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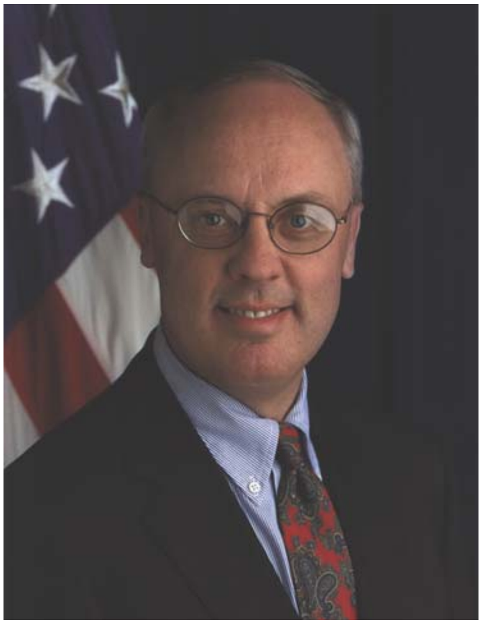
Regulating the Regulators

The First Two Years at the Bush OMB

by Ben Lieberman

Birds fly, fish swim, and regulators regulate—it's their nature. Left unchallenged, regulatory agencies have an incentive to over-regulate: Regulations are their work product, and without a steady stream of new ones they would likely suffer shrinking budgets and diminished power.

Congressional oversight is supposed to keep regulators in check, but Congress often shirks its responsibility to rein in overreaching regulatory bodies. Fortunately, it's not only up to Congress to regulate the regulators. The White House's Office of Management and Budget (OMB), and in particular OMB's Office of Information and Regulatory Affairs (OIRA), can play an important role as a check on regulatory excess. OMB's recent annual report, *Stimulating Smarter Regulation: 2002 Report to Congress on the Costs and Benefits of Regulations and Unfunded Mandates on State, Local, and Tribal Entities,* demonstrates that the Bush OMB is taking a more aggressive oversight role than did the Clinton OMB. However, there is much more to be done.



Office of Information and Regulatory Affairs Director John Graham

The stakes are very high. In the study, OIRA estimates that major rules promulgated between April 1, 1995 and September 30, 2001 cost the U.S. economy $50 to $53 billion annually. Benefits are estimated to range between $48 and $102 billion. OIRA also states that the cost figures for all federal rules presently in effect could be 10 or more times higher.

In reality, the costs could be far higher still, as OIRA frequently has to rely on questionable and often self-serving agency assumptions. Many agencies—including the Environmental Protection Agency (EPA), Food and Drug Administration (FDA), and Occupational Safety and Health Administration (OSHA)—routinely downplay regulatory costs and inflate regulations' alleged benefits to justify an aggressive regulatory agenda. There is much Enron-style accounting going on at federal agencies, and increased OIRA scrutiny will be critical if there are to be any improvements. This report, which discusses the cost estimates and their potential errors, is only a start.

The Bush Administration's concern with the regulatory state is by no means new. In fact, every president since Gerald Ford has found fault with regulatory agencies and has enacted various Executive Orders designed to provide additional oversight. Most significant is Executive Order 12866, which, among other things, requires agencies to provide to OIRA a detailed analysis of the costs and benefits for all new rules with

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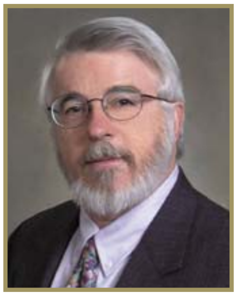
From the President



REAGAN'S THIRD TERM?

by Fred L. Smith, Jr.

Many have noted that the first term of Bush II is more like the third term of the Reagan Administration than was that of Bush I. The first Bush Administration, to the chagrin of free market advocates, was all too willing to appease environmental extremists. To date, Bush II has avoided the worst pitfalls of his father—but conservatives have not yet won the day.

Bush I appointed William Reilly, a true believer in environmentalist dogma, to EPA. Bush I also attended the 1992 Rio Earth Summit, whose agenda was anti-market and anti-technology. CEI and other pro-free market organizations urged the President not to go. But Bush I went—and mischief followed. The U.S. signed and ratified Agenda 21, a pious declaration promising a vast array of commitments to subordinate economic development to environmentalists' policy preferences.

Bush I's costliest decision was to push through a more restrictive Clean Air Act (CAA). Air in the United States had been getting cleaner for years; but a handful of individuals in the administration—including Reilly and Bush OMB associate director Bob Grady—persuaded the White House to support a new bill. The Administration, by pushing "market mechanisms" as a means to achieve CAA goals, gained unexpected support for the bill. Many economists signed onto a letter supporting the bill—forgetting that an efficient means to a dubious goal is hardly desirable. The guillotine was undoubtedly an *efficient* way of dispatching individuals to the next world, but few believe that it improved the quality of French justice!

Our acceptance of the Rio agenda entangled the U.S. in global environmental commitments and stifled the domestic economy with redundant and unnecessary environmental regulations. A heavy price, but still, Grady and others insisted, well worth it. The Republicans, they believed, had won the environmental vote forever. But they were wrong. Environmentalists condemned the Republican position as too little, too late, and urged even more restrictive standards.

Thankfully, Bush II sees things differently: He is aware of the value of energy use and leery of international agreements and tightening of regulatory rigidities. He moved quickly to reject the Kyoto global warming treaty, choosing instead to champion affordable energy. He also questioned the various midnight regulations promulgated by the departing Clinton/Gore team. Bush II did not attend the Johannesburg Earth Summit, a party whose purpose was to throw pies at the face of the U.S. As a result, the Johannesburg conference actually took on a more rational tone. With no U.S. to blame, delegates pointed out that poverty is the most significant cause of pollution in the world, and that sustainable development requires using resources to meet the needs of people *today* as well as those of tomorrow.

However, no one should yet rest easy. The Bush II team includes many greens, especially at EPA and at the Council on Environmental Quality (a White House agency that should have been abolished long ago). The administration greens failed to persuade Bush to endorse Kyoto, but blocked attempts to fully reject the treaty. Our signature remains on this foolish treaty, with the very real—though limited—obligations a signature entails. Moreover, the same focus on means rather than ends has lured even some administration free market advocates into endorsing "voluntary" restraints on carbon dioxide emissions, without questioning the end goal.

Why is this so? Too many people in the administration assume an environmentalist victory is inevitable. Therefore, their goal is to minimize the damage and ease people into accepting energy rationing. The president is ill-advised by this pre-emptive capitulation. There is nothing inevitable about limiting fossil fuel use. The science supporting global warming alarmism has collapsed. And even its supporters now concede that the Kyoto treaty will not work.

The continued move of Bush II into the green thickets of ever more restrictive environmental policy is indicative of the failure of reformers to provide the administration and its allies in Congress both a program and a marketing strategy to challenge the green orthodoxy.

There are no real victories in politics that are not first moral and intellectual. The welfare debate showed that we can win such battles. Now we must challenge the eco-socialist agenda of the White House greens. With the new team in the House and Senate, we have a great opportunity to achieve some real victories.

Fred Lee Smith Jr.

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an expected annual economic effect of $100 million or more. In addition, the Unfunded Mandates Reform Act (UMRA) and the Small Business Regulatory Enforcement Fairness Act (SBREFA) require agencies to take into account—and make every effort to minimize—the impact of new rules on state and local governments and small businesses.

Unfortunately, these and other well-intentioned process reforms have frequently proven to be empty gestures, especially against agencies determined to promulgate their regulatory agenda regardless of the costs. It is here that OIRA can play a vital role in holding regulators accountable. OIRA's main weapon is its authority to return to agencies any new rule that fails to live up to these requirements. Once a rule is returned, the agency then must either fix it or scrap it.

OMB's annual report shows that, after a long hiatus, regulatory oversight is back. During the last three years of the Clinton Administration, not a single significant rule was returned to an agency. In contrast, in Bush's first two years, 22 have been returned. Though the number of returns is itself not a good indicator of regulatory quality, in this case it shows that the OIRA cop is back on the regulatory beat.

These early administration returns should have a preventive effect by convincing regulators to promulgate only those rules that will pass muster. Even so, continued OIRA vigilance will be necessary if we are to see more sensible regulations coming out of Washington.

As important as analyzing new rules is reviewing many already on the books. OIRA can recommend reforms to existing rules, and to this end has solicited comments from the public. CEI was one of several entities that submitted nominations for reform. We urged OIRA to review FDA requirements discouraging the use of new drugs and devices that pose minimal or no added risk, new EPA standards for ozone and particulate matter, and Department of Agriculture labeling standards for organic foods.

Last year, this process yielded several regulatory changes, especially to some of the Clinton "midnight regulations" finalized in the weeks before the change in administrations but scheduled to take effect on Bush's watch. Several rules were modified, such as a Department of Energy conservation standard for air conditioners that was so strict that the agency conceded it would cost consumers more than it would save.

OMB has passed this year's suggestions along to the respective agencies, but only continued OIRA pressure and follow-up will convince many agencies to seriously consider changing these and other existing rules such as the above.

In sum, OMB's annual report shows that OIRA is busier than it has been in quite some time. But the task before it—restoring a semblance of balance to the regulatory process and changing regulations that do not benefit society—remains a daunting one. Its success should be a Bush Administration priority.

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Liddy Does Weeklong Series on
Global Warming and Other Eco-Myths

CEI President Fred L. Smith, Jr. and nationally syndicated radio talk show host G. Gordon Liddy enjoy a laugh during Smith's apperance on the "G-Man's" daily radio show, part of a weeklong series on CEI's latest book, *Global Warming and Other Eco-Myths*. Other guests that week included the book's editor, Ronald Bailey, Nobel laureate Dr. Norman Borlaug, CEI Director of Food Safety Policy Gregory Conko, and CEI Director of Risk and Environmental Policy Angela Logomasini.

In Gaia We Trust

Will EPA Help Environmental Extremists Tap into the President's Faith-Based Initiative?

by Chris Horner

The days are long past when the Episcopal Church could jokingly be called "the Republican Party at prayer." But the environmental movement, now more than ever, does represent the American Left at worship. The green crusade is now crafting a new way for its own troubling religion to pervert traditional faith. With taxpayer dollars in its sights, the Down-With-People machine is donning religious vestments and teaming up with the Environmental Protection Agency to tap into President Bush's faith-based initiative.

CNSNews.com reports that last December, an EPA official told a Washington, DC meeting of environmentalists and religious groups that: "EPA is informally seeking 'ideas' regarding how religious groups who promote green causes like climate change and pollution controls can qualify for the White House's faith-based funds." The very idea of green evangelizing infecting Bush's faith-based initiative should alarm, since the movement has far more in common with pagan themes than with traditional tenets of faith.

The very idea of green evangelizing infecting Bush's faith-based initiative should alarm, since the movement has far more in common with pagan themes than with traditional tenets of faith.

The White House explains: "To strengthen the work of what President Bush terms our nation's 'armies of compassion'—civic, social, charitable and religious groups—he created the White House Office of Faith-Based and Community Initiatives (OFBCI) on January 29, 2001." President Bush seeks to buttress governmental efforts "to battle social distress, [as] too many of our neighbors still suffer from poverty and despair amidst our abundance…[Americans] want to see their Federal dollars making a real difference in the lives of the disadvantaged. And they believe that government should help the needy achieve independence and live responsible lives."

Incredibly, EPA sees green activism as fulfilling this mission. Jerry Lawson, director of Energy Star, an EPA energy-efficiency program, told participants at the Worldwatch Institute symposium, "Invoking the Spirit: Religion and Spirituality in the Quest for a Sustainable World," that, "one of the higher-ups at EPA called me and we talked about grants. This person said to me…'look, if you hear of good ideas of faith-based groups that are environmental proposals, let me know.'"

Can EPA truly be blind to the green agenda of limiting the availability of affordable energy—a move that would be most devastating to seniors and the poor? "Giving society cheap, abundant energy…would be the equivalent of giving an idiot child a machine gun," says green godfather Paul Ehrlich. Oh, the horrors of subjecting millions to affordable heating, lighting and cooling, transportation, and other freedoms. Onward Kyoto soldiers!

Did EPA miss the greens loudly affirming their agenda during last August's World Summit on Sustainable Development in Johannesburg? Among their projects: impeding technology that increases agricultural abundance, even the shipment of food to famine stricken countries like Zimbabwe; lamenting the pernicious influence of indoor plumbing; and complaining that the poor shouldn't want (or get) such comforts as electrification because there are larger, Gaia (earth goddess)-centric considerations at play.

Just feel the love in the Earth Island Institute's September 14, 2001, tantrum, "U.S. Responds to Terrorist Attacks with Self-Righteous Arrogance." Steeped in self-righteous arrogance, this bilge denies that the September 11 attacks represented an act of war. Instead, it "was an act of anger, desperation and indignation." In other words, we asked for it. "This was not an 'attack on all American people,'" fumed EII, because those who died were mostly Pentagon and "multinational financial empire" types. Plus, we should get over it because "[t]his was not the sort of flat-out terrorism that targets random innocents at a disco or a beach."

EEI's statement ought to horrify, but they are only the tip of the iceberg. A visit to voices of greens past and present reveal an anti-life "people are pollution" philosophy prevalent throughout the movement:

- "To feed a starving child is to exacerbate the world population problem." — Lamont Cole (as quoted by Elizabeth Whelan in her book *Toxic Terror*).

- "This is as good a way to get rid of them as any." — Charles Wursta, Chief Scientist for the Environmental Defense Fund, in response to the obvious implications of millions dying from a global ban on DDT (quoted in *Toxic Terror*).

- "I got the impression that instead of going out to shoot birds, I should go out and shoot the kids who shoot birds." — Paul Watson, founder of Greenpeace describing the monster he created (quoted in *Access to Energy*, Vol. 10, No. 4, Dec 1982).

- "The right to have children should be a marketable commodity, bought and traded by individuals but absolutely limited by the state." — Kenneth Boulding, originator of the "Spaceship Earth" concept (quoted by William Tucker in *Progress and Privilege*, 1982)

- "The only real good technology is no technology at all. Technology is taxation without representation, imposed by our elitist species (man) upon the rest of the natural world." — John Shuttleworth, Friends of the Earth manual writer.

As these statements make clear, radical environmentalism runs counter to a core tenet of most major religions: respect for human life.

Invoking religion or appealing to people's faith in order to advance an agenda driven by beliefs wildly inconsistent with dominant religious principles is extremely disturbing.

The greens are patently anti-growth and anti-wealth. Wealthier is healthier and cleaner, and therefore good for the environment—but wealthier means the ability to provide for large families, live suburban lifestyles (i.e., commute), and otherwise act in ways deemed inherently wrong by the anti-people crowd.

These activists find global population unacceptable by a factor of three. They seek to limit technologies that facilitate modern life by pleading an artificial scarcity—thus seeking to convince people that they must choose between prosperity and a healthy environment, but cannot have both—and now they want us all to help pay for their efforts.

Even worse, EPA seems willing to help them. "I would like to offer myself as a conduit," Lawson told the activists at the Worldwatch event. Worldwatch research director Gary Gardner told CNSNews.com: "There is a role for the government to bring religious groups and environmental groups together." In other words, allying themselves with religious organizations will enable environmental groups to receive taxpayer funding.

The green charade must be fought, for it is intolerable that taxpayers should be asked to fund the greens' neo-Malthusian objectives under the guise of aiding the poor and disadvantaged. The greens' philosophy has nothing to do with Judeo-Christian—or even simply humanitarian—principles. Their projects have no place in President Bush's Faith Based and Community Initiative.

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Q & A with VERNON SMITH:

The Economics Nobel Laureate and Founder of Experimental Economics on What Experiments Can Tell Us About Society and Public Policy

Economics Nobel Laureate Vernon Smith, recognized as the founding father of experimental economics, recently spoke with CEI on his development of economic experiments, how his findings illustrate human interaction, and what contributions experimental economics can make to public policy.

CEI: What made you first decide to start performing economic experiments in the laboratory? Did you feel that, because so many introductory-level economics texts are written under the assumption that certain conditions must be present in order for markets to work, someone should test the boundaries of those assumptions?

Smith: I was having trouble teaching introductory economics and telling stories about why the competitive model might be relevant. In fact, it didn't seem to be relevant at all. Of course people were telling stories that you had to have complete information, that you had to have a sea of buyers and sellers out there, but they had to all be price takers. So, I was just trying to understand better what you were supposed to believe about markets. So I did one without really much confidence that it would work...It worked! I thought there might be something wrong with the experiment, so I didn't want more replication. I changed it and everything. It ended up being not a teaching exercise but a research project, and by 1962 I was getting research support for this and still teaching it in the classroom. I was doing real research experiments and paying all the subjects. At Purdue in 1963 I started a graduate seminar in experimental economics.

CEI: Professor Don Coursey of the University of Chicago, who worked with you on many of your experiments, stated that your subjects produced strongly competitive results regardless of their educational or ideological backgrounds. Did conducting the experiments teach you a lot about the differences between people's words and actions regarding taxes and regulations? Did it teach you new ways to illustrate Adam Smith's teachings in the classroom?

Smith: I have a paper, *The Two Faces of Adam Smith*, [in which] I argue that, if you read *The Wealth of Nations,* you get a very different perspective on Adam Smith than if you read *The Theory of Moral Sentiments*. *The Theory of Moral Sentiments* is about our sociality. There's a way to bring them together if you think of friends, associates, as being

people who trade favors, do things for each other—those are exchanges without money, and without contracts. One way to think about that aspect of the human condition is that it is personal exchange. In markets we have impersonal exchange. This is an important part of the research we've done.

We bring people into a room—12 of them—match them anonymously, and they play these extensive-form games. You don't know who you're matched with. You never will know who you're matched with. Half of them cooperate. For example, you are Number Two, and you don't know who One is. He's in the room there with you. If One passes to you, you can either play $25 for each or go for $30...In this particular case, over half move down...If One looks ahead, he sees the payoffs, and thinks ahead and thinks about what he would do if he was in Two's position, and what Two is likely to do. We think that's an exchange, because what One is doing, without saying so, is, "Look, I'm doing you a favor. We only have $40 to split here. If I pass to you, we will have $50 to split."...You can't talk with the guy. All you do is move, and he sees where you moved. This is an important part of reciprocity; you are returning a favor. Two says, "I owe you one," and he pays it off right then. Our reasoning is that Two sees what One gave up, and sees that One is making Two better off, and therefore Two returns the favor...That's an exchange. Each person incurs a risk to make that trade and then they are both made better off.

If you look at hunter-gatherer societies in the anthropology literature, all of them, in one form or another, had a way of sharing the meat from the hunt. They had no refrigeration and they had no money. So what did they do? On any given day, a hunter goes out and brings back nothing. If he does bring back something, and that would happen maybe one in 10 to 15 times, he shares it widely within the tribe, beyond the nuclear family. It is a kind of culturally-enforced exchange system. What's interesting is that if you look at the products of gathering, they're not volatile—they're pretty much the same day in and day out. Those are only shared in the nuclear family. So these guys have worked out an insurance scheme on something very risky for everybody.

Of course, they have a free-rider problem. As a hunter, you may not have as much motivation to bring the game back if you can always share. The Ache in eastern Paraguay are outstanding hunters...Furthermore, their children have higher survivorship. There are a lot of these stories. They are pretty common. It may vary among different tribes, but the point is that there is reciprocity going on in the trading system.

In *The Two Faces of Adam Smith* I developed the idea that specialization probably occurred long before there were markets, because people had exchange systems within the family, the extended family, and the tribe. So, if you look at hunter-gatherer societies today, they have the women and children gather. In the Ache, when a kid gets to be 18, he joins the hunt. The adult men are the hunters. Old men do three things: they advise in the hunt, they make tools, and join the women and children in gathering. So there's a specialization that takes hold...There is a lot of specialization across age and sex. So if that's true, it means that by the time trade with strangers occurred, you already had people who had experience with the gains from trade locally. It's just a matter of getting over the hump of, "You can't be sure that you can trust a stranger." Exchange systems are probably at least two to three million years old, maybe older.

CEI: Your results led to important new insights regarding whether or not monopolists can or cannot corner a market, how regulations can have unintended consequences, and how market principles can be used to address public goods problems. How has experimental economics changed the terms of the debate in these areas?

Smith: I think it's clear from the experiments that the most important thing to be done in markets that may have some tendency to be monopolistic or rig prices is just to be sure that you keep everything open to entry. Every new product starts as just one firm. Monopoly is the way things always get started, and it's profitable, so you have entry. So you just want to keep it open. It may be that there will be no entry because it's not profitable.

The most important thing to be done in markets that may have some tendency to be monopolistic or rig prices is just to be sure that you keep everything open to entry. Every new product starts as just one firm.

Why is intervention so popular? I think what's going on is that people's experience in day-to-day interchange with others is that, when you do good, it is good. I help a friend who is down for some reason because of health or whatever...Therefore, we ought to be able to improve on markets. It is evident that you can do things to improve the lot of the people you work with; we do it all the time. So why can't you improve on markets? This comes from people who don't understand that well-functioning markets are already helping everyone. They don't understand that the extended order of markets is a cooperative system because they're only looking at the distributional aspects of it. That's where that problem comes from. They vote for politicians who intervene because they're doing good, and I am doing good by voting for them. How do you break that? I don't know.

Some economists, as well as the FAA and others, worried for years that TWA had too much control over St. Louis. Why can't they make any money? If they're monopolists, how come they haven't made a profit since 1989? And people worry about Northwest. They dominate Minneapolis. So what? Where's the profit? Where's the money? Southwest Airlines doesn't dominate any port or hub. Last quarter, the *Wall Street Journal* said they made $43 million.

I think the experiments have made it clear. We did experiments back in the early 1980s—the buyers were at Indiana University and the sellers were at the University of Arizona and it was all electronic trading. The sellers in Arizona would go out and post their prices and the buyers could take it or leave it. The buyers would line up and buy from the low prices. Then the sellers would come back to a room and talk strategy and decide what they wanted to do. But whatever they did, they could not talk when they went to the terminals...They could conspire, but they couldn't make threats or side payments. After they had their agreement, then they had to go.

It was like the OPEC cartel—they meet and then go out and do their thing in these various countries. Of course, it was noted a long time ago that what they would tend to do is chisel. That's exactly what they did during these experiments. We would tape record what they said. They didn't have any trouble figuring out what to do. I'll never forget one fellow I met after the first period who came back to talk, and immediately the question came up: "We need to get the prices up." There was a girl there who said, "Yes, I agree with that, but let's not go too fast, because if I was a buyer I know what I would do if I saw the prices down and all of a sudden they were going up." So they came up with a plan. In a different group, what was interesting is that prices would tend to go up, and then someone would start to cut. As soon as someone would cut, it would come back down.

We had a group of four sellers where the conversations were always a bit confusing. There was this one guy. Everyone was up at this price and he had the long one, and when he got back they asked him, "Well, you didn't stay with the group." He said, "Oh, I mistyped." The next time, they talked about different prices and set a long one, and he "misunderstood." He thought they had settled on a different price. He was always coming back with these stories and everybody else was getting outraged.

So the dynamics would vary among these groups, but basically, it would start high and then tend to come down. So you could see what the problem was with something like OPEC. You get these kinds of results and then you ask, "Wait a minute, does this contradict what's going on out there?" You start to look at cases and you recognize that it's the same thing. People forget that OPEC was formed in 1959. The embargo didn't come until the 1970s. Well, what

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CEI Submits Comments to DOT on Proposed Airline Reservation Systems Regulations

On November 30, 2002, James V. DeLong, Senior Fellow for CEI's Project on Technology & Innovation, submitted comments to the Department of Transportation on proposed regulations for airline Computer Reservation Systems. Following are excerpts from the comments. ***Comments can be submitted until March 15*** *(67 Federal Register 69366, November 12, 2002).*

The Competitive Enterprise Institute strongly endorses [the Department of Transportation's] decision to move in a deregulatory direction in revising its rules governing the airline industry's Computer Reservation Services (CRSs)...We also urge it to go the next step by making a commitment to total deregulation as quickly as possible and commencing a proceeding to identify the issues that must be addressed during the transition to a deregulated state.

Internet Regulation Proposals

The proposals that DOT extend regulation to the Internet in the interests of protecting existing industry participants from the winds of change [are not] worth serious attention.

Deregulation and the consequent increase in complexity of the fare structure created a niche for travel agents as suppliers of information. In 1977, they accounted for 38 percent of bookings and commissions were between 4 and 5 percent. After deregulation, agents' share of bookings rose to 85 percent by the early 1990s and commissions rose to a peak of 11 percent.

Since then, as the Internet has developed into a source of information, the economic role of travel agents has narrowed, and both bookings and commissions have declined.

Similarly, the role of Computer Reservations Services, which helped pioneer the development of business oriented data bases, is changing. CRSs are still based on software written for IBM mainframes almost 30 years ago. It is a powerful tool, but advances in computing hardware and software are creating other options. There is no reason for DOT to attempt to extend the life of a product cycle which may be drawing to a natural close. Or which may not be; the CRSs may well find ways to adapt their technology.

Market Power of the CRSs

Almost all discussions of the airline reservation system assume that CRSs have substantial market power over the airlines. The degree of this power seems overstated, however.

A CRS derives some power from the fact that each travel agent subscribes to a single CRS, so any airline that does not allow seats to be booked over that system could not derive revenue from that agent. However, the opposite also applies. If an airline were to refuse to deal with a particular CRS, then the travel agents that used that CRS would not be able to book on that airline. And it is impossible to imagine an agent staying in business if it could not book seats on United, or American, Northwest, or any individual airline that was important to its traveler-customers. The power is not one-sided.

The Internet is eroding whatever CRS market power does exist by making it easier for airlines to reach travelers directly.

Market power of a CRS is limited to its ability to charge fees that provide it with a supercompetitive rate of return only insofar as it does not push this power so far as to cause airlines to engage in massive retaliation.

Role of Travel Agents

Travel agents perform multiple functions. They can be: (1) Agents acting for travelers to locate the lowest fares or best flights according to the travelers' criteria; (2) Independent actors who steer passengers toward whichever airline rewards them most handsomely, even if that airline is higher in price or less convenient (this is not usually known to the travelers); (3) Packagers of travel and other services (e.g., airline, hotel, rental car, tours) that can be sold to the public as a bundle.

The NPRM (Notice of Proposed Rule Making) does not have a consistent view of travel agents. In places, it asserts that any agent that does not provide good service to passengers could not stay in business. On the other hand, DOT's emphasis on display bias is based on exactly the opposite assumption—that travel agents are too lazy or too indifferent to the needs of travelers to look beyond the first screen.

Similarly, DOT's concern about the impact of override commissions (incentive payments for meeting overall sales quotas, or other special payments from the industry) is based on the assumption that travel agents regard their customers as a product that can be sold to the best-paying airline, not as clients to whom the agency is providing services. This concern appears well-founded. A 1998 survey found that 52 percent of domestic travel agencies received overrides in 1997, and 69 percent of these indicated that they sometimes book a specific airline as a result.

The Internet, by making generally available to the public good information on fares and schedules, is reducing the ability of travel agents to treat travelers as products to be sold to the highest-paying airlines...Orbitz, in particular, is a crucial part of the development, because, as CEI has argued at length elsewhere, it represents a recognition by the airlines that all—including both travelers and airlines—are better off if high quality information exists in readily accessible form.

In CEI's view, travel agents will continue to have a major role in the industry. The Internet, which is removing both their value as searchers for airline fares and their ability to steer passengers to particular airlines, is having a positive effect as well. As the volume of information about travel options becomes a torrent, travelers need interpreters who can filter it for them and reduce the flow to manageable size, and packagers who can provide one-stop-shopping. Travel agents can have an excellent future meeting these needs. But DOT should not attempt to forestall the changes in the industry that are being wrought by technology.

Q & A with Vernon Smith
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was going on all that time? They were having a hard time getting their act together, that's what. And they still have a hard time getting their act together. It's unstable. If those other guys will just stay up there, you can make a lot of money by undercutting them.

CEI: You have said that one of the main problems with the market distortions created by regulation is the objective to fulfill all demand all of the time. Do you see a political legacy of regulation in that people will come to expect all demand for certain things to be fulfilled all of the time, and if so, will this expectation create an obstacle to deregulation?

Smith: Yeah, it is an obstacle to deregulation. Electric power, for 95 years, has been regulated; and the regulators, the regulated, and the customers all are thinking in terms that demand is "must serve," meaning "must serve" at a fixed price.

Now, it's very hard to move from that. Consumers have been accustomed to low prices; they don't realize that there would be much lower prices off-peak at night.

The first thing that happened when we deregulated telephones is that we started to get weekends and night rates that were a lot cheaper, and they're still coming down. We have not had anything like that in electric power. The bottleneck primarily is at the level of the local wires utility. Those guys want to tie in the sale of energy with the wires. Wires and energy are completely different. When you rent an automobile, what do you do? You pay for the machine and you buy your own gas. The energy is separate from the vehicle and the steel. Here, the energy can be separate from the copper wires. But you have to open those rules up and allow free entry at the retail level.

In principle there are a lot of places where there are alternative providers, and they can come in to sell energy. But the question is: Will the local wires guy let them into individuals' houses to put switches on individual appliances? Are they allowed into the switchbox on the outside?

They want to put in devices that enable certain circuits to be interrupted insofar as the zones of the house give you some priority. The air conditioner or washer and dryer can be programmed so that, in case you make a mistake and you try to use it at 3:00 in the afternoon, it won't let you use either the washer or the dryer, and you get a lower rate for that, and similarly for the option of cutting off your air conditioner for fifteen minutes per hour or whatever. You need to get down below the substation level and into the end users' homes to do that. We're looking into that now. We're trying to make contact with some public utility commissions to figure out which one of them is most likely to do something aggressive here, and find out what's actually being done, what the barriers are, and what can be done to get past them.

If someone tries something and it takes off, you'll find out that there's money to be made. If it doesn't, you lose money. But it's the business that incurs that, not the customer.

New Zealand separated wires from energy. In fact, their incorporation law required the energy sector to do two billings: a billing for the wire and a billing for the energy. The bill for the wires comes from the local wires company. The energy can be from anyone. So, if you go in and get this guy's customers, you can pass through the wires charge, or the customer can pay them directly. You just send them a bill for the energy.

All of those technologies require the alternative energy provider to get to the wires somehow. The lowest cost way to get interruptible service at a discount is just a simple frequency modulated switch. There are a number of these different switches. One can be automatic. So, when the frequency falls, that means the system is stressed, and it starts cutting off stuff.

Another is, the wholesale provider has bids into the wholesale market. Most of what he's demanding he can't interrupt, so he will pay whatever it takes in order to buy. Then, with additional amounts, he puts in steps. If the price is above a step, he cuts off some of the demand, some of the customers. That makes that thing responsive. If generators try to raise the price, they will just run into this interruption, and find out that they cannot get the price up. All they do is reduce demand.

So, there's the interruption at the individual appliance level, which is just simple switches—and they're cheap. In the next level, a guy can come in and give you just another watt/hour meter. You've already got one. He gives you another one. That's for night.

Think about that. You're a local wires monopoly. You've been selling energy at a flat rate. Well, your marginal costs are much lower at night than they are during the daytime, especially at peak. That means that you are taxing the off-peak consumers and subsidizing the on-peak consumers. Here's where the money is.

Somebody comes in and puts in a night rate. He can make out very well by charging people less than you're charging. If you're losing that business, what do you do? You've got to raise your rates to the peak users. No one has to come in there and make orders to figure out how best to do this—just let the entry decide what's best.

Also, nobody knows what technology is going to be best, what consumer preferences are. You can't figure that out. Consumers don't even know. If you do a consumer survey, you can't be sure that you'll get anything to support anything. But if someone actually goes in there and tries something and it takes off, you'll find out that there's money to be made. If it doesn't, you lose money. But it's the business that incurs that, not the customer. If the government does it, and they get it wrong, [they] make [customers] pay anyway. That's the French. They have time-of-day pricing. It's all centrally-controlled. Do they have it right? I don't know if they have it right. Suppose it's wrong? They're still going to collect.

So there is a political problem, and the problem is to get past that.

Continued in the March issue.

The Good, the Bad, and the Ugly

The Good: Federal Judge Dismisses Anti-Fast Food Lawsuit

The cause of individual responsibility scored an important victory on January 22, when a federal judge dismissed a lawsuit against McDonald's that claimied the fast food chain was responsible for making people overweight. In his ruling, U.S. District Court Judge Robert Sweet emphasized the importance of establishing causality between a product and its alleged harmful effects: "Where should the line be drawn between an individual's own responsibility to take care of herself and society's responsibility to ensure others shield her? The complaint fails to allege the McDonald's products consumed by the plaintiffs were dangerous in any way other than that which was open and obvious to a reasonable consumer."

The suit was brought by legendary trial lawyers Samuel Hirsch and John Banzhaf. Before the ruling, Banzhaf acknowledged that his alleged link between consuming fast food and the adverse effects of obesity was questionable. A week before the ruling, he told MSNBC that, "Everybody knows that if you want to lose weight, you eat less, less calorie input, and more exercise. You don't have to learn that." Last year he told *Men's Health* magazine that, "The biggest problem…is what lawyers call causation…It's hard to tell what caused a heart attack. What percentage is obesity, versus other factors?"

Sweet concluded that "Nobody is forced to eat at McDonalds…to supersize their meals…as long as a consumer exercises free choice with appropriate knowledge, liability for negligence will not attach to a manufacturer."

The Bad: Enviro Radicals Dupe Patient Organizations into Joining Anti-Chemicals Campaign

Radical environmentalists launched a new campaign against the use of chemicals, in an attempt to take advantage of the Centers for Disease Control and Prevention's recently released second "National Report on Human Exposure to Environmental Chemicals." The CDC report does not link trace amounts of substances detected in humans to specific adverse health effects—but that isn't stopping environmentalists from using it to publicize the Collaborative on Health and the Environment, a new coalition that claims that environmental exposure to chemicals harm more than one-third of the U.S. population each year and imposes annual health care costs of $325 billion.

The coalition's radical sponsors—including Environmental Defense, Environmental Working Group, Friends of the Earth, Natural Resources Defense Council, and Public Interest Research Group—have convinced many patients' rights organizations that generally promote important medical research to benefit consumers—including the Breast Cancer Fund, the Lymphoma Foundation of America, and the National Ovarian Cancer Coalition—to sign on to the environmentalists' slick anti-chemicals campaign.

The coalition's mission statement concedes that some linkages between individual substances and diseases are more well-established than others and that additional research should be funded to examine mechanisms, levels, and types of exposures that can adversely affect health. However, that doesn't stop it from endorsing a stringent form of the Precautionary Principle: "The precautionary principle indicates that when there is plausible scientific evidence of significant harm from a proposed or ongoing activity, preventive or corrective action should be taken to reduce or eliminate that risk of harm, despite residual scientific uncertainty about cause and effect relationships…That is, the proponent of an activity bears the burden of assessing its safety and of showing that it is both necessary and the least harmful alternative."

The Ugly: More Africans Go Hungry Amidst Anti-Biotech Hysteria

A two-year-long drought has placed millions of people in southern Africa at risk of starvation. At least six countries are affected by the drought, but it is especially devastating for Zimbabwe, where millions of people could die during the coming months, despite the efforts of food aid distribution organizations. As recently as two years ago, that country was a highly productive agricultural producer and a major exporter of corn, beef, and poultry. What happened?

One reason is Zimbabwean President Robert Mugabe's criminal "land reform" policies, under which productive landowners have been forcibly displaced. Mugabe has also used hunger as a political weapon—he has allowed his supporters to purchase cheap grain at government-set prices while forcing his opposition to go hungry. Another reason is that Mugabe has rejected food aid from the United States because it includes biotech corn, hiding behind environmentalist fears about the safety of biotech products.

However, Mugabe's deeper motivation seems to be a desire to protect Zimbabwe's long-term access to European markets, where most biotech-derived foods are banned. Most westerners agree that Mugabe's manipulation of food aid distribution to advance his interests is an inhuman outrage. But few note that environmentalists in Europe have created the regulatory apparatus that paved the way for this tragedy in the first place. Of all of the anti-biotech campaign's harmful effects on consumers, its effects in less-developed nations are the most pernicious. One can only hope that African citizens, who raised their voices against the anti-development effects of wealthy nations' policies during the UN Summit on Sustainable Development in Johannesburg, will continue to do so.

Media Mentions

Technology Counsel Braden Cox highlights a new terrorism threat—the increasing tendency to cloak questionable domestic policy in the mantle of national security:

On January 7, 2003, Rep. James Leach (R-IA), introduced...the "Unlawful Internet Gambling Funding Prohibition Act"...The bill does not prohibit internet gambling outright. Rather, it indirectly shuts down online gambling by prohibiting banks from processing bank instrument transactions that involve "unlawful internet gambling" web sites. Those in the technology industry should follow the movements of this bill because it attempts to regulate electronic commerce in the name of fighting terrorism.

- United Press International, January 22

Director of Risk and Environmental Policy Angela Logomasini reviews a new volume on the politics of risk and regulation:

"Experts are more likely to be right than are ordinary people," says Cass Sunstein in [his recent book] *Risk and Reason*. Mr. Sunstein contends that, when it comes to comprehending risks, the public lacks good information and is biased toward the most alarming scenarios.

We need to empower discerning minds to make decisions about risk policy, argues Mr. Sunstein. Employing objective tools such as cost-benefit analysis by experts supposedly would bring rationality to our regulatory process.

But Mr. Sunstein devotes little attention to already apparent problems of today's technocratic rule. Regulatory "experts" have their own ideological agendas and personal incentives just like most players in Washington.

- *Washington Times*, January 19

Senior Policy Analyst Ben Lieberman unravels the issue of rising gas prices for Chicago residents:

Since Jan. 1, Chicago motorists have seen prices for regular rise to more than $1.70 a gallon from $1.40. The increase is caused by rising crude oil costs, the raw material for gasoline that accounts for about 40 percent of the retail price for gas.

In contrast, the price spikes in the summer of 2000 and 2001 sent local gas prices to $2 per gallon and more, well above the national average.

Those increases had nothing to do with oil supplies and everything to do with environmental regulations. Tough Clean Air Act requirements for reformulated gasoline (RFG), and the proliferation of distinct fuel blends...paved the way for short-term, localized jumps at the pumps.

- *Chicago Sun-Times*, February 17

Senior Fellow Marlo Lewis, Jr. explains two powerful Senators' latest anti-energy proposal:

Sen. [John] McCain [R-AZ], who chairs the Senate Commerce, Science, and Transportation Committee...and Sen. [Joseph] Lieberman [D-CT] are co-sponsoring [a bill] that would force major energy, manufacturing, and transportation companies to reduce emissions of carbon dioxide (CO_2) to year 2000 levels by 2010 and 1990 levels by 2016.

Although the McCain-Lieberman CO_2 reduction targets are not as draconian as those stipulated in the Kyoto Protocol...McCain-Lieberman is close enough for government work. Moreover, since CO_2 is not regulated under the Clean Air Act...enactment of any CO_2 control legislation would establish a fateful precedent. Once federal agencies get a green light to regulate CO_2, we can be sure climate alarmists like Kyoto Joe Lieberman will return to the charge, demanding ever more stringent controls.

- Tech Central Station, January 8

Senior Policy Analyst Ben Lieberman details the trend away from prohibiting online wine sales:

Internet wine sales have grown substantially in recent years, offering consumers both lower prices and improved product choice. But not everyone has welcomed wine electronic commerce, especially the old-economy liquor distributors. They have prevailed upon many state governments to outlaw this new form of competition.

Fortunately, the tide is turning against Internet prohibition, as four of these laws have recently been struck down on constitutional grounds. But the controversy is by no means over, and in fact may be headed to the U.S. Supreme Court, with implications for all manner of Internet commerce.

- *National Law Journal*, January 6

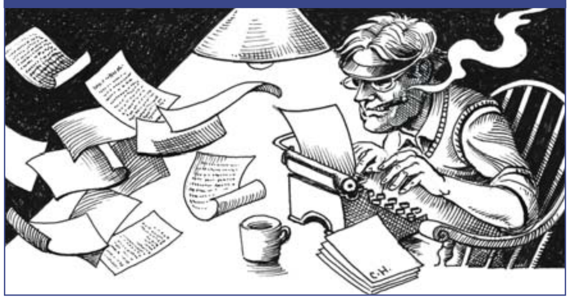
President Fred L. Smith, Jr. probes the reasons behind the U.S. Senate's failure to adopt a free market energy policy:

The [Senate] energy bill, which prohibited oil drilling in the Arctic National Wildlife Refuge (ANWR), gave environmental activists much of what they wanted. It blocked oil development in most of the United States, it subsidized noncompetitive energy sources, and it took the first steps toward enacting the Kyoto Protocol on global warming.

Why did the drilling opponents win? Perhaps the greatest source of environmental activists' power is their ability to tap into the displaced religious values of the intellectual class. On ANWR, Congress voted to ensure that the money-changers (read energy firms) were driven from the temple of nature. Arguments about how much wealth was locked away in ANWR actually strengthened the Greens' position—sacrificing billions demonstrates morality, especially when the sacrifice is borne by others...Free market proponents have created no counterargument with equivalent appeal.

- *American Oil & Gas Reporter*, January 2003

...END NOTES



Trials: Biotech Crops Well-Suited for Developing World

In recent field trials in India, genetically enigeered cotton showed improved yields by up to 80 percent over non-biotech varieties. The tested cotton produces a toxin that kills bollworms, a major cotton pest in India, but which is totally harmless to humans and other animals. The trials were conducted at nearly 400 farms over seven Indian states. University of Bonn researcher Matin Qaim, who led the research, told *New Scientist* magazine that the results counter claims that biotech crops reduce pesticide use without improving yields in developing nations. "You could even argue that the results would be more impressive for food crops," he said.

Supremes: Government Must Respect Bankruptcies

On January 27, the U.S. Supreme Court ruled that government regulators must respect bankruptcy protections the same as do private creditors. In an eight-to-one decision (Justice Stepen Breyer dissented), the Court held that the Federal Communications Commission (FCC) was wrong to cancel wireless licenses it had auctioned to startup NextWave Telecom after NextWave, unable to pay, declared bankruptcy. The FCC then seized the licenses and put them out for a new auction. According to the *New York Times,* NextWave sued the FCC under the federal bankruptcy code's Section 525, which says a government agency may not revoke a license "solely because" a bankrupt license holder is unable to pay. The FCC argued that it had a "valid regulatory motive" for revoking the licenses. But, said Justice Antonin Scalia: "A debt is a debt...such an exception would consume the rule...[and] deprive Section 525 of all force."

United States and Mexico to Fight Freon Traffic

U.S. Justice Department and Mexican environmental officials met in February to discuss ways to combat cross-border smuggling of the auto air conditioning coolant freon. The U.S. banned freon under the North American Free Trade Agreement, but the treaty gave Mexico more time to phase out freon because it is a developing country. The U.S. ban's costs fall heavily on the poor. Millions of drivers of older cars continue to use freon because converting their air conditioners to use alternative coolants is very expensive.

In Other News...

The European Union enacted a rule mandating toys for pigs. "We mean footballs and basketballs," said a British government spokesman. "Farmers may also need to change the balls so the pigs don't get tired with the same one." In Britain, where the new rule is to become law in April, failure to comply could result in a £1,000 fine......The United Nations' Environment Program (UNEP) announced a new public relations campaign to—in the words of UNEP Executive Director Klaus Toepfer—"make sustainable lifestyles fashionable and 'cool,' as the young people might say." According to the Environmental News Service, "UNEP has enlisted psychologists and behaviorists" for its P.R. campaign......People for the Ethical Treatment of Animals recently launched a campaign against Kentucky Fried Chicken......

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