# Viewpoint

## John H. Shenefield

# Government Enterprise–A New Frontier for Regulatory Reformers

THE PAST AND PRESENT of deregulation is among the best and the brightest of Washington's political topics. Virtually all once and future social engineers seem to have written extensively on the subject, and critics of regulation—flushed with victories in the air cargo and air passenger industries—are zeroing in on other federal protectorates on the ground and at sea. Predictably, those enjoying life in the protectorates are marshaling their strength to persuade Congress that—in their cases at least—regulation represents a "particularly advanced form of free enterprise capitalism" (the phrase is John Kenneth Galbraith's).

Five years ago, who would have predicted it? In those days, deregulators were accused of trying to remodel the Alhambra with a steam shovel. But two presidents in succession—Gerald Ford and Jimmy Carter—have given the deregulatory effort substantial force and respectability. In the past few years, we have capped the trend toward proliferating federal agencies that produced more than fifty new regulatory programs between 1960 and 1975. We have rolled back economic regulation, most notably in air cargo and air passenger service. We have had Executive Order 12044, which requires executive branch regulators to consider the economic impact of their regulations. And we have begun to realize, and to act on the realization, that not everyone can sit down at the budgetary banquet at the same time—that, in short, we have to set priorities. Now, with an efficiency-oriented White House, a cost-conscious Congress, and most of the necessary building (or unbuilding) blocks assembled for deregulation, the future looks bright for the free market. Or does it?

*John H. Shenefield is acting associate attorney general of the United States, Department of Justice.*

### Not So Free Markets

Not quite. There are countervailing forces that point toward more, not less, government involvement in the economy—forces having to do with the nature of some of the problems we confront and with the increasing politicization of important economic issues. Let me explain.

First, what do I mean by the "nature of the problems"? Environmentalists, for example, have been arguing ever since the days of early Rachel Carson that we must take externalities into account, particularly the externality of air and water pollution; and policy makers now largely agree that government should intervene to take account of these externalities. Where they disagree, and here the differences are substantial, is on the form the intervention should take. While there is at present an opportunity to minimize the degree of direct regulatory interference (by using pollution taxes, for example), experience justifies the expectation of more intrusive forms of regulatory control. It is important to remember that the kind of regulation we choose for pursuing important social goals has significant implications for the efficient operation of our economy.

Second, what do I mean by the "politicization" of economic issues? Increasingly today our resource allocation decisions are being made in the political arena, a development that Senator Moynihan, for one, finds an inevitable consequence of an already large and intrusive government. As that government becomes more and more the dispenser of desirable goods and services, groups within society coalesce at a geometric rate, to lobby for their "rightful" share. Moreover, this tendency to seek an allocation through the political rather than the market process is accelerated when the public perceives that the economic "pie" has ceased to grow at historic rates.

But if the nature of certain problems and the growing politicization of resource allocation decisions do not drive the government to more active intervention, there is yet another force that might do so. That is the trend toward straight government enterprise—toward the marketplace presence of the government as businessman. Robert Heilbroner has argued that there are three stages in the development of government policies toward the economy, each more interventionist than its predecessor, and that we are moving towards—or have already entered—the last of these stages. In the first stage, the federal government promotes "desirable" private sector activities, as when Congress gave some 131 million acres to the railroads in 1862. Then, government regulates the terms under which these presumptively desirable quasi-public services are offered to the public, as when it began modern regulation with the Interstate Commerce Commission in 1887. There follows, eventually, the third or "guarantor" stage, typified by the bail-out of Lockheed, Conrail, and Amtrak. Because the services involved (defense contracting, transportation) are quasi-public and provided by virtue of public policy, government must act to ensure their availability on "reasonable" terms. This can be accomplished, the argument goes, through loan guarantees, direct subsidies, special statutory "trusts," public corporations, and so on.

The problem of government enterprise in our market economy is not of itself new. The federal government has spent $70 billion on interstate highways—to the great benefit of the trucking and bus industries. In addition, federal outlays to railroad programs (Amtrak and Conrail essentially) totaled $1.8 billion in 1978, and federal loans to Conrail to establish self-supporting service in the Northeast and Midwest are estimated at $2.1 billion for 1979. Along with what is almost de facto nationalization of significant parts of the rail business, the government is now spending over $2 billion a year on urban mass transit to help provide services that until fairly recently were largely private sector offerings. For another example, though the figures on the Defense Department's "nonappropriated fund" activities are obscure, the indications are that the department (through its nationwide network of grocery, variety, and liquor stores, *and* its night clubs, golf courses, and miscellaneous leisure activities) ranks as one of the country's five or six largest retailers. The U.S. Postal Service now has total annual revenues of about $18 billion, slightly above those of IBM; and, though it has yet to adapt its commercial operations to accommodate cash registers, it is currently considering spending some $2 *billion* to diversify into electronic computer-related communications.

## Skewing the Signals

It is obvious that the government is already substantially engaged in businesses carried on in the marketplace. Moreover, to the extent that arguments for public guarantees of one sort or another find political acceptance, the role of the government in the economy will increase, not decline. And from the standpoint of antitrust policy, the implications of expanded government enterprise are clear.

Our system depends on price and profit, for example, to stimulate the flow of investment in the "right" directions. That is, both price and profit are agents of efficiency. The traditional assumption has been that in an effectively competitive market, price will tend to be aligned, more or less, with marginal cost. Firms in the market will be assisted by consumers' signals—the prices consumers are willing to pay—in making their resource allocations. Similarly, firms that are considering a move into a market will tend to be guided by a comparison of prevailing prices and what they believe the costs of new entry will be. The pricing signals generated in many businesses are imperfect at best. We rely on them generally, however, to reflect underlying scarcities and thus to encourage private acts of investment, conservation, and the generation of new technologies.

Of course, pricing signals can be skewed by government policy. This has occurred in the energy market, where prices have been driven to artificially low levels, and in ocean shipping, where demand appears to have been artificially suppressed by government actions aimed at maintaining overly high prices. Here it is important to realize that, while traditional regulation *can* affect the integrity and accuracy of pricing signals, the presence of substantial de facto or de jure government enterprise in an industry almost certainly *will* skew them. When the government owns a particular enterprise, it is exceedingly difficult for politicians and bureaucrats not to manipulate the prices the enterprise charges—this for a variety of usually well-meaning purposes. Because government enterprises either cannot, or are not allowed to, determine prices on the basis of commercial realities, "islands of chaos" tend to materialize in centrally planned economies.

In addition, government enterprise typically entails the loss of the discipline inherent in private competitive markets. Special institutional arrangements and public commitments notwithstanding, it is a fact of life that even the most inefficient and wasteful government enterprise will never have to close down, since it will have access to sources of capital and day-to-day financial nourishment quite independent of its commercial operations. Thus, government enterprises generally appear to have adverse effects on the pricing mechanisms we ordinarily depend on for resource allocation, effects similar to those associated with "simple" regulation. But for government enterprise, the skewing effects are much closer to being certain and, when they come, are probably more severe.

**... while traditional regulation can affect the integrity and accuracy of pricing signals, the presence of substantial ... government enterprise in an industry almost certainly will skew them.... Because government enterprises either cannot, or are not allowed to, determine prices on the basis of commercial realities, "islands of chaos" tend to materialize in centrally planned economies.**

Government enterprise also leads in the long run to a decrease in public accountability. Precisely because a particular public authority is acting on behalf of a generalized "public interest," it may cease to be subject to laws that frame the rest of the marketplace—laws on disclosure, antitrust, sometimes even health and safety. Service of the public interest at large leads to avoidance of public responsibility.

In criticizing government enterprises, I obviously do not mean to slander those that we already have. Many of them serve valuable nonmarket-related purposes. But one can, without being inconsistent, accept the existing enterprises and still be strongly opposed to adding more.

## What Is To Be Done?

While we appear to be winning a battle against traditional forms of economic regulation, we may not be winning the overall war. Those special forms of government involvement that wind up with government enterprise have very substantial policy implications, but we still are only dimly aware of what those implications are. Here is, I believe, a new opportunity for constructive deregulation.

What should we be doing in these new areas? In the case of more traditional regulation, the literature is comprehensive and the case for deregulation is compelling. In this new area, however, much of the basic analytical work has yet to be done. The Antitrust Division of the Department of Justice is turning its attention to the largely uncharted phenomenon of government as a direct participant in the marketplace. In that effort, a lesson from previous regulatory experience must be remembered: the importance of being exceedingly cautious about embracing innovative "solutions" that discard or interfere with efficient markets. There was a time—not long ago—when it was regulation in particular, and government intervention in general, that seemed the best and the brightest of new ideas. But the wheel has turned.

As policy makers consider the competitive implications of the government as guarantor or (it is only a short step further) as businessman in the marketplace, they might take to heart the advice of Jeremy Bentham a century and a half ago. The best action for government to take in that role and in that marketplace, he wrote, is to "Do nothing—keep quiet." ■