reserve University*

Follow this and additional works at: <https://repository.law.umich.edu/mlr>



Part of the [Administrative Law Commons](#)

---

### Recommended Citation

Ernest Gellhorn, *Rationalizing Regulatory Reform*, 81 MICH. L. REV. 1033 (1983).

Available at: <https://repository.law.umich.edu/mlr/vol81/iss4/40>

This Review is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact [mlaw.repository@umich.edu](mailto:mlaw.repository@umich.edu).

# RATIONALIZING REGULATORY REFORM

Ernest Gellhorn\*

REGULATION AND ITS REFORM. By *Stephen Breyer*. Cambridge: Harvard University Press. 1982. Pp. xii, 472. \$25.

Regulatory reform has long been a standard campaign refrain among America's political leaders. Beneficiaries of government largess generally believe themselves entitled to more; those denied government protection are even more readily dissatisfied. Thus, getting government "off the people's back" may have proven to be a particularly effective way to identify with popular concern over ineffective, inefficient, and intrusive regulation, but it was not a new or unusual insight.

On the other hand, knowing what we as a people want and deciding what we do not like is very different from achieving regulatory reform. Indeed, even determining what is meant by regulatory reform remains unsettled and is seldom examined. For example, reformers have approached regulatory problems in recent times from several different directions. Some have focused on the Congress, urging more specific legislative direction and less delegation to the agencies, closer control through intensified committee oversight, and final review of regulations by devices such as the one-house legislative veto.<sup>1</sup> Others have looked directly at the regulatory programs themselves and challenged their validity, urging total or partial deregulation — as in the case of the Civil Aeronautics Board controls on airlines or Interstate Commerce Commission regulation of railroads and trucks — or proposing generic sunset laws that would allow regulatory programs to lapse unless specifically renewed.<sup>2</sup>

Despite evidence that intensified congressional oversight can redirect misguided agency programs (as was the case with the Federal Trade Commission) or that specific deregulation can lower costs and increase efficiency (as with airlines), most of the attention has concentrated on a third approach to regulatory reform, namely improving the operation of agencies by changing internal procedures or external judicial or presidential review.<sup>3</sup>

---

\* Dean and Galen J. Roush Professor of Law, Case Western Reserve University. — Ed.

1. See, e.g., SENATE COMM. ON GOVT. OPERATIONS, II CONGRESSIONAL OVERSIGHT OF REGULATORY AGENCIES, S. DOC. NO. 26, 95th Cong., 1st Sess. 79-111 (1977) (illustrating weakness of congressional oversight); T. LOWI, THE END OF LIBERALISM 92-107 (2d ed. 1979) (criticizing permissive delegation of legislative power); Bruff & Gellhorn, *Congressional Control of Administrative Regulation: A Study of Legislative Vetoes*, 90 HARV. L. REV. 1369 (1977) (reviewing impact of legislative veto on agencies).

2. See, e.g., Airline Deregulation Act of 1978, Pub. L. No. 95-504, 92 Stat. 1705 (codified at 49 U.S.C. §§ 1301-1729 (Supp. IV 1980)); Note, *Sunset Legislation: Spotlighting Bureaucracy*, 11 U. MICH. J. L. REF. 269 (1978).

3. See, e.g., S. 1080, 97th Cong., 2d Sess., 128 CONG. REC. S2713 (1982) (This bill, the "Regulatory Reform Act," was passed by the Senate 94-0 on March 24, 1982); Verkuil, *The Emerging Concept of Administrative Procedure*, 78 COLUM. L. REV. 258 (1978); Exec. Order No. 12,291, 46 Fed. Reg. 13,193 (1981), reprinted in 5 U.S.C. § 601 (Supp. V 1981).

These proposals assume that regulation is necessary and desirable and that the problem is one of people, organization, and decisionmaking processes.

Stephen Breyer's new book, outlining the causes of "regulatory failure" and proposing a framework for matching regulatory cures more closely to unregulated diseases, thus is particularly timely. As he explains it, the inadequacies of legislative oversight and direction or agency personnel and procedures are not the primary causes of the current regulatory malaise; consequently, they are not the proper target for reform. For example, more precise direction from Congress to the Federal Power Commission would not have solved the problems of natural gas supply caused by maximum price controls and government allocations.<sup>4</sup> Similarly, it is not reasonable to expect that rules barring *ex parte* contracts<sup>5</sup> or decisions opening up the administrative process to greater public participation<sup>6</sup> would assure that regulators reached correct results. Requiring Federal Communication Commission decisionmakers to listen to additional voices cannot improve on the present system of allocating broadcast licenses — or at least on a free market system — where assignments are not informed by any standard. Breyer's numerous contributions on these and other related lines are substantial. Among the best is his comprehensive classification of the substantive bases of administrative regulation.<sup>7</sup> He supplies a sophisticated framework for rethinking regulatory designs and programs. Whether Breyer has, in fact, always derived effective rules for regulatory reform and identified viable solutions for regulatory failure is, it seems to me, less certain.

Breyer's text has three parts. In the first he examines eight justifications for regulation,<sup>8</sup> six categories of "classical" regulation,<sup>9</sup> and seven alterna-

---

4. Imposing maximum prices below market-clearing levels discourages innovation and production, stimulates demand, and misallocates resources to other than their most highly valued uses. Because of powerful incentives to "cheat," such controls must be enforced with substantial penalties. In addition, since demand will exceed supply at controlled prices, some mechanism for allocation is necessary. Without the availability of price as the method for selection, nonmarket measures such as prior users, priority users based on political factors or similar standards must be developed and applied in deciding who can purchase the below-market-priced goods and services. Not surprisingly, the administrative process has not proved equal to the task of replacing the market for making such decisions. Inevitably, administratively imposed price controls fail to allocate resources efficiently, protect against windfalls, or deal fairly with users. See generally Jones, *Government Price Controls and Inflation: A Prognosis Based on the Impact of Controls in the Regulated Industries*, 65 CORNELL L. REV. 303 (1980).

5. See, e.g., *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 51-59 (D.C. Cir.) (per curiam), cert. denied, 434 U.S. 829 (1977). See also Gellhorn & Robinson, *Rulemaking "Due Process": An Inconclusive Dialogue*, 48 U. CHI. L. REV. 201, 237-58 (1981).

6. See, e.g., *Office of Communication of the United Church of Christ v. FCC*, 359 F.2d 994 (D.C. Cir. 1966) (Burger, J.). See generally Gellhorn, *Public Participation in Administrative Proceedings*, 81 YALE L.J. 359 (1972).

7. See also Breyer, *Analyzing Regulatory Failure: Mismatches, Less Restrictive Alternatives, and Reform*, 92 HARV. L. REV. 547 (1979). This effort to organize our understanding of the rationale and modes of regulation as well as the less restrictive alternatives has also proved highly useful in introducing students to administrative regulation and administrative law doctrines. See S. BREYER & R. STEWART, *ADMINISTRATIVE LAW AND REGULATORY POLICY* (1979) (reviewed by Gellhorn, *Book Review*, 93 HARV. L. REV. 1384 (1980)).

8. The justifications for administrative regulation are summarized as control of monopoly power, limitation of windfall profits, compensation for "spillovers" or "externalities," correc-

tives in which all but one are "less restrictive."<sup>10</sup> This complex taxonomy seeks to impose order on a field that has developed over almost one hundred years without devoting sufficient attention to the causes of market failure or to whether regulatory solutions are in fact designed to solve market problems. To the economist familiar with the application of price theory to government regulation, this discussion is neither new nor startling. For nonacademic lawyers and other policy makers, however, it is likely to be an eye-opening experience; only occasionally has rigorous economic analysis penetrated legislative halls or regulatory bureaucracies.

A major strength of Breyer's book, then, in addition to its uncommonly crisp style and selective use of particularly instructive examples, is its accessibility to the noneconomist seriously interested in studying regulatory reform without first becoming skilled in econometric techniques or regression analysis. Another impressive feature is Breyer's discontent with simply following standard economic formats in describing regulation. His coherent and systematic coverage of all forms of economic and social regulation provides a picture of the entire field — a prerequisite to any rational trimming. Administrative regulation may result in numerous complaints, but it did not arise unwanted and is not without its beneficiaries and supporters. Indeed, its critics generally only want to improve it. Here, however, Breyer parts company with traditional regulatory reformers, for he argues that reform must proceed "with an eye toward radical substantive change" (p. 191).

This sets the stage for Part II's further development of the book's central message, that the failure of regulation is due to a basic failure in the system — the "mismatch" between the perceived market defect and the governmental response (p. 191). Breyer supports this conclusion with five illustrations drawn from the regulation of airlines, trucking, natural gas, pollution, and telecommunications. He is most effective in describing where past regulatory schemes have gone wrong. Returning, for example, to the story of natural gas, he outlines in brief compass the evolution and demise of natural gas regulation (pp. 241-60).<sup>11</sup> As Breyer explains it, the Federal Power Commission's regulation failed because it could not solve the problem of joint costs (between gas and oil), differing historical costs (of natural gas offered to competing buyers), and uncertain future energy demands (in making allocation decisions). He carefully notes, however, that these particular problems were not caused by any failure peculiar to the FPC, and that attempts to rewrite its authority, appoint better people, improve procedures, etc., would have had no effect. It is simply that government interven-

---

tion of information inadequacy, avoidance of "excessive competition," rationalization of inefficient production, constraints on "moral hazards," and paternalism. Pp. 15-34.

9. The traditional methods of regulation examined are cost of service ratemaking, historically based price regulation, allocation under a "public interest" standard, standard setting, historically based allocation, and individualized screening. Pp. 36-155.

10. The alternative nonregulatory responses to market failure are antitrust laws, disclosure requirements, taxes, marketable property rights, changes in tort liability, bargaining, and nationalization. The latter is, of course, more restrictive. Pp. 156-83.

11. See S. BREYER & P. MACAVOY, *ENERGY REGULATION BY THE FEDERAL POWER COMMISSION* 16-88 (1974).

tion is unlikely to improve on market decisions where competition among energy sources is available.

A virtue of Breyer's study is that he makes his case from a variety of examples. He is equally familiar with numerous forms of economic and social regulation and demonstrates that each situation must be reviewed in context. When so evaluated, he concludes, airlines and trucking regulation also cannot be justified, current pollution regulation is at least a partial mismatch, and local telephone service is a natural monopoly requiring some form of traditional regulation.

Powerful as this demonstration is, it is in his description of the processes and problems of regulatory reform — in Part III of the book — that Breyer provides some of his most useful insights. Drawing on his experiences as staff director of the Senate Judiciary Subcommittee on Administrative Practice and Procedure to illustrate his points, he shows some of the preconditions to successful regulatory reform. His focus is on (1) a sound theoretical understanding of the failure of regulation; (2) empirical evidence supporting the theoretical case; (3) creation of a political awareness of the costs of regulatory mismatch; and (4) preparation of a concrete alternative. In fact, I read his analysis as also suggesting at least two more: (5) leadership by the agency and in Congress as well as in the White House to force the issue on the public agenda; and (6) timing (including a healthy economy). The last is particularly important in light of the benefits regulation confers on a few who will struggle to retain their preferred position — an argument often buttressed in hard economic times by additional equitable claims. On the other hand, Breyer's discussion also wisely recognizes that in political contests there are no roadmaps, so reliance on past approaches is a bit like driving by looking only in the rear view mirror.

Recognizing the towering strengths of the Breyer text, however, should not blind us to some of its limitations. It admittedly looks only to the "justifications for regulation, not causes" (p. 9). Thus, the author disregards the increasingly important literature in economics, political science, and law that has provocatively explored with insight and sensitivity the possible causes of regulation.<sup>12</sup> Contrary to the implications of the Breyer monograph, these studies suggest that regulation is often the result of the collective production of private goods and that it is the regulated parties who, in fact, have sought and obtained government protection from the chilly winds of competition. These studies, therefore, not only strengthen Breyer's argument but also have substantial implications for his analysis of regulatory reform. Reform is, as he acknowledges, as much a practical political exercise as it is an intellectual effort.

Thus it is curious and disappointing that Breyer does not carefully review this literature or its findings. Moreover, he is unpersuasive in contending that only justifications, rather than causes, need be examined because legislators, administrators and judges will be swayed by "arguments on the

---

12. See, e.g., Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971); Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335 (1974); B. MITNICK, *THE POLITICAL ECONOMY OF REGULATION* (1980). Some implications of this "public choice" analysis for administrative law doctrine are suggested and discussed in Aranson, Gellhorn & Robinson, *A Theory of Legislative Delegation*, 68 CORNELL L. REV. 1 (1982).

merits." To be sure, policy rationales are critical to the case for regulatory reform. But the reform of regulation also requires that we fully understand its origins, foundations, functions, and support structure. This does not deny the necessity of showing that, because truckers face competition from alternative means of transport, trucking regulation cannot be justified as a control of natural monopoly. On the other hand, as Breyer himself demonstrates, a pragmatic proposal for reform is more likely to secure support if, borrowing from airline deregulation, it includes protection for small communities or transitional assistance for truckers who previously were the beneficiaries (and possibly the initiators) of that regulation. In other words, if we are to neutralize and overcome the pressures for protection and administrative regulation, we need all available guidance.<sup>13</sup> Thus, I fear that Breyer's undue emphasis on market-failure justifications for regulation reflects a misunderstanding of real-world forces. Moreover, if his analysis is relied on exclusively by regulatory reformers, it may mislead them into believing that rational analysis rather than practical political power, bargained for trade-offs, etc., will probably determine whether deregulation can succeed.

Another limitation of this book is its partial and often selective use of price theory to challenge economic and social regulation. Although Breyer recognizes what Frank Easterbrook calls the "nirvana fallacy"<sup>14</sup> — the belief that once an imperfect state of affairs is discovered, any regulatory change is necessarily an improvement — too often he urges milder intervention as a solution when its only justification is that alternative forms of regulation are less effective and efficient. The critical question to be asked in examining regulatory regimes and considering their reform is: "As compared to what?" Breyer sometimes does not consider that in some of these circumstances, no regulation may be preferred; inaction may be less inefficient than even the least intrusive regulatory proposal. For example, in favoring information and taxes to classic command-and-control regulation, he does not carefully examine the evidence that the use of information or labeling controls or taxes to eliminate rents might lead to equally undesirable or even worse results. Studies of drug regulation (cited by Breyer) make the point (*e.g.*, p. 423 n.24). For example, Peltzman and others have shown that premarket testing and clearance may cost consumers more in terms of the benefits of innovation and drug market than it saves.<sup>15</sup> Breyer, on the other hand, suggests that information and disclosure may, in similar instances, be preferable (p. 155). Before accepting his recommendation, however, decisionmakers must weigh the benefits against the potential costs of information/disclosure regulation. It is here that Breyer's summary of the literature is less than complete for he focuses primarily on the reform of regulation rather than its elimination, which may in fact be the most needed

---

13. See generally DEREGULATING AMERICAN INDUSTRY: LEGAL & ECONOMIC PROBLEMS (D. Martin & W. Schwartz eds. 1977); Gaskin & Voytko, *Managing the Transition to Deregulation*, 44 LAW & CONTEMP. PROBS. 9 (1981); Kahn, *Application of Economics to an Imperfect World*, AM. ECON. A. PAPERS & PROC., 91ST ANN. MTG. 1 (1979); Quinn & Trebilock, *Compensating Transition Costs, and Regulatory Change*, 32 U. TORONTO L.J. 117 (1982).

14. Easterbrook, *Breaking Up is Hard To Do*, REGULATION, Nov.- Dec. 1981, at 25, 26.

15. See, *e.g.*, Peltzman, *An Evaluation of Consumer Protection Legislation: The 1962 Drug Amendments*, 81 J. POL. ECON. 1049 (1973).

reform.<sup>16</sup>

This leads him, and I think unwisely, to support a variety of other generic solutions, including a somewhat dramatic but unlikely device called a "high noon" proposal for regulatory reform (p. 366). Under the version Breyer drafted for Senator Kennedy, presidential commissions would study specified regulatory programs in accordance with a prescribed schedule, and Congress would be required to vote on the commission's proposals. The purpose of this plan is to overcome legislative inertia and force substantive regulatory reform on the lawmaker's docket.

Perhaps, little would be lost in experimenting with this suggestion. Certainly the time deadline in the 1978 Airline Deregulation Act<sup>17</sup> has kept decontrol of the airlines on schedule. But the cases are different and this proposal ignores the causes of regulation elsewhere disregarded by Breyer's analysis. Conceivably, there are situations where the coalition supporting regulation is so fragile and the effects of regulation are so marginal that such procedural mechanisms (one is tempted to say, gimmicks) can tip the scales in favor of regulatory reform, but it seems unlikely. The experience in the states with a similar idea, the "sunset" mechanism whereby regulatory bodies have a limited lifespan unless specifically reauthorized, however, suggests that most economic and social regulation is much sturdier than these agenda-forcing proposals assume,<sup>18</sup> and its survival among regulators and their supporters cannot be readily upset except by the kind of analysis and strategy generally outlined in Judge Breyer's book.

\* \* \* \* \*

Stephen Breyer was one of the principal architects of the decontrol of airline regulation along with Alfred Kahn,<sup>19</sup> John Robson,<sup>20</sup> Edward Kennedy,<sup>21</sup> James Miller,<sup>22</sup> Michael Levine,<sup>23</sup> and numerous others. Several,

16. Compare S. BREYER, REGULATION AND ITS REFORM 161-64 (1982), with Jarrell, *The Economic Effects of Federal Regulation of the Market for New Security Issues*, 24 J. LAW & ECON. 613 (1981) and Schwartz & Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630 (1979).

17. See note 2 *supra*.

18. See, e.g., Behn, *The False Dawn of the Sunset Laws*, 49 THE PUBLIC INTEREST 103 (1977).

19. Now a professor of economics at Cornell University, Kahn was the chairman of the CAB during the early years of the Carter administration and a principal leader in the deregulation of the airline industry.

20. Professor Kahn's predecessor as chairman of the CAB, Robson initiated the agency's efforts at administrative deregulation and had a significant impact in changing the direction of the bureaucracy's thinking.

21. Senator Kennedy was the principal leader in Congress' passage of legislation to deregulate airlines. He used his position as chairman of the Senate Judiciary Subcommittee on Administrative Practice and Procedure to hold hearings in 1975 to educate the public on the costs of regulation and the likely benefits of deregulation. The hearings and committee report (written primarily by Professor Breyer) were instrumental in creating the political forces that resulted in the 1978 Airline Deregulation Act. See SUBCOM. ON ADMINISTRATIVE PRACTICE AND PROCEDURE, SENATE COMM. ON THE JUDICIARY, 94TH CONG., 1ST SESS., CIVIL AERONAUTICS BOARD PRACTICES AND PROCEDURES (Comm. Print 1975).

22. G. DOUGLAS & J. MILLER, ECONOMIC REGULATION OF DOMESTIC AIR TRANSPORT: THEORY AND POLICY (1974).

23. Levine was a law professor at Southern California, then an aide to Chairman Kahn at the CAB and now President of New York Air, one of the new entries favored by deregulation.

such as Michael Levine, have gone on to try to show that airlines can compete and survive — and serve the consumer better — in an unregulated environment, even during times of economic stress and change. Others, including such disparate partners as James Miller (as chairman of the FTC) and Edward Kennedy (as one of the proponents of trucking reform) have turned their attention to different fields where regulatory reform has had greater difficulty taking hold.

Breyer's approach, however, has been unique. As a chronicler of the intellectual and practical forces behind airline deregulation, he has sought to instruct us not only in the particulars of that case, but also in the lessons that can be drawn and in their application elsewhere. In light of his success and the thoughtfulness and comprehensiveness of his structure and strategy, I have little doubt that his views should be heeded and his recommendations tried.

Thus, whatever criticisms or differences I or others might offer to Breyer's text, they pale by comparison to his contribution. He has deepened our understanding of the forces that fuel the regulatory engines and shown how they might be harnessed. In the process, he has also pieced together a puzzle that has often confounded us. One only wishes that there were some way to "command and control" both regulators and legislators to read his book and accept his advice.

---

His works include Levine, *Revisionism Revised? Airline Deregulation and the Public Interest*, 44 L. & CONTEMP. PROB. 179 (1981); Comment, *Is Regulation Necessary? California Air Transportation and National Regulatory Policy*, 74 YALE L.J. 1416 (1965) (written by Levine).