Center for the Study of American Business

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A NEW APPROACH TO REGULATORY REFORM

by Murray Weidenbaum

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This booklet is one in a series designed to enhance the understanding of the private enterprise system and the key forces affecting it. The series provides a forum for considering vital current issues in public policy and for communicating these views to a wide audience in the business, government, and academic communities.

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Over the years, many attempts have been made to reform government regulation, but success has been very limited. These efforts have been severely hampered by distrust on both sides of the regulatory debate. Individuals committed to protecting public health, safety, and the environment are suspicious of any effort that is seen as possibly obstructing or delaying their objectives. In contrast, people advocating the reduction of "big government" decry those who would proceed rapidly to address various problems with costly or ill-designed remedies.

To reconcile these two polar extremes, or at least to narrow the gap between them, it is necessary to raise the level of understanding of the galaxy of issues involved. That objective, in turn, requires a far better flow of information, one based on sound science and professional analysis. Moreover, a broader approach is in order in the regulatory process than has been customary.

The most carefully constructed and well-grounded analysis, however, can antagonize citizen groups, which may jump to the conclusion that wetlands are about to be paved over or national forests sold to the highest bidder. Any successful and comprehensive reform must have a perspective that is not threatening to the widespread concerns of citizens—and that positive approach to achieving the nation's social priorities must be translated into reality.

[T]he various parties to the regulatory debate should recognize that the American people believe there is a legitimate need for government regulation to achieve economic and social goals of high priority to the nation.

In that spirit, the various parties to the regulatory debate should recognize that the American people believe there is a legitimate need for government regulation to achieve economic and social goals of high priority to the nation. There are many areas in which regulation is accepted without question. Airline safety is an obvious example; the public is reassured by the licensing of pilots. Similarly, restrictions on child labor in the United States are no

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longer controversial. Agencies such as the Environmental Protection Agency (EPA), the Equal Employment Opportunity Commission (EEOC), the Food and Drug Administration (FDA), the Federal Trade Commission (FTC), and the Occupational Safety and Health Administration (OSHA) may be viewed as bureaucratic and burdensome "alphabet soup" by those subject to their rulings, but the public at large strongly supports continuing government involvement in their areas of responsibility. Serious shortcomings in market outcomes and in the conduct of business often generate or increase public support for government intervention in private-sector decision making.

The writing of the specific statute, which has been largely ignored by most organized efforts at regulatory reform, is usually the most important action in what is an extended rule-making process

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However, the process of regulation—the way in which a national priority or concern is translated into a specific rule—is not widely understood. It does not begin when a government agency issues a ruling. Rather, it starts much earlier, when Congress passes a law establishing a regulatory agency and gives it a mandate to issue rules governing some activity. The writing of the specific statute, which has been largely ignored by most organized efforts at regulatory reform, is usually the most important action in what is an extended rule-making process. Basic defects in the enabling legislation cannot be cured by the regulatory agency concerned or anywhere else in the executive branch.

Regulations are promulgated by agencies in response to laws passed by Congress to address some perceived "market failure" or to achieve a social goal. Regulatory proceedings are not, for the most part, mere matters of procedure and conformance. Rather, they spring from the desire for clean air, safe drinking water, safe workplaces, reliable financial markets, improved medicines, and competitive industries.

Yet, achieving these desirable results is far more complicated than is commonly understood. It is not simply a matter of Congress proclaiming worthy goals or an executive branch agency promulgating rules to that effect. The regulatory process is funda-

mentally bureaucratic, with all the powers and shortcomings associated with government. Even at its best, regulation is a blunt and imperfect tool. Far too often, it imposes costs that greatly outweigh the benefits achieved, often unnecessarily.

Setting the Stage for Reform

In seriously considering the subject of regulation, an important distinction needs to be made between two types: *economic regulation,* historically used by such agencies as the Federal Communications Commission (FCC), the Maritime Commission, and two agencies which Congress has terminated, the Civil Aeronautics Board (CAB) and the Interstate Commerce Commission (ICC), and *social regulation,* performed by EPA, OSHA, and similar government agencies of fairly recent origin. The characteristics of the two types of regulation are very different and so are the ways of improving them.

Economic regulation relates primarily to such aspects of business as prices, profits, entry, and exit. Typically, an agency or commission regulates a specific sector of the economy, such as transportation, communications, utilities, or banking. Social regulation, in contrast, is characterized by the use of agencies organized along functional or issue lines (ecology, discrimination, product safety) rather than industry categories. Many of these agencies have power to regulate across all industries, although their jurisdiction is limited to one aspect of business activity.

Since the 1970s there has been a strong and consistent effort to reform or eliminate economic regulations where competition adequately serves the public interest. Thus, the CAB and the ICC have been terminated; the Securities and Exchange Commission (SEC) no longer regulates brokers' commission rates; and the FCC is beginning, somewhat fitfully, to let competition replace rate regulation in the rapidly changing telecommunications industry.

The staffing of federal economic regulatory agencies (nearly 30,000 persons in 1997) is dwarfed by the much larger array of inspectors, reviewers, and other officials of federal agencies engaged in social regulation (almost 94,000 in number). However, there has been no sustained effort to reduce social regulations. On the contrary, the recent tendency has been to *expand* the scope of this activity.

In some cases, citizens become so used to regulation that they forget the value of marketplace competition in protecting consumers. For decades, regulation by the ICC was accepted by the truck-

ing industry as a fact of life. But since the effective dismantling of these controls in the early 1980s, thousands of additional firms have entered this market, and the cost of transporting goods in the United States has been reduced by billions of dollars a year. The demise of the ICC goes unmourned.

Thus, substantial progress has been made in deregulating some key sectors of the economy — notably transportation, communication, and financial services — in which competition does an effective job of protecting consumer interests. The United States has enjoyed large productivity gains in these sectors relative to other industrial economies because it has successfully challenged the traditional approach of selecting regulation or public ownership for utilities and related industries and opted instead for the relatively "radical" solution of competition.

The marketplace does not function perfectly. But the relevant question in any given instance is whether it works better than regulation.

It is helpful to recall the limits as well as the advantages of reliance on the market mechanism. Marketplace competition is not an effective way of directing people to follow very specific courses of action. Control of automobile traffic provides an example. Traffic lights, stop signs, and similar command-and-control devices are an accepted part of everyday life. However, for producing changes in behavior that are less specific or that differ among individuals or organizations, economic incentives can be useful. For example, lower fees for toll bridges and toll highways during off-peak hours can reduce the road congestion facing the command-and-control traffic system at peak hours of usage. Likewise, a statutory or administrative command-and-control apparatus can set a specific level of air or water purity for society to strive to achieve, but emission fees or tradable permits can achieve this same level at lower cost than conventional regulatory control mechanisms.

The marketplace does not function perfectly. But the relevant question in any given instance is whether it works better than regulation. The response is less a matter of philosophy than of practicality. The answer can be "yes" or "no," depending on such

Table 1

Paperwork Burden Imposed on Business and Individuals by the Federal Government, Fiscal Year 1996

Department or Agency	Burden (millions of hours)
Treasury (primarily IRS)	5,347
Defense	258
Securities and Exchange Commission	189
Health and Human Services	168
Labor	154
Federal Trade Commission	146
Agriculture	112
Environmental Protection Agency	100
Transportation	91
Education	60
Justice	35
Housing and Urban Development	32
Social Security Administration	27
All other	129
Total	6,848

Source: U.S. Office of Management and Budget, *Information Management Plan of the Federal Government* (Washington, D.C.: U.S. Government Printing Office, 1996).

factors as the type of regulation and the state of technology.

The costs imposed by regulation also are often broader than many people realize. In addition to specific equipment that may have to be added to an automobile or to a production line to meet a federal requirement, the government directive may also have powerful indirect influences. A case in point is the value of time that people must spend waiting in line for permits and inspections or filling out forms.

Table 1 summarizes the estimated paperwork burden imposed by the federal government in fiscal year 1996. If we value the time of those filling out the forms very conservatively at the national average hourly earnings of about $16 an hour, the cost of the 6.8 billion hours consumed was about $110 billion. Since those actually performing much of the paperwork are likely to have earnings substantially above the average, the actual economic cost was no

doubt even higher.

The impact on consumers can be even less transparent, especially since regulations often have unintended consequences. Take the case of a federal requirement that the household ladder be made safer. Such an action not only increases the cost of the product, but may make it more difficult to use. As a result, many families may forgo purchasing this more expensive and less convenient item and stand on chairs or tabletops instead. The unintended adverse result, the reduction of safety in the home, would not be apparent from merely reading the proposed rule.

In another ironic example, the current narrow tolerance standards on pesticide residues on fresh fruits and vegetables do more than merely increase the costs of nutritious foods. A diet rich in fruits and vegetables may reduce cancer rates far more than would eliminating trace pesticides on those foods. Because the standards are so tight, many low-income persons, in particular, do not eat sufficient fruits and vegetables; these foods have become too costly. On balance, cancer rates may actually be higher because pesticide restrictions are too rigid. That unintended result only becomes apparent when we trace through the effects of the government's rule making. Clearly, the rhetorical claim that onerous regulation is always justified because "lives are more important than dollars" is far too simplistic.

On the other hand, critics of regulation must keep in mind the many instances in which regulations, sometimes with very large costs, have served the public interest. Thus, EPA's two-decade-old regulation requiring refiners to stop adding lead to gasoline was an effective way to eliminate hazardous lead particles from exhaust fumes. The costs were substantial; the rule required refiners to adopt more expensive refining techniques, since lead had been a low-cost octane booster. But these costs were exceeded by the important public health gains that resulted from lower levels of lead in the environment.

It is heartening to realize that changes in the regulatory process do not have to start at square one. The appropriate question no longer is, "Are you for or against environmental or workplace regulation?" That question has long been answered. The relevant questions relate to how those regulatory mandates are carried out—to the degree of rule making and the specific approaches directed by a statute or a government agency. Most studies of government regulation conclude that adopting sensible reforms could result in greater social benefits being achieved with the same resources now committed to complying with regulations—or equivalent ben-

efits at much lower economic cost. In this regard, regulatory failure in the public sector can be as costly as market failure in the private sector.

The Need for Change in the Regulatory Regime

Leaving aside for the moment the question of benefits (an important subject to which we shall return), the dollar costs of regulation are too large to be ignored. In the aggregate, the costs of government regulations exceed the budgetary cost of all federal domestic discretionary programs. The widely used estimate prepared by CSAB adjunct scholar Thomas Hopkins shows that complying with federal regulation cost $677 billion (or over $3,000 per capita) in 1996 and will cost $721 billion in the year 2000. Moreover, those regulatory costs fall disproportionately on small businesses; the burden of compliance for firms with fewer than 20 workers in 1992 was about 90 percent higher per employee than for companies with 500 or more workers.

From a more aggregate viewpoint, regulation impairs economic growth.

From a more aggregate viewpoint, regulation impairs economic growth. It is estimated that, when the Clean Air Act of 1990 is fully implemented in 2005, it (in combination with preexisting environmental regulation) will have reduced the nation's capital stock by four percent, increased the cost of capital by five percent, and reduced the real gross domestic product, as conventionally measured, by more than three percent. Moreover, this analysis does not include the effects of costly new air quality standards for ozone (smog) and particulates established in late 1997.

Many people find it hard to comprehend such important, but abstract, aggregate effects. For this reason, the micro analysis presented in Table 2 may be helpful. This tabulation shows how a business firm becomes subject to more and more regulation as it grows in size. Hiring a fifteenth employee, for example, means that the firm must comply with Title VII of the Civil Rights Act and

the Americans With Disabilities Act. Hiring five more people subjects the employer to the Age Discrimination Act, the Older Worker Benefit Protection Act, and COBRA (requiring the continuation of medical benefits for up to 18 months after a job termination). Expanding the firm's labor force by still another five workers brings it under the purview of the Health Maintenance Organization Act and the Veterans Reemployment Act. Some companies have stated that they refrain from increasing employment specifically to avoid becoming subject to the next level of regulation.

When the entire body of federal regulation is examined—something that is rarely done in the executive, legislative, or judicial branches—it becomes apparent that the resulting burdens of compliance are enormous. The typical business firm in this country is subject to regulation of virtually every aspect of its activity. For each box on its organizational chart, from the board of directors down to first-line management, there is at least one government agency, and often more, with the power to shape, review, change, or veto the company's decisions. In the new, global marketplace, complying with this vast array of rules handicaps American companies that compete against foreign firms with lower cost structures.

Regulatory costs, of course, are only half the equation. Were it evident that the benefits of most of the vast array of current regulations justified their economic costs, we should consider these costs well spent. But there is no sound basis for jumping to this conclusion.

It is widely acknowledged that the positive results of many regulatory activities are subject to sharply diminishing returns. Benefits may greatly exceed costs for early interventions, but subsequent actions tend to produce smaller benefits at sharply rising costs. In such circumstances, as a careful survey of environmental economics noted in 1992, "It will be quite easy . . . to enact new, more stringent regulations that impose large costs on society, well in excess of the benefits."

Recent reports on major environmental regulations reinforce these concerns. A study using the government's own regulatory impact analyses reveals that only 38 of the 83 major regulations analyzed by five major federal agencies from 1990 to 1995 met a benefit-cost standard (see Table 3). EPA leads the parade in promulgating rules whose costs exceed their benefits; 40 of their 61 regulations flunk a benefit-cost test. This, perhaps, should not be surprising given the high and often uncritical public support for environmental protection recorded in opinion polls. But the public is ill-served when new rules produce more costs than benefits.

Table 2

Escalating Federal Regulation by Number of Employees

Number of Employees	Law or Regulation	Key Provisions
1 or more	Fair Labor Standards Act	Overtime and minimum wage
	Selective Service Act	To rehire discharged veterans
	Equal Pay Act	To avoid discrimination in wages
	Immigration Reform Act	Documentation
	ERISA	Standards for pensions
4 or more	Immigration Reform Act	Documentation
10 or more	Occupation Safety and Health Act	Job safety standards
15 or more	Civil Rights Act	To avoid discrimination with regard to race, color, etc.
	Americans With Disabilities Act	"Reasonable accommodations"
20 or more	Age Discrimination	Protection against age bias
	COBRA	Medical benefits
25 or more	Health Maintenance Organization Act	Requires HMO option
	Veterans Reemployment Act	Covers military service
50 or more	Family and Medical Leave Act	12 weeks of unpaid leave
	Affirmative Action Program	Coves recipients of government contracts
100 or more	Workers Adjustment and Retraining Notification Act (WARN)	60-day notice of large layoffs

Source: *Modernizing Government Regulation: The Need for Action* (New York: Committee for Economic Development, 1998).

Table 3
Benefit-Cost Analysis of Major Regulations for Five Federal Agencies, 1990-1995

Agency*	Total	CPSC	MSHA	NHTSA	OSHA	EPA
Number of regulations	83	1	1	6	14	61
Monetized benefits exceed costs	38	1	1	5	10	21

*CPSC = Consumer Product Safety Commission;
MSHA = Mine Safety & Health Administration;
NHTSA = National Highway Traffic Safety Administration;
OSHA = Occupational Safety and Health Administration;
EPA = Environmental Protection Agency.

Source: Robert Hahn, *Risks, Costs, and Lives Saved* (Oxford University Press, 1996).

In addition to generating direct costs, regulation often retards the innovation process. Thus, reliance by the Department of Agriculture on continuous inspections instead of on modern sampling techniques discourages or delays adoption of new food safety technologies. Another example is in the treatment of new medical software that models the reaction of cancerous tumors when treated with a specific dose of radiation. The FDA has ruled that this software must be approved as a "medical device." As a result, even a slight change in computer code can require time-consuming and expensive reapproval. Yet, the FDA regulations on medical devices surely did not contemplate the inclusion of medical computer software.

The extensive regulatory reviews to which many new products are subjected in the United States inevitably raise the cost of product innovation and increase the uncertainty of financial success. However, many companies bypass these barriers to innovation by establishing research laboratories and production facilities abroad. Pharmaceutical and medical equipment firms provide striking illustrations. Companies moving to the Netherlands, for example, are not seeking a weak or ineffective regulatory environment, but one that is more flexible and efficient (nor are firms locating in Holland looking for low-cost labor).

In many instances, contemporary regulatory activity is a vestige of responses to problems that have long since passed. A clear

example is the Davis-Bacon Act, which prescribes "prevailing" wages on government construction contracts that are generally above the market wages received by other workers in construction jobs. The statute, which was enacted in the depths of the Great Depression of the 1930s, was designed to prevent sweatshop conditions in the building trades. Sixty years later, the original justification has long since disappeared, but the statute and its regulations survive in full force. Any sound economic reason to continue such wage regulation has yet to be articulated.

Another striking example of the persistence of obsolete rules is found in the administration of the Resource Conservation and Recovery Act (RCRA). EPA's Office of Solid Waste (which administers RCRA) originally placed silver on its toxic characteristic list because silver was so listed by EPA's Office of Drinking Water. However, in January 1991, the Office of Drinking Water eliminated the standard for silver because it determined that silver in drinking water had no adverse effects on humans. Yet, silver remains on RCRA's list of toxic substances. Such examples dramatically illustrate the need for periodic reviews of regulations to ensure that their original purpose remains valid and that shortcomings that emerge from the reviews be corrected.

It is easy to identify regulatory programs that have serious deficiencies and elicit widespread objections. But the problem is more fundamental than suggested by lists of silly regulations. No one sets out deliberately to create burdensome and ineffective rules. Many of the underlying statutes have created huge and unnecessary costs because Congress responded to the concerns of some citizen groups without sufficiently analyzing the problems and the proposed solutions. Powerful examples are asbestos removal and superfund legislation. The shortcomings of these laws are too serious to be brushed off by a general appeal to the universal desire for a healthy environment.

It is useful to remind Congress that it passed a sweeping law that led cities and states to spend nearly $20 billion removing asbestos from public buildings, although EPA concluded, after some research, that ripping out asbestos was an expensive and dangerous mistake: the removal effort *increased* the asbestos fibers circulating in the air. Obviously, the analysis should have *preceded* the legislation. Similarly, the congressionally enacted superfund law has turned out to be a costly bonanza for lawyers because the statute emphasized determining liability rather than reducing health risks.

Compounding the problem, many regulatory statutes, espe-

cially in the areas of environment and job safety, prohibit or severely restrict any use of economic analysis in the executive branch's rule making process. The courts have supported EPA's position that costs should not be considered in establishing air quality standards.

One universal shortcoming of standard rule making is apparent. Each statute or rule is promulgated in isolation, as if no others existed. If there is any lesson that we have learned in recent decades, it is that regulation is a powerful remedy that should be used only in situations where markets do not work adequately. Given the huge amount of regulation in force today, a compelling case can be made for economizing on the government's regulatory power. Like any strong medicine, regulation should be used carefully and with full attention to its adverse side effects.

If there is any lesson that we have learned in recent decades, it is that regulation is a powerful remedy that should be used only in situations where markets do not work adequately. Given the huge amount of regulation in force today, a compelling case can be made for economizing on the government's regulatory power.

Some people argue that regulatory review itself is costly and burdensome. Exactly the opposite is true. The United States substantially *underinvests* in information on regulatory programs and should significantly increase the resources devoted to that purpose. Government regulatory activities involve hundreds of billions of dollars annually in benefits and costs. Yet, the unelected decision makers who issue and enforce these regulations usually have little knowledge of the magnitude of their impact—especially who bears the costs and who receives the benefits. Government agencies and OMB now spend $50 million or less each year to deal with these issues. Expenditures of several times this amount on such informational and analytical activities would be fully justified.

Benefit-cost analysis can also serve broader purposes such as thinking systematically about social issues and more fully understanding the implications of selecting one plan of action over another. Alternative approaches may not involve regulatory powers

at all. However used, a careful calculation of advantages and disadvantages provides an essential discipline to improve the current arbitrary procedure.

To avoid problems inherent in placing monetary values on human lives, benefit-cost analysis sometimes can be structured in terms of lives themselves. For example, sodium nitrite, which is used to preserve food, is a mild carcinogen. Its use creates the possibility that a limited number of people will develop cancer. On the other hand, a far larger number of people would die of botulism if nitrites were not used as a preservative in meat. A comparison of the costs and benefits of restricting the use of nitrites in meats indicates that more lives are saved by its continued use. This type of comparison was the basis for the FDA's sensible decision not to ban nitrites in meat and, instead, merely to urge a reduction in their use.

The recent experiences with air bags further demonstrate that neither the benefits nor the costs of regulation need be measured in dollars but at times should focus directly on human life. The National Highway Traffic Safety Administration issued air bag standards based on automobile tests that made no distinctions about the occupants' age, sex, or height, although car manufacturers had informed the agency of the importance of this difference. As a result, children under the age of ten have experienced a net increase in fatality risk because of air bags. At least 40 children in that age group have been killed by air bags in crashes that otherwise would not typically have been fatal. In that case, the regulatory shortcoming was not an excess of analysis but a shortage of it.

Previous Attempts to Reform Regulation

A brief examination of previous attempts at reform provides a useful background for preparing recommendations to reform the regulatory system.

Since 1974 every president of the United States has attempted to improve the regulatory process. President Gerald Ford launched an effort to modernize economic regulation, particularly with respect to rate regulation of the transportation and financial industries. President Jimmy Carter maintained the momentum with the elimination of the CAB, the reduction of restrictions imposed by the ICC, and the creation of intense price competition in the financial industry. Both presidents also established formal systems to review new government regulations before they were is-

sued. Every subsequent president has carried forward this general approach. Important lessons can be learned from their successes as well as their failures.

President Ford's concerns about the inflationary impact of federal activities, especially regulation, marked the beginning of an organized, comprehensive effort at regulatory reform. His Executive Order 11821 established procedures for preparing "inflation impact statements" to illuminate the economic impact of regulatory proposals. The statements were prepared by the various executive agencies and reviewed by the Council on Wage and Price Stability.

The Ford administration focused on four reforms: (1) measuring and considering the benefits and costs of proposed regulations, (2) reducing the backlog and delays in regulatory proceedings, (3) suggesting changes in legislation under which regulatory programs operate, and (4) ensuring that consumer interests prevail in regulatory proceedings. (Because the so-called independent agencies are not subject to the jurisdiction of presidential executive orders, Ford and his staff could only try to coax them into following the spirit, if not the letter, of his directive.) With some exceptions, the agencies paid merely lip service to this initiative. Nevertheless, this basic way of performing regulatory reviews has continued under successive administrations, with revisions in the details reflecting experience gained over the years.

To formalize regulatory review, President Carter issued Executive Order 12044, replacing Ford's "inflation impact statement" with a new "regulatory analysis." For all new regulations with an estimated economic impact of $100 million or more, preparation of a regulatory analysis was required prior to the publication of the regulation in the *Federal Register*. Each analysis included a description of the proposed rule, an identification of alternative ways of achieving the policy goal, and an examination of the economic impact of the regulation. A rudimentary cost-effectiveness test was also required to enforce the requirement that "the least burdensome of acceptable alternatives has been chosen."

On balance, however, the 1970s will be remembered for an outpouring of new federal rules and an expansion of the number and size of regulatory agencies. The agencies subject to presidentially-ordered regulatory review generally considered benefit-cost analysis merely to be the final hurdle to clear *after* they had completed the regulation design.

Two procedural reforms were enacted by Congress in the last year of the Carter administration. The Regulatory Flexibility Act of 1980 required rule-making agencies to write regulations in a man-

ner that would minimize burdens on small business. Compliance was minimal. Many agencies simply attached a perfunctory statement to new rules to meet the law's formal requirements.

The second and far more useful procedural law was the Paperwork Reduction Act of 1980, which took effect after President Carter left office. The statute created the Office of Information and Regulatory Affairs (OIRA) in the Office of Management and Budget to supervise enforcement of the law's objective of reducing federal reporting requirements. Early in 1981, President Ronald Reagan expanded OIRA's mission to encompass review of regulations promulgated by executive branch agencies.

Regulatory reform was a basic component of President Reagan's economic agenda. One of his most important actions was to establish the Task Force on Regulatory Relief, chaired by Vice President George Bush, to oversee the reform effort. Executive Order 12291, issued in 1981, stated, "Regulatory action shall not be undertaken unless the potential benefits to society from the regulation outweigh the potential costs to society." The presidential directive required agencies to prepare a "regulatory impact analysis" subject to review by OIRA for each "major rule" pending. A federal agency could not publish a notice of proposed rule making until an OIRA review was complete and its concerns had been addressed.

Executive Order 12291 had two real powers: (1) It required regulatory agencies to demonstrate that the benefits of a proposed regulation exceeded the costs, and (2) it gave OIRA power to delay rule making until regulatory agencies had appropriately addressed these broader economic concerns. Another strength of the order was that it allowed OIRA to identify any rule as a major rule, not just those imposing estimated costs of more than $100 million a year.

The regulatory review process during the Reagan administration had a substantial impact, as indicated by the large number of proposed regulations returned, changed, or withdrawn. During 1981 through 1989, over 40 percent of the regulations of the Department of Labor failed, at least initially, to obtain OIRA approval. At the statutory level, President Reagan avoided new regulation. He neither proposed nor authorized a new regulatory agency or a new major regulatory program.

President George Bush continued President Reagan's reforms. The Council on Competitiveness, which replaced the Task Force on Regulatory Relief in 1989, was also headed by the vice president. Like the Task Force, the Council was authorized to review regulations with the aim of eliminating those that inhibited U.S. competitiveness, and it intervened in many specific regulatory mat-

ters. The Council's procedures were frequently criticized, especially those permitting businesses to oppose pending regulations in special *ex parte* presentations.

Presidential review of regulatory decisions was also questioned on constitutional grounds. The Bush administration's response emphasized that the Constitution empowers the president to see that laws are "faithfully executed."

The incoming Clinton administration, in 1993, rescinded the existing executive orders on regulatory review and abolished the Council on Competitiveness. Nevertheless, regulatory reform continued to have a significant place on the federal agenda.

Like its predecessors, the Clinton administration has issued formal guidelines on performing and using economic analysis, but recent rule making often appears to have honored them more in the breach than in the observance.

President Bill Clinton replaced the Reagan-Bush directives with Executive Order 12866. He reaffirmed OMB (via OIRA) as the central agency to review proposed regulations. However, the new executive order made the process more accessible to the public by requiring OIRA to identify publicly its recommended changes for regulatory actions. Under the order, OMB retains no formal power to hold up rule making or to require a demonstration that the estimated benefits of a regulation exceed its costs. Regulatory agencies have to find only that the benefits of the intended regulation "justify" its costs.

The Clinton executive order requires agencies to do many sensible things in drafting rules. They must identify alternative ways of meeting government objectives, consider benefits and costs, and use market-based alternatives and performance standards. The elimination of thousands of pages of environmental and pharmaceutical regulations is a positive result of that effort. However, new regulations have been added at such a rapid rate that they more than offset the reductions.

Like its predecessors, the Clinton administration has issued formal guidelines on performing and using economic analysis, but

recent rule making often appears to have honored them more in the breach than in the observance. In the case of EPA, the largest regulatory agency, only six of 45 "significant" rules issued from April to September 1994 contained the required determination that the benefits justified the costs, only three were based on a compelling public need, and only nine considered alternative approaches to regulating. Of the other 177 EPA rules issued during that period (including those not considered to be "significant"), none was supported by a determination that the benefits justified the costs.

Meanwhile, the aggregate federal rule-making list has grown. The April 1998 semiannual regulatory plan (an innovation instituted in the Carter administration) requires over 1,500 pages merely to list short summaries of the regulatory actions that the federal departments and agencies are working on, including nearly 250 entries by EPA alone. The staffs of federal regulatory agencies have also grown; the total of nearly 125,000 in 1996 represented a 26 percent increase from the 1985 low.

On balance, the formal systems of review put in place by presidents from Ford through Clinton has helped convince often reluctant officials of government agencies to analyze the implications of their rules before issuing them. That approach has been somewhat successful in getting regulators and their supporting interest groups to develop data on the costs and the benefits they impose on society. However, the impact of such analyses on the actual decision making of the regulatory agencies has been very limited.

Congressional Efforts to Reform Regulation

In response to the shortcomings of executive branch efforts to improve the regulatory process, many members of Congress have introduced bills to legislate generic regulatory reform. In 1995, the proposed Comprehensive Regulatory Reform Act, which would have required each regulatory agency to show a detailed benefit-cost analysis prior to issuing a major new rule, failed by one vote in the Senate. The Congressional Budget Office estimated the cost of complying with the proposed law at a modest $180 million a year (compared to the nearly $700 billion that regulation costs Americans each year).

Not all provisions of the various legislative proposals would have truly improved the regulatory process. In quite a few instances, the requirements to be imposed would have greatly complicated rule making. Although these changes would likely have slowed down the issuance of new rules, they also would have made it more

difficult to simplify or eliminate existing ones.

Some of the proposed reform bills would have required detailed analysis of any regulation imposing annual costs of $25 million or more (or an average of $500,000 a state); other versions would set the threshold at $50 million. The benefit-cost ratio of performing the innumerable studies required by such a low threshold likely would not be favorable. Critics, perhaps justifiably, charged that the federal government does not possess the analytical resources that would be required, and that such a provision would swamp any reform effort in an overwhelming paperwork burden. Two decades ago, President Carter focused the analysis effort on those rules generating costs of $100 million or more a year and President Reagan maintained that size cutoff.

Several important reforms have been legislated in recent years, nonetheless. The Unfunded Mandates Reform Act of 1995 requires federal agencies to prepare written assessments of the costs and benefits of significant regulatory actions that may result in the expenditure by state and local governments or the private sector of at least $100 million annually. Independent regulatory agencies were exempted, as were a few politically sensitive programs such as civil rights. The new law requires that an agency consider a "reasonable" number of regulatory alternatives and select the least costly, most cost-effective, or least burdensome alternative that achieves the proposed rule's objectives. The law also requires that Congress have a CBO cost estimate before taking action on such legislation.

Pursuant to the Regulatory Accounting Act of 1996, OMB issued in September 1997 a report on the costs and benefits of federal regulations. The report, prepared by OIRA, estimates the total benefits and costs of federal regulation but provides no supporting detail by agency or program. Congress has now required OMB to issue another such report by September 30, 1998. This report, if extended to include the necessary detail, could become the genesis of a regulatory budget (a mechanism to control the total regulatory costs that federal agencies impose, akin to the limits on direct agency spending set by the fiscal budget). A major stumbling block to a regulatory budget to date has been the absence of an adequate database.

A promising generic reform statute, the Small Business Regulatory Enforcement and Fairness Act (SBREFA), was passed in late 1996. Among its numerous provisions is one establishing a procedure for congressional review of major rules (those involving annual costs of $100 million or more) before they be-

come effective. Congress is given 60 days from the publication of the final rule in the *Federal Register* to review and reject it, subject to presidential veto. SBREFA also requires each regulatory agency to submit to Congress and the General Accounting Office, before the rule takes effect, a complete copy of any benefit-cost analysis.

Congress, however, has not yet used the provisions of SBREFA to challenge any major regulatory proposal. Among the notable lost opportunities was the highly debated new standards for ozone, which will produce comparatively small benefits at very high cost.

While potentially very useful, the new laws, like the presidential executive orders, focus on the middle stage of the regulatory process, when the agencies issue rules, rather than the birth stage, when Congress passes the basic regulatory statutes. In any event, it will take a strong follow-up effort by congressional leaders to ensure that government agencies take these tough new provisions seriously. To achieve the benefits envisioned by the framers of this legislation, hearings should be scheduled on every major regulatory proposal that a regulatory agency sends to Congress, and the agencies' justifications for new regulations should be subjected to rigorous congressional examination. This would require increased analytical capacity for Congress.

Proposals for Reforming Regulation

Specific proposals for reforming regulation need to be developed within a broader framework. The following four basic standards for justifying and evaluating regulation are an attempt to provide such a useful framework:

1. Regulation is warranted only when private markets do not work as well as regulation to protect citizens and consumers.

A worthy objective does not necessarily create a need for regulation. Government regulation is already a very large presence in the American economy, and clearly the American people believe that it is needed to achieve many important economic and social goals. But the ability of competitive markets to protect the public is very powerful. Therefore, the burden should be on those who would replace the market with additional regulation to demonstrate with solid information and careful analysis that the public would benefit from a further extension of government into the private sector.

2. Regulatory authority should not be exercised capriciously, and the delegation of such authority by Congress to regulatory bodies should be limited to ensure this.

Small businesses are especially vulnerable to arbitrary actions by regulators. The Wisconsin toy producer who went out of business following an erroneous report by the Consumer Product Safety Commission is a classic example of a little firm unable to cope with large bureaucracy. The agency had refused to correct its error in a timely fashion even after acknowledging the mistake — and the company lost key sales as a result.

Often, officials lack the authority to correct an error quickly, even when they would like to do so. For example, the EPA admitted it erred in listing the household antibiotic Bacitracin as an "extremely hazardous" substance. However, the agency was precluded from deleting that erroneous listing without going through the same burdensome process that it does in listing a very hazardous product.

3. Congress and the regulatory agencies should publicly and objectively evaluate the expected benefits and costs of proposed major regulatory efforts, using unbiased, professional, scientific advice. Such an evaluation also should be applied periodically to major existing regulations.

Government decision makers involved in the regulatory process necessarily perform a rudimentary form of cost-benefit analysis when they make judgments about programs, whether they know it or not. It is vital that they think hard and analytically about these important decisions, using the best available information. The regulatory process would be improved if decision makers relied more heavily on sound science, including peer review of the technical basis for new regulations. Too often, regulators are influenced more by emotional and widely publicized fears and claims of interest groups than by professional analysis. As a result, priorities of federal agencies frequently do not reflect the relative seriousness of the numerous hazards and risks to which the public is subjected.

4. Where feasible and effective, regulations should be applied with a "soft touch" that allows flexibility of response, including the use of market incentives instead of command-and-control directives.

A regulatory system based on incentives to "do the right thing" can be both more effective and less costly. In pollution control, this means changing people's incentives so that not polluting becomes cheaper and easier than polluting. This approach also is far less

onerous when government is dealing with the average citizen than the more traditional approach, which imposes highly specific and often extremely complex directives and then emphasizes seeking out wrongdoers for punishment. On occasion, simply setting performance standards may suffice, with the private sector having the flexibility to use the most cost-effective approach in achieving those standards.

The Task of Congress

The basic thrust of regulatory reform should be shifted. Virtually all reforms to date have focused on improving the way in which government agencies write regulations to carry out laws already enacted. Although this activity is useful, it ignores the compelling fact that the key decisions occur earlier in the process — when Congress writes an Occupational Safety and Health Act or an amendment to the Food, Drug, and Cosmetics Act or any other important regulatory law, usually with hundreds of pages of detailed specifications.

Each congressional committee should be required, when drafting a regulatory statute, to present estimates of the expected benefits and costs of the regulatory program in the report accompanying the legislation.

Each congressional committee should be required, when drafting a regulatory statute, to present estimates of the expected benefits and costs of the regulatory program in the report accompanying the legislation. The committee should affirm that these benefits justify the program in light of its estimated costs. Such a statement, and the benefit-cost analysis supporting it, should be required before a legislative proposal can be reported to the full House or Senate. To the extent feasible, this report should include a monetary evaluation of costs and benefits as well as a description of other advantages and disadvantages of the regulatory proposal.

The way regulatory statutes are now written frequently precludes the agencies from even considering the most cost-effective approaches. Key provisions of the Occupational Safety and Health Act, the Federal Food, Drug, and Cosmetics Act, the Clean Air Act, the

Safe Drinking Water Act, and the Superfund Act implicitly, or explicitly, prohibit the regulators from taking account of economic impacts when setting standards. Despite well-intended presidential directives, it is impossible for regulators to strike any sensible balance between the costs they impose and the benefits they generate when the basic regulatory laws prohibit costs from being considered at all.

Congress should eliminate provisions in existing regulatory statutes that prevent or limit regulatory agencies from considering costs or comparing expected benefits with costs when designing and promulgating regulations. Regulations that seek to reduce health or safety risks should be based on scientific risk-assessment and should address risks that are real and significant rather than hypothetical or remote.

Congress should establish its own professional, nonpartisan regulatory analysis organization to provide it with reliable data, including the required estimates of benefits and costs.

From time to time, Congress should enact statutes making technical corrections of provisions of regulatory legislation that are widely recognized as inappropriate or generating unintended negative consequences. The successful experience with the technical correction of tax laws provides a good model for such a process. (Of course, these problems could be minimized in the first instance if regulatory laws were written in clear and simple English.)

To help it carry out the expanded reviews of regulatory laws and rules proposed here, Congress should establish its own professional, nonpartisan regulatory analysis organization to provide it with reliable data, including the required estimates of benefits and costs. This organization could be a part of the Congressional Budget Office (CBO). This new organization also should evaluate the costs and effectiveness of existing regulatory programs. Each year it should analyze a limited number of current major regulatory programs.

The CBO itself provides a good precedent for such an organization. In carrying out their respective functions, it would be helpful if OIRA (the regulatory office of OMB) and its new congressional counterpart developed a cooperative attitude on exchanging statistical and technical information, consistent with the separation of

powers between legislative and executive branches. Such an effort would be similar to existing cooperation between CBO and OMB on budget matters.

Congress should also require OMB to continue on an annual basis its report on the costs and benefits of federal regulations, with supporting detail by agency and program. When regulatory cost data become more fully developed, Congress should establish on an experimental basis a regulatory budget for the federal government.

The Task of Regulatory Agencies

The current efforts of government agencies to examine the impact of proposed regulations before issuing them need to be strengthened. By statute, these requirements should be extended to the so-called independent commissions, such as the Federal Energy Regulatory Commission, the Federal Trade Commission, the International Trade Commission, and the Nuclear Regulatory Commission.

Congress should legislate provisions for regulatory review by OIRA similar to those contained in the executive orders promulgated by Presidents Reagan and Clinton. A firm statutory basis would help to provide continuity in this important activity. In addition, Congress should codify in a single statute a requirement that regulatory agencies analyze the impact of significant regulatory initiatives *before* they are undertaken. Such an analysis of expected benefits and costs should be made a routine part of the drafting of new regulations by the various federal agencies.

Difficulties in estimating costs and benefits should not deter efforts to analyze the impact of regulations before they are issued. For example, uncertainty about the dollar benefits of air pollution control is not primarily a problem of statistical measurement. Rather, it may mainly reflect the unpleasant fact that we are unsure how many asthma attacks will be prevented or how much agricultural crop damage will be avoided by a specific emissions reduction. Such uncertainty should be recognized in the analysis, but should not be used as an excuse to proceed without analysis.

Furthermore, in making decisions and setting priorities based on risk, agencies should use best estimates rather than worst-case projections of risk. OSHA has based occupational cancer risks on the unrealistic assumption that a hypothetical worker is exposed to the risk eight hours every day, five days a week, for 50 weeks a year for 45 years. Similarly, the EPA sometimes assumes that an individual is exposed to emissions at a distance of 200 meters from the factory, 24 hours a day, every day for 70 years.

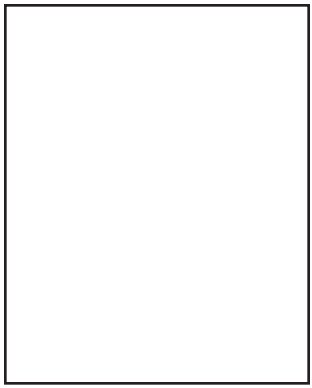
Concluding Thoughts

None of the procedural changes proposed here will succeed in truly improving the regulatory process unless they have the support of the public. It is the public that receives the benefits and pays the costs generated by the very substantial involvement of government in business decision making. Thus, the emphasis in considering these proposals should not be on the effects on either business or government—but on the American people.

Nevertheless, despite the most careful preparation, reformers must be ready for vehement criticism from defenders of the *status quo*. Ironically, when benefit-cost analysis is used to justify large government water projects, local beneficiaries rarely challenge the calculations. But when the analysis contradicts the position of active interest groups, the analysis quickly comes under attack.

A final barrier to careful analysis is the common and erroneous perception that the costs of government regulation are of little concern to citizens because they are simply "paid by business." That is not so. By and large, those costs are ultimately borne by the individual workers and consumers who make and purchase the products and services produced under regulation. Moreover, much of the rule making extends to all employers, be they profit or nonprofit, in the public sector or in the private sector. Many regulations disproportionately affect smaller enterprises and organizations. In the case of paperwork, for example, each firm, regardless of size, may have to fill out the same burdensome form.

The criticism in this report of the government's response to public concerns about worker safety, the environment, and similar issues does not imply that those public concerns are not legitimate or should be ignored. The analysis here, rather, leads to the compelling conclusion that the American people deserve better results from the very substantial amounts of resources, time, and effort devoted to government regulation than is now the case. Air ought to be cleaner, water purer and workplaces safer, at the same time that consumer living standards are higher. The motivating force for the reforms proposed here is to improve the lives of our citizens.



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Before joining Washington University, Dr. Weidenbaum served as Corporate Economist at the Boeing Company. He also served as Assistant Secretary of the Treasury for Economic Policy during the Nixon administration. In 1981 and 1982, he was President Reagan's chairman of the Council of Economic Advisers and subsequently served as a member of the President's Economic Policy Advisory Board.

Dr. Weidenbaum is the author of eight books, his latest being *The Bamboo Network* (1996). His *Small Wars, Big Defense* was judged by the Association of American Publishers to be the outstanding economics book of 1992.

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