Deregulation Revisited: A Tribute to Fred Kahn

September 5, 2008

A GRATEFUL RESPONSE AND SUPPLEMENT

By

Alfred E. Kahn

I am overwhelmed by this celebration, and cannot possibly convey the full measure of my gratitude to my friends, collaborators—all of them also mentors—Phil, Tim, Dennis, Chuck—who have organized and participated in it. In responding to the honor that you have heaped on me, I have jotted here a reminder of Groucho Marx's advice to young would-be entrepreneurs—"The secret to success in business is a reputation for honesty and fair dealing….and if you can fake that, you've got it made"—in this case, substituting for "honesty and fair dealing" "modesty", if not "humility."

— I —

I'm going to take the liberty of concentrating first—and logically—on Phil Weiser's "Case Study of [me as] a Political Entrepreneur," which comes closest—after Tom McCraw's

classic Prophets of Regulation—to biography. By concentrating, understandably, on the one most highly publicized of my professional experiences—my leadership in the gradual dissolution of the Civil Aeronautics Board (C.A.B.)— in limited degree anticipated by Volume 2 of my 1971 Economics of Regulation,[1] it necessarily slights the very large portion of my career first attempting systematically to expound the economics of regulation—in Volume 1—and then apply it in my once-in-a-lifetime opportunity as, chairing a public utility regulatory commission before coming to the Civil Aeronautics Board. To these earlier endeavors I must acknowledge the direct counsel, support and employment of my graduate student, Irwin M. Stelzer, who first provided me with the opportunity in his astonishingly developing economic consultancy to expound the economic principles of regulation, which ended up several years later as the first volume of my "Economic Principles", then in persuading me that I would be crazy to follow my first inclination to turn down New York Governor Wilson's invitation to assume the Chairmanship of the New York State Public Service Commission—in effect, he insisted, the opportunity of a lifetime to apply to real life the results of my academic efforts—for all of which I owe him eternal gratitude. Many years later, after the Civil Aeronautics Board under my chairmanship continued and generalized my predecessor, John Robson's, initial approval of discount fares, I received a formal complaint from one Dr. Stelzer for having had to pay full fare for a seat next to an unkempt and unwashed hippie, who had undoubted paid much less than he for his seat. I formally acknowledged his letter:

> Dear Dr. Stelzer:
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> I have before me your complaint about your recent experience …. Before taking any action, we are waiting to hear from the hippie"

[1] Alfred E. Kahn, The Economics of Regulation: Principles and Institutions, Vol. 1: *Economic Principles,* Vol. 2: *Institutional Issues*, John Wiley & Sons, New York, 1970-71, reprinted by The MIT Press, Cambridge, Massachusetts, 1988.

— a response that apparently did not impair our friendship.

At the PSC I inherited Chuck Zielinski, facilitator, disciple, guide, and, ultimately and justly, my successor as Chairman; and Dennis Rapp, who later played the same role—including the "bad cop" in the "good cop/bad cop" routine at the CAB. Among his major accomplishments—and characteristically—there was to hammer down the slow decision-making process we inherited: in the landmark case that eventuated in our opening Chicago's Midway Airport to free competition, he persuaded our chief Administrative Law Judge to compress it from 15 to 8 weeks, a major achievement. I will never forget also the many nights he spent helping get me established in the White House in my Peter Principle-fulfilling role as Advisor to the President on Inflation, while during the daytime continuing his job as Managing Director of the CAB.

At the Board it was Michael Roach who played the Chuck Zielinski role, my closest advisor, giving me the benefit of his far greater experience with airline regulation and conviction about its need for drastic reform. Then there was Darius Gaskins whom I appointed as Chief Economist, and who later went on to do as Chairman of the Interstate Commerce Commission what he helped us do at the CAB; I happily acknowledge also the initial proposal of airline deregulation by the Ford Administration and the substantial steps taken at the Board by its Ford-appointed Chairman, John Robson. To these efforts I brought my own previous explications of the inefficiencies of cartelization—as in my article on cartels and trade associations in the [1968] Encyclopedia of Social Sciences; "The [Oil Industry] Depletion Allowance in the Context of Cartelization," one of my favorite scholarly articles, in the 1964 *American Economic Review*[2],

[2] Alfred E. Kahn, "The Depletion Allowance in the Context of Cartelization", *The American Economic Review*, Vol. 54, No. 4, Part 1 (June 1964), pp. 286-314.

and the long sections in my second, institutional volume of my Economics of Regulation, describing the absurdity of our governmentally imposed regulatory cartelizations—particularly of trucking. As to the last, I gratefully acknowledge the instruction of the late Walter Adams—a self-proclaimed anti-Chicagoan and, though no Michael Moore, tireless critic of big business—who did epochal work in the mid-1950s with a subcommittee of the Senate's Small Business Committee exposing the evils of governmental cartelization of that industry[3]; our general counsel, Phil Bakes—a gift to us from Senator Kennedy; the Senator himself, and Professor Stephen—now Justice—Breyer; the—invisible to me but—I am authoritatively informed—powerful guiding and goading influence of Mary Schuman—now Boies—behind the scenes in the Carter White House; and C.A.B. members, Betsy Bailey, whose appointment Mary Schuman and I urged upon the President—as well as the carry-over members Joe Minnetti and Lee West—I fear I sound like a gushing 16-year-old starlet's acceptance of an Academy Award!

Finally, there was the important moment when I invited Michael Levine, author of pioneering, powerful expositions of the case for deregulation, to join our efforts, responding to his initial discouraging response about all the other attractive prospects on his plate: "Mike, think of it this way: whether or not you accept, we *will* proceed with [what, we reflecting the tentativeness of our initial efforts, referred to at the time as] 'regulatory reform'; think how you're going to feel if you've not been directly participating?" That did it: he promptly accepted and aggressively led our efforts.

As to the results: to be sure, the 25- to 30-point increase in airline load factors achieved by the unleashing of competitive discounting meant increased crowding and discomfort, often

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[3] See U.S. Senate Select Committee on Small Business, 84th Congress 2 Sess., "Competition, Regulation and the Public Interest in the Motor Carrier Industry, Senate Report No. 1693, Washington, March 19, 1956.

severe, sometimes intolerable. But—the stupid policies of the FAA apart—it was precisely the failure of the industry under regulation to provide travelers of modest means with a choice of economy over comfort that constituted both the need for deregulation and the essence of its success. The experience wonderfully illustrates the principle that cartelization of a structurally competitive industry—in particular, the prohibition of price competition—sets off all sorts of other forms of cost-inflating competition, substantive and non-substantive, the fatal flaw of which is that it denied customers the choice of low-priced service without those amenities.[4]

Returning then to Phil Weiser's generous characterization of me: first, as to my "political entrepreneurship": I initially declined the CAB in the spring of 1977, because it seemed to me that in a new age of renewed anxiety about our energy situation—recall that the OPEC export embargo in 1973-74 had trebled the price of oil from about $3.50 to almost $12 a barrel—"I [did] not regard it as my highest aspiration to make it easier for people to jet all over the

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[4] See my documentation of this proposition in my The Economics of Regulation, Volume 2, pp. 28-32 ("The Tendency of Regulation to Spread") and pp. 208-220 ("The Regulation of Non-Price Competition: Air Transport").

> If price is prevented from falling to marginal cost … then, to the extent that competition prevails, it will tend to raise cost to the level of price.
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> Control entry as well, and the result will be an artificial stimulus to compete by offering larger commissions to travel agents, advertising, denser scheduling, free meals, and bigger seats. The response of the complete regulator, then, is to limit advertising, control scheduling and travel agents' commissions, specify the size of the sandwiches and seats and the charge for in-flight movies. Each time the dike springs a leak, plug it with one of your fingers; just as a dynamic industry will perpetually find ways of opening new holes in the dike, so an ingenious regulator will never run out of regulatory fingers.
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> The economically efficient way of deciding how much higher-cost service should be provided is to give customers a choice between it and lower price/quality combinations. …
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> And price competition does so much more. It puts severe pressure on managements, which regulation can never duplicate, to improve the efficiency with which they operate, and to hold down the prices they pay for labor and other inputs. And, in contrast with capacity controls, it provides the maximum assurance that the cost savings will, in fact, be passed on to the traveling and shipping public.

Presentation before a symposium, "The Changing Environment of International Air Commerce," Georgetown University, Washington, D.C., May 4, 1978; reproduced in *Air Law* (Netherlands), Volume 3, No. 3, 1978.

world"—and that was before I was aware also of the huge contribution of jet engine exhaust to global warming. Indeed, recognizing that in the new world, telecommuting and teleconferencing would have to substantially displace physical transport, I actually inquired timidly about the possibility of my making a switch with whoever might be named to the chairmanship of the FCC: "He can't possibly know less than I about the airline industry," I observed, and I had been involved over at least the preceding two decades dealing with the telephone business in various capacities.[5]

It was only when, shortly thereafter, a telephone call from Senator Kennedy—at whose critically important hearings about the state of the airline industry—organized by Professor—now Supreme Court justice—Steven Breyer, I had testified—"Dr. Kahn? I want you to take that [CAB] job"—and a message, "The President wants to see you"—made it clear that this was where genuine regulatory reform—in effect the subject of my second volume—was going to start, I seized the opportunity—to "play the Walter Mitty role of a mouse driving that

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[5] So much also for a recent, in other respects highly informative historical account by Michele McDonald likewise labels me—quite mistakenly—as a preconvinced deregulator—

> a number of voices had been raised in favor of deregulating the airlines. Among there were a couple of academics who would ultimately make their mark on the industry: A young Yale graduate student named Michael Levine [this reference is entirely correct] and a Cornell professor named Alfred Kahn.

—evidently unaware of how serious the agnosticism with which I ultimately decided to accept the C.A.B. chairmanship. While I had indeed used the regulated airline record as exemplifying the accumulating nature of regulation of a structurally competitive industry—repress competition in price and it will extend and show up in all sorts of socially more dubious forms—I had by no means settled on deregulation as a workable alternative, fully conscious also of the tendency of the industry to destructive competition and the possible threat of unregulated competition also to the familiar imposition on franchisees of such obligations as serving unprofitable markets as a *quid pro quo* for their legal monopolies. See Michele McDonald, "Changed forever — The transition from total government control of the airline industry to open competition has been a wild ride that some enjoyed and some did not," *Air Transport World 40th Anniversary Issue*, (see http://www.atwonline.com/channels/airlineFocus/article.html?articleID=1159).

elephant"—with the enormous benefits to the flying public—transient, alas—authoritatively later documented by Clifford Winston and Steven Morrison.

I do not suggest that the world owes it to me or to itself to acquaint itself with every nuance of my evolving views; but any implication that I came to the CAB with a fixed commitment to flat-out economic deregulation does an injustice to the complexities of the issue—including, prominently, my own—to this day—continuing ambivalence about such regulating policies as the subjection of various other franchised utilities such as municipal bus, cable TV, or, yes, telephone providers to the obligation to serve ubiquitously and on a 24 hour basis—and to the evolution of my own conclusion that, so far as airlines were concerned, there was no acceptable half-way house.

In his recent long memoir, Alan Greenspan summarizes my list, some eight months on the job, of the absurdities forced upon me by the regulation of price competition:

> My favorite description of this was by Alfred Kahn, a wisecracking economist from Cornell University [***moi?***] whom Jimmy Carter made head of the Civil Aeronautics Board and who became known as the Farther of Airline Deregulation. Speaking in 1978 on the need for change, Fred couldn't resist riffling on the thousands of picayune decisions he and the board were called upon to make: "May an air taxi acquire a fifty-seat plane? May a supplemental carrier carry horses from Florida to somewhere in the Northeast? Should we let a scheduled carrier pick up stranded charter customers and carry them on seats that would otherwise be empty, at charter rates? … May a carrier introduce a special fare for skiers but refund the cost of their ticket if there is no snow? May the employees of two financially affiliated airlines wear similar-looking uniforms?" Then he looked at the congressmen and said, "Is it any wonder that I ask myself every day: Is this action necessary? Is this what my mother raised me to do?"[6]

To this selected list, I add two other of my particular favorites at the time

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[6] Alan Greenspan, "The Age of Turbulence — Adventures in a New World", The Penguin Press, New York, 2007, pp. 71-72.

- How many facilities on what purported to be an organized tour might the tour operator *neglect* to inspect on the premises, while still qualifying for free passage?

- Then there was the early evening telephone call, well after office hours, from someone whose name I didn't recognize asking me what had happened to his petition for approval of an arrangement he had made—once again, with an unlicensed or supplemental carrier—to transport a cargo of his sheep from some place in Virginia to England. His need for prompt approval, he averred, was urgent because the sheep (I should have been more specific, the *ewes*) were in heat and being transported for breeding purposes.[7]

—hardly the view of a preconverted deregulator, but reflecting six months of experience of trying to "reform" regulation, gradually and partially. It was only over that time that I came to realize there was indeed no acceptable half-way house; only a few months later, industry leaders themselves either came to the same conclusion—or recognized the necessity of adjusting to *mine*.[8]

In correcting the historical record, I cannot refrain from observing also that while graciously giving me this credit, Alan Greenspan characterizes deregulation consistently and ungraciously as "the Ford Administration's great unsung achievement": President Carter, Senators Ted Kennedy, Howard Cannon and Bob Packwood. Stephen Breyer and Mary Schuman Boies receive none at all.

The irony of these omissions was further exemplified by an uneasy meeting that I had a few months later with Frank Fitzsimmons, the powerful boss of the Teamster's Union, in which, speaking in my new and not-very-congenial role of Advisor on Inflation to a president he

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[7] Talk to the New York Society of Security Analysts, Feb 1979, available from the CAB files in Cornell University Archives.

[8] See my "A Funny Thing Happened on the Way to Cincinnati", talk to American Association of Airport Executives in Cincinnati, OH, May 22, 1978; referring particularly to the "epiphany and miraculous conversion" of Albert Casey, CEO of American Airlines. In contrast, as Professor Robert Solow, then President of American Economists Association, aptly pointed out when introducing my delivery of the Richard Ely lecture at the organization's Annual Convention, "Applications of Economics to an Imperfect World", *American Economic Review* 69 (2), 1979**,** "Delta Airlines was not ready when he was."

probably held in contempt, I tried to persuade him to comply with our wage guidelines—fully recognizing that the only effective recompense I could offer was the one neither President Carter nor I was willing to consider: a promise to relent in our efforts to deregulate trucking.[9] In that sense, we clearly had the last laugh—at the predictable price, however, of having eventually to leave the curing of inflation to Fed Chairman Paul Volcker—also, be it noted, a Carter appointee—whose successful restraints were steadfastly continued by Mr. Greenspan.

There are other parts of my history as regulator, some clearly compatible, others really inconsistent with the picture of me that Phil has drawn from my airline experience:

- my determined application of the marginal cost pricing principles expounded in my first volume to regulation of electric and telephone services in New York State—regarded as sufficiently revolutionary at the time to inspire an unsuccessful effort to get me to recuse myself from electric rate proceedings for having "prejudged" that issue—proudly detailed by me in a series of articles in *Public Utilities Fortnightly*[10];

- my long opposition to AT&T's bundling its own customer premises equipment with its franchised monopoly telephone service—refusing to permit the attachment of competitively provided equipment—first expressed in a memo I sent in 1956 (as a member of the Senior Staff of the President's Council on Economic Advisors to Arthur Burns, then Chairman, in indignant reaction to an FCC decision sustaining AT&T's barring the clip-on attachment to the customer's phone of the Hushaphone independently-offered device—prohibited by AT&T on the ground that it made voice messages unintelligible—("all the party at the other end has to do, I said, is exclaim 'I can't understand you!' or, more helpfully, take that damned muffling device off your phone") a position we generalized two decades later at the New York Commission, as Chuck Zielinski has just described;

- my parting memorandum to AT&T in 1969, after several years membership in its National Economic Advisory Council, urging it to abandon its exclusionary practices that ultimately led to its dissolution and instead adopt what I labeled as "A Grand Competitive Strategy"; and

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[9] I belatedly acknowledge the yeoman contributions to that accomplishment of Ron Lewis, one of my senior deputies at the White House.

[10] "An Economics at Work at Utility Rate Regulation," *Public Utilities Fortnightly*, January 5, 19 and February 2, 1978.

- my testimony in Congress in opposition to several "Bell bills" seeking to retain or restore the Bell monopolies.

It has taken some thirty years for my earlier (in no sense original) prognostication about aviation to be vindicated: no industry has been more adversely affected than commercial aviation by $140 barrel oil. I admit to some rueful satisfaction in having been prematurely prescient, even though it will mean an equally dramatic reversal in the accomplishments of deregulation. It was a glorious ride, however bumpy for the drivers, but it is, alas, largely over. How "largely" I will not try to predict, but I have no doubt consumers will continue to be better served under deregulated competition than by a restoration of governmental cartelization.

— II —

The First Skunk at our Picnic: My Views on Antitrust Policy

Having taken your acceptance of the invitation to this conference as probably reflecting the agreement of most of you—18th and 20th century liberals alike—with my conclusion about airlines, I hope that you will find it interesting, and not merely provoking, if I confront the almost certainly far wider spectrum of opinion on antitrust policy which, it is commonplace to observe, takes over responsibility when direct regulation is withdrawn.

To put it simply, my views in antitrust cases are more likely to be reflected in the—alas, dissenting—opinions of Justices Stevens, Souter, Ginsburg, and Breyer than in the—alas, predominating for at least the next several years—Justice Scalia. There! I trust that observation alienates enough of you to affect your—along with Milton Friedman and Alan Greenspan's—praise of my role on airline and trucking deregulation.

As a self-proclaimed 20th century liberal[11]—I have long been an antitrust true believer of the pre-Chicago variety, emphasizing its role as a proscription of anti-competitive *conduct*—collusion and exclusion of rivals from a fair opportunity to compete—and—how old fashioned can one get?—the *intent* that may be inferred from it.[12] Any doubts that this was the intention of the 1890 Sherman Act[13] should have been put to rest by the 1914 Federal Trade Commission Act, with its flat prohibition of "unfair methods of competition".

The last half-century has, however, witnessed the virtual triumph of the opposing, conservative view, rationalized by University of Chicago economists, highly sophisticated liberals of the eighteenth century variety, that the prohibitions of antitrust and of discrimination in particular should apply only upon clear demonstration of a genuine threat of injury *to consumers*[14].

This issue is clearly exposed in the carefully articulated proposal of the ambitious Digital Age Communications Act (DACA) Project, sponsored by the Progress and Freedom Foundation in which Phil Weiser was an active participant, explicitly recommending application of the Section 5 FTC Act unfair methods of competition "model"—which accords completely with my own position—but then recommending that the prohibition apply only to practices or behavior that demonstrably "pose a substantial and non-transitory risk to consumer welfare"—a clear

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[11] See my "The Threat of Latter-Day 'Progressives' to an Authentically Liberal Economic Policy," published by the AEI Center for Regulatory and Markets Studies, January 2008.

[12] "Standards for Antitrust Policy," Harvard Law Review, Volume 67, November 1953, pp. 28-54, reprinted in Homewood-Irwin, Readings in Industrial Organization and Public Policy (American Economic Association, 1958), pp. 352-375. "Cartels and Trade Associations," International Encyclopedia of the Social Sciences, David L. Sills, Editor, The Macmillan Company & The Free Press, Vol. 2, 1968, pp. 320-325.

[13] See, for example, Hans Thorelli's definitive The Federal Antitrust Policy, Origination of an American Tradition, Baltimore, Johns Hopkins Press, 1955.

[14] For a lucid, approving summary, see George A. Hay, "The Quiet Revolution in U.S. Antitrust Law", Cornell Law School research paper No. 07-023.

victory for the University of Chicago, and probably, also representing a consensus view of most respectable economists, for whom it happens also to be a Full Employment Act.[15]

At the cost of further provoking the many of you who applaud my 18th century but not my 20th century liberalism, I am compelled to repeat my long-expressed belief that there is such a phenomenon as predation, that it has occurred—in the airline industry among others—to the injury of consumers; and that it can be inferred and sufficiently established from a pattern of *conduct* by incumbents before, during and after the entry and exit of the provocateur-victim.[16]

While recognizing the overwhelming importance of Schumpeterian, intermodal competition as protector of the public interest in telecommunications, I am more uneasy than, I suspect, most of you about the steady process by which mergers have changed the structure of those markets into duopolies, each dominant *in all three platforms*—cable, terrestrial and wireless; and while I am a believer in the desirability of slot auctions at airports and for rights to the spectrum, I have long ago expressed concern that the value of a slot at a congested airport will ordinarily be greater to a hub-dominating incumbent than to a would be challenger—a position, I find it difficult to doubt, was vindicated by the fact that in the recent spectrum super-

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[15] For an explicit confrontation of this issue and exposition and defense of the position I explicate here, see Eleanor M. Fox, Chapter 11 "Abuse of Dominance and Monopolisation: How to Protect Competition Without Protecting Competitors", in European Competition Law Annual 2005: What Is An Abuse of A Dominant Position?, Ehlermann and Atanasiu (eds.), pp. 69-77, Hart Publishing (2006).

[16] See my "Thinking about Predation—A Personal Diary," in *Review of Industrial Organization*, Vol. 6, The Netherlands: Kluwer Academic Publishers, 1991, pp. 137-146; "Comments on Exclusionary Airline Pricing," *Journal of Air Transport Management*, Volume 5, Issue 1, January 1999, pp. 1-12; *Whom the Gods Would Destroy, or How Not to Deregulate*, AEI-Brookings Joint Center for Regulatory Studies, May 2001, Chapter 6; "Telecommunications: The Transition from Regulation to Antitrust," *Journal on Telecommunications & High Technology Law*, Volume 5, Issue 1, October 2006, pp. 159-188.

auction numbers 1 and 2 wireless providers Verizon and AT&T, walked off with the lion's share; wireless providers numbers 3-6 did not even bid[17].

The Second Skunk at Our Picnic (or Skeleton in the Closet?): Regulation of the Field Price of Natural Gas, 1968-72

I cannot conclude this commentary and confessional without alluding to what will surely appear to most of you as a most serious violation of my later fully-articulated and applied marginal-cost pricing principles—the leading role that I played in the late 1950s in not only defending federal regulation of the field price of natural gas, but in drafting the two-price regulatory plan that the Federal Power Commission actually adopted. I trust you will appreciate the irony that while, unsurprisingly, I never succeeded in persuading my then-boss, Arthur Burns, of my views, I was myself heavily influenced in them by the leadership role in support of regulation played in Congress by an illustrious University of Chicago Professor of Economics refugee—Senator Paul Douglas.

My esteemed biographer, Tom McCraw, generously treats this experience only briefly as a hangover of my earlier institutionalist's learning process that eventuated a decade later in publication of my "masterwork", Economics of Regulation, on the road to my ensuing career that occasioned this—to me climactic—celebration:

> as a scholar steeped in institutionalist methods, Kahn enjoyed certain advantages. In the real world, neither oil nor gas was priced solely through the interaction of supply and demand. Instead, the prices of both were influenced by regulation. Oil was [*etc*.]…. By itself, natural gas also was regulated; it came under the purview of the Federal Power Commission, which engaged in a constant struggle to rationalize its pricing. Just at the

[17] "Verizon and AT&T Win Big in Auction of Spectrum", *New York Times*, March 21, 2008, p. C3.

> time Kahn became interested in the subject, the FPC seemed to be failing in this job. As James Landis, in his *Report to the President-Elect* of 1960, reminded his readers, the FPC "represents the outstanding example in the federal government of the breakdown of the administrative process." The point was not lost on one reader at least.
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> Kahn knew that if he were going to do serious work on the regulation of oil and gas, he must master every relevant tool of economic analysis. To be sure, some of these tools belonged to institutional economics. But even more essential, he must learn to use better the methods of neoclassical microeconomics. His research into the pricing mechanisms of oil and gas had to be based on the theory of price. At this point in his career, Kahn began the final stage of his intellectual odyssey….
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> He continued to study the natural gas issue, as he immersed himself in the vast multidisciplinary literature of regulation and started intensive work on his new book. As he later recalled, "My sense of the economics of all this [pricing of natural gas] didn't really get straight until I wrote my *Economics of Regulation.*" By 1967, Kahn had begun to chart the course of his masterwork …. In 1970, the first volume of his great book appears in print….[18]

Very briefly, the facts as I saw them were: that in their search for oil, the major oil companies had discovered huge reservoirs of natural gas—much of it physically associated with and providing the lifting energy that brought the oil explosively to the surface, others in pure gas reservoirs, unassociated with oil. Most of the former gas was simply burned off—so that, I was assured, someone flying over an oil field in the middle of the night could read a newspaper by its light; others simply capped for lack of a market—the development of which awaited the arrival of long-distance gas transmission lines. This later, adventitious development of a huge market for that gas naturally occasioned intense competition among gas pipeline ventures for long-term contracts committing those reserves, which were prerequisites of FPC certification.

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[18] Thomas K. McCraw, Prophets of Regulation: Charles Francis Adams, Louis D. Brandeis, James M. Landis, Alfred E. Kahn, Belknap Press of Harvard University Press, Cambridge, MA, 1984, pp. 234-235.

My successful testimony, not only elaborating the rationale for FPC regulation of the field price but also proposing the two-price plan that the Commission likewise adopted—a lower historical-book cost for gas already discovered, a higher price intended to reflect the higher costs of gas discovered and developed henceforward—both of them, observe, involving only plausible allocations of cost between (regulated) gas and (unregulated) liquids

I have felt compelled to relate this story because that testimony probably was, paradoxically and by coincidence, the critical factor leading to our celebrations today: I was appointed to the New York Commission evidently upon the recommendation of my predecessor, Joseph C. Swidler, who had previously been Chairman of the very Federal Power Commission that had adopted my plan for regulating natural gas! In consequence, I felt compelled in my Volume I testimonial to marginal cost pricing principles to reconcile with them the position I had taken with respect to natural gas some fifteen years previously. I take the liberty of attaching those attempted rationalizations from my first volume, for those of you interested in this confessional or, more likely, in this ancient issue.

My conception—hardly original—was that the "old" gas, already discovered and, for want of a market either capped or flared on-site after driving up the oil with which it was associated, had a zero marginal cost; that—reflecting my youthful exposure to Henry George's Progress and Poverty and my 20th century political liberalism—it had something close to a zero marginal cost: permitting its price to soar, as it was in the process of doing, to the full marginal cost of "new" gas (or above, in the short run) conferred something like pure economic rent on its owners.

Whatever the merits of this rationalization, the simple economic efficiency preached in my Volume I requires that all supplies of a standardized product, whatever the differing circumstances of their discovery and production, be priced at the marginal cost of supply necessary to clear the market. The field price of natural gas, thus regulated, it cannot be doubted, fell increasingly over time short of that level: the result was the necessity for ever-tighter direct rationing, the responsibility for which, by a sort of poetic justice, I myself was forced to take over once I assumed the Chairmanship of the New York Commission.

Dropping the Final Shoe—Swiftly and Lightly

By now surely one or more of you must have glanced at your watch wondering when I was going to get around to the inevitable subject of network neutrality—and how long that was going to take. Please be reassured, much too much has already been said on this subject, and repeatedly. I challenge myself to reduce my wavering views to a few bare propositions. **(PAUSE FOR SUSTAINED APPLAUSE)**

- The rapidity of technological and commercial changes in telecommunications definitively precludes anything even remotely approximating traditional cost of services, economic regulation, whether of aggregate revenues or of the prices of individual services.
- Each of the principal telecommunication carriers is subject to competitive pressure to offer the full range of possible services from its several platforms.
- But when something like two multi-platform companies have come to dominate these several markets, in very large measure by mergers of previous competitors, one cannot be fully satisfied that competition will suffice to protect consumers or independent profferors of content.
- The only interventions clearly justified, at this time, would be antitrust-like in character—discriminations against providers of content competitive with those of the carriers themselves—and refusals to interconnect with one another for the transmission of competitor-originating content.

- But the version of antitrust that I would urgently recommend would flatly prevent discriminations against competitors, or refusals to deal with them, without the University of Chicago mandated demonstration of injury to customers, such as the enduring 5% price differential required in the Department of Justice's merger guidelines.

- It is emphatically not discriminatory—or in itself undesirable—for internet access providers to vary their charges depending on the demands that the several users impose on their networks, or to offer different guaranteed speeds of delivery at different prices, reflecting those varying requirements. On the contrary, that is the result that would be produced by effective, consumer-protecting competition.