Modernizing Government Regulation: The Need For Action

A Policy Statement by the Research and Policy Committee of the Committee for Economic Development
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The Committee for Economic Development is an independent research and policy organization of some 250 business leaders and educators. CED is nonprofit, nonpartisan, and nonpolitical. Its purpose is to propose policies that bring about steady economic growth at high employment and reasonably stable prices, increased productivity and living standards, greater and more equal opportunity for every citizen, and an improved quality of life for all.

All CED policy recommendations must have the approval of trustees on the Research and Policy Committee. This committee is directed under the bylaws, which emphasize that “all research is to be thoroughly objective in character, and the approach in each instance is to be from the standpoint of the general welfare and not from that of any special political or economic group.” The committee is aided by a Research Advisory Board of leading social scientists and by a small permanent professional staff.

The Research and Policy Committee does not attempt to pass judgment on any pending specific legislative proposals; its purpose is to urge careful consideration of the objectives set forth in this statement and of the best means of accomplishing those objectives.

Each statement is preceded by extensive discussions, meetings, and exchange of memoranda. The research is undertaken by a subcommittee, assisted by advisors chosen for their competence in the field under study.

The full Research and Policy Committee participates in the drafting of recommendations. Likewise, the trustees on the drafting subcommittee vote to approve or disapprove a policy statement, and they share with the Research and Policy Committee the privilege of submitting individual comments for publication.

Except for the members of the Research and Policy Committee and the responsible subcommittee, the recommendations presented herein are not necessarily endorsed by other trustees or by the advisors, contributors, staff members, or others associated with CED.
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*Voted to approve the policy statement but submitted memoranda of comment, reservation, or dissent. See page 34.
Government regulation of economic and social activities permeates our lives. While regulation in many instances yields important public benefits, regulations often are imposed on individuals and organizations with too little thought or analysis of what is gained in comparison with the losses incurred in time, money, indecision, and productivity. The federal government’s own data show that in far too many cases, the costs of regulation outstrip its benefits.

Further, the growth of government involvement in the market system sometimes constrains our ability to achieve fundamental economic and social goals. In today’s global economy, a country’s regulatory climate is an important competitive issue. Other leading nations — with safe workplaces and environments, but more rational, flexible regulatory structures — are becoming more attractive than the United States, as locations for production.

We urgently need a clear and studied appraisal of what we get for our regulatory efforts and how they can be improved.

Most of the recommendations in this policy statement focus on overhauling the way Congress creates regulatory law. We recommend that Congress be required to assess the likely effects of regulatory proposals before they become law and explicitly affirm that anticipated benefits justify expected costs. We also urge establishing a new office to assist Congress in these efforts. Other recommendations are designed to remove existing statutory barriers to more rational regulations and to improve regulatory review in the Executive Branch.

Fundamental reform is unlikely unless all of us, who rightly want clean air, safe products, and safe workplaces, fight vigorously for better outcomes from the enormous resources currently consumed by social and economic regulations.

A HISTORY OF CONCERN


ACKNOWLEDGMENTS

Special thanks are due to the members of CED’s Subcommittee on Reforming the Regulatory Process (see page vi) and to its chairman, Roderick M. Hills, President of Hills Enterprises, Ltd. and former Chairman of the Securities and Exchange Commission. Special thanks are also due to project director Murray Weidenbaum, Chairman of the Center for the Study of American Business at Washington University, for the thought, experience, and expertise he brought to this project.

I also want to acknowledge the important contributions of Van Doorn Ooms, CED’s Senior Vice President and Director of Research, and Andrew R. Haggard, CED Research Associate.

We are grateful to the GE Fund for its generous support of this project.

Josh S. Weston
Chairman
CED Research and Policy Committee
I. Introduction and Summary

After a comprehensive review of the structure and process of government regulation of our society and our economy, CED believes that the living standard and quality of life of Americans can be raised by improvements in the regulatory system. When modest-size firms across the nation report that regulation, rather than profitability, has become their biggest challenge, it seems clear that government decision makers need to pay more attention to this area.¹

Suppose it were proposed that Congress grant the President the authority to repair the U.S. highway system without regard to prior analysis or cost and to tax any group of citizens he wished to pay for it. Congress and the public would reject such a proposal out of hand. Yet, our regulatory procedures are often effectively conducted in just this manner. The recommendations in this policy statement would simply establish rules for regulatory accountability like those that currently apply to fiscal legislation. Congress is required to estimate the costs of proposed programs, to judge whether their benefits justify those costs, and to finance them transparently. Our regulatory arrangements should require no less.

The current debate on global warming underscores the need for promptly carrying out the recommendations presented in this report. Should the treaty on global climate change, developed at Kyoto in December 1997, be ratified, Congress should use scientific risk assessment procedures and economic analysis of the benefits and costs of new regulations that would be required to comply with the treaty. The specific recommendations presented in this report will help legislators and the public evaluate new proposals with far-ranging environmental, economic, and social consequences. Such an analysis should be done before enacting any regulatory program.

Swift action to improve our regulatory structure is also needed to respond to the regulatory reforms being adopted by other industrial nations. These reforms will increase the competitiveness of these economies, making the task of modernizing the U.S. regulatory structure even more urgent. The challenge that faces us is not to dismantle regulation, but to improve the often arcane structure that has accumulated over the years.

This policy statement presents our approach to modernizing government regulations and our recommendations for the changes required to do so. Unlike most previous examinations of regulatory reforms, which focus on the drafting of regulations in the Executive Branch, this statement emphasizes the need to revise the basic statutes governing regulation. The legislative process is the true birth stage of regulation, the point at which we have the greatest opportunity to affect the results of the entire regulatory process.

In considering regulation, an important distinction needs to be made between (1) eco-

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¹ A survey by Arthur Andersen reported in late 1994 that 52 percent of the midsize firms stated that government regulation was their biggest challenge. Only 18 percent listed turning a profit as their top concern.
omic 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 (2) social regulation performed by the Environmental Protection Agency (EPA), the Equal Employment Opportunity Commission (EEOC), the Occupational Safety and Health Administration (OSHA), and similar government agencies. The characteristics of the two types of regulation are very different and so are the ways of reforming or improving them.

Economic regulation relates primarily to such characteristics of industries 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. As Figure 1 shows, the staffing of federal economic regulatory agencies is dwarfed by the much larger array of inspectors, reviewers, and other officials of federal agencies engaged in social regulation.

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. Much existing social regulation is inefficient, often capricious, and extremely expensive. Nonetheless, CED does not believe wholesale deregulation is an appropriate response to the shortcomings of social regulation. Rather, we advocate improvements in the way these government units function that would secure the social benefits the public seeks at a lower cost.

We believe that providing better information and more relevant analysis to policy makers in some of the most controversial areas of public policy will improve the results substantially. Making more and better information available also provides a middle ground between those who seem to wish to expand regulations almost uncritically and those who seem to want to eliminate regulation entirely.

Our review concludes that all new regulatory efforts and all efforts to reform existing regulatory programs should be guided by four broad principles:

- Regulation is warranted only when markets do not work as well as regulation to protect citizens and consumers.
- Regulatory authority should not be exercised capriciously, and the delegation of such authority by Congress to regulatory bodies should be limited to ensure this.
- Congress and the regulatory agencies should publicly and objectively evaluate in some form the expected benefits and costs of proposed major regulatory efforts, using disinterested, professional scientific advice. Such evaluations should also be applied periodically to major existing regulations.
- Where feasible and effective, regulations should be applied with a “soft touch” that allows flexibility of response, including the use of market incentives, in lieu of command-and-control directives.

Our major findings and recommendations are summarized below.

FINDINGS

1. The American people overwhelmingly — and correctly — believe that government regulation is needed to achieve many important economic and social goals. Regulations spring directly from the desire for clean air, drinkable water, safe workplaces, reliable financial markets, improved medicines, and competitive industries. Government regulation is therefore a large and necessary presence in the American economy.

2. Nevertheless, the current regulatory system produces too few benefits at excessive cost. This is not well understood by the public, since the main costs of regulation are hidden from public view. Those costs show up only indirectly in the form of higher prices, diminished product variety, lower rates of innovation and productivity growth, and reduced job opportunities. A more efficient regulatory system would be both more effective and less costly.

3. A seemingly endless stream of litigation and administrative appeals that predictably delay and make uncertain many regulatory decisions has added to the burden of the regulatory environment.

4. Defects in our basic regulatory laws are the major shortcoming in the American regulatory system. Many of these statutes limit or

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3. For a graphic example involving the American Lung Association and EPA, see J. W. Anderson, “New Air Quality,” Resources (Fall 1997) p. 8.
prevent the regulatory agencies from even considering costs in the preparation of new regulations; other regulatory laws do not allow the agencies to use economic analysis to evaluate regulatory benefits and burdens or to seek the most effective, least-cost method of achieving accepted regulatory goals. This cluster of problems relates to the fact that Congress itself, in the crucial stage of writing regulatory statutes, neither performs nor uses the modest but basic methods of professional analysis that the Executive Branch agencies now routinely have available to them.

5. There is a lack of generally accepted standards of measurement of regulatory impacts and reliable data on which such measurements could be based.

6. Every president from Gerald Ford to Bill Clinton has tried to reduce the high cost of achieving our regulatory goals. While substantial progress has been made in eliminating unneeded economic regulation, efforts to reform social regulation have been disappointing. In many cases, the president’s jurisdiction does not extend to key regulatory agencies. (As noted above, a governing statute often inhibits the ability of an agency to respond to a president’s directive even if the agency is inclined to do so.) In addition, many regulatory agencies seem to be institutionally opposed to the systematic regulatory review that we believe is needed.

7. Current efforts to effect meaningful regulatory reform are severely hampered by distrust on both sides of the regulatory debate. Individuals committed to the resolution of health, safety, and environmental problems are suspicious of any effort that is seen as possibly obstructing or delaying their objectives. Individuals committed to the reduction of “big government” decry those who would proceed rapidly to address such problems with costly or ill-designed remedies. To reconcile these two polar extremes, or at least to narrow the gap between them, CED believes that better information, based on sound science and analysis, is needed in the regulatory process.

8. Congress far too often grants overly broad authority to regulators because it cannot or will not resolve major conflicts over objectives in its legislation, leaving the resolution of such conflicts to the regulators. As a result, administrators have leeway to act in a capricious fashion.

**SUMMARY OF RECOMMENDATIONS**

1. Each congressional committee should be required, when writing a regulatory statute, to articulate 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. To the extent feasible, this articulation would include a monetary evaluation of costs and benefits as well as a description of other advantages and disadvantages of the regulatory proposal. Congress should also create a statutory requirement that it use cost-benefit analysis in its consideration of regulatory legislation.* Congress could not consider regulatory legislation unless a cost-benefit analysis was available and the Committee had affirmed that the regulatory program was justified by its benefits.

2. Congress should eliminate or amend 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

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*See memorandum by JOHN DIEBOLD, (page 34).
Introduction and Summary

risk assessment and should address risks that are real and significant rather than hypothetical or remote.

3. 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 separate agency or a part of the Congressional Budget Office (CBO). This new organization also should establish a program to evaluate the costs and efficacy of existing regulatory programs; each year, it should analyze a limited number of current major regulatory programs. (Major means those that impose annual costs in excess of $100 million on society.)

4. Congress should legislate provisions for regulatory review by the Office of Information and Regulatory Affairs (OIRA), a unit of the Office of Management and Budget (OMB), similar to those contained in the executive orders promulgated by Presidents Reagan and Clinton.

5. Congress also 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, standardized to the degree deemed appropriate by OIRA, should be made a routine part of the drafting of new regulations by the Executive Branch and independent agencies and should be made public.*

6. On an established timetable that could range from five to ten years, each regulatory agency should be required to publish the objectives of its significant regulatory programs, and such stated objectives should be confirmed by legislative action.

7. We substantially underinvest in the information required for effective regulatory analysis and should significantly increase our efforts and resources to acquire it.

8. Congress should also require OIRA 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 one or two major regulatory agencies.6


6. For an illustrative example, see Harvey James, Jr., Estimating OSHA Compliance Costs (St. Louis, Mo.: Washington University, Center for the Study of American Business, October 1996).

*See memorandum by JOHN DIEBOLD, (page 34).
II.

Why Comprehensive Reform Is Necessary

We begin with a fundamental agreement. The American people overwhelmingly believe that there is a legitimate need for government regulation to achieve many 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 longer controversial. Agencies such as the EPA, EEOC, the Food and Drug Administration (FDA), the Federal Trade Commission (FTC), and 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. Shortcomings in market outcomes or the conduct of business often generate or increase public support for government intervention in private-sector decision making.

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 giving 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 can be an extended rule-making process. 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, drinkable 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 fundamentally 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 is not at its best and imposes costs that far outweigh the benefits achieved, often unnecessarily.

HOW REGULATION SHOULD BENEFIT THE PUBLIC

THE POWER OF MARKETS

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

the trucking 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.

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 “radical” solution of competition. The problem today is that economic deregulation too often bogs down in controversy and litigation before the appropriate amount of deregulation has been achieved.

It is therefore helpful to recall the advantages as well as the limits 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 that society strives to achieve, but effluent fees generally can achieve this same level at lower cost than conventional prescribed 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 answer can be yes or no, depending on the type of regulation, the state of technology, and other factors.

**BALANCING COSTS AND BENEFITS**

When a reasonable case can be made that regulation is required to supplement or replace the market, its objective should be to find a favorable balance between the advantages and disadvantages of regulatory intervention. Even when a proposed regulation appears to provide a favorable balance, there are often opportunities to achieve the same or better results at a lower cost.

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.

When officials make a reasoned decision to accept or reject a regulation, or indeed any other proposal, they are doing a benefit-cost analysis, whether they recognize it or not. Benefit-cost analysis is no more than a method to organize and discipline that decision process. In such a process, decision makers explore alternatives for achieving objectives, thereby minimizing the cost to society of reaching them. Although formal cost-benefit analyses have been performed for many years in evaluating other aspects of government activity, notably public works investments, their application to regula-

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tion is still controversial. Better public explanation of the need for the analysis is obviously necessary.

Debates over a regulatory proposal follow a standard pattern: Proponents focus on the seriousness of the problem to be addressed and the good their change will accomplish; opponents point to the costs, burdens, and other shortcomings of the proposal.

Usually, both sides have a point, and neither should be ignored. Good public policy requires identification and evaluation of the full range of advantages and disadvantages of proposals for change, be they regulatory or other uses of government power. That, at its heart, is the role of benefit-cost analysis. It is not a mechanical application of accounting and statistics, but a method for helping decision makers evaluate a new law or rule. Contrary to widespread misconception, decision makers, not benefit-cost analysts, would continue to make regulatory decisions. But those decisions would be better informed.

The fact that a given regulation imposes a burden, even a large one, is not sufficient reason to oppose it; the advantages of the regulation may far outweigh the disadvantages. Similarly, just because the same regulation may generate some desirable benefit is not cause to endorse it; there may be a far more effective way of obtaining the benefit. A useful evaluation must consider the balance between the two.

Unfortunately, not all regulatory decision making is clear cut. One important difficulty is the widespread existence of hidden and indirect costs. For example, while the FDA keeps unsafe or ineffective drugs off the market, it also delays the introduction of new and better pharmaceutical products. The visible impacts of these two consequences, however, are very uneven. The adverse side effects produced by some medicines are very visible. In contrast, a patient whose illness lingers because a better drug is delayed by the government’s review process is unlikely to be aware of that fact; the cost to the patient remains invisible. In such instances, bureaucratic delays can be literally fatal. Recently, the FDA has made significant progress in expediting reviews, but it is apparent that far more can be done.10

In many areas of regulation, opportunities abound for benefiting one segment of the society at the expense of the rest — and for doing so in a stealthy fashion. Such hidden subsidies arise particularly in traditional economic rule making, where regulators sometimes impose lighter costs on some interest group or region, with the result that heavier costs are borne by others subject to the regulation. Examples range from lower utility prices in rural areas to disproportionately low landing fees for owners of light aircraft.

The use of cross subsidies is a particularly pernicious case of such misguided regulatory action. Before the elimination of the CAB, airlines that wished to fly longer, more profitable routes such as Los Angeles to New York were required to offer shorter, unprofitable service to smaller cities. The cross-country flyers thus were effectively “taxed” in the form of higher prices to subsidize those flying shorter distances. Now the FCC is using a hidden tax on all long distance telephone calls to finance Internet access in classrooms across the country. CED believes that such programs, whatever their merits, should be financed broadly and transparently, not by hidden taxes on consumers of particular services.

The costs imposed by regulation are also 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. Figure 2 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 per 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.\footnote{11}

But 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 boxes or tabletops instead. The unintended adverse result, the reduction of safety in the home, would not be apparent from reading the proposed rule.

In another ironic example, the current narrow tolerance standards on pesticide residue 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. As a result of the tight standards, many low-income persons in particular do not eat sufficient fruits and vegetables because they have become too costly. On balance, cancer rates may actually be higher because pesticide restrictions are too rigid.\footnote{12} Clearly, the rhetorical claim that onerous regulation is always justified because “lives are more important than dollars” is too simplistic. In this case, it is simply wrong.

For many of these reasons, estimating precise benefits and costs of individual rules is difficult and thus quite controversial. (See “Advantages and Disadvantages of Benefit-Cost Analysis,” page 10.) These difficulties are accentuated by the fact that few widely accepted standards are available to guide reviews of proposed regulations. For example, how do you measure an extension of working life? How clean should the air be?\footnote{13}

Because of these difficulties, some analysts believe that benefit-cost analyses have severe limitations.\footnote{12} Rather than serving as the prime

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<td>Health and Human Services</td>
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<td>Transportation</td>
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<td>Education</td>
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<td>Justice</td>
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Benefit-cost analysis is not an abdication of human judgment, but the vigorous application of that judgment. While its techniques may sound arcane, they are widely used and routinely taught in economics courses. It is not unreasonable to ask that they be generally understood by those in positions to make $100 million policy decisions. The basic concepts are not difficult.

Benefit-cost analysis involves several technical procedures. The most important are (1) defining the scope of benefits and costs, (2) estimating the value (“willingness to pay”) to individual members of society of such benefits as reductions in risk to life and health and increases in amenities and recreational opportunities, and (3) “discounting” future benefits and costs to present values so that they can be usefully compared.

Benefits should be broadly defined and not limited to favorable effects that can be quantified. They may include significant identifiable but nonquantifiable benefits, such as increased freedom of choice for consumers and enhanced opportunities for public enjoyment of the environment. When some important aspect of a benefit cannot be quantified, the proposal should describe the benefit in some detail, explaining why it is important.

Sometimes difficulty in quantifying benefits does not reflect measurement shortcomings so much as deficiencies in the necessary underlying technical or scientific information. For example, EPA’s internal guidance for the preparation of benefit-cost analyses recognizes that valuing reduced health risks is difficult because of uncertainties about the relationship between different pollution levels and corresponding health effects.

Similarly, costs are broader than out-of-pocket expenditures by those directly subject to the rule making process. Total economic costs can include the value of time that people spend waiting in line for permits, poorer health resulting from the delay in bringing new therapeutic drugs onto the market, and the inconvenience, or worse, resulting when products are forced off the market by burdensome regulatory procedures.

Benefit-cost analysis does involve uncertainties and opportunities for subjective judgments. The most important difficulty may be that individual interests and preferences vary widely. Different people attach different values to (and are willing to pay different amounts for) cleaner lakes or safer automobiles. Such variations arise inevitably from differences in income, occupation, age, abilities, health status, and tastes. Any estimate of society’s benefits and costs from a uniform government rule will, to some extent, obscure these differences.

However, these and related criticisms of benefit-cost analysis miss the central point: The problems arise not from the measurement of benefits and costs, but from the nature of regulation itself. To say that individual preferences differ in ways a single benefit-cost assessment cannot capture is the same as saying that a uniform government rule will necessarily be too strict and costly for some people and too lenient and cheap for others. Averaging and approximation are inevitable when government regulates. The question is how to strike the best balance. Benefit-cost analysis is not intended to provide a final answer, but to frame the debate in a useful and productive way.

SOURCE: Based on testimony of Christopher DeMuth, American Enterprise Institute, and Paul Portney, Resources for the Future, before the Senate Committee on the Judiciary, February 8, 1995, with modifications by CED.
basis for regulatory decisions, such analysis, in this view, should serve broader purposes such as thinking systematically about social issues, forcing the collection of relevant data, and especially, clarifying the implications of decisions. For example, rather than serving as the basis for determining whether a hazardous product should be banned, benefit-cost analysis would be used to examine the various effects resulting from such an action, thereby providing valuable new information to the policy maker. In the process, the analysis may stimulate efforts to develop alternative approaches to the problem, which may or may not involve regulatory powers. But, however used, a careful calculation of benefits and costs 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. 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.14

The recent experiences with air bags demonstrate that neither the benefits nor the costs of regulation need be measured in dollars but can refer to human lives. The National Highway Traffic Safety Administration issued air bag standards based on automobile tests that made no distinctions about the occupant’s age, sex, or height. 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.15

Where benefits are especially hard to measure but certain to exist, it is important to have reliable cost data to determine the most cost-effective measures. Choosing between regulatory methods by comparing their costs to customers and producers is a more limited approach than cost-benefit analysis but can still be very useful. Cost-effectiveness approaches have been applied successfully to areas ranging from defense procurement to health programs.

**BARRIERS TO BALANCING BENEFITS AND COSTS**

The political appeal of regulation creates an obstacle to the dispassionate scrutiny of attractive-sounding proposals. After all, who can oppose a standard that is described as providing the consumer with safer products? Regulation usually is politically popular because it enables legislators and regulators to claim credit for its benefits, such as ridding the society of some hazard, while ignoring the heavy but hidden or widely diffused costs of compliance. Those costs appear in no government budget. Instead, they are buried invisibly in the higher prices of goods and services paid by those same consumers and voters.

As a related matter, one serious problem in any effort to reform regulation is that the mere suggestion of change is likely to generate emotional counterattacks. The most carefully constructed and well-grounded analysis can antagonize citizen groups, who 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 widespread citizens concerns. Reform must therefore transcend the technicalities of benefit-cost analysis and speak clearly to basic public goals.

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Nevertheless, despite the most careful preparation, reformers must be ready for vehement criticism from defenders of the status quo. Of course, when benefit-cost analysis is used to justify large government water projects, local beneficiaries rarely challenge the calculations. But when the analysis does not support 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 because they are simply “paid by business.” In general, 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. Regulation can be as burdensome for a school or hospital as for a steel mill or a chemical plant. In addition, because there are substantial economies of scale in complying with many regulations, smaller enterprises are often disproportionately affected. In the case of paperwork, for example, each firm, regardless of size, may have to fill out the same form.

### WHEN REGULATION FAILS

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. Our review has convinced us that greater social benefits could be achieved with the same resources now committed to complying with regulations. In this regard, regulatory failure in the public sector can be as costly as market failure in the private sector.

### REGULATION’S COSTS

Leaving aside for the moment the question of benefits, 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. One widely used estimate indicates 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 (see Figure 3). Moreover, those regulatory costs fall disproportionately on small business; the burden of compliance for firms with fewer than 20 workers in 1992 was about 90

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16. These cost estimates cover a wide variety of regulatory activities ranging from environmental controls to import restrictions. The measured impacts are also quite broad, including both direct resource use and wealth transfers. See Thomas D. Hopkins, Regulatory Costs in Profile (St. Louis, Mo.: Washington University, Center for the Study of American Business, 1996), p. 6.
percent higher per employee than for companies with 500 or more workers.

It is often noted that regulation impairs economic growth.\(^\text{17}\) It is estimated that when the Clean Air Act of 1990 is fully implemented in 2005, it (in combination with other 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.\(^\text{18}\)

Many people find it hard to comprehend such important but abstract and aggregate effects. For this reason, the more micro analysis presented in Figure 4, page 14 may be helpful. This table 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 upon 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 burden is enormous. The typical business firm in this country is subject to regulation of virtually every aspect of its activity. For every 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 different and often much 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 this does not appear to be the case. Although the recent OMB Report to Congress on the Costs and Benefits of Federal Regulations estimates that the total annual benefits of all federal regulations in 1997 exceeded their cost, this tells us little about whether the marginal regulatory interventions adopted recently provide net benefits, which is the relevant question.\(^\text{19}\) It is widely acknowledged that the net benefits from 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.”\(^\text{20}\)

Recent analysis of major environmental regulations reinforces these concerns. A study using the government’s own regulatory impact


analyses (RIAs) reveals that only 38 of the 83 major regulations analyzed by five major agencies from 1990 to 1995 met a benefit-cost standard, and only 23 of 54 final rules did so (see Figure 5, page 15).21

REGULATION AS AN OBSTACLE TO INNOVATION AND COMPETITION

The innovation, cost reductions, and competition that result from rapidly changing technology and markets may be impeded by outmoded statutes and regulations. Thus, the reliance by the Department of Agriculture on continuous inspections instead of on modern sampling techniques has discouraged or delayed the adoption of new food safety technologies. Another example is new medical soft-

21. The analysis monetized costs and benefits where possible when the agency analysis had not done so. The agencies found monetized benefits greater than costs for only 17 rules in total and 9 final rules. The large variation in agency methodology and data indicate the need for a standardized methodology, stronger Executive Branch review, and the non-partisan regulatory analysis organization to assist Congress that are called for in this report.
ware 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
requires time-consuming and expensive
reapproval. Yet, the FDA regulations on medi-
cal devices surely did not contemplate the in-
clusion of medical computer software. 22

The extensive reviews to which many new
products are subjected in the United States
evitably raise the cost of product innovation
and increase the uncertainty of its financial
success. Many companies bypass these barriers
to innovation by establishing research labora-
tories and production facilities abroad. Phar-
maceutical and medical equipment firms pro-
vide striking illustrations. 23 This movement
overseas should stimulate the proponents of
tough regulation to take a hard look at their
approach. Companies moving to the Nether-
lands, for example, are not seeking a weak or
ineffective regulatory environment, but one that
is more flexible and efficient.

Ironically, older companies that have mas-
tered the intricacies of government rules often
find that regulatory barriers can be useful in
keeping out new competition. In these circum-
stances, the regulatory battle can become a
struggle between the “ins” and the “outs.” A
classic product of such a struggle is the provi-
sion in the Clean Air Act that mandates the use
of expensive scrubbers even if the utility uses
expensive “clean” coal. That provision was
championed by the regions producing cheaper
but dirtier coal, which had to be scrubbed to
meet the Clean Air requirements. The univer-
sal requirement for scrubbers was far more a
regional cross-subsidy from clean to dirty coal
producers than a true environmental action.
Unfortunately, the beneficiaries of regulatory
action often are aware that markets work all
too well, and they therefore support the con-
tinuation of regulations that restrain their com-
petition.

THOUGHTLESS OR
OUTMODED RULES

Examination of these larger economic ef-
fects should not preclude consideration of the
arbitrary and thoughtless nature of certain in-
dividual regulations. A case in point is the or-
der by regulators requiring a Kansas City bank
to put a braille keypad on a drive-through ATM
— to be installed on the driver’s side. 24 Yet
another example is a federal law prohibiting
home builders from installing toilets that hold
more than 1.6 gallons of water. This statutory
provision, instead of conserving water, often
requires using two or three flushes to get the
job done — quite apart from the question of

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24. Bonar Menner and Dan Margolies, “Regulatory Overkill is Pushing America’s Businesses to the Brink,” Kansas City Busi-
why water should be singled out among consumer goods for regulation.25

Of more serious economic impact are the rules of the Department of Agriculture requiring farmers to dispose of millions of pounds of peaches, nectarines, and other good fruit because they are smaller than federal standards permit. As a result, food that could be sold or given away to the needy is left to rot. Sadly, these examples of appalling regulations are not unique.

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, 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. No sound economic reason to continue such wage regulation has been 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 review of regulations to ensure that their original purpose remains valid and a more efficient process for eliminating, correcting, and simplifying those that require it.

**INSUFFICIENT OR DEFICIENT ANALYSIS**

Although the most critical part of the regulatory process occurs when Congress enacts statutes under which regulatory agencies operate, this crucial legislative stage is completely exempt from any requirement to examine the potential impact or effectiveness of the proposed law. None of the recent legislative proposals to enact generic regulatory reform contained any provision for Congress to include such reviews in its deliberations.

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 did not sufficiently analyze the problems and the proposed solutions before taking action. 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 because the removal effort increased the asbestos fibers circulating in the air.26 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 bill effectively

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emphasized the determination of liability rather than the reduction of pollution.\(^{27}\)

Compounding the problem, many regulatory statutes, especially in the areas of environment and job safety, prohibit or severely restrict any use of economic analysis in the Executive Branch’s rulemaking process. For example, in two related decisions the Supreme Court interpreted the underlying statute as precluding the use of cost-effectiveness criteria in the development of OSHA regulations.\(^{28}\)

Along the same lines, the Clean Air Act has been interpreted to prohibit EPA from considering costs of any kind, much less using benefit-cost analysis, in setting air-quality criteria. However, while the Toxic Substances Control Act authorizes EPA to impose controls on a chemical if it poses an “unreasonable risk of injury to health or the environment,” it also requires that EPA take account of the economic disadvantages of eliminating or restricting the availability of the chemical.\(^{29}\)

These limits placed by statutes on Executive Branch review place the agency heads in an impossible situation. The situation is now worse than the quandary that faced an incoming administrator of the EPA in the late 1970s: “He found his hands were tied. Of approximately 125 regulations under development, all but a few were specifically required by a statute or by a court order interpreting a statute.”\(^{30}\)

Thus, it is often futile for the president to direct a regulatory agency to choose the most cost-effective approach. This is especially the case when the governing statute closely prescribes the specific actions to be taken, which may be far from the most cost-effective approach. The byzantine requirements and timetables of the almost 800 pages of the Clean Air Act Amendments illustrate the problem. It was easy to forecast that the Clean Air Act would create a litigation bonanza. Serious analysts inside and outside the government quickly noted the enormous burdens that would be imposed by many of the detailed provisions, and especially by unrealistic timetables and deadlines.

Analysts at Resources for the Future showed in 1990 that the pending Clean Air Act Amendments would flunk the simplest benefit-cost test: the high end of the range of estimated annual benefits ($6 to $25 billion) was below the low end of the range of annual costs ($29 to $36 billion).\(^{31}\) Analysis done at the President’s Council of Economic Advisers came to the same conclusion. Although critical to the bill being debated, this basic analysis was ignored in the rush to enact the legislation because there was no requirement that Congress consider any such analysis.\(^{32}\)

Another regulatory shortcoming results from proliferation of uncoordinated and overlapping statutory authority and administrative rule making. A dozen federal agencies, ranging from the Department of Labor to the Nuclear Regulatory Commission (NRC), have different definitions of hazardous substances and different inspection standards for packaging these substances. Each refuses to accept the standard of another as legitimate. As a result, compliance is needlessly difficult.

One universal shortcoming of standard rule making is apparent. Each statute or rule is promulgated in isolation, as if no others ex-

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isted. As noted above, when EPA sets standards under the Clean Air Act, by law it may consider only health as a criterion in setting permissible pollution levels, with no regard to costs. Neither can it consider alternative, more effective approaches to improving health, nor even the other forms of pollution generated by compliance. The problem is illustrated graphically by the artificial lakes of sludge generated by the scrubbers required to clean the air.

Ironically, the governing statute at times requires ignoring important potential benefits of regulation. For example, under the Community Right-to-Know Act (a section of the law that established the Superfund), companies must publicly report the amount of their emissions each year. Such information has led many companies to step up their pollution control efforts. However, government agencies are exempt from the reporting requirement, even though some of them are the biggest polluters in the nation. The benefits achieved by the Community Right-to-Know Act would be increased if its requirements were extended to the public sector. This leads to a more general point. The costs and potential benefits of government regulation are not restricted to business; they extend to the nonprofit sector of the economy as well as to portions of the public sector.

One glaring deficiency is the inherently limited scope of Executive Branch review of regulations. This review has been established by executive order rather than statute, so that a future president may eliminate these reviews. Of more immediate concern, however, is the fact that independent regulatory agencies are generally exempt from this process, although they may voluntarily choose to follow some of the procedures. In practice, this means that large bodies of federal regulation are beyond the purview of reform efforts—those of the FCC, Federal Energy Regulatory Commission (FERC), FTC, International Trade Commission (ITC), National Labor Relations Board (NLRB), NRC, SEC, and Federal Reserve Board.

Many regulators, whether subject to presidential directive or not, appear to be out of sympathy with reform, or at least very suspicious of the results of economic analysis of their programs. Out of habit and protective instinct, the agencies follow bureaucratic, inefficient procedures within a legalistic mind-set that has been called “the death of common sense.” It will take a basic change in the culture of federal regulatory agencies, and of their congressional and private-sector supporters, to develop an atmosphere that welcomes new regulatory approaches in lieu of simply expanding existing regulations.

Moreover, experienced government officials are proficient at offering lip service to circulars issued by OMB to implement presidential policies. The ritual presentation of some perfunctory economic analysis enables agencies to ignore the spirit of the effort while still meeting formal requirements. When the General Accounting Office (GAO) examined the 23 regulatory analyses performed by EPA under the Clean Air Act from 1991 to 1995, it found that 12 did not assign dollar values to estimated benefits, 6 did not make the required comparison of alternatives, and 8 did not specify key economic assumptions such as the discount rate.

HEAVY HAND AND SOFT TOUCH

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 regulation. Like any strong medicine, regulation should be used carefully and with full attention to its adverse side effects.

34. See testimony of L. Nye Stevens of the General Accounting Office to the U.S. Senate Committee on Governmental Affairs, Washington, D.C., September 12, 1997.
The appropriate regulatory response to serious shortcomings of the marketplace or society lies within a range of alternatives along a spectrum, with the reporting of information at one end and traditional directive rule making at the other. Intermediate positions include a variety of mechanisms which involve the use of the price system, such as pollution taxes and emissions trading.

In many instances, regulatory objectives can be achieved without resorting to traditional command-and-control interventions. For instance, a requirement for disclosure of information of point source pollution from industrial plants or surgical procedure success rates from hospitals, can often produce the desired changes in behavior and outcomes by informing consumers and citizens groups. Each organization will have both an incentive to seek improvements and the flexibility to achieve them in the most cost-effective manner. While information disclosure is obviously not adequate to deal with all problems, it should be considered a first step, or the lightest touch of a government agency addressing a regulatory problem.

Command-and-control regulation creates an appearance of certainty and fairness. The result is decreed; everyone must obey the rule. Yet, the results are often disappointing. Consider the numerous times that Congress has postponed the effective date of some tough new environmental rule after experience has shown that attaining the narrowly defined goal is infeasible. In contrast, relying on the market provides less apparent certainty because it is difficult to forecast specific outcomes. Yet, the direction of change is generally clear. For example, raising landing fees at a major metropolitan airport will divert some traffic to less congested nearby airports, but to an undetermined degree. If implemented, incentives subsequently can be adjusted in light of new information to achieve desired results. Such adjustments are much more difficult to make under a command-and-control regime.

Other flexible approaches can also play a useful role. For example, tradable permits represent an alternative way of attaining a desired level of environmental cleanup at lower costs than the more traditional method of relying on quantitative controls (see “Using Tradable Permits,” page 20). The more incentive-oriented economic approaches also encourage the development of new technologies that can achieve society’s objectives with less disruption and delay or more effectively. We must recognize, however, that even these incentive approaches are normally accompanied by a substantial regulatory component. For example, the government sets specific allowable pollution levels in the trading of sulfur dioxide permits.

The regulatory shortcomings cited here are becoming more apparent as our society spends many billions of dollars annually to secure limited improvements. When combined with the high overall cost of regulation, they underscore the need for reform.

To restate a fundamental but overlooked point — economists breathe the same air and drink the same water as everyone else. Their criticism of the government’s response to public concerns about worker safety, the environment, and similar issues does not imply that those legitimate public concerns should be ignored. It rather suggests — and this may be the most compelling reason for this CED statement — that the American people deserve better results from the resources, time, and effort devoted to government regulation. Our air ought to be cleaner, our water purer, and our workplaces safer, at the same time that our consumer living standards are higher.
USING TRADABLE PERMITS

Emissions trading is the major concession to economics in the Clean Air Act Amendments of 1990. The approach relies on the fact that individual companies can usually devise less costly ways of reducing their pollution through changes tailored to their specific situations than government regulators can by using across-the-board requirements. The Act’s emissions trading policy for sulfur dioxide emissions is an attempt to take advantage of this fact by creating markets in de facto “rights to pollute.” Trading of emissions rights concentrates air pollution control efforts on those emissions sources that are cheapest to control, thereby reducing overall costs. If one company can reduce emissions more cheaply than another, both can benefit if the former purchases emissions rights from the latter.

Emissions trading can result in substantial economic gains, in the form of reduced compliance costs for business, with almost no negative effect on the environment. The basic unit of currency for emissions trading is the one-ton emission reduction credit. Credits are created when pollution sources such as public utilities reduce their emissions below the levels allowed by their permits. These reductions can be achieved in a variety of ways; burning cleaner fuel, installing new control equipment, or shutting down a polluting facility altogether. Emissions allowances may be bought, sold, or banked like any other commodity. If a utility holds surplus allowances, it may sell them to units whose emissions levels exceed their allowance supply, or it may save them for use in future years.

The market for pollution credits has been developing. The volume peaked at 16.7 million credits traded in 1995 and has generally been in the range of 8 to 10 million a year. The typical price per ton-credit has declined substantially, from $600 in 1990 to $110 in 1997. Overall, the usefulness of this approach has been demonstrated quite clearly.

Illinois Power saved $91 million by purchasing allowances instead of installing scrubbers, and Wisconsin Electric Power saved almost $90 million by avoiding the need for scrubbers. This positive trend is continuing. Duke Power has projected savings of $300 million. Clearly, the new flexibility in the air pollution control law has eased the burden of complying with EPA standards. In 1997, the New York State government found an interesting use for the pollution credits it possessed. It offered them as an attraction to a glass manufacturer who wanted to build a new factory in the state.
III. Previous Attempts at Reform

Past efforts to reform the process of writing regulatory laws and implementing regulations have failed or fallen short. This has been due principally to lack of public support or insufficient oversight on the part of the legislative and Executive Branch leadership. In this policy statement, we recommend innovations in the regulatory process that will promote important social goals as well as economic efficiency and long-term growth. A brief examination of previous attempts at reform provides a useful background for these recommendations.35

LESSONS FROM THE PAST

Since 1974, every president has attempted to improve the regulatory process. President Ford launched a bipartisan effort to improve economic regulation, particularly with respect to rate regulation of the transportation and financial industries. President Jimmy Carter continued that effort with the elimination of the CAB, the reduction of restrictions imposed by the ICC, and creation of intense price competition in the financial industry. Each of these presidents also established a formal system to review new government regulations before they were issued. 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 (CWPS).

President Ford 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 tried to coax them into following the spirit, if not the letter, of his directive.) With some exceptions, the agencies paid only lip service to this initiative. Nevertheless, this general approach to regulatory review has continued under successive administrations, with revisions in the details reflecting experience gained in conducting the reviews.

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, presentation of a Regulatory Analysis was required prior to the publication of the regulation in the Federal Register.

35. The cause of regulatory reform has been advanced in recent years by a variety of detailed analyses that deal with some but not all of the issues discussed in this statement. See Toward Smarter Regulation (Washington, D.C.: The Business Roundtable, 1995) and An Agenda for Federal Regulatory Reform (Washington, D.C.: American Enterprise Institute and Brookings Institution, 1997).
Each Analysis included a description, an identification of alternative ways of achieving the policy goal, and an analysis 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.”

By the end of the 1970s, some agencies appeared to be warming to the concepts advocated by regulatory reformers. In order to quantify the benefits of regulatory actions, OSHA began employing economists in 1978. Although OSHA was not required by statute to consider benefits and costs when developing regulations, it attempted to do so. (However, the Supreme Court ruled in 1981 that the law required OSHA to use feasibility rather than cost-benefit analysis as a basis for regulation.)

On balance, the 1970s will be remembered for an outpouring of federal rules and an expansion of regulatory agencies. The employee head count at federal regulatory agencies rose from fewer than 70,000 in 1970 to almost 122,000 in 1980. More substantial progress toward regulatory process reform came later, when cost-benefit analyses became mandatory (at least nominally) for Executive Branch agencies and were incorporated into the regulation-design process.

Although the reform efforts of Presidents Ford and Carter encouraged weighing the costs and benefits of proposed regulations, the final authority for rule promulgation remained with the regulating agency. There was no requirement to refrain from promulgating a regulation whose costs exceeded its benefits.

Economic impacts were not systematically considered during the design of a regulation nor during the preceding legislative process. No president, of course, could unilaterally correct such a fundamental legislative shortcoming. In addition, independent regulatory agencies, such as the FTC, were not subject to presidential directives. The federal agencies that were subject to presidentially ordered regulatory review generally viewed cost-benefit analysis merely as 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 manner 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 act 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 Reagan used an executive order to expand 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 the establishment of 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 for each “major rule” pending, subject to review by OIRA. 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: It required regulatory agencies to demonstrate that the benefits of a proposed regulation exceeded the costs, and it gave OIRA power to delay rule making until regulatory agencies had appropriately addressed broader economic concerns. Another strength of the order was that it allowed OIRA to identify any rule as a major rule.
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. The Department of Labor was especially affected. From 1981 to 1989, over 40 percent of its regulations failed, at least initially, to obtain OIRA approval. At the statutory level, President Reagan’s major accomplishment was the avoidance of new regulation. He neither proposed nor authorized a new regulatory agency or new major regulatory program. With respect to procedural reforms, the Reagan Administration promoted an effort to accelerate FDA drug approvals and revisions in the enforcement procedures of EPA and OSHA.

President George Bush deviated little from President Reagan’s reform program. 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 matters. The Council on Competitiveness’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 president’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 agenda, as President Clinton replaced the Reagan-Bush directives with Executive Order 12866. President Clinton 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.36

President Clinton’s 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, many of the eliminations were perfunctory, covering regulation of products no longer sold. New regulations have been added at such a rapid rate that they more than offset the reductions.37

Like its predecessors, the Clinton Administration has issued extended 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. For example, in the case of EPA, the largest regulatory agency, only 6 of 45 “significant” rules issued from April to September 1994 contained the required determination that the benefits justified the costs, only 3 were based on a compelling public need, and only 9 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 rulemaking list has grown. The April 1997 semiannual regulatory plan (an innovation instituted in the Carter Administration) requires

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36. A determination that the benefits “justify” the costs does not require that measured benefits in fact exceed the costs.

1,466 pages merely to list short summaries of the regulatory actions that the federal departments and agencies are working on, including 225 entries by EPA alone. The staff of federal regulatory agencies has also grown; it totaled 124,915 in 1996, a 26 percent increase from the 1985 low. At the same time, as shown in Figure 6, there has been a recent significant slowdown in the pace of regulatory review by OMB.38 Insufficient power for direct oversight, review, and systematic analysis of all regulatory programs allows the current situation to persist.

On balance, the formal systems of review put in place by presidents from Ford through Clinton helped convince often reluctant officials of the 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 consider the costs and the benefits they generate for society. Also, the public has begun to realize that regulations have disadvantages as well as advantages. For example, when EPA in 1996 issued for comment preliminary new rules governing ozone and particulate matter emissions (smog and soot, to use everyday terms), the news media pointed out the higher gasoline prices and utility bills as well as health benefits expected to result from them. Such balanced coverage is fairly new on the environmental policy front.

**RECENT CONGRESSIONAL ACTION**

Over the years, a number of bills have been introduced in Congress to legislate generic regulatory reform. In 1995, the proposed Comprehensive Regulatory Reform Act, which required each regulatory agency to show a detailed cost-benefit analysis prior to issuing a new rule, failed by one vote in the Senate. CBO estimated the cost of complying with the proposed Act at a modest $180 million a year.

Not all provisions of the proposed generic reform bills would have truly improved the regulatory process. In many instances, the requirements imposed by these proposals would have greatly complicated rule making. Although these requirements would likely have slowed down issuance of new rules, they also would have made it more difficult to simplify or eliminate existing ones.

Under some of these proposals, nongovernment, scientific peer review panels would be given power to delay issuance of new regulations if the panels disagreed with the underlying science. Although attractive in concept, such a change would give considerable public power to those neither elected nor appointed. Nevertheless, we believe that government decision makers should be encouraged to use sci-

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38. Figure 6 covers both regulations classified as "economically significant" and other regulations. The number of economically significant regulations reviewed declined from 138 in fiscal 1994 to 80 in each of the two following years.
cientific analysis, including the results of such panels, in their own deliberations.

Some of the proposed reform bills would require detailed analysis of any regulation imposing annual costs of $25 million or more (or an average of $500,000 per 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 would not be favorable. The federal government does not possess the analytical resources that would be required, and such a provision would swamp any reform effort in an overwhelming paperwork burden. In 1981, when prices were substantially lower, President Reagan focused the effort on those rules generating costs of $100 million or more a year. This underscores the point that the administrative feasibility of regulations and the regulatory process deserves far more consideration than it has received to date.

Nevertheless, some important changes have been legislated in recent years. 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 the 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 the 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 little supporting detail by agency or program. Congress has now required OMB to issue another such report by September 30, 1998. As noted in Chapter IV, this report, if extended to include the necessary detail, could become the genesis of a regulatory 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 become 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 GAO, before the rule takes effect, a complete copy of any cost-benefit analysis. Congress has not yet used the provisions of SBREFA to challenge any major regulatory proposal.

While potentially very useful, the new law, like the presidential executive orders, focuses 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. 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, as recommended in Chapter IV.

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40. Alternatively, a major rule is defined as one that OMB finds likely to result in a “major” increase in costs or prices or which will have “significant” adverse effects on employment, productivity, innovation, or competitiveness.
IV. 
CED's Recommendations

CED believes that Congress, acting with a strong bipartisan consensus, must create and institutionalize a more sensible and lasting statutory basis for governing regulatory programs. It should do so by establishing a reasonable framework for carrying out regulatory efforts and by rewriting statutes that seriously affect existing regulatory programs. The recommendations presented in this chapter should be applied both when considering new regulations (such as those required to implement any global climate change treaty) and when reviewing the existing body of regulatory laws and rulings.

BASIC GUIDELINES FOR REFORM

To guide our examination of government rule making, it is useful to keep in mind four basic standards for justifying and evaluating regulation:

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

We must begin from the premise that a worthy objective does not necessarily create a need for regulation. Government regulation is a large and necessary presence in the American economy, and the American people overwhelmingly and correctly 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. The burden is on those who would replace the market with regulation to show with solid information and careful analysis that the public would benefit.

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; the agency had refused to correct its error in a timely fashion even after acknowledging the mistake. In other agencies, 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 in some form the expected benefits and costs of proposed major regulatory efforts, using disinterested, 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 cost-benefit analyses when they make judgments about programs, whether they know it or not. It is vital that they think hard and analytically about these programs, using sound 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 hazards and risks to which the public is subjected.43

4. Where feasible and effective, regulations should be applied with a “soft touch” that allows flexibility of response, including the use of market incentives, in lieu 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 is cheaper or 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 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.

A NEW ROLE FOR CONGRESS

The basic focus of regulatory reform should be shifted. Virtually all regulatory reforms that have been initiated focus on improving the way in which government agencies write regulations to carry out laws already enacted. Although this activity is useful, it ignores the fact that the key decisions occur 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.

CED believes that each congressional committee should be required, when writing a regulatory statute, to articulate 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 an articulation, and the cost-benefit analysis informing it, should be required to permit consideration of the legislation on the floor of Congress. To the extent feasible, this articulation would include a monetary evaluation of costs and benefits as well as a description of other advantages and disadvantages of the regulatory proposal.

The way those statutes are 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 considering economic impacts when setting standards. 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.  

We also recommend that Congress 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.

Because Congress is the birthplace of regulation, the most essential reform is for that body to take the medicine that it wants to administer to the Executive Branch. Congress should create a statutory requirement that it use cost-benefit analysis in its consideration of regulatory legislation. Congress needs to determine, on the basis of reliable data and analysis, whether the regulatory objective it seeks is a “book worth the candle.” This is not a statistical question of whether the precise dollar benefit estimate exceeds the cost estimate. Rather, the intent is that Congress make an informed judgment that the benefits are worth the costs of the regulatory laws they are enacting. Such a judgment, and its rationale, should be made an explicit part of the law’s legislative history.

In writing such legislation, Congress should relate new regulatory proposals to existing federal laws and regulations to prevent different agencies from working at cross-purposes. (In this effort Congress would have the assistance of the new regulatory analysis organization described below.) It should recognize the large array of state and local rules and ordinances and attempt to minimize the conflicts and overlap that can readily occur in our federal system. Finally, legislators need to respect the limits of regulatory efficacy in an imperfect world.

Despite the urgings of various interest groups, there are directives and prohibitions that will not work even if an army of regulatory geniuses is available to carry them out.

We recommend that, from time to time, Congress enact a statute 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.) In response to the Report of the National Commission on Restructuring the Internal Revenue Service, the House has passed a bill, that provides procedures for the review of tax legislation being considered by the Congress to reduce its complexity. That approach creates a useful precedent for the enactment of the proposals in this policy statement.

A NEW REGULATORY ANALYSIS CAPABILITY FOR CONGRESS

CED recommends that Congress 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 separate agency or a part of the Congressional Budget Office (CBO). This new organization also should establish a program to evaluate the costs and efficacy of existing regulatory programs; each year it should analyze a limited number of current major regulatory programs. (Major means those that impose annual costs in excess of $100 million on society.)

The CBO provides a good precedent for such an organization. In carrying out their respective functions, it would be helpful if OIRA and its new congressional counterpart would develop a cooperative attitude on exchanging statistical and technical information, consistent with...

44. See Portney, Statement to the Senate Committee on Governmental Affairs on S.891: To Reform the Regulatory Process, p. 6.
45. H.R. 2676, Internal Revenue Service Restructuring and Reform Act of 1997, introduced October 21, 1997, by U.S. Representative Bill Archer. At time of publication, this measure had been passed by the House and was under Senate consideration.
with the separation of powers between legislative and executive branches, and similar to existing cooperation between CBO and OMB on budget matters.

The two regulatory analysis groups can draw on the experiences of OMB and CBO in serving the key decision makers on the budget. In the case of budget proposals, each committee proposal for new spending must be accompanied by an estimate of costs before it can be considered on the floor. The corresponding requirement in the case of regulation would be the inclusion of the statement affirming that the expected benefits justify the regulatory program in light of its estimated costs.

AN ENHANCED ROLE FOR REGULATORY AGENCIES

The current efforts of government agencies to examine the impacts of proposed regulations before they issue them need to be strengthened. The following recommendations are designed to enhance the role of the regulatory agencies, including the independent commissions.

We believe that Congress should legislate provisions for regulatory review by OIRA similar to those contained in the executive orders promulgated by Presidents Reagan and Clinton. 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, standardized to the degree deemed appropriate by OIRA, should be made a routine part of the drafting of new regulations by the Executive Branch and independent agencies and should be made public.

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, for example, 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. For example, 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.46

Finally, on an established timetable that could range from five to ten years, each regulatory agency should be required to publish the objectives of its significant regulatory programs, and such stated objectives should be confirmed by legislative action. This process would ensure a review of the rationale for regulatory programs, making it less likely that agencies like the ICC would outlive their useful lives by so many years.

INVESTING IN BETTER INFORMATION FOR DECISION MAKING

Good regulation requires good information. There is a lack of generally accepted standards for the measurement of regulatory impacts and of reliable data on which such measurements could be based. The absence of a common statistical base to display and compare benefits and costs of different types of regulation is a serious barrier to improvement.

It is sometimes argued that regulatory review itself is costly and burdensome. We believe exactly the opposite is true. The fact is that we substantially underinvest in needed information and should significantly increase our efforts to provide the resources to acquire it. Government regulatory activities involve hundreds of billions of dollars annually in benefits and costs. Moreover, the unelected decision makers who impose those costs usually have little knowledge of their magnitude. Government agencies and OMB now spend $50 million or less each year to determine whether resources are being devoted to the right problems, whether benefits of regulations exceed their costs, and whether regulatory objectives could be met at less expense.47 Expenditures of many times this amount on such activities would be fully justified. The objections by special interests to using facts and analysis in regulatory decision making are understandable, but not very convincing.

As noted in Chapter III, OMB has been required to prepare reports on the costs and benefits of federal regulations for 1997 and 1998. We recommend that this report be required annually and that it be extended to provide supporting detail by agency and program.

In addition, we note that the useful annual census report on the costs of compliance with environmental regulation was recently eliminated. Such information is essential for effective regulatory review. This report should be reinstated and its coverage extended to other major regulatory activities.

REGULATORY BUDGETS: INCENTIVES FOR THOUGHTFUL DECISION MAKING

The large aggregate costs imposed by federal regulation have led to proposals for regulatory budgets. The rationale is straightforward. Only the costs of operating regulatory agencies are included in the federal budget. The far larger economic compliance costs imposed on the private sector are not. Consequently, when Congress, OMB, and department managers review a regulatory agency’s annual performance, they are focusing on the tip of the regulatory iceberg.

Policy makers and the public would achieve a better understanding of regulatory burdens if it were possible to identify the economic costs generated by regulatory agencies. Such information would make clear the large public and private national resources devoted to regulatory purposes and would facilitate comparisons of the costs of alternative regulatory programs.

Like conventional fiscal budgets, regulatory budgets would display only the costs of programs, not their benefits or any calculations of “net benefits.” These cost estimates, like those of fiscal budgets, would not in themselves provide decision makers with sufficient information to set budget priorities, especially in the aggregate. However, again like fiscal budgets, regulatory budgets, by presenting administrators or legislators with ceilings on total costs, would serve a useful disciplinary function. Decision makers faced with constraints have a stronger incentive to prioritize and therefore to perform the explicit or implicit comparisons of costs with benefits required for rational decision making.

As with the existing budget system, in which both OMB and Congressional appropriators present agency heads with fiscal ceilings, these constraints would encourage regulatory administrators to identify their most effective activities and give them priority in their requests for authorization or funding. In the process, they would obtain greater flexibility to manage regulatory programs. If they wanted to expand an

47. Economist Paul Portney presents a case for spending $1 billion a year to analyze whether resources are being devoted to the right problems, whether the benefits of regulations exceed their costs, and whether the goals of federal regulatory programs could be met less expensively than is currently the case. “Portney Testifies on Regulatory Review,” Resources, (Fall 1996): 20-21.
existing regulatory effort or initiate a new one, they might have to identify lower-priority programs to be eliminated or cut back. We recommend that when regulatory cost data become more fully developed, Congress establish on an experimental basis a regulatory budget for one or two major regulatory agencies. Such a budget would place a ceiling on the costs that could be imposed by the agency’s regulations. Should this experiment prove successful, it might then be extended to a more comprehensive regulatory budget.

JUDICIAL REVIEW

A related aspect of regulatory reform concerns the role of the judiciary. Judicial review of regulatory changes has both advantages and disadvantages. On the positive side, appeals to the judiciary provide an effective remedy for shortcomings in the conduct of regulatory agencies. However, resort to the courts can result from a very different motive—to slow down or sidetrack the performance of a legitimate and appropriate government activity. The accompanying box suggests a procedural reform to address this problem without losing the substantive benefits that flow from continued citizen access to the courts. (See “A Suggested Procedural Reform,” below.)

A GLOBAL PERSPECTIVE

The regulatory reforms just described will not be easy to enact or implement, but there is an urgent reason for ambitious and timely action. Many of our leading overseas competitors are undertaking substantial reforms of government regulation to improve the efficiency of their economies. The Netherlands, for example, employs an unusual combination of voluntary agreements involving the interested parties — business, government, and citizen

48. The ceiling might be applied only to rules for which the estimated costs exceed the estimated quantifiable benefits. Exempting rules that pass a quantifiable benefit-cost test would ensure that the cost ceiling “would not stop implementation of rules that clearly are expected to improve the well-being of the average citizen.” See Robert Crandall, et. al., An Agenda for Regulatory Reform (Washington, D.C.: American Enterprise Institute and The Brookings Institution, 1997), p. 16.

A SUGGESTED PROCEDURAL REFORM

Attorney Philip K. Howard, author of The Death of Common Sense, has offered an interesting suggestion concerning judicial review of rules of a procedural nature. Cleaning up rule books is delayed by years as agencies crawl through internal proceedings believing that, unless they can prove they were extremely attentive to public comments, a court might overturn their action. Mr. Howard proposes removal of this disincentive to action by eliminating judicial review over agency processes and substituting for them periods of delay.

For proposed changes to a minor rule, regulatory agencies would publish the proposed change in the Federal Register, wait 60 days, and then implement that change without any judicial review of the process for making the change. An aggrieved party could still sue over substance — for example, that the change does not comply with the government statute — but no longer could sue over how hard the agency had thought about it.

A similar process would be followed in the case of a change to a major rule, but a longer period (six to nine months) would be allowed between the publication of the change and its implementation. This extended period of time would allow those affected by the regulatory change to seek congressional action to overturn the rule or to modify the authorizing statute. Litigation over the lawfulness of the proposed modification would not be precluded.

These seemingly modest changes would allow agencies to operate more efficiently by eliminating the trial-like processes that now precede many changes in regulations.
groups. These agreements attempt to achieve integrated pollution control, coordinating air, water, and surface regulations, in an effort to achieve an extremely ambitious set of environmental quality goals. The United States has a huge stake in an effective, flexible, and responsive regulatory system that will allow it to maintain its competitive position and achieve stronger growth and more productive, higher-paying jobs.  

As a fundamental economic matter, the increased cross-border economic integration of business generates pressure for individual nations to reduce the regulatory burdens they impose. Large and rapid improvements in transportation and, especially, communication have enabled companies to operate more efficiently and profitably in far-flung locations. They can now move their operations more rapidly than in the past to political jurisdictions that are more favorable with regard to costs and market opportunities. As a result, the interest groups favoring higher levels of regulation have been urging governments to standardize their regulatory policies. Such “deep integration” is most advanced in the case of the European Union.  

Recognizing that regulatory reform has now become an important international issue, the Organization for Economic Cooperation and Development (OECD) has recently prepared a set of common principles for reform. (See  

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50. See the CED policy statement U.S. Trade Policy Beyond the Uruguay Round (1994).  

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<tr>
<th>OECD RECOMMENDATIONS FOR REGULATORY REFORM</th>
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<tr>
<td>The Organization for Economic Cooperation and Development (OECD) in 1997 developed the following eight recommendations to guide the regulatory reform efforts of its member governments. This CED statement is consistent with the spirit and the details of the OECD report.</td>
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<tr>
<td><strong>Regulatory Principles</strong></td>
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<td>1. Adopt and maintain only regulations whose costs are justified by benefits and that attain their objectives at lowest cost, taking into account nonregulatory approaches.</td>
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<td>2. Promote competition and efficiency throughout the economy.</td>
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<td>3. Eliminate regulatory barriers to trade and investment.</td>
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<td><strong>Regulatory Processes</strong></td>
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<td>4. Systematically review, update, and streamline existing regulations.</td>
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<td>5. Estimate potential impacts and consult with affected parties before adopting new regulations.</td>
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<td>6. Create engines of reform to oversee and promote regulatory reform.</td>
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<td><strong>Supporting Policies</strong></td>
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<td>7. Expand the scope and effectiveness of competition policy.</td>
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<td>8. Identify important impacts on other public policy objectives, and develop coordinated reforms to reduce negative impacts while retaining the benefits of more efficient markets.</td>
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The OECD maintains that regulatory reform will increase productivity, lower prices, increase innovation, expand consumer choice, and ultimately raise economic growth. Member governments also see advantages to regulatory reform because it can harness the innovative forces of the private sector through the use of incentives at the same time that it improves social policy.
CED’s Recommendations

“OECD Recommendations for Regulatory Reform”). In view of the tendency of some American companies to move to Western Europe to take advantage of more flexible regulatory regimes, it would be prudent for U.S. policy makers to examine carefully their relatively enlightened systems for government regulation of business.

SOME FINAL THOUGHTS

Regulatory reform is not a program to turn the clock back by ignoring pollution, workplace hazards, and unsafe food and drugs. The problems of a complex, industrial, urban society are real and in some cases, such as food safety, may be increasing. Their importance, however, argues that they should be addressed efficiently, so that greater benefits can be secured from the resources we devote to them. The tasks that government properly undertakes should be performed well. Our current regulatory process does not meet this elementary standard.

Our proposals for change may seem incongruous with the problems we describe. We propose, essentially, that more and better information from reliable sources be provided to and used by our regulatory decision makers. This does not sound very revolutionary. However, the consistent development and use of such information in this instance would be a far-reaching step.

Furthermore, it is essential that we develop and publicize such information if we are to achieve the bipartisan consensus for reform that is needed for progress. Surely, the history of regulatory reform has been fundamentally bipartisan. Each president in the past 24 years has advanced the cause. Congressional leaders of both parties have recently introduced important legislation, including the Regulatory Improvement Act recently proposed by Senators Carl Levin (D-Mich.) and Fred Thompson (R-Tenn.).

Our recommendations will be criticized by others because it will take time for them to have the impact we seek. However, our regulatory system has been developing since our nation’s birth and will continue to evolve. It took many years for Congress to develop the internal procedures and the institutional capacity and reputation of CBO that have improved the effectiveness of the budget process. Real and sustained regulatory reform will require of us patience as well as dedication.

In addition, it would be useful to experiment with sunset provisions that go into effect if after a set number of years, objectives stated in the law or regulation are not achieved. It should be possible to state regulatory objectives in a way that allows review, after a set time period, to see if objectives have been met or if an entirely different form of regulation should be tried. Such provisions could well require hearings to review ineffective programs and perhaps suggest changes in programs before they could be renewed.

The criteria against which agency performance will be reviewed, as well as the time scale anticipated in the legislation, should also be specified in advance.
OBJECTIVES OF THE COMMITTEE FOR ECONOMIC DEVELOPMENT

For more than 50 years, the Committee for Economic Development has been a respected influence on the formation of business and public policy. CED is devoted to these two objectives:

To develop, through objective research and informed discussion, findings and recommendations for private and public policy that will contribute to preserving and strengthening our free society, achieving steady economic growth at high employment and reasonably stable prices, increasing productivity and living standards, providing greater and more equal opportunity for every citizen, and improving the quality of life for all.

To bring about increasing understanding by present and future leaders in business, government, and education, and among concerned citizens, of the importance of these objectives and the ways in which they can be achieved.

CED’s work is supported by private voluntary contributions from business and industry, foundations, and individuals. It is independent, nonprofit, nonpartisan, and nonpolitical.

Through this business-academic partnership, CED endeavors to develop policy statements and other research materials that commend themselves as guides to public and business policy; that can be used as texts in college economics and political science courses and in management training courses; that will be considered and discussed by newspaper and magazine editors, columnists, and commentators; and that are distributed abroad to promote better understanding of the American economic system.

CED believes that by enabling business leaders to demonstrate constructively their concern for the general welfare, it is helping business to earn and maintain the national and community respect essential to the successful functioning of the free enterprise capitalist system.