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The Threat of Latter-Day "Progressives" to an Authentically Liberal Economic Policy

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Executive Summary

The assumption of Democratic control of Congress last year and the probability that its majority will be increased by this year's elections portends a growing, deeply troubling ideological split within its ranks, already visible, on matters of economic policy generally and regulatory policy specifically—between the more radical (and at the same time reactionary) populists, who label themselves "Progressives", and the 20th century liberals, who have dominated in the formulation of their party's economic programs for the last three-quarters century.

This paper examines the economic issues on which the two are likely to diverge, defending and proposing policies consistent with historical 18th through 20th century liberalism:

- international trade policy, in which the "Progressives" demonstrate a formidable misinterpretation of our huge trade deficits and insufficient appreciation of the major contribution of retaliatory beggar-my-neighbor policies to intensifying the Great Depression of the 1930's;

- threatened recartelization of industries deregulated in the 1970's and 80's—such as the airlines, trucking, and telecommunications;

- recourse to wage and price controls rather than monetary policy as a curb on inflation;

- recourse to concerted anti-competitive restrictions or rationing rather than market pricing as a remedy for congestion, and

- proposed laws imposing "network neutrality" obligations on providers of access to the Internet.

It concludes by proposing remedial policies consistent with the liberal traditions.

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> "When I use a word," Humpty Dumpty said, in rather a scornful tone, "it means just what I choose it to mean—neither more nor less."
>
> "The question is," said Alice, "whether you can make words mean so many different things."
>
> "The question is," said Humpty Dumpty, "which is to be master—that's all."
>
> Lewis Carroll, Alice's Adventures in Wonderland, 1865

The early hopes generated by the Democratic electoral victories in the fall of 2006 that their new Congressional majorities might obstruct or overturn some of the most reactionary policies of the Bush Presidency were soon dashed by the gradual realization that the majorities were neither veto- nor filibuster-proof. Removal of those impediments in the fall of 2008 elections would still leave those Democratic majorities hobbled by the worrisome schisms within their ranks between people who consider themselves Liberals, the "Vital Center" defined and eloquently defended by the late Arthur Schlesinger, Jr., in his 1949 book of that title—and others, former "radicals" and populists, who today call themselves "Progressives". Not the least crime of the latter group has been its hijacking of the banner originally raised by the Wisconsin LaFollettes, carried on to this day by such worthies as Will Marshall's Progressive Policy Institute and the Democratic Leadership Council, originally manned by refugees from the Carter Administration and chaired by then-Governor Bill Clinton. There is an instructive historical parallel here as we approach the 60th anniversary of Henry Wallace's quixotic run for the Presidency under that same banner. Hillary Clinton's public adoption of that same P-banner, shedding the political baggage attached by conservatives and reactionaries to the L-word—tying it explicitly, however, to the LaFollette rather than the Wallace or the current populist version—gave these distinctions real currency (and, incidentally, have virtually forced me to vote for her, despite her early, perhaps opportunistic endorsement of the President's inexcusable Iraq adventure).

The political and economic philosophies and programs of these two groups—as of their opponent conservatives and reactionaries—are at the heart of our intellectual and political history of the last two hundred fifty years or so, reaching back before 1776—the publication date of Adam Smith's *Wealth of Nations*. It is the difference in their attitudes towards economic regulation, broadly defined, that I attempt to expose here, on the basis of long historical experience.

A distinguished expositor and proponent of liberalism has admonished me in a private communication that "it is impossible to give these two terms ['Progressives' and 'Liberals'] a consistent interpretation over historical periods." That observation is of course correct, as a statement of fact, and I endorse his warning about the changes over time in the programs of these several parties—as the economy overall has gone through major cycles of prosperity and depression—as well as the wide range and rich diversity of their several views.

My entire argument, however, is hortatory: the use of the label "Progressive" in both 1948 and 2007 has in important measure been a cynical attempt to conceal an often unprogressive, illiberal platform. As I will argue, partly on the basis of my own experience as a regulator, deregulator, and advisor on inflation to a liberal President, there is nothing either "progressive," "liberal" or desirable about—successively—populist protectionism, xenophobia, competition-suppressing regulatory cartelization, repression of energy prices, recourse to price controls as a remedy or preventive of inflation or a rush to rein in or hamper the dynamic market processes of technological change—the major areas in which authentic liberals will continue to clash with latter-day "Progressives".

I. <u>Open Market Principles of Liberals, Past and Present</u>

Eighteenth to 20th century liberalism

Liberals—and today's principled conservatives—have historically advocated an open market—private, free enterprise, free trade—economy, with consumers best served by competition among producers and sellers, both internationally and domestically. Late 19th and early 20th century liberals and LaFollette Progressives, confronting the rise of big business and a massive national merger movement a century or so ago, were and continue to be consistent advocates of a vigorous antitrust policy, to preserve competition and protect competitors from exclusionary practices by their more powerful rivals. In contrast, conservatives, while rarely openly denying the need for antitrust laws in principle, have tended, except in instances of outright collusive price-fixing or market-sharing, to side with the defendants, decrying prosecutions of companies for engaging in unfair methods of competition as confusing the legitimate goal of preserving the competitive *process* with protecting *competitors* from deserved extinction.

Increasingly sensitive to the imperfections of real world product, capital and labor markets, 19th and 20th century liberals, more and more in association with "institutionalist" skeptics of the "folklore of capitalism" and socialists, crypto- and overt—fought with increasing success for consumer protections such as pure food and drug and, later, consumer product safety and investor-protection laws, prohibitions of misleading advertising, comprehensive regulation of public utilities, conceived to be "naturally monopolistic", and labor-protective and social security legislation, such as unemployment insurance, child labor, worker's compensation, workplace safety, minimum wage and maximum hours laws, and protection of the right of workers to bargain collectively. While most of those interventions may be conceived or rationalized as efforts merely to supplement or improve the functioning of essentially unregulated markets, others—supported, notably, by the industries themselves, as well as by above-mentioned "free-market" skeptics, curbed competition as "unethical" or "destructive", as indeed it sometimes was.

The remedy was often to subject practitioners to mandatory licensure, assertedly to ensure their competence, and imposing on them the obligation to serve all comers, without "undue" discrimination—an issue of enormous importance today in the form of legislative proposals to require Internet service providers to practice "network neutrality" (see Part IV, below), but also having the—often intentional—effect of restricting their number and prescribing higher-than-competitive prices. In a series of epochal decisions over a half-century, the U.S. Supreme Courts struggled successively to decide whether this or that industry—grain elevators, employment and insurance agencies, theatre ticket brokers, local ice companies—was sufficiently "clothed with a public interest" to justify such regulation. Along the way, in 1922, Chief Justice Taft, speaking for a unanimous Court, attempted a summary of the precedents to date (1923):

> Businesses said to be clothed with a public interest justifying some public regulation may be divided into three classes:
>
> (1) Those which are carried on under the authority of a public grant of privileges which either expressly or impliedly imposes the affirmative duty of rendering a public service demanded by any member of the public. Such are the railroads, other common carriers and public utilities.
>
> (2) Certain occupations, regarded as exceptional, the public interest attaching to which, recognized from earliest times, has survived .... Such are those of the keepers of inns, cabs, and grist mills....
>
> (3) Businesses which though not public at their inception may be fairly said to have risen to be such and have become subject in consequence to some government regulation .... In the language of the cases, the owner by devoting his business to the public use, in effect grants the public an interest in that use and subjects himself to public regulation to the extent of that interest. ...
>
> It has never been supposed, since the adoption of the Constitution, that the business of the butcher, or the baker, the tailor, the wood chopper, the mining operator, or the miner was clothed with such a public interest that the price of his product or his wages could be fixed by State regulation....
>
> An ordinary producer, manufacturer or shopkeeper may sell or not sell as he likes.... [1]

Ultimately prevailing, however—insofar as the constitutionality of such legislative interventions was concerned—was the view enunciated by Justice Oliver Wendell Holmes in one of his classic dissents:

> The notion that a business is clothed with the public interest and has been devoted to the public use is little more than a fiction intended to beautify what is disagreeable to the sufferers. The truth seems to me to be that, subject to compensation when compensation is due, the legislature may forbid or restrict any business when it has a sufficient force of public opinion behind it.[2]

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[1] *Wolff Packing Company v. Kansas*, 262 U.S. 522, 535-537 (1923).

[2] Dissenting opinion in *Tyson v. Banton*, 273 U.S. 418, 446 (1927), and by Chief Justice Stone, likewise dissenting:

> "The phrase 'business affected with a public interest' seems to me to be too vague and illusory to carry us very far on the way to a solution. It tends in use to become only a convenient expression for describing those businesses, regulation of which has been permitted in the past. To say that only those businesses affected with a public interest may be regulated is but another way of stating that all those businesses which may be regulated are affected with a public interest." *Ibid.*, p. 451.

And by his unequivocally liberal junior partner in dissent, Justice Louis Brandeis:

> The notion of a distinct category of business 'affected with a public interest,' employing property 'devoted to a public use,' rests upon historical error. . . . In my opinion, the true principle is that the State's power extends to every regulation of any business reasonably required and appropriate for the public protection.[3]

Sensitive also to increasing inequality in the distribution of income and opportunity, 19th and 20th century liberals have supported free public education and progressive income and inheritance taxation. In this they have been joined by conscientious conservatives: John Stuart Mill, apostle of classical economic liberalism, endorsed what the Bush Administration has been pleased to call the "death tax," as a means of promoting the equality of opportunity that a free market economy was intended to offer, and that de Tocqueville praised as contributing to America's "meritocracy", and Clinton Rossiter—the eloquent expositor of a 20th century version of Conservatism in America to which 20th century liberals could also readily subscribe—identified as its final "shift in approach or emphasis": it

> has given some ground under the pressures of the age of anxiety and now admits that government can act positively in defense and elaboration of 'the greatest of all rights—the right to equal opportunity.'[4]

While radicals have frequently supported these liberal reforms, they have tended to regard them as superficial, at best palliatives, at worst "opiates for the masses"—delaying the

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3 Brandeis, dissenting in *New State Ice Company v. Liebmann*, 285 U.S. 262, 301-303 (1932).

4 Conservatism in America, 2nd edition, revised, Cambridge, Massachusetts: Harvard University Press, 1982, pages 186-187. *The New York Times*' token but authentic conservative columnist, David Brooks, berated the Republican Presidential candidates for the fact that, in their economic debate in Michigan,

> there was almost nothing that touched concretely on the lives of the ambitious working-class parents who are the backbone of the G.O.P.
>
> Sometimes the candidates seemed more concerned with massaging the pleasure buttons of the Club for Growth than addressing the real concerns of the middle class. They talked far more about cutting corporate taxes, for example, than about a child tax credit for struggling families, [leaving to be] "seized by a Democrat [Hillary Clinton] programs aimed directly at members of the aspiring middle class
>
> Yesterday, it was a tax credit for college …. The way our tax code is structured, people up the income ladder get big tax incentives to save, while working people, who have the most trouble saving, get the smallest incentives.

"The Hamiltonian Ground," October 12, 2007, p. A47. See also Irwin M. Stelzer's characteristically bold challenge to fellow conservatives, Inheritance Tax: From Grave to Cradle, Building a Meritocracy, London, Social Market Foundation, 2003.

ultimate triumph of socialism. In a horrible but not unrepresentative example of this perverse reasoning, the Communists in Germany threw their support to the Nazi Party in the early 1930s, providing its margin of victory over the Social Democrats.

More modest but equally enlightening examples of this kind of self-defeating political "realism" that I have witnessed were the decision of the incumbent, authentic Progressive Wisconsin Senator Robert LaFollette Jr. and his supporters to abandon their independence in 1946 and attempt to take over the stronger State Republican organization; and of the state's New Deal Democrats crossing over into the Republican senatorial primary to vote against the popular LaFollette, because they thought that his obscure opponent would be easier for their liberal candidate to defeat in the general election. The opponent was a comparatively unknown state judge, Joseph McCarthy.

Statutory cartelization: the effect of the Great Depression of the 1930s

The apparent victories of the latter-day liberals continued in spurts throughout the 20th century, from Theodore Roosevelt's successes in conservation and—almost certainly undeservedly[5]—trust-busting: recall his attacks on the "malefactors of great wealth"—Woodrow Wilson's New Freedom, Franklin Roosevelt's New Deal, and the Fair Deal, New Frontier and Great Society programs of Presidents Truman, Kennedy and Johnson.

Some of the "reforms" were less progressive than their proponents thought. Regulation of the railroads, it became increasingly clear, was promoted as much by the railroads themselves, to suppress competition among them, as by farmers captive to a single transporter of their crops. Similarly, the telephone and electric companies accepted—indeed, promoted—cost-plus regulation by state public utility commissions—often manned by pliable failed politicians—as a small price to pay for the franchises that gave them legal protection from competition.

And the several industry-wide trade associations that sprang up in the 1920's, with the encouragement of Secretary of Commerce Herbert Hoover, and supported plausibly by the conception that competition itself might be improved and important benefits might flow from collaborations among all industry members—for example, in gathering information, conducting

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[5] See the bitter criticisms of him in (the first) Robert M. LaFollette, *A Personal Narrative of Political Experiences*, Madison, Wisconsin: the Robert M. LaFollette Co., 1911, Chapter XIII, "Why I Continued as a Candidate; Roosevelt Never a Progressive…."

research, promoting sales—inevitably also periodically invoked charges by the Antitrust Division of the Department of Justice that they were in individual cases also suppressing competition—confirming Adam Smith famous warning in his Wealth of Nations that “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.” And from the perspective of the Left, Robert A. Brady characterized “Business Self-Regimentation”as “the American Way” of Business as a System of Power, (New York: Columbia University Press, 1943).

The Great Depression of the 1930’s understandably reinforced those trends and caused other widespread desertions of liberals from the competitive free-market ideal. Some of them acquiesced to the Republican-led highly protectionist Smoot-Hawley tariff in 1930, a major propellant of the mutually frustrating downward spiral of international trade world wide—in the face of determined opposition, be it noted, of a group of mid-west “Progressives”, including the elder Senator LaFollette (following the eloquent lead of William Jennings Bryan a half-century earlier). Even more ominously, the 1933 National Recovery Act imposed a comprehensive cartelization on the entire domestic economy under codes of “fair competition,” drafted, industry by industry, by business and labor leaders—often (or typically) employing the trade association structure of the 1920’s—setting prices and imposing output quotas, company by company, in the erroneous belief that since competition had intensified the vicious downward wage/price spiral, the remedy was to suppress it. President Reagan was not confusing a movie plot with historical reality in this case when he likened those “reforms” to the syndicalization of industry in Fascist Italy and Nazi Germany.

Partial resurrection of liberalism in the later New Deal

After the Supreme Court declared the N.R.A. unconstitutional, in 1935, the New Deal turned back to authentic liberalism in two important ways that remain thoroughly valid today. The first was its revival of antitrust enforcement under the vigorous leadership of Thurman Arnold—spurred also by the disclosures of a vast network of international cartels involving such companies as Standard Oil of New Jersey, DuPont, the German IG Farben and British Imperial Chemical Industries. And, second, Cordell Hull, Secretary of State in the Roosevelt

Administration, chipped away at the Smoot-Hawley barriers by negotiating a series of trade agreements extending most-favored-nation treatment, reciprocally, to the exports of its signatories. The logical successor efforts were our joining the World Trade Organization in 1995, President Clinton's successful promotion of the North-American Free Trade agreements (NAFTA), and his request of Congress—repeated by his Republican successor and still pending—for fast-track authority to negotiate others.

II. Enter the Latter-Day "Progressives": International Economic Policy

Free trade, protectionism, and globalization

Judging from the pages of *The Nation*—with its drum-beat criticisms of these trade liberalization initiatives—this is the first area in which the economic policies of today's "Progressives," mouthing Marxist or populist rhetoric, depart dramatically from the bipartisan liberal tradition. A fair sample is their consistent criticism of the North American Free Trade Agreement, and the now pending Central American counterpart (CAFTA), as supported by "corporate-friendly free-trade arguments," for having "allowed global corporations to move production and capital around the world with no thought to the human and environmental consequences"[6]—a "policy that has benefited multi-national corporations while driving down the standard of living for workers here *and abroad*"! [the italics and exclamation point are mine].[7]

That the flight from liberal international trade policy has moved far beyond the pages of *The Nation* is amply affected by the news on January 2nd of the new year, 2008, that all three leading Democratic presidential candidates—prominently including Hilary Clinton—had felt it necessary over the preceding week to proclaim their intention to "look into changing" the North American Free Trade Agreement, NAFTA, one of the proud liberal accomplishments of her husband's Presidency.[8]

Principled liberals, in contrast, accept the classical logic to the effect that free trade and free international flow of investment capital benefit all trading partners—the wealthier ones in

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6 Eric Alterman, "Dude! Where's My Debate?", *The Nation,* February 26, 2007, page 10.

7 Andrea Batista Schlesinger, "Pro-Immigrant Populism," *The Nation*, March 5, 2007, page 5. Somewhat surprisingly, this solicitude for the interests of American labor is accompanied with a laudably liberal attitude toward immigration.

8 Ian Swanson, "Top Democrats Ponder Changing NAFTA", Truthout.org, January 1, 2008; see http://thehill.com/campaign-2008/top-democrats-ponder-changing-nafta-2008-01-01.html.

expanded markets for their—typically higher-tech—products and lower-priced imports of raw materials and consumer products. And, in recognition of the costs that displaced workers bear in consequence of those benefits to consumers at large, they advocate generous and extended transitional assistance to workers displaced by imports, *including carryover of employer-provided medical and retirement benefits.*

This unoriginal resolution, standing alone, is more than a trifle glib, passing over a great deal of deprivation and suffering on the part of the displaced workers and their families, the mitigation of which requires a correspondingly determined, creative social effort; but mere protectionism entails a greater, though less visible, cumulative exploitation of both foreign workers and domestic consumers. The prescribed carryover of employee benefits, one important part of the transitional assistance, would correct what those of us with the longest memories will still regard as an original error, although probably politically expedient: the financing of Social Security (and, later, medical) benefits by taxes on payrolls, rather than by graduated income and inheritance taxes, as the more radical self-styled authentically Progressive members of Congress attempted to do at the time. In determined—and almost certainly politically shrewd—opposition to having social security regarded as a "dole", President Roosevelt insisted that it take the form of insurance, financed by taxes on the beneficiaries and their employers' payrolls. Minnesota Senator Ernest Lundeen—one of that same group—introduced a bill that would have financed those benefits instead from general revenues, and particularly progressive income taxes (for the last of which many latter-day liberals would perhaps substitute a similarly graduated tax on consumption expenditures). The anomaly—I should think liberals and "progressives" alike would think it anomalous—that the richness of the medical and retirements benefits enjoyed by families depends so heavily on the ability of workers to earn and employers to continue to pay—was further accentuated by the exemption of employee fringe benefits from the wage and price controls during World War II. It should also be a matter of more than historical interest that economists Milton Friedman and James Tobin, prominent exemplars, respectively, of 18th and 20th century liberalism, both in effect endorsed the alternative, authentically progressive position when they both advocated graduated negative income taxes as the superior remedy for poverty—proposals that turned up in the exemplary earned income tax credit enacted under President Clinton.

Louis Uchitelle, often a critic of free markets, cites the inspiring example of Denmark, where "[e]mployers … are relatively free to lay off workers, but the state then steps in with benefits that replace 70 percent of the lost income for four years." Their government also finances retraining and education, pressuring the unemployed to participate and then insisting that they accept reasonable job offers or risk cuts in their benefits. The Danish government, he says, devotes three percent of the nation's gross domestic product to retraining compared to less than one percent in the United States. And, of course, everywhere in Europe the state pays for health insurance and for pensions that often encourage early retirement by replacing large percentages of preretirement income.[9]

Agricultural subsidization and protectionism

One area in which the two sides ought nevertheless to be able to agree would be our deplorable longstanding restrictions on imports and subsidized exports of agricultural commodities. One example of especial poignancy today is our egregious quota restrictions on imports of sugar, which have held domestic prices far above world levels[10], to the benefit of one percent of the total farm population, many of them corporations and most of them with other good uses for their land.

That deplorable program has taken on a wholly new dimension in recent years, as our dependence on foreign oil has grown, and with it the cost of subsidizing the energy-inefficient substitution of domestically produced ethanol from corn. It is now common understanding that ethanol from sugar—that is, foreign sugar—would be far more economical and energy-efficient. We should not have been surprised, upon realization of that fact, to discover that some not very anonymous parties had long ago beaten all of us to the punch, with a 54 cents per gallon tariff on imported ethanol *along with* the federal subsidy of 51 cents for domestically-produced ethanol from corn. (Evidently this outrageous protectionism is mitigated by an exemption from the tariff of ethanol produced in Caribbean and Central American countries from raw materials grown there; but, perhaps because of the indefensible 51¢ subsidy, imported ethanol accounted last year

9 "Job Securities Too, They Have a Happy Medium," *New York Times*, February 25, 2007, Bus. Page 5.

10 U.S. General Accounting Office, Supporting Sugar Prices Has Increased Users' Costs While Benefiting the Producers, June 2000, estimated the cost to American consumers at $1.9 billion a year.

for only slightly more than ten percent of our total consumption.[11] An economist has no especial competence to predict whether recognition of this increasingly absurd reality and the perfect case it makes for the Bush Administration's Caribbean Free Trade initiative will suffice to overcome the opposing political reality—symbolized by the continued scheduling of the first Presidential primary in Iowa. More powerful than the sheer economic merits, we can only hope, will be such forces as the interest of American exporters in freer access to these markets, our geopolitical interest in the region, such less visible effects as the $1 or so increase in the retail price of a gallon of milk here in recent months, which in part reflects the sharply increased cost of animal feed, and the similar complaints of the National Cattlemen's Beef Association, the National Chicken Council and National Turkey Federation (all presumably more influential here than the riot-provoking trebling of the price of tortillas in Mexico[12])—some of them explicitly demanding a ban on government subsidies for corn-based ethanol and lifting of the duty on the foreign product.[13]

A Liberal is an internationalist, a protagonist of globalization, solicitous of the interests of foreign as well as domestic workers. He takes satisfaction from the rapid economic development of South, South-East and East Asia over the last half century, taking advantage of their lower labor costs and assisted by Western capital and technology—just as foreign capital contributed powerfully to our own economic development in the 19th century. And he recognizes that begger-my-neighbor protectionism is a negative zero-sum game that neighbors can play as well as we.

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11 "US and Brazil Seek to Promote Ethanol in Hemisphere", *New York Times,* March 3, 2007, page A1 and C9. See also, more generally, Amani Elobeid and Simla Tokgoz, "Removal of U.S. Ethanol Domestic and Trade Distortions: Impact on U.S. and Brazilian Ethanol Markets", Center for Agricultural and Rural Development, Iowa State University, Working Paper 06-WP 427, October 2006.

12 Ray Northstine, "The unintended consequences of the ethanol quick fix", reprinted from *The Christian Science Monitor* in *The Ithaca Journal*, August 13, 2007, p. 7A. In further demonstration of the proposition that everything is related to everything else, or "what goes around comes around," Northstine reports the warning of religious leaders in Brazil "that a rapid increase in ethanol production based on sugar cane could lead to widespread deforestation, massive relocation of workers and their communities, and harsh working conditions for cane cutters"—strongly supporting the proposition that the real need is for more conservation on the demand side.

13 Colin A. Carter, Henry I Miller, "Drunk on Ethanol", AEI-Brookings Joint Center Policy Matters, 07-18, May 2007, and Robert A. Hahn and Caroline Cecot, "The Benefits and Costs of Ethanol", AEI-Brookings Joint Center for Regulatory Studies, Working Paper 07-17, November 2007.

Balance of trade deficits

At least one contention of the latter-day protectionists, implying that we are in a better position to play that game—more effectively and with more justification—than our trading partners because we buy more goods and services from them than they buy from us, is ignorant: I recently heard the host of my local "progressive" radio talk show declare, in a tone that would brook no contradiction (or, characteristically, telephoned interruption—have any of you listened to their smug cacklings?) that our huge, ominous balance of payments deficits have been caused by the modestly liberalizing trade agreements negotiated in the last two decades. The assertion is flatly wrong: the trade deficits have been the simple reflection of our total national spending exceeding our domestic income and production, the difference necessarily financed by increases in debt—domestically by the horrendous federal government deficits and consumer (including mortgage) debt, and internationally by the foreign accumulations of dollars and other dollar-dominated assets. *If it had not been financed in this way by foreigners, this excess of our aggregate government, business and consumer spending over our own production would have been showing up instead in accelerating inflation.* All of that—simple arithmetic—has *nothing* to do with whether limitations on our imports are or have been high and rising or low and declining.

The same arithmetic applies as foreigners have, in recent months, been increasingly reluctant to accumulate those overvalued dollars, in consequence of which the foreign exchange value of the dollar has plummeted—as much as fifty percent relative to the Euro and the Canadian dollar. The diminished foreign exchange value of the dollar has, in turn, increased the prices of our imports—resulting in fewer bargains in Wal-Mart—and making our exports more and more attractive to foreigners. The cheaper dollar has also encouraged a sharp increase in foreigners investing here—taking over the ownership of existing American companies and setting up new ones—in both cases preserving jobs that would otherwise have been lost and creating new ones—all of this welcome, but causing the *Times*' formidable Maureen Dowd to ask "Who is going to own the American economy?"[14]

The process has nothing to do with NAFTA, nothing to do with our having joined the World Trade Organization, nothing to do with whether we have the wisdom to eliminate our

[14] "Red, White And Blue Tag Sale", *New York Times*, January 20, 2008, Week in Review, p. 12.

stupid 54 cent tariff on imported ethanol or the 51 cent subsidy for ethanol produced domestically from corn.

Foreigners are taking over American property and companies *because* we have been fighting a war in Iraq, financing it by government borrowing, *because* we have cut taxes on the wealthy, making it possible for them to build palaces in which to live.

And the fact that we buy more goods and services from foreigners than we sell to them carries no implication whatever that we could better sustain a war of import restrictions than their trading partners.

Labor protective conditions

There is one argument of the protectionists, however, that a conscientious liberal has to take seriously, all the while recognizing that it is typically a pretext for protectionism. A century or so ago we supported laws limiting child labor, prescribing minimum wages and conditions in the workplace, and protecting the right of workers to bargain collectively—even though they tended to shelter labor in our wealthier states from competition from the less advanced. Passage of national—as distinguished from state or local—environmental protection laws has had the same, altogether legitimate, consequence. It is difficult therefore to disagree in principle with the efforts of self-proclaimed progressives to attach such conditions to our imports from low-income countries, even though their motives are protectionist. The conscientious liberal must, however, insist on an equal sensitivity on our part to the fact that the attachment of such conditions to our purchases from low-income countries can deny *their* workers opportunities to improve their lives: the "equalization" of wages, working conditions and environmental protections here and abroad, or, for that matter, flat prohibitions of child labor,[15] cannot be a legitimate pre-condition of trade—although that tendency may be its beneficial result. The reported agreement between the Bush Administration and Democratic leaders of Congress to attach environmental and worker protections to several pending trade agreements[16] is therefore heartening—but only to the

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[15] Marc Lacey, "Bush to Press Free Trade in a Place Where Young Children Still Cut the Cane," *The New York Times,* March 12, 2007, page A10 (referring to the Administration's laudable initiative to encourage the production of ethanol from sugar).

[16] Steven R. Weisman, "Bush in Accord with Democrats on Trade Deals," *The New York Times*, May 11, 2007, page 1F.

extent the “protections” are genuinely beneficial to the foreign nationals rather than merely protective of ours.

Here again, the victories of three-quarters of a century ago at home point the way to the liberal enforcement of that proviso internationally: The pertinent labor-protective laws in the United States were applied and enforced by the Federal government, not the individual states, where they could easily have become agents of protectionism. That was the genius of our constitutional prohibition of states interfering with interstate commerce. So, today—doubtless frustrating the intentions of latter-day “progressives”—any such labor-protective conditions would have to be established and enforced bilaterally or, preferably, multilaterally, by the International Labour Organization of the U.N. or World Trade Organization—not unilaterally by us.

Quotas on Japanese cars

Though not a fundamental cause of the economy-wide inflations of the 1970s, the behavior of our oligopolistic, strongly unionized automobile and steel industries, with their own private wage/price spirals and each with its own particular technological and competitive backwardness, aggravated nationwide stagflation. Unsurprisingly, both successfully exerted powerful political pressure to stem the flow of imports that was a competitive economy’s retribution for their failures.

The automobile industry posed a particularly poignant dilemma for liberals. Battered by the inflow of German and Japanese cars that was the richly deserved competitive retribution for its poor record of durability, fuel economy and costly, frequent superficial changing of models, it mounted an intense campaign in the late ‘70s for the imposition of import quotas. By liberal standards, however, the UAW was a “good,” progressive industrial union; and the industry was an Equal Rights employer, providing good jobs to comparatively unskilled minority workers emigrating from Southern farms. Still it was shocking to discover that *their demand for quotas was supported by the Consumer (sic) Federation of America*.

I do not recall President Carter ever receiving the acknowledgement he deserved for his courage in resisting those pressures. Confronted with evidence that the Japanese and German cars averaged slightly more than one major repair in their first year of operation, while the most popular American cars fell in the three- to four-times-a-year range, the President refused to support the demand for quotas, even though he was well aware of how badly he needed the support of the UAW in the impending Presidential primary and election campaigns. For the record, it was the subsequent Reagan Administration, under pressure from a compliant Congress, that capitulated and imposed the quotas.

III. <u>Domestic Policy: Recartelization in the 1930's, Decartelization in the '70's and "Progressive" Recidivism in the '90's and '00's</u>

Regulatory cartelization

The will to cartelize from the Great Depression onward was not entirely vanquished by the Supreme Court's interment of the NRA. On the theory that trucking and air transportation were especially prone to "destructive competition" and under pressure from the industries themselves and their unions, comprehensive regulatory cartelization was imposed on them in 1935 and in 1938, respectively. Under those regimes, the Interstate Commerce Commission and Civil Aeronautics Board imposed highly restrictive licensure of entry—by type of cargo and routing—and strictly enforced prohibition of price competition, overt or covert, direct or indirect. My first General Counsel at the Civil Aeronautics Board advised us, for example, that we had no choice but to disallow United Airlines' clever promotional fare on some winter flights to Denver—refundable if there were insufficient fresh snow for skiing—because it would have committed the sin of departing from its filed tariff. Unsurprisingly, among the strongest—and only—supporters of airline and trucking regulation were the airlines themselves and their unions, and in the case of trucking, not only the American Trucking Association and Teamsters, *but also* the railroads, eager to stem the competitive incursions of the truckers. Equally illuminating, the farm lobbies exercised their formidable political power to *exempt* the carriage of agricultural commodities from the "protections" of the new regulatory regime, leaving farmers free to provide their own carriage or invoke or take advantage of price-cutting competition among truckers, licensed and unlicensed.

Wage and price controls

Just as the regulatory cartelizations of the 1930s were a response to economy-wide deflation, so the deregulations of the late 1970s reflected the perception that the most serious threat to the economy was a chronic tendency to inflation. That the inflation was in fact essentially a monetary or macroeconomic phenomenon, fueled by the military appropriations of the Cold War and the upsurge of debt-financed consumer spending, became undeniable after the failures of wage and price controls, mandatory under President Nixon, hortatory under Presidents Ford and Carter. Predictably, it ultimately took a determined application of the monetary brakes by the Federal Reserve in all three cases—the third and most severe, be it noted, under the leadership of Paul Volcker, appointed to the Chairmanship by President Carter—to bring inflation under control, at the (likewise predicted) cost of a severe recession.

The effort of liberals to avoid that outcome—while remembering also the distortions produced by President Nixon’s mandatory wage and price controls—by pursuing the path of essentially voluntary restraints, produced yet another dilemma—no doubt amusing to some Olympian observer. It was epitomized by an uneasy meeting that I had with Frank Fitzsimmons, the powerful boss of the Teamster’s Union, in which, speaking on behalf of a President he probably held in contempt, I tried to persuade him to comply with our wage guidelines—fully recognizing that the only effective recompense I could offer was the one neither the President nor I was willing to consider: a promise to relent in our efforts to deregulate trucking. In that sense, we clearly had the last laugh—at the predictable price, however, of having eventually to leave the control of inflation to Chairman Volcker.

That last historical experience itself reflected another evolution of the liberal tradition. The Progressive movement was agrarian in its origins—following the Granger, Greenback and Populist movements of the 1870s-90s—and hostile to Eastern financial interests and tight monetary policies: recall William Jennings Bryan’s long-time advocacy of “free [monetization of] silver” and denunciation of the “Cross of Gold” in his Presidential nomination acceptance speech in 1896. So they, along with twentieth century liberals—such as prominently, John Kenneth Galbraith (and I, before my searing experience of attempting to enforce voluntary price standards)—were apt to call for wage and price controls as an alternative to more stringent monetary policy as the preferable method of combating inflation. I have learned that lesson (while also not forgetting that the French designers of the Maginot Line in the period between the First and Second World Wars likewise thought they had learned the lesson of the First). And so, liberals such as I have over the last twenty years came generally to accept or even, grudgingly, praise Alan Greenspan's exercise of monetary restraint, picking up the Volcker mantle, to prevent a resurgence of inflation in the next quarter-century. In opposition, William Greider, *The Nation's* "progressive" resident Fed basher, has dismissed these comparatively successful policies as products of the last "20-25 years of rightwing governments [that have] suppressed working-class wages."[17] Indeed they have—at least so far as *money* wages are concerned—but they have also stopped self-defeating wage/price spirals.

None of this is to deny our proper dismay at the virtual stagnation of real wages in recent decades. It is to say only that the *solution is not to be found in price controls or government suppressions of competition*. The latter do tend to shelter, indeed inflate wages in the cartelized industries—but only at a greater cost to workers and consumers at large.[18]

Deregulation

The deregulations, concentrated in the period 1977-80, were the product of a coalition of 20th century liberals and conservatives, beginning in the Ford Administration, and carried to fruition under President Carter, with the active leadership of Senator Ted Kennedy (ably assisted by Professor—now Supreme Court Justice—Stephen Breyer) and support of such conservative Democrats as Senator Howard Cannon and liberal Republicans as Senator Bob Packwood. Leading non-governmental members of the coalition were The Consumer Federation of America, Common Cause, Ralph Nader's Public Citizen—remember those organizations, in preparation for a "progressive" sequel—Southwest Airlines (which was eager to be permitted to bring its low-cost low-fare style of operation to the interstate arena) and the National Association of Manufacturers, presumably representing the interests of business travelers. These groups were abetted, in the case of trucking, by the National Federation of Small Businesses, some very large industrial and mercantile shippers, and farm organizations, the last of these chafing at restrictive Interstate Commerce Commission interpretations of the original 1935 Act's exemption of the carriage of agricultural commodities (should it, for example, include frozen chicken?)—another tip-off to whom that Act was really intended to protect. Only such broadly based coalitions and

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17 William Greider, "The Future is Now," *The Nation*, June 26, 2006, page 24.

18 I take pride in having explicitly drawn these lessons from direct experience in my "Can Liberalism Survive Inflation?" reprinted by National Economic Research Associates from *The Economist*, March 7, 1981.

a determined President could have prevailed against the concerted opposition, respectively, of the airlines, truckers and their several unions.[19]

"Progressive" recidivism

Despite the breadth of these coalitions, the left-wingers among the liberals—a prominent example of whom was the aforementioned Professor Galbraith—were never enthusiastic about the deregulations—just as they have been prone to underestimate the effectiveness of competition in the economy generally. Afterwards, in coalition with the airline unions, some of the most ardent consumer organizations originally supportive of deregulation in the '70s decided it had all been a mistake:

> "Deregulation was supposed to cut prices, expand choice, enhance service—improve your life. So how come you're not smiling?"[20]

A decade or so after deregulation, the Economic Policy Institute, evidently supported by organized labor, hired a law professor, Paul Dempsey, another long-time opponent, to point out triumphantly that while average fares had declined very satisfactorily in real terms after deregulation, they had declined no more rapidly than during the corresponding preceding period—conveniently overlooking the fact that, as I had myself suggested twenty years previously, the explanation in the earlier period was the *deus ex machina* of the jet revolution, whereas in the later period it was the furious competitive discounting made possible by the change in the law. And the economist and co-founder of the Institute, Robert Kuttner, began his complaint about deregulation, "High cost of flying" (*The Boston Globe,* September 18, 1988):

> It costs $352.50 for a round-trip coach ticket between Boston and Washington, a distance of 406 air miles. But if you want to go to London, 3,267 miles away, it costs as little as $298—provided you meet the restrictions.[21]

Despite my response (in *The Washington Post*, September 25), that he had, unforgivably, chosen the highest of the first range of fares and the lowest of the second—

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19 See my "The Political Feasibility of Regulatory Reform: How Did We Do It?" *Reforming Social Regulation: Alternative Public Policy Strategies*, Leroy Graymer and Frederick Thompson (eds.), Sage Publications, 1982.

20 *Consumer Reports*, July 2002, pp. 30-35

21 Robert Kuttner, "High costs of flying," *The Boston Globe*, September 18, 1988.

> As for the $352.50 [for Boston/Washington], Eastern Airlines tells me that this July, the following percentages of its Boston/Washington passengers traveled at the following average round-trip fares, including tax: 30 percent at $325.03, 9 percent at $280.46, 24 percent at $152.20 and 34 percent at $138.07. … That produces a weighted average round-trip fare of $226.22….
>
> The $298 Boston/London fare is even more so. He seems to be referring to the fall excursion fare just announced by Pan American and TWA, which is available only with severe restrictions during this fall's off-peak season …. Eastern has supplied me with the other published round-trip fares between Boston and London … excursion fare, low season: $401; excursion fare, high season: $506; regular tourist fare: $1,587….[22]

he committed the same offense some eighteen and a half years later:

> It costs me more to fly to Washington, D.C., than to Washington State, even though it's less than one-sixth the distance. [23]

And once again, *The Nation's* William Greider, characteristically permitting ideology to determine the facts:

> "The deregulated system raised costs for the least affluent, while larger business customers were able to bargain for lower prices."[24]

No one who has looked at the facts of the last 25 years can fail to see that, on the contrary, the most dramatic and immediate effect of airline deregulation was the explosion of discounting, cutting average fares by about one-half, inflation adjusted, and bringing air travel at once within the reach of people of modest incomes. While large businesses also were enabled to bargain for bulk discounts, the most bitter complainers about the new fare structures were in fact the business travelers who, finding it inconvenient to qualify for the discounts—two weeks advance purchase, mandatory stay over the weekend and the like—had to pay something much closer to full fare. The significant economic fact is that those discount fares, employed almost at once by the overwhelming majority of travelers, *made possible*, and, correspondingly, were *made possible by* the increase in the average percentage of seats sold—load factors—from the low 50s

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22 Alfred E. Kahn, "Airline Deregulation: 'I Would Do It Again'," *The Washington Post*, September 25, 1988.

23 Robert Kuttner, "Chaos in the skies," *The Boston Globe*, May 4, 2007.

24 William Greider, "The Future is Now", *The Nation*, June 26, 2006, p. 26. Likewise echoing the apparent party line, Robert L. Borosage, "The Turning?", *The Nation*, June 26, 2006, p. 14.

in the decade before deregulation, with comfortable spacing of seats, into the very high 70's and now low 80's—for torsos only. That release of price competition produced annual benefits to consumers that Clifford Winston and Stephen Morrison, the foremost academic students of this experience, have estimated at $20 billion a year.

And it did this without in any way interrupting the long-term decline in accident rates, ensured by continuing safety regulation and improvement in technology—confuting the dire predictions of opponents that the pressures of price competition unleashed by deregulation would force managements to skimp on safety. (Similar predictions by the trucking companies and the Teamsters were likewise contradicted by experience, as well as by studies demonstrating the efficacy of increased random roadside inspections, checking drivers' logs and equipment.)

Conveniently demonstrating the inexcusable recidivism of today's self-styled Progressives has been the intense political battle set off by the Bush Administration's move to fulfill our side of the bargain, in the North American Free Trade Agreement, to permit Mexican trucking companies to cross our national borders, accompanied by the unexceptionable assertion of the Department of Transportation's Inspector General's Office that we need tighter control on Mexican truck and bus drivers with driving convictions and intensified inspections at the border. The opposition of the American teamsters is of course unsurprising. Although not surprised, I found myself nevertheless outraged to read of the support of that protectionism by Ralph Nader's Public Citizen, assertedly representing the "public interest."[25]

To be sure, the 25- to 30-point increase in airline load factors has meant increased crowding and discomfort, the intensity of which I have no intention to minimize. But it was precisely the failure of the industry under regulation to provide travelers of modest means with a choice of economy over comfort that constituted both the need for deregulation and *the essence of its success.* The airline experience wonderfully illustrates the principle that cartelization of a structurally competitive industry—in particular, the prohibition of price competition—sets off all

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[25] Angela Greiling Keane, "Tighter Mexican-vehicle oversight urged," *Arizona Daily Star*, 8/22/07, http://www.aztarnet.com; Paul Elias, "Administration urges court to open borders to Mexican trucks," *Houston Chronicle*, 8/30/07, http://www.chron.com; Paul M. Drawzak, "Allowing Mexican trucks delayed", *The San Diego Union Tribune*, 8/31/07, http://www.signonsandiego.com.

sorts of other forms of competition, substantive and non-substantive—the fatal flaw of which is that it denies customers the choice of low-priced service free of those amenities.[26]

Bumping rules for airlines

One such specific choice, for the offer of which I claim some credit, was the bumping rule that I persuaded the Civil Aeronautics Board to adopt shortly after assuming the Chairmanship. As to the conception, I happily acknowledge the priority of the late Julian Simon, who had struggled in vain for many years to convince the airlines and the Board to install such a scheme—and sent me a bouquet of roses the day I fulfilled his mission—and that of other economists, such as the Nobel Laureate William Vickrey and, independently, my former colleagues Harold E. Bierman and Harold J. Thomas, who had also suggested specific quasi-auction schemes). For years, the Board had searched in vain for some ethical principle on the basis of which to decide who should have priority in retaining his seat and who should be

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[26] The airline experience clearly illustrates the principle that in an industry with a number of competitors, actual and/or potential, suppressions of price competition set off wasteful competition instead in quality of service, real and imaginary. In a compromise between economy of effort and modesty, here is how I expressed the principle, first generally, in 1981:

> If price is prevented from falling to marginal cost … then, to the extent that competition prevails, it will tend to raise cost to the level of price.

The Economics of Regulation, reprinted, Cambridge, Mass., The MIT Press, 1988, Volume 2, p. 209.

Then, more specifically, to an international aviation audience:

> The typical answer of foreign governments to asserted excessively low load factors, namely the imposition of direct limitations on the amount of capacity offered, market by market, provides yet another illustration of the inexorable tendency for regulation of a competitive industry to spread. Control price, and the result will be an artificial stimulus to entry. Control entry as well, and the result will be an artificial stimulus to compete by offering larger commissions to travel agents, advertising, denser scheduling, free meals, and bigger seats. The response of the complete regulator, then, is to limit advertising, control scheduling and travel agents' commissions, specify the size of the sandwiches and seats and the charge for in-flight movies. Each time the dike springs a leak, plug it with one of your fingers; just as a dynamic industry will perpetually find ways of opening new holes in the dike, so an ingenious regulator will never run out of regulatory fingers.
>
> The economically efficient way of deciding how much higher-cost service should be provided is to give customers a choice between it and lower price/quality combinations. …
>
> And price competition does so much more. It puts severe pressure on managements, which regulation can never duplicate, to improve the efficiency with which they operate, and to hold down the prices they pay for labor and other inputs. And, in contrast with capacity controls, it provides the maximum assurance that the cost savings will, in fact, be passed on to the traveling and shipping public.

Presentation before a symposium, "The Changing Environment of International Air Commerce," Georgetown University, Washington, D.C., May 4, 1978; reproduced in *Air Law* (Netherlands), Volume 3, No. 3, 1978.

selected to surrender it in the event the number of travelers with confirmed reservations turning up for a flight exceeded the capacity of the aircraft.

At the first opportunity, I proposed the simple resolution of what I pointed out was an economic rather than an ethical or moral problem:

> it seems to me the April 25 staff memo before me fails to focus clearly on the significance of the central point I heard Judge [Lee] West make at the last Board meeting on this subject: namely, that the cost of a denial of boarding will vary enormously depending on the circumstances of the particular traveler who is bumped.
>
> This suggests to me that the essential job before us is to see to it that the ones who are bumped are the ones whose pain is least, relative to the compensation they receive. Indeed, the ideal result would be one in which all non-boardings in the event of overbooking are <u>voluntary</u>, i.e., the "bumpees" get off, or don't get on, because the compensation is sufficient to make it worthwhile. If we could achieve that end, there would be no objections to boarding denials—a result certainly worth a dedicated effort to achieve.[27]

And, then, at the next opportunity:

> I'd like to suggest the following possible plan for dealing with the overbooking problem.
>
> That the Board issue a proposed rulemaking, the central feature of which would be a declaration of intention to prohibit all involuntary bumping. (If you read my memo of June 22 on this subject, you will recognize that this is <u>not</u> necessarily a prohibition of overbooking, but requires only that the people who are bumped from flights be self-selecting, because they are satisfied with the proffered compensation.)[28]

—from which followed the common—perhaps universal—practice of airlines offering compensation in the form of free flights on some other occasion, sufficient to elicit the requisite number of volunteers to surrender their seats on the flight that turned out to have been over-overbooked.

Some Board members and "progressive" consumer advocates—such as (once again!) Ralph Nader's Aviation Consumer Action Project, whose leader had, in a notorious incident, been the victim of one such denial of boarding—contended that deliberate overbooking was

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27 Memorandum to Board Members: "Overbooking", June 22, 1977.

28 Memorandum to Board Members: "Overbooking, a Specific Proposal", July 20, 1977.

immoral and our solution equally so because it would be *the poorer* people who would typically give up their seats; and that the regular airline practice of overbooking, in recognition of the probability that not all holders of reservations would typically claim their seats, should be subject to severe penalties when—inevitably, under the laws of probability—it resulted in carriers overestimating the number of no-shows and being forced in consequence to deny some passengers their right to a seat. What I succeeded in persuading my colleagues—none of them, of course, economists, until I was joined, happily, by Elizabeth Bailey—was that the practice itself had nothing to do with morality, but was efficient: that permitting planes to fly out with empty seats was pure waste; and that overbooking in order to minimize the likelihood of that eventuality would be economically efficient *so long as* the benefit to the carrier could be made to exceed the cost—the inconvenience to travelers volunteering to surrender their reserved seats on those occasions when the overbooking turned out to have been excessive. The obvious solution, which we adopted, was the rule that on those occasions in which the number of travelers with reservations appearing at the ticket counter exceeded the number of available seats, the airline would be required to offer all its passengers the option of compensation—typically, as it turned out, a future free round-trip ticket anywhere on the carrier's domestic system—sufficient to induce the required number of them to surrender their seats voluntarily. From the standpoint of both the carrier and society at large, the practice would be efficient so long as the net additional revenues of the carrier attributable to its overbookings exceeded the compensation required to induce the requisite number of volunteers to surrender their seats when necessary. Conversely, so long as the compensation offered was sufficient to elicit the requisite number of volunteers and, on the other hand, less than the net additional revenue from filling seats that would otherwise go out empty, *no party would be a loser,* neither the airline nor the volunteers. If the costs of the necessary bribes, instead, turned out to exceed the additional net revenue earned by its overbooking, it would be the carrier itself that would bear the cost of its mistake—a healthy discipline against over-over-overbooking. And, most important, such a rule should have appeased—although it did not, universally—the "consumer advocates" who objected that the burden of denied boarding would under this arrangement always fall on the "poor": *no party, rich or poor, would give up his seat so long as the anticipated inconvenience of having to wait for the next flight exceeded the value of the compensation*; and while, conversely, it would indeed typically be the less affluent who would accept such bribes, they would still do so only voluntarily—that is only if, as a result of doing so, they would come out winners. A perfect example of a no-loss no-loser arrangement.

Congestion and congestion pricing

Since I freely admit—indeed, proudly claim—some responsibility for the increased crowding and discomfort and, in particular, the increased congestion in the skies and on the ground and consequent delays (the worst in the first half 2007 since the DOT began keeping track in 1995[29])—even far beyond the ones that the airlines have already implicitly acknowledged by increasing their scheduled flight and arrival times—I feel entitled to point out that they were easily foreseeable and the preventive identified and urgently advocated—by me early in the deregulation process[30] and, before that and before he became my cohort in deregulation, Michael E. Levine[31]: *charging more efficiently for airport and air traffic control services*. This means, above all, the adoption of time-of-day and location-varying congestion pricing—following the identical, unexceptionable principles I induced my colleagues at the New York Public Service Commission to apply to the pricing of public utility services thirty years ago[32], and New York City Mayor Bloomberg, today, following the lead of London and Singapore, wants to apply to automobiles entering downtown Manhattan. (Incidentally, it would also have substantially mitigated the explosion in the price of electricity in California when it deregulated wholesale prices without explicitly requiring generators and/or retailers to maintain a stipulated margin of reserve capacity.[33])

Airport landing fees continue to be based largely on the weight of the aircraft, which may reasonably reflect wear and tear on the runway but totally ignores the far more important

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29 The Associated Press, "Airline Delays Reach a 13-Year High", *New York Times*, August 7, 2007, p. A11.

30 "Route Awards and Airline Scheduling Practices", Federal Aviation Conference, March 22, 1978 [copies available upon request].

31 Michael E. Levine, "Landing Fees and the Airport Congestion Problem," *The Journal of Law and Economics*, Vol. 12, April 1969, pp. 79-108, and William D. Grampp, "An Economic Remedy for Airport Congestion: The Case for Flexible Pricing," *Business Horizons*, October 1968, Vol. 11, pp. 21-30.

32 In this I reluctantly concede the priority of the Wisconsin Public Service Commission, under its then Chairman—now U.S. Circuit Court of Appeals Judge—Richard D. Cudahy, in a case involving the Madison Gas Company, consoling myself with the assumption, without evidence, that one or more of the expert witnesses in that proceeding had read my Economics of Regulation.

33 See my "The Adequacy of Prospective Returns on Generation Investments under Price Control Mechanisms," *The Electricity Journal*, March 2002, pp. 37-46.

respective contributions of scheduled flights to congestion at different times and places. Similarly, air traffic control services—provided by the Federal Aviation Administration—are financed by taxes on fuel and passenger tickets, *neither of which reflects the same wide differences and fluctuations in congestion*. Both have the additional absurd consequence that light, private business aircraft with one or only a few passengers can, at minimum cost, contribute just as much to congestion as large commercial aircraft (actually more because of the wider spacing of flights that they require), with no penalty or charge reflecting the costs they impose on others. That cost, incidentally, is not necessarily alleviated by their use of nearby airports: Teterborough's reliever airport for private aircraft, in northern New Jersey, uses the same airspace as Newark. Even more generally, as Dorothy Robyn, representing the Department of Transportation, graphically pointed out several years ago, this system of cost recovery or charging has inefficiently encouraged the substitution of smaller, regional jets for larger aircraft, vastly increasing the burden of congestion in the sky and on the ground at peak hours.[34]

No doubt unsurprisingly, but no less appalling, the Bush Administration has reacted to the present genuine crisis by calling upon executives of the airlines and officials of airports to submit recommendations involving

> schedule reductions, whether achieved by negotiations or by government order … [in time] to be effective by the peak summer travel season … Brian Turmail, a spokesman for the Transportation Department …. said the … Department preferred a negotiated solution rather than a 'blunt' government order.[35]

Doubtless reflecting equally tin ears on both sides of the legislative aisles for the evils of cartelization, a prominent Democratic Senator announced he too would be calling on the Transportation Department *to convene a meeting of airlines to coordinate scheduled cuts* ….", a proposal easily predicted—by me—*twenty-nine years* previously:

> As I read through the list of topics and questions that were given to me by FAA as possible items to discuss, they all really seem to come down to one question, "Can you people at the CAB do more than you are doing to reduce those demands that you are placing upon us and the pressures that they are creating?"….

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34 Dorothy Robyn, "Remarks to International Aviation Club," July 18, 2000.

35 Matthew L. Wald, "Talks Sought for Airlines to Address Congestion, *New York Times*, October 11, 2007, *available at*: http://www.nytimes.com/2007/10/11/business/11air.html.

The first part is no; I am not interested in helping you directly. I am not interested in … controlling airline scheduling…. [or] authorizing the carriers to get together and collaboratively regulate their schedules or otherwise limit the capacity that they offer and, therefore, the pressures that they impose on airport [and air traffic control] facilities….

I am not interested in cooperating in any way in imposing hourly quotas and airport slotting. These are all forms of direct rationing, and everybody here knows that direct rationing is extremely inefficient….

[A]t a time when we at the CAB are trying to restore economic rationality to this industry … to place increasing reliance on the competitive market … to decide how much airline service should be provided and where; at a time when we at the CAB are doing our best to lift the heavy burden of pervasive, direct, arbitrary, artificial bureaucratic interventions, we are not about to set about enthusiastically to intensify precisely those same kinds of arbitrary controls in order to solve the problem of limited airport [and air] space inefficiently….

There is no guarantee that freer competition on the airline side of the equation—that is the part that creates the demand for airports [and air traffic control]—alone will solve these problems. On the contrary, it will stimulate more air travel….

The allocation of scarce airport [and air] space is an economic problem just like any other economic problem, and the decision about whether to incur the cost of additional capacity or the cost of expensive R&D or what kinds of R&D to develop new technologies … is an economic problem. And it will never be made intelligently until the users who are responsible for the incurrence of those costs … pay the full cost reckoned on a marginal or replacement basis…. It would also encourage the use of big planes if you had the proper charging because their cost per passenger would be lower than the cost of small planes if they happened to coincide with the system peak.

[M]y moral is simply this to the FAA: If you are going to follow economically irrational policies, don't ask the CAB to bail you out by doing the same thing: As the gang in West Side Story said at the end: "Officer Krupke, we've got problems of our own." If, however, you are willing to be thinking about using economically rational policies, then we would be very happy to cooperate.[36]

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36 "Route Awards and Airline Scheduling Practices", Federal Aviation Conference, March 22, 1978, italics supplied and with bracketed modifications reflecting my later recognition that the statement applied with equal force to air traffic control services.

The only possible—and sufficient—solution is to entrust air traffic control to a separate, corporate entity, *independent of Congress,* empowered to raise the capital it needs to adopt the most modern technology—apparently employing global positioning—financing the investment with user fees reflecting marginal costs and, above all, independent of the Congressional budget process.[37]

Airline passenger "Bills of Rights"

The enormous increase in flying spurred by deregulation, the increased crowding and congestion on planes, in the airways and on the ground, and the intensified pressures on carriers to cut costs—these instruments and manifestations of the *successes* of deregulation—have also, understandably, been the occasion also for mounting complaints by travelers generally about mistreatments, both real and imagined. Liberals and latter-day Progressives alike would recognize the need for governmental protection of consumers against deceptive or otherwise unfair treatment, inviting complaints of specific asserted mistreatments and empowered to provide redress—as, most recently, in New York State's "Airline Passenger Rights" legislation, effective January 1, 2008, entrusting this responsibility to the State Consumer Protection Board.

Statement of this unexceptionable principle provides little substantive guidance for the resolution of the most familiar complaints, about losses of baggage and cancellations of flights, the latter because of weather, asserted mechanical problems or shortages of crew. There is an entire jurisprudence to be developed here, involving the optimal distribution of risk or cost between carriers and travelers—subject also of course to the demands of safety. (My first inclination was to attach the adjective "overriding" or "absolute" to these last demands, only to recognize that total assurance is impossible if passengers board airplanes at all, and, even more so—if one can conceive of gradations of "impossibility"—if they travel by car instead.)

Apart from recognizing that there is a problem here, having little or nothing to do with economic merits of deregulation, I have no particular wisdom to impart about the proper distribution of burdens of these failures between carriers and travelers—a problem which

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[37] See Robert W. Poole, Jr.—a pioneer advocate—"The Urgent Need to Reform the FAA's Air Traffic Control System," The Reason Foundation, *Executive Summary Backgrounder*, No 2007, July 20, 2007; GAO Panel, "National Airspace System — Experts' Views on Improving the U.S. Air Traffic Control Modernization Program", April 2005; Steven A. Morrison and Clifford Winston, "Delayed! U.S. Aviation Infrastructure Policy at a Crossroads," in Clifford Winston and Gines de Rus, editors, Aviation Infrastructure Performance: A Study of Comparative Political Economy, Brookings Institution Press, forthcoming 2008, estimating the colossal losses imposed by our present irrational system of providing infrastructure and charging for it.

Congress has been grappling with unsuccessfully for at least the past decade. The possible encounter of weather unfit for flying is obviously an inherent part of the bundle of services covered by purchasing a confirmed reservation: so long as the certification of that contingency is by an objective third-party, that is a cost that air travelers and carriers already assume—with no apparent reason for government regulation to change its distribution between them.

In contrast, the costs to flyers of flight cancellations for mechanical reasons or lack of sufficient in-flight staff—or simple economy—would seem clearly the responsibility of the airlines themselves, and an equitable consumer protection program would presumably call for full compensation (however measured) to purchasers of tickets—which would also give the carriers the proper incentive to maintain the optimal balance between the costs of maintaining spare equipment and personnel sufficient to avoid such cancellations and the likely costs to them and to passengers of cancellations attributable to insufficient spare capacity.

Energy policy

After their—one would hope—embarrassing support for quotas on Japanese cars, the other early premonitory defection of 20th century "liberals", first informally, then openly in Senator Kennedy's campaign in 1980 for the Democratic presidential nomination, was over the issue of retention or abandonment of the price controls on crude oil and gasoline—previously imposed under the terms of the oil import quota system enacted in 1959. In my role as administrator of the President's ill-fated wage and price standards, I was visited by representatives of many of the consumer organizations that had previously supported our airline and trucking deregulations, in which Ralph Nader warned me that if President Carter removed those ceilings they would withdraw their support from the entire anti-inflation program. Recognizing that those controls, holding the domestic price of crude oil far below world levels, represented terrible energy policy, the President proceeded to set a schedule for deregulation—another exhibition of courageous adherence to principle for which he never received the credit he deserved. Even bolder was his subsequent invocation of his authority under that same Import Control Act to impose a ten-cents-a-gallon tax on gasoline—again, impeccable energy policy—which promised the additional benefit of raising the $10 billion a year we needed to bring in a balanced budget for the next fiscal year. Although the President urgently invited the members of the House and Senate to blame him, while letting the tax stand, Congress proceeded promptly to rescind it.

IV. “Network Neutrality”—The Unseemly Rush to Regulate

And while the House of Peers withholds its legislative hand
And noble statesmen do not itch to interfere in matters
Which they do not understand
So bright will shine Great Britain's rays
As in King George's glorious days.
Chorus:
So bright will shine Great Britain's rays
As in King George's glorious days.

W. S. Gilbert, Iolanthe

One of the most important current regulatory issues in which not only “Progressives” but also, alas, most of my fellow liberals seem to be on the regulatory or re-regulatory side, revolves around proposed legislation to require providers of high-speed Internet access to practice “network neutrality”—a movement set off by a deregulatory-minded FCC’s disclaimer of mandatory jurisdiction.[38]

From the “commons”—no charge—to no “discriminatory” charge

The concept of network neutrality evidently evolved out of a romantic (the characterization is descriptive, not derisive) vision of the Internet as a “commons,” open to all offerers of programs and content, free of charge, with guaranteed immediate access of any one broadband service subscriber to all others. This vision has, anomalously, led some professed consumer activists to make the astounding proposal that the *only* charges be to the subscribers—the ultimate consumers: that originators or suppliers of Internet programs, content or service not be subject to additional charge at all for access to them[39]. That contention—obviously self-

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38 National Cable & Telecommunications Ass’n v. Brand X Internet Services, 543 U.S. 1185 (2005).

39 See Mark C. Cooper, Director of Research of the Consumer [sic] Federation of America: “Let the consumer pay—it is the consumer that uses the network”, and the critique by Larry Darby, Am. Consumer Inst., Consumer Welfare, Capital Formation and Net Neutrality 6 (2006), *available at:* http://www.theamericanconsumer.org/Net%20Neutrality%20Study.pdf; editorial, “Open Net,” *The New Republic*, June 26, 2006. Sometimes one wonders who is supporting these several “consumer activists”!

interested on the part of such prominent suppliers of content and service as Google—ignores the fact that access to subscribers—the ultimate customers—is not only costly to provide (consider, for example, the multi-billion dollar investments of the telephone companies extending fiber to the premises, which will enable them to offer video in direct competition with the hitherto franchised-monopoly cable companies; and the similar huge investments in wireless[40]) *but independently valuable to the content suppliers themselves* as a potential source of advertising and other revenue:

> Google has become a powerhouse in advertising largely by selling short text advertising closely associated with topics people are researching or reading about on the Web. But it is increasingly looking to place more elaborate advertisements that are more attractive to marketers promoting product brands. Last year, it started allowing advertisers to bid to place advertisements using graphics and animation on sites it represents.[41]

It is just as misguided for consumer advocates to want to forbid the telephone and cable companies that carry those messages charging advertisers for access to the public as it would be to impose a similar prohibition on newspapers, television broadcasters or cable companies, requiring them to obtain their revenues exclusively from readers, purchasers, subscribers or viewers: think instead, for example, of who pays now for the annual broadcasts of Super Bowl games!

It has made good economic sense, therefore, and been beneficial to both content suppliers and receivers to have had both of them together bear the heavy and continuously growing costs of connecting them: the goal of an open, free "commons" has therefore given way to a demand that Internet access providers be required only to practice "network neutrality".

It has not always been clear exactly what the supporters of that obligation have wanted. In general, their objection has been to the telephone and cable companies either charging at all, or "discriminating" in their charges among suppliers of content or programs and/or, specifically, "discriminating" on the basis of guaranteed priority in speed of delivery. Such a practice, they

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40 Marguerite Reardon, "Citywide Wi-Fi spending could hit $3 billion," CNET News.com (October 25, 2006), *available at* http://m.news.com/Citywide+Wi-Fi+spending+could+hit+3+billion/2163-7351_3-6129655.html. Additionally, Sprint/Nextel announced a year or so ago that, in partnership with Intel, it would be spending $3 billion in the next two to three years extending mobile Wi-Max service nationwide.

41 Saul Hansell, "Google Moves to Sell Space for Video Spots on Network of Web Sites," *New York Times*, May 23, 2006, at C3.

express the fear, would be to the advantage of "deep-pocketed corporations" (whenever I hear that metaphor, I immediately reach for my own pocket, to make sure it is tightly buttoned) leaving all other content providers (the "little guys") to "the digital equivalent of a winding dirt road"[42]—a fair example of the populist rhetoric of leading advocates.

The concern, however demagogically put, is not ridiculous. The Internet is obviously something revolutionary, and there is room for something less than full confidence in the adequacy of competitive exploitation of its full potential under what is still essentially a telephone and cable company duopoly. The disagreement is in important measure therefore over the sufficiency of wireless access as a third option, particularly as the FCC opens more of the spectrum for that use, limiting the market power of the two dominating ubiquitous incumbent terrestrial systems. To be sure, there are already many, many more subscribers now to wireless or cellular than to traditional land-line telephone service—subscriptions to the latter have dropped by 11 percent in just the last six years: phone books are becoming palpably thinner. But while broadband wireless is likewise growing rapidly, to the point that it (including satellite) had as of the end of 2006 captured some 7.7 percent nationwide of what the FCC calls advanced services lines (over 200 kilobits per second in both directions)—I am frankly unable to judge whether that figure or the 27.8 percent and likewise rapidly increasing share of satellite and wireless in "higher speed lines over 200 kbps in at least one direction"[43] is the more relevant—except for my understanding that the 200 kbs standard is today very slow service—the overwhelming majority of subscribers still confront a duopoly; and promised broadband over the ubiquitous electric power lines remains on the horizon. [44, 45]

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42 Lawrence Lessig and Robert W. McChesney, "No Tolls on the Internet," *Washington Post*, June 8, 2006, p. A23.

43 Federal Communications Commission, "High-Speed Services for Internet Access: Status as of December 31, 2006," FCC Industry Analysis and Technology Division, Wireline Competition Bureau, October 2007, tables 1 and 2. The figures were 4.5 percent and 18.4 percent, respectively, only six months previously. Ibid, corresponding report of January 2007.

44 For a critique of the FCC's optimistic assessments of the sufficiency of wireless as a competitive restraint on the landline duopoly providers of internet access, including the observation that the 200 kbps is "unrealistically low" (*accompanied by an arguably contradictory argument for common carrier obligations of the—assertedly still only spottily available—franchised wireless carriers* as well) see Rob Frieden, "Internet 3.0: Identifying Problems and Solutions to the Network Neutrality Debate", 1 *International Journal of Communications*, pp. 461, 479-480 (2007), *available at:* http://ijoc.org/ojs/index.php/ijoc/article/view/160/86. See, however, my own somewhat hesitant endorsement of common carriage obligations, partly under influence of Professor Frieden, text at notes 63-64, below.

As to the aforementioned "arguably contradictory" contention, it seems to me that the justification Professor Frieden gives for imposing or retaining net neutrality requirements on the terrestrial carriers—namely, the

The revolutionary, inherently competitive potential of telecommunications technology, however, and the large, risky investments required to exploit it, argue strongly against subjecting Internet access to the thoroughgoing regulation traditionally applied to common carriers.[46] Moreover, the blanket objection to "discrimination" among suppliers of programming or content on the basis of a guaranteed priority in speed of delivery is ignorant. To an economist—and, one would hope, in ordinary parlance as well—"discrimination" is confined to differences in price, whether for the same service or for different services, that are not justified by differences in the cost of supplying them. Manifestly, however, preferential guaranteed speed of delivery for particular messages can, when the network is congested, entail a delay, however slight, in the transmission of non-priority services: that is a real cost. And, in the longer-run, it involves the cost of providing additional broadband capacity sufficient to minimize—strictly "optimize"—that negative effect.

Differences in charges reflecting such differences in the cost of providing different qualities of service are the consequence not of monopoly but of an effectively functioning market. The notion that it is "discriminatory" to charge users for services—such as voice telephone (VoIP), virtual teleconferencing, on-line gaming or downloading movies, the last a frighteningly growing demand—that *use more bandwidth than others*, for the guaranteed priority in delivery that they require for intelligibility or the additional investment that they invoke is ignorant.[47] So is the failure to recognize also the legitimacy of genuine price discrimination as a

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asserted spottiness and insufficiency of their wireless competition—conflicts with his later proposal to impose *on the wireless challengers* the same obligation to permit attachment of "alien" devices or terminal equipment at the subscriber's end as the 1968 *Carterfone* precedent applied to the local AT&T franchised *monopolies*. See my discussion of the "alien attachments" issue in *The Economics of Regulation*, Vol. 2, pages 140-145.

For a convincing marshalling of the evidence, however, that the rapid expansion of wireless and cable telephony as well as the effect of heavy sunk costs on the level of profit-maximizing prices (in an argument anticipated by J.M. Clark's distinction between prices and "*margin*" elasticity of demand 47 years ago in his Competition as a Dynamic Process, Washington: Brookings, 1961, pp. 149-150, justifies deregulation of retail prices, see Timothy J. Tardiff, "Changes in industry structure and technological convergence: implications for competition policy and regulation in telecommunications", *International Economics and Economic Policy*, 4:2, 2007, pp. 109-133.

45 See the thoroughly nuanced factual assessment by the staff of the Federal Trade Commission, *broadband connectivity competition policy* June 2007, Chapter VI, culminating in "Suggested Guiding Principles" fully consonant with the policy conclusions I offer here.

46 For persuasive warnings, see Robert Hahn and Scott Wallsten, "The Economics of Net Neutrality", AEI-Brookings Joint Center for Regulatory Studies, Related Publication 06-13, 2006, and Randolph J. May in a number of venues—the most recent, "The Threat to the Net from Net Neutering", The Free State Foundation, January 8, 2008, citing an almost apocalyptic prediction of imminent congestion by *The Economist*.

47 For a clear recognition of this by the more sophisticated advocates of network neutrality, see, among others, Frieden, *op. cit.*, note 37 above. For an incisive explication of the simple economic corollary that interference

means of recovering the heavy fixed and common costs of providing telecommunications services to a multiplicity of markets, *provided it is not anti-competitive*.[48]

The proper agencies for administering that last proviso—which I intend emphatically to be the opposite of perfunctory—are the FCC and antitrust agencies, acting as enforcers of the antitrust laws and *not* as traditional regulatory agencies—prescribing rates and allowable rates of return overall: that is my liberal conception of the lessons of history—lessons I spell out in greater detail and with greater emphasis in section V, following.

In these circumstances, the remedy proposed by the network neutrality advocates is likely to be counter-productive. The most powerful competition stems from technological innovation—the kind exemplified, preeminently, by telecommunications. Comprehensive, compulsively tidy public utility-style regulation is not only unnecessary in such markets, it is an obstruction to developing competition among technologically different platforms: The advocates of legislatively mandated network neutrality are proposing in effect to equalize the regulatory status of the competing telephone, cable and wireless companies by bringing the last two under the former's public utility tent—the very opposite of what turbulent technological competition demands.

The—or one—right direction is pointed out by a *Statement on U.S. Broadband Policy*, issued in March 2006 by 27 prominent economists,[49] and the several reports of the Digital Age Communications Act (DACA) Study Commission that was assembled by the Progress and Freedom Foundation (right-wing, to be sure, but in association with liberal advocates of competition and strong antitrust law enforcement). Both of them ask Congress to preempt and eliminate the thousands of local franchising regulations that restrict competitive entry of

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with network pricing that reflects the differing technical demands of the several services—insisting, for example, that "packets corresponding to some real-time medical procedure between a doctor and a distant hospital (be) subject to the same delay and jitter as packets carrying Yahoo instant messages between bored high schools students in math class," threatens massive welfare losses, *see* William E. Taylor, "Freedom, Regulation, and Net Neutrality", NERA, September 12, 2007.

48 Michael E. Levine, "Price Discrimination Without Market Power," *Yale Journal on Regulation* 19:1, 2002, pp. 1-36; William J. Baumol, "Regulation Misled by Misread Theory, Perfect Competition and Competition-Imposed Price Discrimination," AEI Press, March 2006. For my own insistence that this recognition should not exonerate price discriminations that are predatory, see my "Telecommunications: The Transition from Regulation to Antitrust," *Journal on Telecommunications & High Technology Law*, 5:1, 2007, pp. 165-175.

49 Elizabeth E. Bailey et al., "Economists' Statement on U.S. Broadband Policy", AEI-Brookings Joint Center for Regulatory Studies, Related Publication 06-06, March 2006, *available at* http://www.aei-brookings.org/admin/authorpdfs/page.php?id=1252; *see also* Robert W. Hahn & Scott Wallsten, op. cit.; Thomas W. Hazlett, "Cable TV Franchises as Barriers to Video Competition", George Mason University Law and Economics Research Paper Series 06-06, March 2006, *available at* http://ssrn.com/abstract=889406.

broadband access suppliers. And in this network industry, in which the owner of any particular link in the interconnecting web of carriers can prevent messages or context initiating with any other carrier reaching all subscribers—the vision of the "commons"—the DACA Report adds, the antitrust or regulatory agencies *should have the authority to require* owners of all broadband links to interconnect with one another for the reciprocal transmission of messages or content, as they now routinely do.[50]

In describing the danger that the telephone and cable companies will, as the preponderant suppliers of broadband access, discriminate against competitive providers of service or programming, [51] every network neutrality advocate appears to have cited the case of the Madison River Telephone Company's refusal to carry the messages of Vonage, the leading independent provider of voice telephone service over the Internet—VoIP. Few of them mention the fact that the FCC promptly stepped in to prohibit that clear violation of antitrust principles, as did the Canadian Radio-television Regulatory Commission in the same situation. Others have suggested, similarly, that cable companies might discriminate—genuinely discriminate—against streaming video applications, because such uses would compete against their own video offerings. *It is unthinkable, however, that in a deregulated regime agencies charged with antitrust responsibility would not similarly strike down—or not be explicitly instructed by any deregulation legislation to strike down—any such genuine discriminations by the franchised or hitherto franchised land-line telephone or cable companies against competing providers of content in favor of their own or of their affiliates.* Observe that this solution simply bypasses the increasingly complex and turgid controversies—largely in [University of] "Chicago" and "post-Chicago" terms—about the likely frequency of such practices and their injuriousness to consumers.

Following this principle, the consumer groups that have asked the FCC to stop Comcast's admitted delaying of some traffic—specifically file sharing—assertedly (and plausibly) in order

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50 Digital Age Communications Act, Proposal of the Regulatory Framework Working Group, The Progress and Freedom Foundation, June 2005, pages 24-29.

51 See, for an excellent sampling, Brett M. Frischmann and Barbara van Schewick, "Network Neutrality and the Economics of an Information Superhighway: A Reply to Professor Yoo" (and the Yoo articles cited there), accepted for publication by *Jurimetrics, the Journal of Law, Science and Technology,* Vol. 47, Summer 2007—supporting legislatively mandated neutrality—and, on the other side, Douglas A Hass, "The Never-Was-Neutral Net and Why Informed End Users Can End the Net Neutrality Debates", *Indiana Legal Studies Research Paper Series, No. 82,* pp. 56-64, January 2007, *available at* http://ssrn.com/abstract=957373.

"to keep a few file sharers from slowing down traffic for the majority of users,"[52] have filed their complaint with the competent agencies, properly empowered to determine whether, as they claim, the differential treatment of the two groups of customers was indeed discriminatory (rather than cost justified) and, if so, in some way anti-competitive. As to the enforcement agencies and their mission, Professor Philip Weiser has them just right

> the debate (over network neutrality) is best addressed by the Federal Communications Commission and the Federal Trade Commission…. (B)oth institutions are better positioned than Congress to reject the categorical calls for and against regulation and to recognize that the concerns that animate this debate are best confronted with a scalpel, not a sledgehammer.[53]

V. <u>An Olive Branch to "Progressives": Reinvigorated Antitrust Enforcement, Consumer Protection, and Preservation of an Obligation to Serve</u>

The conflicting conceptions of antitrust

Having rejected the recidivism of the most strident "Progressives" (and many otherwise genuine liberals), I remind them that a vigorous and vigilant enforcement of antitrust and consumer protection laws has always been an essential part of the liberal program.

That generalization fails in itself to confront the wide gulf that has emerged in antitrust literature and jurisprudence.

On the one side are 20th century liberals, such as I, who have for at least a half-century insisted that the proscriptions of antitrust apply specifically to anti-competitive *behavior*—suppressions of competition by agreement, collusion, combination, *or* by actions of individual, dominant firms that deny rivals a fair opportunity to compete on the basis of their own efficiency and the attractiveness of their offerings.[54]

As Hans B. Thorielli pointed out in his definitive <u>The Federal Antitrust Policy, Origination of an American Tradition</u>, this was clearly one distinct original intention of the 1890 Sherman Act:

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[52] Staci D. Kramer, "Consumer Groups Ask F.C.C. to Halt Comcast's File-Sharing Delays", *The New York Times*, November 2, 2007.

[53] Philip J. Weiser, "The Next Frontier for Network Neutrality", unpublished manuscript 2007.

[54] See my <u>Fair Competition, the Law and Economics of Antitrust Policy</u>, in collaboration with Joel B. Dirlam, Ithaca: Cornell University Press, 1954.

> The government's natural role in the system of free private enterprise was that of a patrolman policing the highways of commerce. It is the duty of the modern patrolman to keep the road open for all ... [T]his means that occupations were to be kept open to all who wished to try their luck … and that hindrances to equal opportunity were to be eliminated…
>
> There can be no doubt that the Congress felt that the ultimate beneficiary . . . was the consumer…. The immediate beneficiary legislators had in mind, however, was in all probability the small business … whose opportunities were to be safeguarded from the dangers emanating from those recently-evolving elements of business…. strange, gigantic, ruthless and awe-inspiring.
>
> This is one reason why it was natural to adopt the old doctrines of the common law, doctrines whose meaning had been established largely in cases brought by business or professional people dissatisfied with the behavior of competitors.
>
> Perhaps we are even justified in saying that the Sherman Act is not to be viewed exclusively as an expression of economic policy. In safeguarding rights of the 'common man' in business 'equal' to those of the evolving more 'ruthless' . . . the Sherman Act embodies what is to be characterized as an eminently 'social' purpose.[55]

Any doubts on that score should have been put to rest by the passage in 1914 of the Federal Trade Commission Act—one of the triumphs of the original, authentic Progressive movement—with its flat prohibition of "unfair methods of competition"—as before, *actions*, *policies*, or *behavior* restricting the competitive *process*. Specifically, I suggest that the high termination fees evidently typically incorporated in cellular service contracts by the dominant providers[56] might well constitute unfair methods of competition or exclusionary practices under the Sherman and FTC Acts.

The last half-century, in contrast, has witnessed the virtual triumph of an opposing, conservative view, inspired and powerfully rationalized by University of Chicago economists, highly sophisticated liberals of the eighteenth century variety, that the prohibitions of antitrust laws generally and of discrimination in particular should apply only upon clear demonstration of

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[55] The Federal Antitrust Policy, Origination of an American Tradition, John Hopkins Press, Baltimore, MD (1955), pp. 226-227 (1955), *referring only to the Sherman Act*:

[56] See the eloquent protest of Randall Stross, "When Mobile Phones Aren't Truly Mobile," *The New York Times*, July 22, 2007, Business Section, p. 3.

a genuine threat of injury *to consumers*[57]—the application of which has typically involved the courts in competing testimonies by economist-witnesses.

This issue is clearly exposed by the carefully articulated proposal of the ambitious Digital Age Communications Act (DACA) Project, sponsored by the Progress and Freedom Foundation, in which I participated, and incorporated in the DeMint bill, introduced in the 109th Congress, 1st Session, explicitly recommending application of the Section 5 FTC Act unfair methods of competition "model"—which accords completely with my own historical position. The DACA proposal goes on, however, to recommend that the prohibition of discrimination or other practices denying rivals a fair opportunity to compete apply only to practices or behavior that demonstrably "pose a substantial and non-transitory risk to consumer welfare"—a clear victory for the University of Chicago, but also representing a consensus view of most respectable economists as well as the courts.[58]

My own historical position—that antitrust proscriptions of unfair methods of competition should apply to all genuine discriminations by franchised wireline and wireless telephone and cable companies in favor of affiliated content providers, to the disadvantage of unaffiliated ones—is the main olive branch I offer to advocates of network neutrality legislation.

To return to the present flood of highly emotional demands on Congress to enact such a requirement, by all means let there be congressional hearings, and administrative agencies explicitly instructed to subject claims of "discrimination" to critical scrutiny. There is nothing liberal or progressive, however, about the government rushing in to regulate the wonderfully promising, turbulent, technology-based competitive developments in telecommunications. Whatever the professed disillusionment of "progressives" with the results of the economic deregulations to date (by which, of course, I emphatically do not refer to the deliberate and systematic disembowelment of health, safety, environmental and investor protection laws and agencies by the present Bush administration), liberals of eighteenth through the twenty-first century varieties and authentic progressives as well will put their trust in competition, reinforced by explicit, legislatively-demanded application of traditional antitrust and consumer-protective

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57 For a lucid, approving summary, see George A. Hay, "The Quiet Revolution in U.S. Antitrust Law", Cornell Law School research paper No. 07-023.

58 For an explicit confrontation of this issue and exposition and defense of the position I explicate here, see Eleanor M. Fox, Chapter 11 "Abuse of Dominance and Monopolisation: How to Protect Competition Without Protecting Competitors", in European Competition Law Annual 2005: What Is An Abuse of A Dominant Position?, Ehlermann and Atanasiu (eds.), pp. 69-77, Hart Publishing (2006).

principles—unless and until an objective, non-ideological review of experience demonstrates their inadequacy to ensure fair and efficient competitive exploitation of the Internet miracle.

The Verizon blunder: does it demonstrate the need for network neutrality legislation?

In late September of 2007, in a master-stroke of ineptitude, Verizon Wireless unwittingly performed the major public service of forcing liberal opponents of legislatively-mandated network neutrality, such as I, to look to the internal consistency of our several views, by—initially—refusing to make its mobile network available for a text-message proffered by the National Abortion Rights League. The responsible employee did so, he said, in accordance with the Company's asserted policy against distributing content that "may be seen as controversial or unsavory to any of our users"[59] The refusal, almost immediately reversed by a wiser higher management,[60] brought down a storm of protest and widespread assertions that this was exactly the kind of practice that statutorily mandated network neutrality would be intended to prevent. Perhaps significantly, the *New York Times* did not relate its condemnation of the initial Verizon action specifically to its long-time advocacy of such legislation, condemning it instead simply as a case of "textbook censorship" and calling upon the Federal Communications Commission merely to

> quickly issue regulations that … bar interference with text messaging:
>
> "Freedom of speech must be guaranteed, right now, in a digital world just as it has been protected in a world of paper and ink."[61]

Those of us with long memories will recall that this was the vision also of the "fairness doctrine"—the obligation of radio and television broadcasters, in exchange for the gift of valuable rights to the spectrum, to air or permit use of their networks as open forums for the exchange of ideas, prominently including political views. That obligation was, however, rescinded by the FCC in 1985[62] on the plausible ground that the "market place for ideas" had become sufficiently diverse and competitive to render it not only unnecessary but in conflict with

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[59] Adam Liptak, "Verizon Rejects Text Messages from Abortion Rights Group," *New York Times*, September 27, 2007.

[60] Adam Liptak, "Verizon Reverses Itself on Abortion Rights Messages," Ibid., September 27, 2007.

[61] "The Verizon Warning," *New York Times*, October 3, 2007, Page A24.

[62] *Syracuse Peace Council*, 2 FCC RCD 5043

freedom of speech for the government to impose "neutrality" obligations on any one or all of the participants.[63] And that recidivism or its supporting logic was evidently the basis of the Progress and Freedom Foundation's Adam Thierer's scornful reaction to the *New York Times* editorial:

> The perversely named Fairness Doctrine, which threatened licensed broadcasters with fines if they didn't "afford reasonable opportunity for the discussion of conflicting views," as the government defined it, has shown up in the news again recently, as federal lawmakers and liberal media activists have called for increased regulation of a media marketplace that they feel is spinning out of their control. But the push to reimpose the doctrine—which the Reagan administration abandoned in the late 1980s as obsolete and harmful to free speech—may be mostly a diversionary tactic. The Left has a much bigger target in its regulatory crosshairs: the Internet. Over the past few years, many of the same policymakers and activists who have long trumpeted the Fairness Doctrine have advocated that its rough equivalent apply to Internet service providers. And they've come up with another Orwellian term for the proposal: "net neutrality."
>
> In theory, net-neutrality regulation would ban Internet operators from treating some bits of online traffic or communications more favorably than others, whether for economic or political purposes. Proponents of net neutrality use the same kind of fantastic rhetoric to describe it that they once used for the Fairness Doctrine: it's a way to "save the Internet" from "media barons," they say, who're apparently hell-bent on controlling all our thoughts and activities…..
>
> It's a brilliant tactic by the Left. Why exert all your energy attempting to reimpose "fairness" mandates on broadcasters alone when you can capture them, and much more, by regulating the entire Internet? After all, in a world of media convergence and abundance, bright lines dividing distinct media sectors or their products have vanished. Everything from TV shows to text messages run on multiple networks making the old, broadcast-oriented Fairness Doctrine a less effective means of reestablishing a liberal media monopoly. So the liberals got smart and came up with the perfect solution: use net neutrality as the backdoor way to reimpose the Fairness Doctrine on the entire media marketplace.[64]

The logic of the fairness doctrine was, however, not the basis of my dismay at the original action by the misguided Verizon executive. It was, instead, its violation of the historic common carriage obligations of franchised communications companies: *they have no business examining and interfering with messages transmitted over their facilities*.

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[63] Candor requires me to express a layman's skepticism about undiluted application of the First Amendment to artificial "persons".

[64] "Net Neutrality: A Fairness Doctrine for the Internet", Progress and Freedom Foundation, Progress Snapshot, Release 3.11, October 2007.

My above-mentioned colleague, William Taylor, an incisive opponent of network neutrality legislation, allows me no such easy escape:

> If I've got that right, the obvious question then arises: what is it about legislatively-mandated network neutrality [which you oppose] that differs from your view of the "quo" that a cable/telco might reasonably owe, stemming from its historical monopoly franchise?[65]

His question is shrewd: *Can it be that the "olive branch" I offer to progressives is actually the whole tree?* How can I, logically, oppose a legislative mandate of "network neutrality", while at the same time reaffirming the historical obligation of franchised utility companies to act as—*neutral*—common carriers of whatever content is offered them—an obligation effectively acknowledged by the higher Verizon official who reversed his hapless subordinate?

My response is that network neutrality legislation, in contrast, would seem to deny carriers the right to differentiate their charges, *non-discriminatorily*, on the basis of the respective technical requirements of the messages—that is, in reflection of their differing short-term opportunity and long-run investment costs—*and* impede their recovery of heavy common investment costs truly discriminatorily, in economic terms—that is, necessarily, on the basis of what the respective traffics will bear, even if not anti-competitively in intent or effect.[66]

My hope is that we can retain that obligation of common carriage, reinforced by prohibitions of unfair competition, without recourse to legislatively-mandated "network neutrality," with its ignorant blanket prohibition of "discrimination" and invitation to all the other trappings of traditional public utility-style regulation to determine whether actual discriminations were or were not "reasonably" required for the recovery of joint and common costs.

From Prohibitions to Active Consumer Assistance

In most versions of the prohibition of unfair competition of which I am aware, the prohibition is extended—either explicitly or by interpretation—to "deceptive" methods or practices.

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65 Private communication. See also note 46, above.

66 See, e.g., my "How to Treat the Costs of Shared Voice and Video Networks in a Post-regulator Age," Cato Institute, Policy Analyses #264, November 27, 1996.

Even after making allowance for my generation's (or at least *my*) especial discomfort, if not bewilderment, when confronted with the decisions forced on consumers by rapidly changing telecommunications technology and service offerings, it seems to me that the task of making intelligent choices has become excessively complex even for succeeding generations. Paradoxically, that complexity has been intensified by the competitive pressures on cable, telephone and wireless companies to satisfy the apparent preference of most consumers for paying in a single bill for what used to be separate "local" and "long-distance" telephone service, broadband access—of varying speeds or capacity—as well as video. Confronted as I am with multi-paged monthly telephone company bills—including wireless—in the $160 range and separate cable company bills in the $80 range, with varying combinations of wireless charges for placing and/or *receiving* calls, varying special discounts for varying periods of time and—one of which I was not even aware until recently—forbiddingly high wireless service termination fees—I am reminded forcefully each time of Oscar Wilde's complaint, "The trouble with Socialism is it takes up too many evenings". While resigned acceptance has become the rational choice for most of us individually, I have difficulty accepting that it represents the rational situation for consumers *collectively*—one example, I take the liberty of pointing out, of what I described some forty years ago as "the tyranny of small decisions."[67]

That observation provides me with the opportunity to conclude this extended criticism of Progressives on the conciliatory note of proposing agreement that government *prohibition* of "unfair" methods of competition should in the present circumstances be interpreted broadly, not merely to *proscribe* practices likely to be deceptive or misleading to a large body of consumers but to *prescribe* forms of bills that disclose in simple terms what each item or group of items is and what alternative options are available.[68]

As I lack the ability or the will to have penetrated the thicket of time-varying bundled offerings as a consumer, I have no particular competence to suggest ways in which it might be perfectly consistent with liberalism for a government agency to play such a more active role. One of the olive branches that a liberal extends to "Progressives" is a solicitation of their collaboration in framing legislative or administrative proposals to this end—although enactment

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67 "The Tyranny of Small Decisions: Market Failures, Imperfections, and the Limits of Economics," *Kyklos*, Volume 19, 1966.

68 See the concluding section and central recommendation of Hass, note 50, *op. cit.*, in lieu of mandated network neutrality, pp. 56-64, 2007.

of a "wireless consumers bill of rights" such as has been introduced in the U.S. Senate[69] might well recall Bismarck's analogy between the making of laws and sausages.

[69] S. 2033: Cell Phone Consumer Empowerment Act of 2007, sponsored by Senator Amy Klobuchar, co-sponsored by Senators Byron Dorgan, Russell Feingold, and John Rockefeller, September 7, 2007.