THE "STATE" OF REGULATORY REFORM

Bruce E. Babbitt

THE JOB OF regulatory reform is fairly begun at the federal level—but that is only half the job. We must also intensify parallel efforts at the state and local levels. All around the compass, moreover, the goal is the same: to place increasing reliance on the competitive marketplace as our principal and "natural" regulator.

My own initiation to regulatory reform came when I was elected attorney general of Arizona in 1974. I was confronted at once with the bittersweet task of defending the state regulatory agencies against a tidal wave of complaints, grievances, and litigation brought by members of the public. And more often than not, the aggrieved consumer was right: regulation had itself become the biggest part of the problem. Even more disquieting, these new clients of mine often wanted to solve the problems of regulation by engaging in more of the same—urged on by the regulated occupations or industries. My only recourse was a crash self-education program to learn what it is these agencies do, and why.

What I discovered, of course, was that most of them had been spawned by the New Deal and steeped in post-depression attitudes of pessimism about the free market system. State legislatures, following the example of Congress, assumed that the best response to almost any problem was to set up a government agency to solve it. Even in such bastions of traditional laissez faire as Arizona, the legislature erected a vast array of "expert" administrative agencies with responsibility for virtually every imaginable sector of the economy—and some, as we will see, not so imaginable. Whatever the apparent justification, this mind-set systematically underestimated the marketplace and oversold government regulation as the preferred method of allocating resources and making economic choices.

Our experience with regulatory reform in Arizona—and I suspect it is typical—suggests that economic regulation tends mostly to benefit those being regulated and that it passes the costs, both needless and substantial, along to the public. Let me give some examples in three principal areas: rate and entry regulation, occupational licensing, and outright statutory prohibitions on competition.

Rate and Entry Regulation

In Arizona, as in many other states, bus and trucking companies are required to have public service certificates granting them monopolies on particular intrastate routes. The regulatory

The author is governor of Arizona.

agency then maintains a rate-setting bureaucracy in order to prevent abuse of the monopoly power that the agency created in the first place. This regulatory framework replicates to some extent those found in federal regulation of air transport, trucking, railroads, and buses—where, happily, the controls are now being relaxed.

These monopoly operating certificates are bought and sold for enormous sums at both the state and federal levels—one good measure of the added costs that this type of regulatory scheme imposes on the public. It is governmental regulation pure and simple that creates "value" for an otherwise worthless piece of paper and, in turn, artificially inflates the cost of transportation. For example, several years ago a Tucson firm acquired from the Arizona Corporation Commission a common-carrier certificate allowing it to operate heavy trucks and machinery. But the company never purchased so much as a single truck. It simply leased its certificate to another operator. At the end of the lease period, the certificate holder—still with absolutely no tangible holdings, goodwill, or operating history—sold its "assets" to yet another company for $150,000. All it really had to sell, of course, was that original state-granted monopoly, whose purchase price will be amortized (as was the lease) by higher rates to consumers. Unhappily, this Arizona experience is much the same as that at the federal level where, for example, one company holds certificates from the Interstate Commerce Commission (ICC) to operate in twenty-two states, although it owns no trucks and no terminals. The company leased all of its licenses to actual operators and skimmed $7.7 million off the top.

State-granted monopolies are so valuable that their holders—like all good monopolists—fight hard to keep them. Again, it is the public that suffers. An Arizona monopoly carrier whose vans are specially equipped for serving the handicapped is actually suing one charitable organization for daring to provide free transportation to needy handicapped persons. Such service, according to the suit, whether for free or for pay, is solely the province of the certificated carrier and may not be offered by others. The sorry fact is that tariff restrictions do preclude other entities even from possessing the vehicles needed to serve the handicapped. More outrageous still, Handi-car Inc. has obtained a court order preventing the city of Tucson from contracting with government agencies to provide transportation services to the handicapped or from providing free service to the low-income handicapped who would normally be the monopoly's customers or have insurance coverage for such services.

Moreover, monopoly privileges can lead to utterly absurd results. For example, riders who board one major company's buses in Phoenix can be carried *through* but not *to* Flagstaff. The buses stop there to pick up passengers headed out of state, but passengers boarding in Phoenix cannot be allowed to disembark because the company does not have service rights between Phoenix and Flagstaff. For a similar crazy reason, passengers cannot travel from Phoenix to Tuscon on the buses of another major carrier, even though the buses stop in Tucson to discharge travelers from out of state. The innocent passenger confronting such no-no's is sometimes amused, often puzzled—and always frustrated.

So it is more than time for the state legislatures to follow the lead of the U.S. Congress—emulating its actions in air and surface transportation—and move to deregulate intrastate transportation. While estimates differ, it is reasonable to conclude that federal and state deregulation of trucking, buses, and taxis would probably save consumers a cool $6 to $7 billion a year. I made transportation deregulation my top legislative priority last year and lobbied with a coalition of citizens groups to push it through. To the surprise of many, we were successful in totally dismantling rate and entry regulation of trucking within the state, subject only to a constitutional referendum that will be on the ballot this November. (Responsibility for safety regulation will be moved from the public utilities commission to the Department of Transportation.)

Some of the opponents complain that small towns will be the losers—that they will be denied service now required as a condition of certification. They argue that inflated profits on monopoly routes—between Phoenix and Tucson, for example—are necessary in order to subsidize service to the less profitable outlying areas of the state. Yet, all of the available evidence suggests that there is in fact no such cross-subsidization of trucking service and

that, for a host of reasons, trucking deregulation is more likely to benefit than harm small communities. Moreover, if we must have subsidies for such service, they should not be hidden in the maze of rate regulations. Instead, subsidies should be openly sought and openly granted, so that the public can fairly evaluate whether they are needed and worth the price. The federal Airline Deregulation Act of 1978 provides an example: it contains a subsidy program tied directly to the maintaining of service to small cities and towns. Experience with that act is exemplary in another way as well: after one year of airline deregulation, the CAB found that fares had fallen, that flights and passenger loads had increased overall, and that new airlines were receiving interstate authority for the first time in many years.

Our efforts in Arizona to deregulate motor carriers have engendered some unlikely alliances. Most of the regulated bus, truck, and taxi companies—the certificate holders, that is—are fighting hard to preserve monopoly regulation, notwithstanding their usual complaints about government interference with private enterprise. Considerable sums are being spent to convince the voters that monopoly transportation is necessary—that small communities will be abandoned, indeed that rapists will become cab drivers—if the regulated monopoly system is eradicated. This referendum battle in Arizona bears watching. It may tell us which way the winds of change are blowing, and how hard, both for deregulation in general and for the deregulation of transportation systems in particular.

Occupational Licensing

The granting of occupational permits to lawyers, doctors, geologists, surveyors, landscape architects, and myriad other callings is a traditional state function, long justified as a way of guaranteeing quality service and protecting consumers from fraud. A number of recent studies strongly suggest, however, that occupational licensing more generally protects those in the regulated occupation than it does the consumer of the service. Too often, licensing boards use their statutory powers primarily to restrict entry and prevent competition. The economic effect is not to make the market work better but rather to transfer income from the consumer to the service provider. In some instances, occupational licensing boards have simply become the captives of the very professions they are supposed to regulate. By way of illustration, here are a few examples that we uncovered while reviewing Arizona's occupational licensing practices.

In Arizona, as an article noted in these pages just two months ago, the course of instruction for barbers requires a minimum of 1,250 hours of study, more class time than is generally needed to obtain a law degree in most American universities. The 1,250-hour requirement includes no less than 250 hours devoted to such esoteric subjects as bacteriology, the structure of the head, face, and neck, and the various diseases of the skin, hair, and glands. With refreshing candor, the chairman of the state Board of Barber Examiners recently admitted that such regulation was necessary "to protect the barbers." Without such stringent requirements, he added, "anyone can come into the state and become a barber." Barbering, however, is for beginners. Cosmetology—a more sophisticated art—requires 1,800 hours of instruction!

Another example: In Arizona there is reciprocity for dentists entering from other states—but only if they do not charge for their services. The state Dental Board prohibits such "alien" licensed dentists from practicing dentistry for a fee unless and until they pass the state exam. They may, however, with a special permit, practice on a volunteer basis for charities. The anticompetitive animus of such a policy could hardly be plainer.

Some of the most interesting examples that we found involve the Registrar of Contractors, whose regulations embody an elaborate market division scheme. In the first place, specialty contractors are protected from encroachment by general contractors. Because a general contractor's work must involve "more than two unrelated trades," he or she can build a sidewalk or patio wall if it is part of a larger job—like building a house—but not if that is all that is wanted. Moreover, any one type of specialty contractor is protected from competition from all other types—and the list is endless. There are separate licenses for floor covering, carpet installation, composition floor, marble, masonry, terrazzo, tile (ceramic, metal,

and plastic), and wood floor laying, not to mention numerous categories of carpentry and remodeling. There are several hundred specialty licenses in all, and the regulations spell out in detail the scope of work permitted under each license. A craftsman may hold several licenses, of course; but there are separate bonding, examination, and experience requirements for each one. Incidentally, a recent exemption for "handymen"—for jobs under $500—applies only if any advertising by such persons states that they are *not* licensed. Some come-on! A Contractor Study Commission now has these problems under review and will report to the legislature and to me on January 1, 1981.

Even in Arizona, a free market state—or so we are proud to claim—more and more occupational groups are demanding regulatory agencies of their own as shelters from the vicissitudes of competition. My office has recently been flooded with demands that palm tree trimmers be regulated. Now, the trimming of palm trees is a venerable trade in Arizona, usually plied by college students, itinerants, and others who like occasional piecework and are unafraid of heights. In this particular case, the demand for regulation is coming not from those itinerant trimmers but from licensed landscape architects who claim that palm-tree trimming is part of *their* regulatory turf. Landscape architects frequently voice similar complaints—and demand prosecution—against unlicensed entrepreneurs caught planting lawns and trees and doing similar work suitable only for landscape architects. (When I was attorney general, barbers claimed that the cosmetologists' use of barber poles as decorations constituted "unfair competition.") At this point I am happy to report that a Board of Palm Frond Cutters does not appear to be imminent.

Obviously we cannot do away with all occupational licensing. Nor should we. Doctors and lawyers ought to be licensed, and probably security salesmen as well—even if landscape architects should not. Some rules are needed to protect consumer health and safety from the incompetent, but we should be careful not to extend license laws beyond this narrow justification—stringently applied. So, case by case, we must take a careful look at the true regulatory purpose and consider how best to accomplish it with minimal restraint on entry and price competition. We must be particularly skeptical of any regulation, whatever its guise, whose outcome is predictably protectionist. And insofar as genuine health and safety justifications can be adduced, we must search out the least restrictive means to protect the public interest.

Statutory Prohibitions on Competition

Along with rate regulation and occupational licensing, a third major area of needed reform is that of statutory bans on competition. In Arizona we repealed our fair trade laws in 1976, but that was only the first step in the process of needed reform.

"Unfair" sales laws—which are, like fair trade legislation generally, a product of the depression—prohibit retailers from selling below some prescribed markup. The minimum markup in Arizona was 12 percent. Their purpose is to protect retailers from competition, "unfair" or otherwise. Whatever validity this idea may have had forty or fifty years ago, its time has certainly passed. Government has no business insulating the inefficient from competition by mandating that the consumer pay a higher price. "Unfair" cuts both ways.

In the same vein is the assortment of state laws that prohibit certain businesses and professions from advertising. The landmark case of *Bates* v. *State Bar of Arizona* began while I was attorney general; the U.S. Supreme Court's decision in this case guarantees the right of lawyers to advertise and of consumers to shop for the lowest price. Since *Bates*, we have been able to prevent professional trade organizations from prohibiting advertisements by their members. For example, the State Bar has adopted a new conduct code that prohibits only "unprofessional" advertising.

But this battle is by no means over. Across the country, many states still have laws that prevent consumers from doing comparison shopping through the perusal of advertising. These include bans on advertising by denturists in Alabama and optometrists in Oklahoma, and a number of state laws that prohibit the advertising of such specified medical services as cures for venereal and other "sexual diseases." Until all such laws are rooted out, competition will still be foreclosed and consumers denied the benefits of the lower prices and the greater

availability and quality of services that come with increased competitive marketing.

Sunset Laws . . . and Other Disciplines

Another important vehicle of regulatory reform is sunset legislation—which typically mandates termination dates for regulatory and other governmental programs, subject of course to explicit renewal by the legislature. Initially I was a skeptic about this approach, but experience has taught me how effective it can be. The first round of agency performance audits under Arizona's sunset law, passed in 1978, led to a few outright fatalities and served in other cases to publicize the inadequacies—sometimes blatant failures—of the agencies involved. The state sunset movement began in Colorado only four years ago. Since then, thirty-three states have followed suit. And, as experience in Arizona shows, the benefits are measurable in more than just the gross "body count" of agencies abolished and dollars saved. Equally important is the way in which performance audits can lead to better oversight, more finely tuned regulation, and greater competition.

Some of the reforms I have been suggesting require statutory change. But quite apart from new statutes (or none at all), high quality appointments may be an equally important vehicle of regulatory reform. All of us in the executive branches of government, at whatever level, have the opportunity to impart a new regulatory philosophy by our appointments to licensing and regulating bodies. Alfred Kahn's work at the CAB and Darius Gaskins's work at the ICC are striking examples of what one appointee can do.

Putting the "right" people on regulatory boards is nowhere so simple as just finding them, however: many state laws mandate that most or all members of licensing boards be chosen from the professions being regulated. An extreme example in Arizona is the dental board. Under our statutes I am limited to appointing those dentists—and only dentists—specifically recommended to me by the Arizona State Dental Association. This requirement falls just short of outright delegation of regulatory authority to the profession itself, a case of the rabbit guarding the lettuce patch (which puts an almost intolerable burden on even the most public spirited of rabbits). As a result of this sweetheart relationship, the Arizona dental board has become an arm of the association, not necessarily attuned to public needs—or at least with a "higher" and conflicting loyalty. For many years now, that board has not suspended the license of a single dentist. But in those years the board has, at the urging of the dental association, spent most of its energies attempting to prevent denturists—the paraprofessional technicians who make dentures—from cutting into the dentists' traditional preserves. The anticompetitive impact is plain.

One way of controlling this type of abuse is to put lay representatives on professional licensing boards. California has led the way in this regard, requiring a majority of lay members on most of its occupational boards. In Arizona, the legislature has begun to follow this same route, although we still have far to go. The results can be dramatic. The appointment of one aggressive, public-spirited citizen to our funeral board transformed that previously scandal-ridden agency into something of an exemplar for the nation.

Finally, let me note that strengthened state antitrust enforcement is a necessary corollary to the deregulation effort. Once we do away with legal rate-setting, statutory price-fixing, and regulatory barriers to entry, we must see to it that private parties do not attempt to carry on what the government was doing before. All of our experience indicates that the risk is real. Indeed, even *with* regulation, private firms and individuals have been known to engage in anticompetitive activity quite on their own.

REGULATORY REFORM, believe me, does not come easy. It is generally opposed by strong, well-financed special interest lobbies which, using the shield of regulation to fend off the rigors of free enterprise, have grown lazy and noncompetitive. It is difficult to highlight these issues in a way that commands public support. But it can be done. And once legislators and the public become aware of the full costs of regulation and the harm done to consumers, the idea of reform can be politically irresistible.

So, whatever the course of regulatory reform at the national level, it is a truism that the federal government cannot do the whole job. Our challenge in the fifty states is to regulate less ourselves—and do that "less" better. ■