TEXT OF ADDRESS BY LEWIS A. ENGMAN, CHAIRMAN, FEDERAL TRADE COMMISSION, BEFORE THE 1974 FALL CONFERENCE OF THE FINANCIAL ANALYSTS FEDERATION DETROIT HERITAGE HOTEL, DETROIT, MICHIGAN OCTOBER 7, 1974

I imagine many of you followed with the same interest I did the summit and pre-summit economic conferences last month.

Probably you were not surprised at the fact that inflation -- or perhaps, to put it more accurately, "stagflation" -- was widely agreed to be the country's number one problem.

You should not have been surprised either that there was little agreement on how to deal with it. You get that many economists, businessmen and labor leaders together and you will be lucky if you can get them to agree on where to go to lunch.

Can you imagine acting as moderator for that group? I can think of less frustrating jobs. Like being the construction foreman on the Tower of Babel, for instance.

I don't want to be unfair to the summits. Although gatherings like that do not exactly produce an ideal decision-making environment, I believe it was worthwhile to get everyone's views out on the table. It also demonstrated that the present inflation is not a problem susceptible to a quick or easy "fix".

As for getting a consensus from that many independent minded people on a subject as complex as how to stop inflation, I suspect that anything resembling agreement would be most likely to be a sort of eclectic anthology of economic wisdom, and I'm not at all sure that is a good idea.

If we are going to make it up the long haul ahead of us, it is more assuredly not going to be in an economic policy vehicle that has John Kenneth Galbraith's engine block, Otto Eckstein's clutch, Dick Gerstenberg's drive shaft and Leonard Woodcock's transmission.

That kind of compromise approach reminds me of the husband and wife, one of whom wanted to paint the house red, and the other blue. Since neither would settle for the other's color, they mixed the two paints together and got purple, which was ugly but okay because neither one of them liked it.

In economic planning as in painting, the only thing to be said for that approach is that it is equitable.

Certainly there is no shortage of suggestions for how to deal with inflation.

On the front shelf is the traditional medicine, prescribed since time immemorial for the symptom of uppity prices: tight money and a balanced budget. There are those who doubt the effectiveness of this old cure in a cost-push world, but its proponents still outnumber its detractors.

In addition, there are some, myself among them, who also believe that inflation can be reduced by purging the economy of anti-competitive behavior. The FTC and the Justice Department's Antitrust Division are both looking with especial care for the types of trade restraints, collusion and unfair marketing practices which reduce competition and lead to higher prices for consumers.

Some have suggested that import duties and quotas be lifted to permit entry of more lower priced foreign goods.

Others cast their vote for the reimposition of controls or, at least, for some form of guidelines.

But the suggestion enjoying perhaps the greatest vogue at the moment is that inflation can be curbed by reducing the government's involvement in the economy; more specifically, by reducing its regulatory role. It is not just the survival-of-the-fittest, every-man-for-himself free-marketeers who make this suggestion. It has the support of many people generally viewed as liberal and interventionist in their approach to the economy.

It has received the blessing of Ralph Nader.

And it is about to be endorsed by Lew Engman.

And here's the reason. Though most government regulation was enacted under the guise of protecting the consumer from abuse, much of today's regulatory machinery does little more than shelter producers from the normal competitive consequences of lassitude and inefficiency. In some cases, the world has changed reducing the original threat of abuse. In other cases, the regulatory machinery has simply become perverted. In still other cases, the machinery was a mistake from the start. In any case, the consumer, for whatever presumed abuse he is being spared, is paying plenty in the form of government-sanctioned price fixing.

Take the airline industry for instance. Under the Federal Aviation Act, the Civil Aeronautics Board controls the entry of new carriers to the market, controls the distribution of routes and has the power to disapprove or modify an airline's rate change proposal after hearing complaints from the so-called competition.

The result is that in the areas of rates and routes for all intents and purposes there is no competition at all. Competition, where it exists, is concentrated on the one unregulated aspect of airline activity, customer service. That is why the average airline commercial looks like an ad for a combination bawdy house and dinner theatre.

This may lead to some pleasing amenities. But it puts the customer in the position of captive buyer. Nobody asks him if he would rather have the money than the movie, or if he would like to brown bag it from New York to California instead of having the steamship round of beef au jus on the little plastic plate. He is just asked to pay up.

If you have any doubt that one consequence of the CAB's control over rates and routes is higher prices, you need only look at what happened some years ago in California when Pacific Southwest Airlines, an intrastate carrier not subject to CAB rate regulation or entry restrictions, entered the San Francisco/Los Angeles market with rates less than half those being charged by the interstate CAB certified carriers TWA, Western and United. What happened? After attempting to ignore PSA's lower fares, the CAB carriers were forced to cut their rates to meet the competition. Even today, to fly from L. A. to San Francisco it costs only about half as much on a per-mile basis as it costs to fly from Washington to New York.

Of course, it is true that a major airline will try to make a fat profit on a high volume run like Los Angeles/ San Francisco because it knows it is going to lose a bundle flying between Black Rock and Where-am-I City which the CAB, with the full support of concerned and interested members of Congress, requires it to do.

Except in those instances where it encounters competition from a PSA, it will succeed in this little book balancing act, charging one customer to pay for the flight of another so the CAB can perpetuate a network of routes which no longer and perhpas never did conform to the pattern of demand.

Certainly, no interstate carrier need be excessively concerned about new competition. The CAB has not approved entry of a new trunk carrier to the market since 1938. And just last month, the CAB rejected an application by Laker Airways, a privately-owned British airline, to fly regularly scheduled New York/London flights for $125 each way. That price, by the way, is little more than one-third of the economy fare charged now by Pan Am, TWA, and the other members of the international rate-fixing cartel.

As if that were not enough, the CAB also has been moving in directions which would raise prices in the heretofore unregulated charter market. Recently, it approved discussions between scheduled and charter carriers in hopes that a mutually satisfactory rate-floor for charter flights could be agreed to. I hardly need add that any such floor would be higher than current rates.

I would find it hard to imagine a more obvious instance of prices being pushed up by regulation than the case of the airlines.

Unfortunately, I do not have to imagine such a case, for we have the Interstate Commerce Commission. That body, as you know, was created way back in 1887 supposedly to protect shippers against the monopolistic power of the railroads.

But by 1935, the nation had sprouted a network of highways, and the trucks which rolled over them were biting deeply into the market power of the railroads.

With the trucking field still wide open to new entrants, this might logically have been the time to dismantle the ICC. The railroad monopoly was broken, competition could take its course.

Did that happen? No sir. Instead of freeing the railroads from regulation, Congress, in the Motor Carrier Act of 1935, just cast the regulatory net wider to include the interstate truckers as well.

As a result, today we have a situation in which market entry by new trucking firms is restricted by the ICC at the same time that rates are being fixed by the carriers who are given antitrust immunity to do so. Though the ICC has authority to investigate rate findings by the carriers, according to testimony given before a House Committee two years ago, the Commission was doing so in less than one percent of the cases.

And what is the result? Well, when the Supreme Court held some time ago that fresh dressed poultry was an agricultural commodity under the ICC Act and thus not subject to regulation, the average rate for shipping it fell by 33 percent. It is gratifying to note that the party who got the short end of the 5-4 decision was a certificated carrier who was trying to stamp out the competition of an uncertificated carrier who had the temerity to haul chickens without a license.

I have given you just a couple of examples. But, when you take all of the industries subject to direct federal regulation -- that's air, rail and truck transport, power generation, television, radio, the securities industry and others -- it works out to a substantial fraction of the economy.

In fact, it is estimated that these regulated industries account for 10 percent of everything made and sold in this country. What makes them even more important from the point of view of inflation is that they tend to be industries whose prices show up as costs buried in the prices of hundreds of other products.

Take transportation for example. When you change the price of hauling freight, that change is going to show up in a lot of other products. Moreover, it will show up not just once but again and again. By the time you get a piece of meat from the pasture to the plate, it carries with it numerous transportation charges.

And these industries subject to direct regulation are only part of the story.

There are, in addition, the dozens and dozens of federal and state regulations, prohibitions, proscriptions and requirements all of which subvert competition in the name of a greater objective -- though sometimes it is hard to see exactly what that greater objective is or on whose judgment its greatness rests. I refer to things such as:

- state laws against advertising the prices of eyeglasses or prescription drugs;
- the Jones Act forbidding foreign competition in the shipping business between U.S. ports;
- the Federal Government's own "buy American" procurement preferences which can allow domestic producers to charge as much as 50 percent more than foreign sellers for some items. I should add that many states have similar preferences;
- an agricultural price support program which asks the consumer to buy with his tax dollars what he does not want, cannot use and will never eat;
- an agricultural export subsidy program which asks the consumer to pay the farmer to sell his product to some foreign buyer at a price lower than that at which the consumer himself can get it.

The effect of some of this regulation may perhaps be seen in some recent events in California. This summer the California Milk Producers Association dumped 420,000 gallons of fresh skim milk into Los Angeles harbor. The dairy co-op said that it was necessary to dump the milk "because no market could be found for it."

At what price, I might ask. I suspect that more milk could be sold if it were not for the elaborate government programs designed to maintain higher than competitive prices on the producer, processor and on the retail levels.

I mention only a few. Former Council of Economic Advisers' member Hendrik Houthakker has compiled a list of 45 regulatory policies that contribute to inflation.

The list of noble goals advanced to support these regulatory subsidies is virtually without end. I'm as humane as the next guy. I am not criticizing these goals. A responsive government must take action to address the demands of the people.

But mischievous means are not justified by noble ends.

To me, the most distressing development is the pervasive and well-accepted dishonesty that prevades the government's approach to regulation.

The existing crazy quilt of anti-consumer subsidies embodied in the intricately woven fabric of federal and state statutes and regulations is pernicious because:

-- The subsidies are deliberately hidden from public view.

-- The government has irresponsibly lost track of the actual cost of these subsidies.

-- In most, if not all, cases, we have adopted the least efficient form of subsidy with the purpose of hiding the subsidy from the public and obfuscating its true cost.

From time to time, proposals have been made to provide direct cash subsidies in lieu of the patchwork of regulatory subsidies that now pervade our economy. Opponents rise indignantly to object that hard-working individuals and businesses don't want handouts. Well, a rose by any other name. . .

Our airlines, our truckers, our railroads, our electronic media, and countless others are on the dole. We get irate about welfare fraud. But, our complex systems of hidden regulatory subsidies make welfare fraud look like petty larceny.

I have no way of knowing what the numerous regulatory measures cost the consumer each year. I have seen private estimates indicating that the annual costs in the transportation area alone may exceed $16 billion.

I invite students of this kind of thing to come up with their own figures. Whatever they are, I think we can all agree on this: the costs are too high.

There are free market purists who are reveling in the growing disenchantment with heavy-handed regulation. They have contended all along that the market was the fairest and most rational allocator of resources; that you could no more improve its performance by regulation than you could improve the performance of a fine watch by poking around in its works with a paperclip.

It seems to me that these arguments -- taken to the extreme -- are both naive and destined to be ignored. They are naive because they stress only the virtues of the long range adjustment facility of the market system. They ignore the short term dislocations that market forces produce and they discount legitimate social objectives that enlightened peoples choose to pursue. Voters do not live on bread alone. And to the extent they do live on bread, it is this year's bread, not next year's.

The market will not prevent bank failures or compensate their victims. It will not guarantee safe toys or unadulterated drugs. And it will not ensure a clean environment.

If we want to be assured of these things, we may need some regulation.

Regulation may also be needed to protect the consumer where natural monopolies exist, that is, where economies of scale argue strongly for a market being served by a single producer. Electric power and local phone service are good examples of this.

These are instances in which some would say that the benefits of regulation can be said to exceed its costs.

But the trade-off between benefits and costs is not always an easy determination to make. Moreover, neither the benefits nor the costs will remain constant over time. Some of the costs, such as direct expenditures, are obvious. Others, such as the costs the consumer pays for diminished competition, are not so obvious.

The problem of weighing costs and benefits is made more complex because often it is necessary to compare unlike qualities. (How, for instance, do you give pain and suffering a monetary value?) Or because those who bear the costs may be far more numerous than those who reap the benefits. (In order to spare one person 100 units of discomfort, is it fair to assess 100 people more than one unit each?)

I don't know the answers to these questions. The point is that each and every regulation or regulatory policy that contributes to inflation should be re-examined to make sure that the trade-off between costs and benefits which presumably brought about its institution, is still valid. We may well find that some of the more costly ones look a lot less attractive in a world of 12 percent inflation than they did in a world of 3 percent inflation.

We should also re-examine them to see whether those imagined trade-offs were accurate in the first place. For instance in the case of the ICC, rates wasted no time in going up immediately after the agency's creation.

When truckers are permitted to fix prices and are subject to a panoply of regulations all because the transportation mode with which they compete once had excessive market power, one is hard pressed for a logical explanation When airlines are going broke despite the fact that they charge twice as much as others are willing to fly for, something is seriously wrong.

The fact of the matter is that most regulated industries have become federal protectorates, living in the cozy world of cost-plus, safely protected from the ugly specters of competition, efficiency and innovation.

There are those who hold the businessman to be so unprincipled and greedy that they regard any governmental interference with his free movement as an addition to the social welfare.

Experience would seem to contradict that point of view. In point of fact, the effect of government interference frequently has been to remove the one thing that stood in the way of the anti-social exercise of greed; I am referring to competition. Meanwhile, the scheme of regulation has proven at least as susceptible to the lure of protectionism as the private interests it replaced.

As a political matter, we will not be able to pare away our excessive regulatory fat unless the public can be assured of adequate protection against the abuses that regulation was designed to curb.

We at the Federal Trade Commission can help provide that assurance. Through a vigorous antitrust policy, we can help prevent the aggregations of private market power which permit consumer abuse and create a need for regulation.

But there will still be cases in which regulation is necessary. For those cases, the advice I would offer is that the costs of the regulation -- and I mean the direct costs, the indirect costs, the present costs and the future costs -- be fully understood and consistent with what we hope to gain.

The task won't be simple. Cost calculations of the type I propose are likely to be imperfect. We currently lack not only accepted calculation methodologies but also much of the raw data necessary to informed estimates. But unless substantial progress is made, our regulators will continue to stumble around in an increasingly expensive game of blind man's bluff.

Unless and until these facts are brought to light, I see little hope for assuming that public actions will match up to public expectations or the public interest.

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