



Fred Kahn's First-Class Flight

December 31, 2010

By Thomas W. Hazlett

This week's passing of economist Alfred Kahn, 93, has brought tributes for the Cornell professor's key role in the 1970s deregulation of US airline fares. That achievement saves Americans a stunning \$20bn annually.

Yet Kahn's contributions to electricity regulation and telecommunications policy may even exceed this high-flying success. Thanks to a superb, Pulitzer Prize-winning history of Kahn's career, Thomas McCraw's 1984 "Prophets of Regulation," as well as Kahn's own two-volume magnum opus, "The Economics of Regulation" (2nd Ed., 1988), and his papers and speeches on a variety of regulatory topics, we have a rich, bull-bodied view of the colourful life of a remarkable man.

Alfred Kahn liked to boast that he was the last living doctoral student of Joseph Schumpeter, the classic exponent of capitalist "creative destruction." But the young scholar was not so warm for the charms of the market. His initial work channelled Thorsten Veblen, who was critical of consumers' choices and heralded wide scope for government regulation.

But Kahn studied on. He was surprised to find that markets accommodated productive forces that eluded the immaculate models of economic analysis. He saw that that government regulation was no *deus ex machina*. Administrators faced challenges of their own; buffeted by political lobbying, they often raised prices for customers. Theory said that market forces should push prices down to marginal cost, and that regulators could help supply some oomph when competitive pressures were weak. But Kahn found electricity regulators fixing charges at the same level no matter the time of day. Analogising to the butcher shop, Prof. Kahn asked: "What would happen if everything that came out of the cow – steak, hamburger, suet, bones, and hide – were priced at average cost per pound?"

Kahn came to conclude "that society's choices are always between or among imperfect systems." But markets generated a dynamism lacking elsewhere, giving them an edge: "Wherever it seems likely to be effective, even very imperfect competition is preferable to regulation."

In 1974, Prof. Kahn was asked to head the New York State Public Service Commission, an agency deeply committed to an arcane system of rates, taxes, subsidies, and profits, crafted by lobbyists, honed by lawyers, honoured by administrative appointees, and understood by none other.

Amazingly he strolled into this rigged casino and beat the house with cards dealt from a stacked deck. The new Sheriff learned every accounting trick, engaged every argument, debated all interests. He did it earnestly, not cynically. The chairman did not just hold hearings; he led them, challenging facts, questioning assumptions, explaining economics, championing consumers.

Chairman Kahn did the unthinkable – he spoke freely and offered opinions citizens (and journalists) could understand. This not only broke ranks with regulators and other interested parties, whose coded language had been conveniently indecipherable, but was a radical academic departure. The guilds of academe are quite as barrier-conscious as the special interests of Albany.

Fred Kahn paid it no mind. He upended many regulatory inefficiencies at the PSC with reforms that rippled nationwide. Consumers, the environment, and the economy benefited. Then he moved to the Civil Aeronautics Board. After being appointed chairman by President Jimmy Carter in 1977, he characteristically read – and rejected – bureaucratic gobbledeegook. He wrote his staff:

“Please, try very hard to write Board orders... in straightforward, quasi-conversational prose – as though you are talking to or communicating with real people. I once asked a young lawyer who wanted us to say ‘we deem it inappropriate’ to try that kind of language out on his children – and if they did not drive him out of the room with their derisive laughter, to disown them.”

His gambit was clear: “If you can’t explain what you are doing to people in simple English, you are probably doing something wrong.” When he caught the agency “hiding behind a cloud of pompous verbiage,” he smelled a rat.

Indeed, the CAB did not protect the public, but fleeced it, raising airfares and squandering productive assets. Under Kahn, its charter collapsed. Fares were deregulated, and the CAB closed shop – by a 1978 act of Congress – in 1985.

Kahn spent much of his last three decades analysing communications policy. The 1996 Telecommunications Act boldly rejected monopoly, eliminating barriers to market rivalry. The law was a paean to the dean of regulatory economists.

But its execution left much to be desired. Kahn blasted the FCC’s attempts to impose textbook conditions of perfect competition – including improper mandates for marginal cost pricing. “I ... had anticipated the very error the FCC was about to commit,” wrote Kahn in a 2004 book (“Lessons from Deregulation”). Confused by the textbook version of “perfect competition,” regulators mandated existing telephone networks to share their lines with rivals, charging only what the new users cost them directly. This ignored the risks taken to create such networks in the past or improve them in the future. Such policies deterred, rather than advanced, the deployment of competing phone or broadband systems.

Justice Stephen Breyer, in Supreme Court decisions in 1999 and 2002, cited the Kahn critique. The powerful economic logic drove the DC Circuit (in 2004) to toss out the FCC's ill-crafted network-sharing rules. Quickly, cable operators built out "digital phone" services. Today, the US residential market features nearly ubiquitous head-to-head fixed-line phone competition. This, and mobile rivalry – another deregulatory bonus – may far exceed the consumer gains delivered to air travellers.

Fred Kahn passed away in Ithaca, New York on December 27. On the previous Thursday, he was downloading articles for a new article on antitrust law. When he then took a turn for the worse, a piano was brought into his room. He was singing with friends and loved ones on Sunday. His legendary humour did not fail him, but his journey had come to an end. Professor Alfred Kahn served as living proof that there need be nothing dismal about the science he loved.

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