
Perspectives

on current developments

OSHA and the Fourth Amendment

The recent Supreme Court decision in *Marshall v. Barlow* offers businesses a Fourth Amendment shield against warrantless inspections by the Occupational Safety and Health Administration. Although hailed by some business spokesmen as a great victory, the decision is unlikely to have much effect on OSHA enforcement.

At issue in *Barlow* was the constitutionality of Section 8(a) of the Occupational Safety and Health Act that empowers agents of the secretary of labor to inspect an employer's work area for safety hazards and other violations of OSHA rules without getting a warrant. Seeking injunctive relief against warrantless searches, *Barlow's, Inc.*, argued that Section 8(a) contravened the Fourth Amendment's protection against unreasonable searches and seizures. By a 5-3 vote, the Supreme Court agreed. It reaffirmed its earlier rulings that warrantless searches are presumptively suspect under the Fourth Amendment, that the presumption shields places of business as well as residence, and that Fourth Amendment protections apply to both civil and criminal investigations.

In presenting its case, the government had urged that two exceptions to the warrant requirement kept Section 8(a) from contravening the Fourth Amendment. The first exception strips warrant protection from heavily regulated industries (liquor and firearms, for example) because there can be no reasonable expectation of privacy from government intrusion in their case. Its rationale is that persons going into business in such industries in effect consent to statutory curtailments of privacy rights. The second exception allows warrantless searches that are necessary to effective enforcement of regulatory statutes and do not seriously threaten privacy rights. Warrantless OSHA inspections were necessary, the government contended, because an employer might

hide or remedy safety defects during the time between an inspector's abortive request to search a plant and the procurement of a warrant.

The Court held that neither exception applied in the case. The first failed because the targets of Section 8(a) are not limited to heavily regulated industries. Noting that this section reaches all businesses having an effect on interstate commerce, the Court asserted that it would be fanciful to infer a voluntary consent to warrantless inspections by the millions of employers subject to OSHA. The second exception, which is founded on administrative necessity, failed on the grounds that warrants may be issued *ex parte* and executed without delay or prior notice, thereby preserving the advantage of surprise. Moreover, the Court noted, OSHA's regulations, which require inspectors to get court orders if refused entry to business premises, belie the claim that warrants would jeopardize the effectiveness of the existing inspection system. Accordingly, the Court held that the enforcement concerns voiced by the government were insufficient to brush aside the general Fourth Amendment requirement of a warrant to justify searches.

In reaching this conclusion, however, the Court largely vitiated its significance by refusing to require that OSHA warrants be granted only if there is probable cause for believing a violation exists on an employer's premises. The Court stated:

A warrant showing that a specific business has been chosen for an OSHA search on the basis of a general administrative plan for the enforcement of the Act derived from neutral sources such as, for example, dispersion of employees in various types of industries across a given area, and the desired frequency of searches in any of the lesser divisions of the area, would protect an employer's Fourth Amendment rights.

Thus, warrants will be granted in cases where reasonable legislative or administrative standards for inspection are satisfied.

Little change should be expected in the frequency and effectiveness of OSHA inspections in the wake of the *Barlow* decision. First, OSHA regulations apply to approximately 5 million businesses and are enforced by only 1,300 inspectors. Ordinary principles of good management would require deploying these inspectors under a plan that (according to *Barlow*) will justify issuance of a warrant to inspect particular businesses. OSHA's managers apparently had used such plans prior to *Barlow*, because *Barlow's, Inc.*, was chosen for inspection on the basis of the accident experience and number of employees exposed in its industry. It is thus unlikely that OSHA will be compelled to alter its enforcement strategies in order to obtain inspection warrants. Indeed, *Barlow* left open the question whether judicial orders for inspections routinely sought under the secretary's existing regulations when employers refuse entry are the functional equivalent of warrants and thus satisfy the Fourth Amendment.

Second, when OSHA's inspectors conduct criminal investigations with the assistance of a U.S. attorney, they may obtain warrants by telephone pursuant to Rule 41(c)(2) of the Federal Rules of Criminal Procedure. (If the purpose of an OSHA search is to obtain evidence of crime rather than civil infractions, probable cause to believe criminal conduct has occurred must be shown to justify a warrant.) This procedure will minimize any dissipation of criminal enforcement energies.

Third, *Barlow* erects no barrier to surprise inspections because warrants may be issued ex parte and summarily executed without prior notice to an employer.

The only important safeguard *Barlow* offers employers is protection against inspections conducted in bad faith or for purposes of harassment. These will be forestalled by the requirement that a warrant application both state the purpose of the intended search and show that the target was chosen on the basis of a plan containing specific and neutral criteria.

Whether *Barlow* foreshadows judicial condemnation of warrantless searches authorized under other regulatory statutes (such as the

Mine Safety Act and the Air Pollution Control Act) is uncertain. The Court expressly reserved decision on these questions, noting that the specific enforcement needs and privacy guarantees of each statute would govern the constitutional determination in each instance. However, the Court's readiness to countenance the issuance of warrants on the basis of a relaxed showing of cause would appear to minimize the significance of curtailing warrantless searches by administrative agencies.

The Railroads' "Yo-Yo" Provision Expires

When Congress enacted the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act), it intended, among other things, a major change in the way railroad rates are set. The plan was to let the marketplace determine rail rates in areas with effective competition. To this end, the act contained two key provisions:

- (1) The Interstate Commerce Commission could no longer hold any rail rate to be "unjust and unreasonable" (too high or too low) so long as the rate contributed to the "going concern value" of the railroad—*unless* the ICC found that the railroad possessed "market dominance" over the traffic concerned.
- (2) Railroads could increase or decrease rates by as much as 7 percent without those rates being suspended by the ICC—*unless*, again, the ICC found that the railroad possessed market dominance.

The latter provision, dubbed the "yo-yo" by its detractors, was viewed by the Congress as an experiment and was therefore scheduled to expire two years after enactment.

In the two years, rate filings under the "yo-yo" provision were inconsequential, despite the fact that many experts had expected the provision to inject considerable price competition into the industry. Why, in the face of these expectations, did it have so little effect? There appear to have been two major reasons.

First, under the 4-R Act, rate changes are still covered by provisions of the Interstate Commerce Act prohibiting discrimination among shippers and commodities. Many shippers simply protested rate increases on those

grounds, and the time-consuming and costly process of meeting these challenges soon discouraged railroads from filing rates under the "yo-yo." A more important reason was the ICC's way of determining market dominance. The 4-R Act defined market dominance as an "absence of effective competition from other carriers or modes of transportation," and directed the ICC to come up with rules for determining whether, in a given situation, a rail carrier possessed such dominance. Thus, the act gave the commission broad discretion to establish an important determinant of the degree of rate flexibility to be allowed.

When in August 1976 the ICC issued its initial proposal for ways of determining market dominance, there followed a series of pitched verbal battles, with the industry, the Department of Justice, and the Department of Transportation opposing the ICC staff and some shippers. Finally, on October 1, 1976, the ICC announced four conditions that would establish a *rebuttable presumption* of market dominance (that is, if these conditions obtained, the railroad would have to prove it did *not* have market dominance). The conditions were the following: (1) when a railroad's rate exceeds the variable cost of providing the service by 60 percent or more, (2) when the railroad handles 70 percent or more of the traffic to which the rate applies, (3) when a shipper has made a "substantial" investment in ancillary rail equipment or facilities, and (4) when the proposed rate has been discussed in a rail rate-bureau proceeding.

The railroads asked the Court of Appeals for the District of Columbia to review the ICC's decision, arguing (mainly) that it was contrary to congressional intent since its effect would be to limit rather than promote rate flexibility and competition. The appeal was rejected on May 2, 1978. Although the court did ask the ICC to clarify certain aspects of its 60-percent-of-variable-cost standard, it found that the decision was reached through proper procedure and was consistent with the act.

Before that decision, in February 1978, the "yo-yo" provision expired amidst general disinterest. In this there must be a lesson for those who would reform regulation by granting the regulatory agency significant discretion to determine the degree and speed of change.

New Rules against "Redlining"

With considerable fanfare, the Federal Home Loan Bank Board moved in May to strengthen rules designed to prevent discrimination in the lending practices of its member savings and loan associations. Many of the new rules (which were effective July 1, 1978) seem relatively innocuous. But the one designed to end discrimination against entire neighborhoods, a practice known as "redlining," raises difficult questions.

Under the equal opportunity provisions of various civil rights and home financing laws, the FHLBB moved some time ago to prohibit discrimination in lending on the basis of the race, color, religion, sex, or national origin of prospective owners or tenants. Recently, however, savings and loans have been accused of indirectly continuing such discrimination by using loan decisions based on the age and location of the dwelling as a means of denying loans in neighborhoods in racial transition or with large minority populations. The FHLBB's new regulations will stop redlining of this sort by forbidding savings and loans

—from denying loans or varying loan terms solely on the basis of the age or location of the dwelling, or on the basis of the race, color, religion, sex, or national origin of residents in the vicinity of the dwelling, and

—from using appraisals that are discriminatory in the same way.

The goal of ending redlining is widely supported. The practice exacerbates neighborhood decline by discouraging homeownership and rehabilitation, by reducing the values of the existing dwelling units, and by encouraging a trend toward higher-density rentals. Because racial transition per se is not a cause of urban decline, prohibiting it as a basis for determining whether to make loans could help stabilize residential neighborhoods. The impact of the FHLBB action should be far-reaching, since savings and loans accounted for roughly half of the net increase in residential mortgages during 1977 and since nearly 98 percent of all savings and loans are members of the board.

The issue of discrimination arises in this instance not so much out of prejudice on the part of the lenders as out of the fact that information on the relative security of loans is

neither perfect nor free. In many cases it may be less costly for the lending institution (and for those who receive mortgages) to have simple rules of thumb that identify dwellings in some locations as "good" risks and those in others as "bad" (and similarly with respect to age). What the FHLBB's regulations do is require that lending institutions look beyond rules of thumb so as not to place undue weight on age and location. While these may be two major factors in a property's present and future market value, the rules limit their significance by clarifying the acceptable locational risk factors, by requiring greater emphasis on the physical characteristics of the dwelling, and by insisting that negative factors associated with the dwelling be clearly documented.

The recent FHLBB action illustrates the difficulty of achieving balance between preserving sound business judgments and eliminating potentially discriminatory practices. In this instance, the key to successful regulation is to write rules that forbid discrimination, while still allowing the lender to determine the security of the loan in a way that is both objective and not overly costly. When the FHLBB proposed the regulations last November, it clearly recognized this problem, stating that

loan decisions should be based upon the value of the individual structure . . . unless specific neighborhood factors affecting its present or short-range future value (such as current market trends based on actual transactions involving comparable property, or housing abandonment in the immediate vicinity) are clearly established and documented.

The final guidelines have made the rules more rigid by spelling out the criteria—zoning changes and a "significant" number of abandoned homes in the immediate vicinity—that may be legitimately considered as risk factors. Moreover, in certain cases even these criteria may not be used to deny a loan or require more stringent terms.

In view of the constraints on the loan-approval process, there is concern in the industry that savings and loan associations may be forced to make loans in excess of the true market value of the dwellings. This would lead to increased losses in the event of foreclosure (since the dwelling could not be sold for the

amount of the loan) and perhaps also to an increased number of foreclosures (since restrictions would have been placed on determining property value). The result would be higher interest rates, inasmuch as increased costs would eventually be passed on to consumers.

This concern is fed by the prospect that the new regulation will open up highly profitable opportunities for unscrupulous realtors in much the same way that HUD's Section 235 interest-subsidy program did in the early 1970s. In that case, a program to stimulate homeownership for lower- and middle-income people was used by some realtors to sell inner city homes at inflated values (and thus with inflated commissions). Banks and savings and loan associations had less incentive to ascertain a property's true value or a borrower's creditworthiness when HUD assumed a large part of the risk by insuring the mortgagee. Similarly, the new regulations might lead to a situation where lenders would provide needed financing even for sales where the property value is inflated—in this case, not for lack of incentive to determine true property values but because they will be unable to act otherwise.

Ultimately, of course, the validity of such fears will depend on the FHLBB's interpretation and enforcement of its own regulations. Eliminating redlining without undesirable side effects is not likely to be easy.

The Valproic Acid Controversy

Epilepsies—symptoms of neurological disorders characterized by seizures—afflict an estimated 2 million Americans. Many of these Americans, plus their physicians and congressmen, are calling for a review of the domestic drug-approval process because of their frustration in the valproic acid case.

Valproic acid is an anticonvulsant drug that has been used in Europe for a decade but was only recently approved by the Food and Drug Administration for marketing in the United States. The benefits of the drug are clear. It prevents several types of seizure, is not a sedative or subject to abuse, causes less severe side effects than many other anticonvulsants, and, perhaps most important, appears to be the

only drug capable of effectively controlling seizures for a small number of epileptics.

Nevertheless, because the vast majority of epileptics are satisfactorily treated by existing drugs and may be hesitant to try a new one, a relatively small market was envisioned for valproic acid. This, together with rising costs for new drug development and marketing in this country, may explain why it took seven years for the drug's French developer to locate a licensee in the United States. In 1974, the tenth U.S. firm approached, Abbott Laboratories, agreed to pursue development of the drug.

Although valproic acid was already available in ten countries, the FDA required additional clinical (human subject) tests, claiming that only one of the 200-odd foreign studies of valproic acid published since 1967 was fully acceptable. It rejected the others for using controls said to be inadequate or for supplying insufficient raw data to enable the FDA to conduct independent evaluations of safety and effectiveness.

Moreover, even after domestic tests were conducted, the rigorous FDA approval process resulted in further delays. For example, in 1977 a collaborative study on valproic acid's effectiveness by Abbott Laboratories and the National Institute of Neurological Diseases and Stroke was submitted with Abbott's New Drug Application (NDA, an application that must be approved before a drug is marketed). The FDA rejected the study because of a biased test sample and requested further data, despite the fact that its Neurological Drugs Advisory Committee had unanimously recommended approval of the NDA on the basis of available information.

Meanwhile, the Epilepsy Foundation of America charged that the FDA's refusal to approve valproic acid was causing many epileptics to suffer unnecessarily and driving some to smuggle the drug from Mexico. Its publication, *National Spokesman*, was carrying monthly articles on the "intense pressure" being applied to the FDA and Abbott by outspoken parents of epileptic children and broad media coverage. The FDA stood its ground, insisting that until what it judged to be "adequate and well-controlled" studies were supplied by would-be manufacturers, neither cries for congressional investigations, nor reports from independent panels of experts (convened by the

Epilepsy Foundation), nor attention from NBC News would "cut any ice." Only after additional research reports were supplied did the FDA finally approve the marketing of valproic acid in February 1978.

The three-year experience with valproic acid is being used to generate support for the Drug Regulation Reform Act (H.R. 11611 and S. 2755), now before the Congress (see *Regulation*, May/June, p. 12). The bill's supporters maintain that a "crescendo of complaints" was needed to push a dilatory regulatory agency into action. They look favorably upon provisions in the bill that would provide for speedier, but *provisional*, approval of particularly promising drugs, and would establish a National Center for Clinical Pharmacology within the Department of Health, Education, and Welfare to develop valuable drugs of little commercial interest to private firms. Yet, other observers praise the "unusually quick approval" of Abbott's NDA and describe the FDA's regulatory process as "working effectively and objectively in the face of strong emotions and partisan pressure." Still others, maintaining that the valproic acid controversy merely highlights the need to reform the whole regulatory approach, would eliminate the proof-of-effectiveness requirement enacted in 1962 and restrict the FDA's role to ensuring that drugs are safe. Each view has its adherents, suggesting that valproic acid will take its place in the formulary for continuing congressional debate on public health issues.

Vermont Yankee Power: Judicial Oversight of Agency Procedures

A recent opinion of the Supreme Court may have far-reaching implications for the fairness and efficiency of the regulatory process. As starkly exemplified by the *Home Box Office* case (discussed in the July/August 1977 issue of *Regulation*), some federal courts, and in particular the U.S. Court of Appeals for the District of Columbia, have felt free to engraft additional requirements upon the rulemaking procedures established by the Administrative Procedure Act. These statutory procedures are, quite simply, to publish the proposed rule in

the *Federal Register*, to give interested parties the opportunity of making written or (at the agency's discretion) oral comments, to consider such comments before promulgating the final rule, and to set forth a concise statement of the rule's basis and purpose. In *Home Box Office*, as *Regulation's* readers may recall, the Court of Appeals for the District of Columbia sought to add to these procedures *in all cases* the requirement that the agency entertain no off-the-record communications with persons outside the agency concerning the proposed rule. Such a general requirement at least has the virtue of being predictable in its operation. Even more troubling for agency counsel have been those court decisions which do not lay down a general requirement, but which state that the peculiar characteristics of a particular rulemaking proceeding demand a specific additional procedure (for example, cross-examination of witnesses) or, worse still, an unspecified "something more"—a procedural *je ne sais quoi* that the court (in deference to the agency's expertise) declines to identify and the agency must guess at on remand.

Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, decided on April 3, 1978, involved the latter sort of decision by the Court of Appeals for the District of Columbia. At issue was a rule adopted by the Nuclear Regulatory Commission dealing with the manner in which the environmental impact of nuclear fuel reprocessing or disposal would be evaluated in power plant licensing proceedings. Challenging the rule, environmentalists complained that they had been denied the procedures of discovery and cross-examination. The court of appeals agreed that the procedures used by the agency were inadequate, though it refused to say wherein:

We do not presume to intrude on the agency's province by dictating to it which, if any, of [various procedural devices listed earlier, including discovery and cross-examination] . . . it must adopt to flesh out the record. . . . It may be that no combination of the procedures mentioned above will prove adequate, and the agency will be required to develop new procedures. . . . On the other hand, the procedures the agency adopted in this case, if administered in a more sensitive, deliberate manner, might suffice.

The Supreme Court's disposition of the appeal constitutes an emphatic reversal. "Absent constitutional constraints or extremely compelling circumstances," it said, agencies are free to fashion their own procedures as long as the bare minima of the Administrative Procedure Act are met. It characterized the approach of the court of appeals as "Monday morning quarterbacking [which] not only encourages but almost compels the agency to conduct all rulemaking proceedings with the full panoply of procedural devices normally associated only with adjudicatory hearings." The court, it said, should not "stray beyond the judicial province to explore the procedural format or to impose upon the agency its own notion of which procedures are 'best' or most likely to further some vague, undefined public good."

In its *Vermont Yankee* opinion, the Supreme Court also disposed of another case involving reversal of the Nuclear Regulatory Commission by the Court of Appeals for the District of Columbia. The precise issues presented in that case, *Consumers Power Co. v. Aeschliman*, are of less general application; suffice it to say that they also (1) pertained to the appeals court's imposition upon the NRC of onerous procedural requirements not clearly set forth in the governing statutes and (2) produced a sharp reversal by the Supreme Court. In fact, the Court's criticism in this part of its opinion is even more acerbic: "To characterize the actions of the Commission as 'arbitrary or capricious' [as the court of appeals had to do in order to meet the statutory standard for reversal] . . . is to deprive those words of any meaning." Also, "This surely is, as respondent Consumers Power claims, 'judicial intervention run riot.'" What is more, "To say that the Court of Appeals' final reason for remanding is insubstantial at best is a gross understatement." Finally, "To . . . nullify [agency action for the reason given by the court of appeals] borders on the Kafkaesque."

The opinion concludes with a passage intimating that the court of appeals may be somewhat "result-oriented" in its approach to judicial review:

Nuclear energy may some day be a cheap, safe source of power or it may not. But Congress has made a choice to at least try nuclear energy, establishing a reasonable

review process in which courts are to play only a limited role. The fundamental policy questions appropriately resolved in Congress and in the state legislatures are *not* subject to reexamination in the federal courts under the guise of judicial review of agency action. . . . [The National Environmental Policy Act] is to ensure a fully informed and well-considered decision, not necessarily a decision the judges of the Court of Appeals or of this Court would have reached had they been members of the decision making agency. Administrative decisions should be set aside . . . only for substantial procedural or substantive reasons as mandated by statute, not simply because the court is unhappy with the result reached.

The Vermont Yankee/Consumers Power opinion may be less important for the precise points of law it resolves than for the general philosophy it displays with regard to the limited role of the courts in the administrative processes. The opinion is an extraordinarily sharp rebuke to the activism of the Court of Appeals for the District of Columbia. Particularly impressive is the fact that the opinion was unanimous. (Justices Powell and Blackmun did not participate in the decision.) To tell the truth, however, the opinion represents an enormous change in the attitude of the Supreme Court itself over the past few years. In a much-cited opinion handed down in 1971, the Court emphasized the need for a "thorough, probing, in-depth review" of administrative action. By contrast, the concluding sentence of the current opinion insists that "a single alleged oversight on a peripheral issue . . . must not be made the basis for overturning a decision properly made after an otherwise exhaustive proceeding."

It is not difficult to predict the reactions of agency lawyers and the public interest bar to the apparent new regime of judicial restraint—elation for the former (suppressed so as not to antagonize the Court of Appeals) and keen disappointment for the latter. But for lawyers representing the regulated industries, the new dispensation may be half-blessing, half-curse. It was, after all, the company lawyers who carefully cultivated the flower of judicial review from the 1920s through the 1950s—as a barrier (they would say) against agency arbitrariness or as an opportunity

(others would say) for producing delay and for providing their clients a "second bite at the apple." Only in the 1960s did the flower begin to take on, in their estimation, some of the characteristics of a weed—as drastic revision of court-made doctrines such as standing and ripeness made it increasingly easy for both overly lenient and overly strict regulatory judgments to be challenged, and as public-interest lawyers multiplied to take on that task.

From the standpoint of the general welfare, however, the new direction represented by *Vermont Yankee/Consumers Power* should probably be welcomed. Result-oriented decisions aside, there is much to be said for the view that the recent activism of the courts in the review of administrative action has driven home to the agencies, as nothing else would, their responsibility for designing fair and informative procedures. That being granted, however, the evidence is mounting that the cost of delay—both the primary delay involved in routine appeal to highly receptive courts and the derivative delay caused by super-cautious agency procedures—outweighs the benefits to be derived from continuing case-by-case elaboration of a basic lesson already taught.

The nuclear power plant involved in *Vermont Yankee* is a case in point. Application for a construction permit was filed with the Atomic Energy Commission in the second year of Lyndon Johnson's last term as President and was granted a year later. Application for the second necessary federal permit, an operating license, was filed in the first year of Richard Nixon's first term; an agency decision on that matter was reached in the first year of Nixon's second term; the intra-agency appeal consumed another year; and appeal to the first level of judicial review was begun the year Gerald Ford entered office. Moreover, the Supreme Court's decision (rendered in the second year of Jimmy Carter's presidency) is not the end of the matter, since its judgment merely remands the case to the court of appeals—which may in turn, and in due time, either affirm the grant of the operating license or remand the case to the Nuclear Regulatory Commission (the Atomic Energy Commission having become defunct during the long course of this case) for still further proceedings. There may, indeed, be worse evils than imperfect procedures.

Interest on Checking Accounts: The Fed, the Banks, and the S&Ls

In a highly controversial decision, the Federal Reserve Board voted on May 1 to allow commercial banks to transfer funds automatically from individual depositors' savings accounts to their checking accounts, if the depositor wants them transferred. This action has been justified as one way of increasing the attractiveness of savings accounts (since, in effect, depositors would be writing checks on their savings accounts) and lowering the cost of making payments by check (since a fee is usually charged when checks "bounce"). Whatever its justification, many see it as an end-run around that part of Regulation Q which implements the 1933 Banking Act's prohibition against paying interest on checking accounts (demand deposits). Because the new regulation is so controversial, the board has postponed the effective date until November 1 in order to give Congress a chance to respond.

This regulation has reopened the debate over the extent to which financial institutions should be allowed to compete for household funds. Crucial in this regard was a last-minute change championed by the Fed's new chairman, G. William Miller. Whereas the original proposal of February 2, 1978 (unanimously supported by the board) would have required that thirty days' interest be forfeited on funds transferred from savings to checking accounts, the final version dropped this requirement (by a 4-3 margin, with Chairman Miller casting the deciding vote). Thus, each commercial bank will be free to decide what penalty (if any) it will charge for transferring funds. (The lack of a forfeiture requirement is significant because household checking accounts generally turn over more than once every thirty days. A forfeiture requirement would lower the incentive for persons to put funds in commercial bank savings accounts instead of S&L savings accounts or commercial bank checking accounts.)

There is some difference of opinion among commercial bankers on what to expect from the new rule. Most of them think banks will be net earners on the additional deposits the rule should produce—that is, returns will more than offset the increase in interest payments. But others, expecting the increase in savings de-

posits to be small, think banks might simply end up paying interest on deposits that were formerly "free," with an ensuing decline in profits. This concern may explain why one third of the commercial banks commenting on the proposal objected to it.

In addition, thrift institutions (savings and loan associations) still vehemently oppose the Fed's action, arguing that it will give commercial banks a clear competitive advantage in attracting household savings. Thrifts are now permitted to pay one-quarter of a percentage point higher interest on savings accounts to offset the commercial banks' monopoly on checking accounts. Many in the thrift industry believe the savings and loans' competitive position will be jeopardized when people can be relieved of concern about overdrawing their checking accounts simply by placing savings in their commercial banks. The U.S. League of Savings Associations, an industry trade group, is challenging the Fed's action in the courts on the grounds that it effectively violates the statute prohibiting the payment of interest on demand deposits.

The regulation of interest rates has long been used to limit the competition for funds within the banking industry. At issue is the fact that savings and loan associations and commercial banks (both big and small) compete for the same deposits but lend in different markets. Savings and loans primarily finance home mortgages, small commercial banks lend locally to both households (consumer loans) and small businesses, and large commercial banks generally lend a major share of their deposits to large corporations. Consequently, any change in interest rate regulation ultimately affects the distribution of funds among these borrowers.

The Fed's action has prompted not only debate over the narrow issue at hand but also renewed interest in financial reform legislation currently stalled in the Congress. A Senate bill backed by the Carter administration (S. 2055) would allow both banks and savings and loans all across the country to provide NOW (negotiable orders of withdrawal) accounts—interest-bearing transaction accounts that are, in effect, checking accounts and are currently available only in New England. In the House, Representative Fernand St. Germain (Democrat, Rhode Island), chairman of the House

Subcommittee on Financial Institutions, recently introduced a bill (H.R. 8981) to permit interest-bearing checking accounts at all types of financial institutions. In part, congressional action has been delayed by the savings and loan associations' concern that if they received authority to offer interest-bearing transaction accounts they would have to give up their quarter-point interest payment advantage. The recent Federal Reserve Board action may be intended to convince the thrift industry that change is imminent and that some legislative compromise would be preferable to leaving the matter to the Fed.

Should Polluters Pay?

In a recent nationwide Harris Survey, persons over 18 were asked whether they favored or opposed using taxes to induce "socially responsible" behavior on the part of corporations. The main thrust of the survey is illustrated by the first question:

In general, would you favor or oppose a federal tax system under which companies that are bad polluters of the air and water have to pay higher taxes, and those companies cleaning up air and water pay lower taxes?

Some 82 percent of those surveyed responded affirmatively. (Other questions in the survey related to worker and product safety, job creation, energy conservation, and minority hiring practices. In each case, a majority of respondents supported the taxing of firms that failed to meet some preconceived standard of performance.) While the survey was designed to measure opinion on the general merits of tax incentives, it nonetheless revealed strong popular support for the use of the "polluter pays" principle in managing environmental quality.

It has been argued that the present practice of having government set specific emission standards is a less efficient way to reduce pollution than having the government tax each unit of waste discharged. A tax on pollution emissions, if properly designed, would cause the discharger to consider the "opportunity cost" of its actions. In other words, if the cost of treating emissions were lower than the tax, the firm would reduce its emissions, but if

treatment costs exceeded the tax, the firm would continue to pollute. By the government's setting the tax at the proper level, all firms, taken together, could be induced to meet overall environmental standards.

Treatment costs vary widely among industries and among processes within plants. As an example, consider the following: In 1976 the Council on Wage and Price Stability analyzed a proposal by the Environmental Protection Agency to require the steel industry to reduce effluents discharged into rivers. The council concluded that the marginal cost of removing a ton of suspended solids would be \$18,000 in one steel-making process, but only \$2,000 in another in the same plant. So if the federal government were to impose a tax of (say) \$5,000 per ton of discharge, the firm would be likely to do more to clean up the second process and less to clean up the first than it would under EPA's proposed standards. Management would adjust its clean-up efforts on the two processes until the additional cost of treatment in each case would equal the \$5,000-per-ton tax. If the new level of emissions were, in EPA's opinion, too high or too low, the agency could remedy this by raising or lowering the tax. The result would be a social cost of meeting any emission standard significantly lower than under EPA's proposal.

Another benefit of a "polluter pays" approach is that environmental regulators would not need to set specific effluent guidelines for thousands of firms, based in each case on the "best" control technology available. (They would, of course, have to establish overall emission standards and monitor emissions so as to apply the tax.) Still another benefit is that the prices of goods would rise to cover the amount of the tax, thus causing consumers to reduce their purchases of environment-intensive goods.

In a way, it is curious that the United States relies on uniform standards and specific technologies rather than on market principles to manage its environmental problems. At this point, Czechoslovakia, East Germany, Hungary, Poland, West Germany, Finland, France, and the United Kingdom all use taxation or effluent fees of one type or another as a means of reducing the cost of attaining their environmental goals.

The CAB, the Congress, and Competition for the Airlines

With different House and Senate bills to reform airline regulation moving slowly through Congress, the Civil Aeronautics Board under Chairman Alfred Kahn is proposing measures of its own to stimulate competition in the industry. All three proposals seek more flexible pricing and freer entry into airline markets. So the question is, if the CAB can do these things on its own, why does the Congress need to act? Or are the three proposals substantially different?

In the area of fare flexibility, the CAB's proposals appear to be much like those in the Congress. On April 13, 1978, the CAB proposed to change its current rate-making policy—which, broadly speaking, establishes the standard fares that scheduled airlines charge the public on each route. The CAB would (1) establish a "zone of reasonableness" within which proposed fares would not ordinarily be suspended as too high or too low, with the zone's ceiling being the CAB-determined standard fare for the relevant market and the floor one half that amount, (2) remove the fixed-percentage relationship between the fares charged to first-class and coach passengers, and (3) allow the airlines to introduce discount fares within the zone without providing economic justification.

The airline reform bill that recently passed the Senate (S. 2493) would likewise establish a zone of reasonableness—ranging in this case from 5 percent above the standard fare to 35 percent below it—and would require the CAB to issue regulations encouraging lower fares during off-peak hours. While the floor is somewhat more restrictive in S. 2493 than in the CAB's proposal, the board would be authorized to lower this floor further if that were determined to be in the public interest. (The ceiling, however, could not be altered.) The House bill (H.R. 12611), recently voted out of committee, would establish a zone of reasonableness with a ceiling equal to the standard fare and a floor 25 percent below it during the first year and 50 percent below it thereafter.

Both Congress and the CAB are trying to bring a measure of price competition to interstate air service. (Traditional CAB regulation,

in discouraging fare reductions, has led airlines to compete mainly on the basis of service.) But whether the current efforts—especially the CAB's—would succeed in stimulating the kind of price competition apparently envisioned is problematical.

The reason is that, while the zone-of-reasonableness provisions in both the House and Senate bills provide standards for ultimately determining whether a fare is lawful and are thus stronger than the CAB's provision (which would apply only to the suspension of fares), neither attacks the question of "preferential, prejudicial, and discriminatory" pricing. Under the existing statute, there are two principal grounds on which the board may suspend a proposed fare or ultimately find it unlawful: (1) if the fare is "unreasonable" (too high or too low) or (2) if it is "preferential, prejudicial, or discriminatory" (treats passengers differently or unfairly—as, for example, charging a passenger on the first leg of a one-stop flight more than a passenger making the entire journey). Typically, what has happened is that a low fare is contested on reasonableness grounds and, if it is suspended by the CAB, the carrier withdraws it rather than incur the expense of an investigation. Under the new CAB proposal, the board could not suspend fares within the zone for reasons having to do with "reasonableness," but could still suspend them on grounds of "preference, prejudice, and discrimination." Thus, some of those seeking to bring true price competition into the airline industry fear that, under this scheme, the grounds for fare suspension would merely be shifted from "reasonableness" to "preference, prejudice, and discrimination"—if not by the board, then by opponents of a fare decrease who might get CAB policy overturned in the courts. This is one reason why many of those advocating reform—including the current board—insist that congressional action is essential.

Closely related to the issue of fare flexibility is that of market entry. The root of the problem is the statutory requirement that applicants for new routes obtain a "certificate of public convenience and necessity" before they may begin service. Although CAB policy has recently grown more liberal in this regard, gaining entry is still a costly process. Market entry is related to the issue of pricing flexibil-

ity because if certification requirements impede entry into new markets, there is a chance that airlines already serving a market will tend to maintain fares near the flexible-pricing zone's ceiling. In other words, flexible pricing may not lead to effective competition in all markets unless there is a realistic threat of entry into markets where fares are high or service is poor.

In the Oakland Service Case, the CAB has departed from its past practice and proposed multiple permissive route awards—that is, it would certificate all airlines applying to fly a particular route rather than just one or two. It has also proposed to drop the requirement that, as a condition for approval, airlines applying for route authority prove they can earn a profit on the route and will not divert traffic from other carriers. The dropping of this requirement, if implemented and upheld by the courts, would eliminate the major barrier that airlines have faced in expanding into new markets.

At first glance, the entry reforms being considered by Congress do not seem to go so far as the CAB's. The Senate bill has an "automatic market entry" provision that would allow all scheduled interstate airlines, plus supplementals (charters) and large intrastate airlines, to enter one new route a year for the first two years after the bill's enactment and two new routes a year thereafter, without getting explicit CAB approval. Routes awarded under this provision could total no more than 3,000 statute miles each year for each airline. The House bill, which would apply to the same groups of airlines, would allow automatic entry into one new route during the first year, but after that would require the CAB to submit a study of the program to Congress before extending it any further. Both bills would allow airlines to "protect" a few of their routes from automatic entry by other carriers (though this protection would be phased out in a few years).

The major difference between the congressional and CAB initiatives on market entry is that the new CAB policy of multiple permissive route awards would still require board approval for each new route, whereas the Senate and House bills would make certification automatic in a limited number of cases. Moreover, both bills would liberalize the statutory stand-

ards governing CAB policy toward the granting of certificates. This may be especially important if (as is likely) the board's policy initiative is challenged in the courts.

To return to our question, is new legislation needed if true price competition in air service is to come to pass any time soon? The answer would appear to be yes. For one thing, it could be a long time before the CAB's new policy is fully implemented through normal rule-making procedures and court tests. Also, the CAB may not have the authority to do all that it proposes—that is, its initiatives might be reversed in the courts. In fact, it has been said that if Congress fails to act, the opponents of the CAB's proposals would, *because of that*, have an easy time convincing the courts that increased competition is not in the public interest. Finally, if existing law allows the present CAB to move in a procompetitive direction, it would allow a future CAB to move just as far and just as rapidly in an anticompetitive direction. In view of all this, it would seem that the ultimate decision on how (and to what extent) the airlines will compete must be made by the Congress, not by the CAB.

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