

## THE REGULATION OF AMERICAN INDUSTRY

The relation between government and industry is a problem not of economics but of political economy. It is a problem of controlling and civilizing economic power in order that it may be used for the public good within the framework of democratic institutions. It is a problem of striking a delicate balance between individual freedom and centralized control. It is a problem for which there is no monistic solution and which transcends the clichés of popular controversy between conservatives and liberals.

As a pluralist, pragmatist, and federalist society, America does not speak with a single voice. Its policies are characterized by an ambivalence and dualism not unknown in other lands. As Lewis Galantière has put it: "Just as every Frenchman may be said to be at one and the same time a child of monarchical authoritarianism (Richelieu, Louis XIV, Napoleon) and of Republican individualism (the Revolution of 1789), so every American contains within him the seed of Hamiltonian mercantilism and the seed of Jeffersonian agrarianism with its distrust of the merchant. Americans have encouraged unbridled business enterprise as Hamiltonians; they have been suspicious of it as Jeffersonians."

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It is not surprising, therefore, that the American economy exhibits a diverse organizational pattern. First, and most important, there is the free-enterprise segment, which is subject only to the general and negative restraints of the antitrust laws. Second, there is the regulated segment where a number of special government commissions impose detailed and continuing surveillance on particular industries and firms. Third, and least important, there is the segment where public corporations coexist side by side with private companies in a framework of "institutional" competition.

In this paper I propose to discuss each of these segments which together make up America's "mixed" economy.

### I. FREE ENTERPRISE AND THE ANTITRUST LAWS

When Congress passed the Sherman Act of 1890, it created what was then—and what has remained to this day—a uniquely American institution. Heralded as a Magna Carta of economic freedom, the Sherman Act sought to preserve competitive free enterprise by prohibiting monopoly and restraint of trade. The objective of the Act, according to Judge Learned Hand, was not to condone *good* trusts or to condemn *bad* trusts but to forbid *all* trusts. The goal was an organization of industry in units small enough to compete effectively with one another.<sup>1</sup>

This antimonopoly legislation reflected a fear of concentrated economic power which is deeply rooted in American traditions—the tradition of federalism, the separation of church and state, the system of governmental checks and balances. It expresses a sociopolitical philosophy which believes in the decentralization of power, a broad base for the class structure of society, and the economic freedom and opportunity for new men, new ideas, and new organizations to spearhead the forces of progress. This is not to be confused with other theories of free enterprise or capitalism which impose curbs only on governmental powers without similar checks on excessive private power.

America's distrust of concentrated power, it should be noted, is not the product of dogmatic, doctrinaire, or rationalistic philosophizing but the result of sad historical experience. When Thomas Jefferson said that the government which governs least governs best, he had in mind the abuses of mercantilism—where government was a creator of private privilege, the promoter of monopoly, and the oppressor of individual

1. Cf. *United States v. Aluminum Co. of America*, 148 F. 2d 416 (2d Cir., 1945).

liberty. Reading the lessons of history, he came to believe that only in a framework of decentralized power can the individual be politically and economically free. Jefferson thus became the symbol of the democratic American tradition which was carried on by Jackson, Theodore Roosevelt, Wilson, and Franklin Roosevelt. It is the same tradition which forms the philosophical base of America's antitrust laws.

### *Provisions and Enforcement*

The major provisions of the Sherman Act were brief and to the point. Section 1, dealing with collusion, stated: "Every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations is hereby declared illegal." As interpreted by the courts, this section made it unlawful for businessmen to engage in such collusive action as agreements to exclude competitors by systematic resort to oppressive tactics and discriminatory policies—in short, any joint action by competitors to influence the market. Thus Section 1 was, in a sense, a response to Adam Smith's warning 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 on some contrivance to raise prices."

Section 2 of the Sherman Act, dealing with monopolization, provided: "Every person who shall monopolize or attempt to monopolize, or combine or conspire with any other person or persons to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a misdemeanor, and . . . punished." This meant that businessmen were deprived of an important freedom—the freedom to monopolize. Section 2 made it unlawful for anyone to obtain a stranglehold on the market either by forcing rivals out of business or by absorbing them. It forbade a single firm (or group of firms acting jointly) to gain a substantially exclusive domination of an industry or a market area. Positively stated, Section 2 attempted to encourage an industry structure in which there are enough independent competitors to assure bona fide and effective market rivalry.

To summarize the judicial interpretation of these provisions over the last sixty years is no easy matter. This much, however, can be said with assurance: Section 1 has always been strictly enforced, and the courts have consistently condemned all sorts of price-fixing schemes. Price-fixing, as the Supreme Court has said, is illegal per se because it strikes at the central nervous system of the economy. It is no defense to argue

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that the prices fixed are reasonable, that the conspirators have earned no more than normal profits, or that their intent has not been to exploit the consumer but only to prevent cutthroat competition. The reasonable price of today, said the Court, is the unreasonable price of tomorrow. Besides, in the absence of competition, it is almost impossible to determine what a reasonable price is. (Note, for example, the difficulty encountered by public utility commissions in computing a "fair return on a fair value.") Finally, it is administratively impractical to maintain the constant and detailed surveillance of particular markets to assure that prices fixed by agreement are indeed reasonable.<sup>2</sup>

Under Section 2 the courts have been far less consistent, and their interpretation of the law has tended to vacillate over the years. In the early cases the courts insisted on a literal construction of the statute. The Northern Securities Company, for example, which was a merger between two railroads linking Chicago with the West, was ordered to dissolve. Later, the courts adopted a so-called "rule of reason," under which monopolies were illegal only if they used unfair or predatory practices. Even in the face of this interpretation, however, the great Standard Oil and American Tobacco trusts were broken up. Today, the courts seem to have returned to the original strict enforcement of the Act. The prevailing view is that the mere *possession* of monopoly power constitutes a violation—regardless of how the power is used. In short, there is no attempt to distinguish between good trusts and bad trusts. The existence, not the exercise, of monopoly power is the test of illegality.<sup>3</sup>

How effective the law has been cannot, of course, be stated with quantitative precision. Suffice it to say that the classic single-firm monopoly has disappeared from major American markets. There is more than a germ of truth in the quip (*railleurie*) that the ghost of Senator Sherman attends every board of directors meeting in the nation. Most of all, perhaps, the recurrent attempts to weaken and emasculate the law are a tribute to its effectiveness—or at least to its value as a deterrent force.

### *Criticism of the Antitrust Approach*

The recent criticism of the antitrust laws by some American scholars is

2. Cf. *United States v. Trenton Potteries Co.*, 273 U.S. 392 (1927); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940).

3. Cf. *United States v. American Tobacco Co.*, 328 U.S. 781 (1946).

noteworthy. As a rule, these critics do not demand an outright repeal of the Sherman Act but rather a policy of more selective and restrained enforcement. Their main point is either that bigness and concentration are innocuous because the “right” people are in control or because concentration in a particular industry is subject to effective checks and balances. Let us analyze these theories in some detail.

The first, usually associated with the name of Adolph Berle, is based on the belief that the business leader of today is a far different type from the robber baron of yesteryear.<sup>4</sup> Berle argues that industrial statesmanship, social responsibility, enlightened self-restraint, and progressive labor relations and customer relations have replaced the exploitative behavior, the sharp-shooting competitive practices, and the “public-bet damned” attitude of a bygone age. In short, Berle maintains that the managers of giant corporate enterprise have demonstrated their capacity for exercising industrial stewardship. They are subject to self-imposed limitations. They have acquired a “corporate soul.”

The second theory, following Schumpeter’s notion of “creative destruction,” holds that the effectiveness of competition should be judged not in terms of market structure (i.e., the degree of concentration in particular industries) but rather by market results (i.e., performance in the public interest).<sup>5</sup> Schumpeter suggests that we replace the classical concept of competition—competition among sellers *within* an industry—with the more dynamic concept of *interindustry* or technological competition. Technological development, he says, is the only genuine safeguard against any short-run monopoly position which may be established. Thus a monopoly in the glass-bottle industry will be destroyed through the introduction of the tin can; and the dominance of the tin can will, in turn, be undermined by the introduction of paper containers. The consumer need not rely, therefore, on the static competition between many small firms as protection against exploitation. In the long run, says Schumpeter, the consumer is better served by the technological competition among a few large firms which—through research and innovation—tend to destroy any position of market control or dominance.

4. Cf. A. A. Berle, *The 20th Century Capitalist Revolution* (New York: Harcourt, Brace & Co., 1954).

5. Cf. J. A. Schumpeter, *Capitalism, Socialism, and Democracy* (New York: Harper & Bros., 1942); E. S. Mason, “Current Status of the Monopoly Problem,” *Harvard Law Review*, 1949.

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The third theory in defense of the status quo is the countervailing power (*pouvoir compensateur*) doctrine of Professor Galbraith.<sup>6</sup> Galbraith concedes the pervasiveness of concentration and oligopoly but maintains that the dangers of exploitation are minimized by certain built-in safeguards in the American economy. According to Galbraith, the actual or real restraints on a firm's market power are vested not in its competitors but in its customers and suppliers. These restraints are imposed not from the same side of the market (as under classical competition) but from the opposite side. Thus "le pouvoir économique privé est tenu en échec par le pouvoir compensateur de ceux qui y sont assujettis. Le premier engendre le second." A monopoly on one side of the market offers an inducement to both suppliers and customers to develop the power with which they can defend themselves against exploitation. For example, concentration in the steel industry will stimulate concentration among the industry's customers (automobile manufacturers) as well as among its suppliers (steelworkers). The result will be, says Galbraith, a balance of power within the economy—the creation of almost automatic checks and balances which require a minimum of interference or supervision.

These theories are subject to several serious reservations. I would not deny, of course, that market power is subject to both external and internal restraints. Monopoly is never omnipotent, and rarely is it as bad in practice as economic theory might have us suppose. Nevertheless, it is clear that neither Berle, Schumpeter, nor Galbraith comes to grips with the basic problem. As Professor Lewis has pointed out, "results" or "performance" alone do not throw light on the really significant question—namely, whether good results or good performance have been *compelled* by the system or whether they simply represent the dispensations of managements which happened for the moment to have been benevolent or "smart."<sup>7</sup> Clearly, the mere absence of identifiable extortion or restriction is no proof that monopoly is under effective control. If we are to consider the discipline of the market effective or workable or even acceptable—in any significant, lasting sense—the market must not only permit but also compel the results we want by the necessary and continuing operation of its processes. Satisfactory results which

6. Cf. J. K. Galbraith, *American Capitalism* (Boston: Houghton Mifflin Co., 1952).

7. Cf. B. W. Lewis, "The Antitrust Laws: A Symposium," *American Economic Review*, 1949.

happen but which, equally, might not have happened are not good evidence of the successful working of an economic system. The process by which results are achieved and assured, says Professor Lewis, is the very essence of an economic system. And one mark of a desirable economic system is its ability systematically and predictably to compel economic decisions and results which are in the public interest.

It is not enough, therefore, to say that monopoly is subject to limiting market forces. Such forces are, to some extent, ubiquitous. They exist in a socialist state where the steel monopoly is a check on the aluminum monopoly, and where the trades-union congress offsets the power of the central industry planning board. They are present, in some degree, in a fascist corporate state as well as in a sovietized society. However, the mere presence of these forces and their operation in a general way do not transmute monopoly into an instrument for the public good. They do not prevent the emergence—or assure the neutralization and eventual destruction—of economic power concentrates. Nor is the “corporate soul”—a concept which transcends the objective phenomena of the market place and rests on certain metaphysical assumptions concerning the perfectibility of man—a reliable instrument for assuring a socially responsible use of economic power.

Finally, with respect to the Galbraith theory, let us note that countervailing power is, at best, a supplement to, rather than a substitute for, competition.<sup>8</sup> There are three basic reasons for this. First, countervailing power operates only so long as the forces on opposite sides of the market engage in arm’s length bargaining—only so long as they are controlled by separate and financially independent decision-making units. As we all know, however, a bilateral monopoly or oligopoly situation is not stable. It can break down when the opposing sides in the market are combined through top-level financial control or when they are merged through a process of vertical integration. Thus a firm may reach forward and merge with powerful distributors, or it may reach backward in the marketing process and acquire powerful suppliers. In either case, the countervailing power visualized by Galbraith breaks down. Second, even in the absence of outright merger, it is doubtful if countervailing power operates effectively. This can be seen most clearly, perhaps, in the labor market, where powerful unions are poised against oligopolistic firms in industry-wide bargaining. Far from

8. Cf. W. Adams, “Competition, Monopoly, and Countervailing Power,” *Quarterly Journal of Economics*, 1953.

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countervailing each other's power, it is possible for unions and management—without necessarily conspiring—jointly to exploit the consumer. This is especially true in times of inflation, when employers may grant wage increases with relative impunity and then pass their costs on to the consumer in the form of higher prices. An increase in steel wages will become the pretext for an increase in steel prices, which, in turn, will be reflected in higher automobile prices, and so on. These higher prices thereupon become the basis for new wage demands, and the inflationary spiral is sent on another merry spin. Instead of countervailing power between unions and management, the result is, in effect, a combination against the unorganized consumer. Third, Galbraith's belief that these inherent defects in the countervailing power process can be remedied by the intervention of government on behalf of the weaker party is quite unrealistic. It rests on the untenable assumption that government is an autonomous, monolithic, self-contained organism which is separate and apart from the economy. It assumes that political power always checkmates economic power by intervening on the side of the underdog. Unfortunately, this is no more than a fond hope. Experience demonstrates that economic interest groups today are largely politicized units, making their claims upon and through the institutions of government. Sometimes the power of government is used not to countervail the power of interest groups but indeed to help them intrench their position and to give them a claim to legitimacy.

In the final analysis the current attacks on antitrust policy are based on the implicit assumption that firms must be big to be efficient—that modern technology requires a high degree of economic concentration for its effective utilization. This is the modern American version of economic determinism. Technology, by this reckoning, is a dynamic, material force which operates by natural laws of its own being and exercises imperatives as exacting, inexorable, and deterministic as the Marxian concepts of class conflict and mode of production. This technological determinism, whether expressed in crude dogmatic form or in the refined subtleties of Schumpeterian dialectic, fortifies the pretensions of the monopolist that modern technology makes him the “wave of the future.”

Surprisingly enough, this assumption rests on evidence which is neither scientific nor convincing. On the contrary, a critical examination of the data reveals that technology is but one of many interrelated forces which have made economic concentration *possible*, not *necessary*



or *inevitable*. Moreover, it is the *control* of technology, not the technological process itself, which exercises deterministic effects on the structure of the economy. Failure to make this distinction between monopoly control of technology and the inherent nature of the technological process is a source of much confusion and leads to the erroneous conclusion that technology causes, requires, or necessitates monopoly for its effective utilization.<sup>9</sup>

Given modern technology, the crucial question is not “Do firms have to be big?” but rather “*How* big must a firm be to operate efficiently?” In the iron and steel industry, for example, few would deny that a firm must be big both horizontally (i.e., in any one branch of the industry) and vertically (in successive stages of operation). Nevertheless, it is doubtful whether the combination of geographically and functionally separate plant units yields any significant economies. To be sure, efficiency might require integrated operations at X or Y or Z; but is there any technological justification for combining these functionally independent plant units under the administration of a single firm?

Consider for a moment that the United States Steel’s plant at Gary, Indiana, *alone* is bigger than all the plants of Jones & Laughlin (the fourth largest steel producer) *combined*. This inevitably raises the question whether Jones & Laughlin and the other medium-sized companies in the industry are big enough to be efficient. If they are, and this has not been questioned, then certainly the United States Steel’s Gary plant—standing on its own feet and divorced from the industrial family of United States Steel—should also be capable of efficient operation. In fact, several economists have suggested that a dissolution of United States Steel would increase, not decrease, efficiency. Professor Stocking, after a careful weighing of the evidence, concluded that United States Steel “was neither big because it was efficient, nor efficient because it was big.” Professor Stigler observed that “one can be opposed to economic bigness and in favor of technological bigness in most basic industries without inconsistency.” My own studies of the steel industry certainly confirm these judgments. They indicate that industrial gigantism per se is neither a guarantor nor a prerequisite for technical efficiency and optimum utilization of the industrial arts.

Moreover, it is misleading to argue that a high degree of concentration is the price of technical progress. It is not enough to point to the

9. Cf. W. Adams and H. M. Gray, *Monopoly in America* (New York: Macmillan Co., 1955).

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highly concentrated petroleum industry and say that it is progressive while condemning the intensely competitive bituminous coal industry as technologically backward. Such comparisons do not provide a sound basis for judgment. Thus it is noteworthy that, in highly concentrated industries like steel and meat-packing, the increase in output per man-hour has been somewhat less than spectacular. Moreover, we have the testimony of T. K. Quinn, a former vice-president of General Electric, who claims that "original inventions are no more plentiful, proportionately, in big than in small organizations."<sup>10</sup> Citing concrete examples, Quinn says that "in the electrical appliance industry, the better clothes-washing machines have not been produced by the giant companies, but by relatively small, independent companies specializing in one or two products. This," he says, "is also true of electric stoves, vacuum cleaners, radios, toasters, mixers, home freezers, fans, clocks, heaters, air-conditioning units, and so forth." The accomplishments of the giants lie not in the field of inventing, according to Quinn, but in using their capital advantage for the purpose of "moving in, buying out, and absorbing the smaller creators."

Clearly, the evidence on technological progress points both ways. Depending on the selection of examples, one can prove almost anything. An objective appraisal of the evidence, however, tends to indicate that there is no apparent correlation between concentration and progressiveness. As one student points out, "it seems probable that the progressiveness of an industry is associated not with the size of firm but with the industry's age and more especially the age of the technology which underlies it." Other students of the subject have concluded that technical progress is usually high when an industry is young and expanding and tends to diminish as the industry matures. They base this conclusion on a survey of the inventive process in several dozen different fields.

The record shows that the correlation between giant size and technical progressiveness is essentially spurious. Evidence so far available is of little comfort to the technological determinists. How, for example, can they reconcile the stagnation in steel and meat-packing with the dynamism of chemicals and electronics—all industries with considerable concentration? How can they account for the significant increases in output per man-hour while the automobile industry was young and composed of many firms and the slower progress in later years when the industry became highly concentrated? How do they explain the

10. *Giant Business: Threat to Democracy* (New York, 1952).

fact that the highly concentrated anthracite coal industry is technologically no more progressive than the almost purely competitive bituminous coal industry? How do they account for the fact that, in a concentrated industry like steel, the medium-sized companies have been more progressive than the giant United States Steel Corporation? True, a firm must be big to invent and innovate; but *how* big is big enough?

## II. THE REGULATED INDUSTRIES

Historically, the regulation of public utilities is nothing new. In America such enterprises as local gas, electricity, and transportation companies were usually in private hands but subject to regulation by the state. Public utility regulation was applied in those industries where the cost of entry was so great or the duplication of facilities so wasteful that some degree of monopoly was considered unavoidable. This type of regulation was essentially static and its objectives limited. It assumed stable techniques, markets, and geographic location of productive activity. It dealt with established, mature, going concerns. It operated in areas of minimum risk where the relatively minor hazards of enterprise could be compensated for through slight variations in the profit rate. It contemplated a type of product or service which was immune from the external competitive pressure of substitutes. It was basically consumer-oriented, the purpose being to protect consumers against extortionate prices, restriction of output, deterioration of service, and unfair discrimination.

Under the impact of the Great Depression, this type of regulation was extended and its orientation transformed.<sup>11</sup> Between 1934 and 1940, Congress created a number of new regulatory commissions and increased the power of existing commissions: the Federal Communications Commission (FCC) was entrusted with control over radio and television, the Civil Aeronautics Board (CAB) over airlines, the Federal Power Commission (FPC) over the natural gas industry, the Securities Exchange Commission (SEC) over public utility holding companies, and so on. Also the Interstate Commerce Commission's (ICC) power over the railroads was extended to include motor carriers and water carriers. The purpose of this depression-born legislation was

11. Cf. H. M. Gray, "The Passing of the Public Utility Concept," *Journal of Land and Public Utility Economics*, 1940; H. C. Simons, *A Positive Program for Laissez Faire* (Chicago: University of Chicago Press, 1934).

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not so much to control monopoly but to restrict competition. Regulation became industry-oriented rather than consumer-oriented.

The trucking industry illustrates the problem.<sup>12</sup> Today no one can establish an interstate truck line without first obtaining a license from the ICC. The Commission decides who may operate between specified points, what routes he shall travel, what commodities he may carry, and what maximum and minimum rates he may charge. Existing firms cannot expand, and newcomers may not enter the industry unless they can convince the Commission that the proposed operations are required by the "public interest." Demonstrating that the new service would be better or cheaper—or that shippers prefer it to existing service—is not enough. The Commission often ignores its duty to promote efficient, economical, and flexible transportation service for the public.

Shipper need, the Commission says, is to be measured in physical rather than in economic terms; that is, as long as existing carriers are physically capable of performing a particular service, prospective competitors are to be denied entry—even if their service is cheaper and more efficient. Repeatedly, the Commission emphasizes that, where existing carriers have expended their energy and resources in developing facilities to handle all available traffic, they are entitled to protection against the establishment of new, competitive operations. This is what might be called the "going-concern" theory of regulation, a reluctance to subject existing firms to competitive pressures. The test throughout is the physical adequacy of existing service, not the promotion of better and cheaper service.

The economic results of such regulation are not only restrictive but, at times, absurd. Some carriers are not allowed to use the shortest route between two points. Others may transport goods in an east-west direction but not a west-east direction. About 40 per cent of the specialized carriers may transport only one commodity. About 70 per cent are not allowed to serve all the intermediate points along their route. About 30 per cent have some sort of return-load limitation, and 10 per cent may not carry any return load at all. That these regulations result in empty mileage, higher unit costs, inefficiency, and wastefulness is too obvious for comment.

But, more fundamentally, why are *any* entry restrictions necessary, if the objective of regulation is to protect the public? The trucking

12. Cf. W. Adams, "The Role of Competition in the Regulated Industries," *American Economic Review*, 1958.

industry does not fit the traditional public utility, “natural monopoly” model. It does not require one or a limited number of large firms to achieve cost minimization. In trucking there are no substantial economies of scale. According to one study, for example, the coefficients of rank correlation between carrier size and cost per vehicle mile or cost per ton mile were so low as to indicate that size of firm bears little relation to operating cost. Efficiency in trucking seems primarily related to effective route utilization rather than size. This means that large firms have no inherent economic advantage over small firms and that existing firms have no insurmountable lead over new firms. It means that entry, in the absence of restrictions, would be brisk and the number of competitors large. It also means that, by increasing competitive pressures, entry could work toward better route utilization and hence greater operating efficiency.

In an industry of this sort, entry restrictions tend merely to preserve the capitalized expectations of established carriers—carriers who maintain, on the one hand, that they are efficient and provide superior service and who demand, on the other, government protection from interlopers and competitors. In the final analysis, however, these restrictions do not assure the adjustment of capacity to demand, because the Commission, unlike its British counterpart, limits the number of firms rather than the number of trucks in operation. Entry control does not prevent established carriers from creating and, in the absence of rate competition, from perpetuating excess capacity. Without competition, moreover, there are no effective pressures to compel either efficient use of existing capacity or the elimination of the excess capacity which tends to develop in a “cartelized” industry. Thus, ironically enough, regulation may breed the very evils it was supposed to eradicate.

A similar problem exists in the airline industry where the Civil Aeronautics Board controls entry into the field.<sup>13</sup> Like trucking, air transport is not a natural monopoly. It does not require a heavy investment in fixed plant. The individual airplane is the basic unit of efficiency, and there are no marked economies of scale. Competition, therefore, is technologically and economically feasible. Yet, until very recently, the CAB’s licensing policy was unduly restrictive and protective. Despite a 4,000 per cent increase in demand between 1938 and

13. U.S. Senate Small Business Committee, *The Role of Irregular Airlines in the United States Air Transportation Industry* (Report No. 540 [Washington, D.C., 1951]), and *Future of Irregular Airlines* (Report No. 822 [Washington, D.C. 1953]).

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1956, not a single major passenger carrier was allowed to enter the industry. As a result, the carriers which were in the industry when regulation was first instituted still earn roughly 90 per cent of the industry's revenues.

The CAB refused to license any new companies, because it feared that new competition would divert traffic from the established lines and undermine their financial stability. The CAB was convinced that the amount of air travel was fixed, that competitive rate reductions would make little difference—in short, that the demand for air travel was hopelessly inelastic. But, as the independents—the so-called “irregular” or “non-scheduled” airlines—demonstrated, the Board was mistaken. These carriers were allowed to engage in very limited operations, without the benefit of government subsidy and under constant harassment by the CAB. Nevertheless, these independents showed that demand was highly elastic and that competition could play a promotional and developmental as well as a regulatory role. They introduced low-cost coach (second-class) service to hundreds of thousands of new travelers and tapped formerly virgin markets. Rather than diverting traffic from the licensed companies, the independents created traffic which formerly did not exist. They showed that lower rates meant more customers and that more customers meant fuller utilization of capacity, which in turn meant lower unit costs, which in turn justified the original rate reductions.

This was the “Henry Ford” philosophy in action—making bigger profits through lower prices and bigger volume. The question obviously was not whether new competition would hurt the established firms—it was not what portion of a fixed pie any one company will get—but rather how much the entire pie could grow. And this is precisely what a restrictive and monopoly-minded regulatory agency could not understand. It failed to grasp the developmental role of competition and could see only the need for protecting established interests.

In short, I do not think that America's experiment with regulatory commissions is something worthy of imitation. Even if we could assume that the men appointed to these commissions are honest and devoted to the public interest—a doubtful assumption, at times—the fact remains that regulation tends to be static, negative, inflexible, and unimaginative. It involves a duplication of the managerial function. It invites corruption of government, because private profits depend as much on the ability to influence the regulatory authority as on efficiency

in the market place. In inherently competitive industries, therefore, regulation is a far less satisfactory control instrument than the free market. In inherently monopolistic industries, it yields all the ills of socialization and none of its possible benefits. Throughout, regulation means bureaucracy, and bureaucracy, as Balzac so aptly observed, means "great power wielded by pygmies."

### III. THE PUBLIC CORPORATION

In America the nationalization of basic industries is both unknown and, for the present, unthinkable. There are, to be sure, some municipally owned utilities (trams, busses, waterworks); there have been some temporary experiments with nationalization during periods of emergency; but, by and large, the public corporation has never been regarded as an effective instrument of national policy. Where it has developed, it has been integrated with and adapted to the American free-enterprise philosophy. Its role has been to promote competition rather than to effectuate nationalization.

The Tennessee Valley Authority illustrates this point. Recognizing the futility of regulation, the need for competition, and the economic obstacles to entry in the electric power industry, Congress, in 1935, created a government corporation to develop the water resources of the Tennessee River. The intent here was not to socialize the industry and to experiment with a government monopoly over electric power. On the contrary, Congress wanted TVA to coexist side by side with private electric companies and to stimulate competition where it would not otherwise exist. TVA was to serve as a "yardstick" by which the performance of private industry could be measured. It was to be a regulatory device which would show what level of rates and what types of service were technically and economically possible. It was to be a promotional device which would push the development of electric power beyond the point which a conservative, monopoly-minded industry considered feasible. In short, TVA was to be both a regulator of rates and a stimulant for expansion.<sup>14</sup>

In my opinion, the TVA experiment proved eminently successful. It led to a realistic re-examination of the financial feasibility of rate reductions. It established the fact that considerable rate reductions not only benefited the public but were also profitable for the private electric

14. Cf. D. E. Lilienthal, *TVA: Democracy on the March* (New York: Harper & Bros., 1944).

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companies. Significantly enough, the rate reductions were greatest in the areas adjacent to TVA and other federal power developments. Even more significantly, the profits of the private companies operating close to the TVA area went up much faster than the national average for all private electric companies. In short, the competitive yardstick imposed by TVA brought increased sales, revenues, and profits to the private utilities; it encouraged a tremendous electrification of farms; it created untold opportunities for industries dependent on cheap electric power; and it formed the basis for a phenomenal development of relatively backward regions. TVA proved that the demand for electric power was far more elastic than an overly cautious industry, functioning in a non-competitive milieu, had ever dared to imagine.

This is not an indorsement of nationalization. I, for one, have serious reservations about a public corporation which controls a nationalized industry and exercises monopoly power. Such a corporation may easily succumb to the disease of security, conservatism, procrastination, and bureaucracy. It may, as a result of supercentralization and lack of competitive incentives, come to suffer from inflexibility and inelasticity. It may get in the habit of using its monopoly power as a cloak for inefficient operations—raising prices to meet increased costs and thus avoid showing a deficit. Finally, there is the distinct possibility that the very people in whose interest a particular industry may originally have been nationalized will eventually lose control of it. This result is probable for two reasons: (1) general elections are no substitute for the market as an instrument for social control (because people cannot indicate their dissatisfaction with a *particular* public enterprise by means of the ballot) and (2) the public enterprise, if it is to operate efficiently, must be taken “out of politics” and put in the hands of an autonomous body—again with the result of removing the public enterprise from the direct control of the electorate.<sup>15</sup>

TVA avoids these pitfalls. It is an experiment not in nationalization but in institutional competition. It is a check against excessive private power, not the substitution of one monopoly for another.

### CONCLUSION

On the basis of the evidence available I would conclude that the “invisible hand” of Adam Smith has not outlived its usefulness. It is a far

15. Cf. E. Davies, *National Enterprise* (London: Gollancz, 1946); B. W. Lewis, *British Planning and Nationalization* (New York: Twentieth Century Fund, 1952); F. Machlup, *The Political Economy of Monopoly* (Baltimore, 1952).



more efficacious organizing and regulating device in society than many modern progressives are inclined to admit. Its primary virtue is not that it tends to prevent economic extortion but that it comes to grips with the political and social implications of concentrated power. The alternatives to competition—however attractive they may appear in theory—have proved quite wanting in practice.

Of course, I am not so naïve as to suggest that a policy of competition means *laissez faire* and that this will automatically produce the greatest good for the greatest number. The competitive market is a tender plant which must constantly be guarded against attack and destruction. Even a vigorous enforcement of the antitrust laws is not enough, because it imposes only negative restraints on the conspiratorial and monopolistic action of private parties. More is required. In this age of “big government” the preservation of competition requires action by all echelons of the state—legislative, administrative, and bureaucratic—to keep the channels of industry and commerce free. The state today is no longer a neutral force. What it does has a profound effect on the structure of the economy, especially in periods of partial or total mobilization. If competition is the goal, therefore, positive government action is needed to promote it on all levels of decision making.

Needless to say, we in America do not have all the answers and have not solved all these problems. But tradition and experience have taught Americans the simple wisdom of Lord Acton’s dictum that power corrupts and absolute power corrupts absolutely. To most Americans, free enterprise means more than a policy of *laissez faire*. It means that government should do nothing to promote private privilege and private monopoly. It also means that government should do everything in its power to maintain economic freedom, the equality of opportunity, and the vertical mobility which are the prerequisites of an open society. In its best sense the American free-enterprise creed is an expression of a democratic, libertarian, and equalitarian tradition.