AN AGENDA FOR FEDERAL REGULATORY REFORM

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American Enterprise Institute for Public Policy Research and The Brookings Institution
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Executive Summary

Federal regulation has grown dramatically in recent decades, whether considered absolutely, as a relative share of the U.S. economy, or as a relative share of the output of the federal government. Businesses increasingly face an assortment of federal mandates and legal liabilities that dictate decisions about production, products, payrolls, and personnel practices.

The authors of this statement of principles believe that the current approach to federal regulation urgently needs repair. The problem is not simply that current expenditures mandated by regulation are large—on the order of $200 billion annually for environmental, health, and safety rules alone. It is rather that a substantial share of those expenditures is ineffective: as a result, more intelligent policies could achieve the same social goals at much less cost or more ambitious goals at the same cost.

We do not take the view that all regulation is bad or that all regulation is good. We should judge regulations by their individual benefits and costs, which in the past have varied widely. The important point is that, in an era when regulation appears to impose very substantial costs in the form of higher consumer prices and lower economic output, carefully assessing and weighing the likely benefits and costs of rules has become a central task of responsible government.

This primer identifies six critical problems with regu-
lation and offers eight concrete recommendations for regulatory reform. We offer this agenda for reform in hopes of engaging legislators and policymakers interested in constructive action.

Some of our recommendations, such as revising many existing laws and experimenting with a regulatory budget, may be politically difficult. But several recommendations—routine reporting of the benefits and costs of federal regulation, improving regulatory analysis, and increasing resources devoted to regulatory analysis—could and should receive serious consideration in the 105th Congress.

If Congress continues to allow regulations to be produced without much attention to their full economic consequences, there is a very real danger that the standard of living that most citizens enjoy will slowly but surely erode. If, on the other hand, Congress takes the lead in more effectively targeting regulation at the nation’s most important social problems, Americans can count on enjoying a high standard of living and continued social progress.
Introduction

Federal regulation—especially environmental, health, and safety regulation—has grown dramatically in recent decades, whether considered absolutely, as a relative share of the U.S. economy, or as a relative share of the output of the federal government. With that growth has come contentious political debate over the goals and methods of regulation and the standards and procedures that the federal regulatory agencies employ. The debate was particularly heated and partisan in the 104th Congress.

The authors of this statement of principles believe that the current approach to federal regulation urgently needs repair. The problem is not simply that current expenditures mandated by regulation are large—on the order of $200 billion annually for environmental, health, and safety rules alone. It is rather that a substantial share of those expenditures is ineffective: as a result, more intelligent policies could achieve the same social goals at much less cost or more ambitious goals at the same cost. Since 1980, scholars across the political spectrum have been carefully articulating that view. We believe that recent legislative debates have masked a broad consensus among knowledgeable observers on the need for regulatory reform, and we have written this primer in the hope that the current Congress will devote greater attention to fashioning needed reforms.

We do not take the view that all regulation is bad or
that all regulation is good. We should judge regulations by their individual benefits and costs, which in the past have varied widely from rule to rule. Some regulations may be desirable from a social standpoint, regardless of their impact on measured economic output. Pollution controls, for example, can adversely affect standard measures of output yet still be worthwhile because the statistics may not adequately reflect the benefits and costs of those controls. Policing against racial discrimination may or may not increase economic growth, but concerns of elementary justice make doing so desirable. The important point is that, in an era when regulation appears to impose very substantial costs in the form of higher consumer prices and lower economic output, carefully assessing and weighing the likely benefits and costs of rules has become a central task of responsible government.

The federal government has made substantial progress in reforming economic regulation, particularly in the area of deregulating specific industries. For example, over the past two decades consumers have realized major gains from the deregulation of transportation services. Still, policymakers can achieve significant additional gains from fully deregulating other industries, such as telecommunications and electricity.

While deregulating specific industries has led to substantial economy-wide gains, the steady rise in social regulation—which includes not only environmental, health, and safety standards but many other government-imposed rights and benefits—has had mixed results. Entrepreneurs increasingly face an assortment of employer mandates and legal liabilities that dictate decisions about products, payrolls, and personnel practices. Several scholars have questioned the wisdom of that expansion in social regulation. Some regulations, such as the phaseout of lead in gasoline, have been quite successful, while others, such as the requirement for safety caps on aspirin bottles, have led to increased risks. As those regulatory activities grow, so does the need
to consider their implications more carefully.

We have identified six critical problems in the way social regulation is carried out:

- *Congress frequently does not allow agencies to consider costs explicitly in developing standards.* In addition, Congress almost never requires regulations to pass an explicit benefit-cost test. While some regulations pass a benefit-cost test according to agency estimates, most do not.\(^8\) Balancing the incremental benefits and costs could help reduce waste and inefficiency and improve economic welfare.

- *Congress frequently specifies the technical means for achieving regulatory goals instead of letting consumers and firms decide how they can best achieve the goals without wasting valuable resources.* Over the past two decades, many of the laws Congress has passed call for highly prescriptive and often excessively costly regulation. Many scholars have shown that by designing more flexible rules, regulators could achieve better results at a lower cost.\(^9\)

- *Neither Congress nor the regulatory agencies have procedures by which to set regulatory priorities on a routine basis.* As a result, there are wide differences among regulations in the costs of achieving a given benefit (such as lives saved or extended).\(^10\) Moreover, policymakers have few incentives to narrow those differences and thus improve the return the public earns on its regulatory investments.

- *The economic information on which regulations are based and promulgated is often weak and biased.* Agencies spend few resources to collect high-quality information on the benefits and costs of many regulations.\(^11\) Nevertheless, they have an incentive to overstate expected net benefits to make their regulations appear more attractive. At the other extreme, firms affected by regulation have incentives to overstate the costs of proposed rules in the hope of persuading agencies to soften or discard them.
• Budgetary pressures make regulation a politically attractive substitute for government spending. In recent years, Congress and the president have constrained the growth of the federal government's discretionary spending. As that constraint on spending becomes more onerous, legislators will look to off-budget programs as a way of promising voters something that does not have an immediate budgetary cost. We can thus expect environmental, health, and safety regulation and mandates regulating employment relations to increase.

• The federal government regulates many activities that are best left to the states and localities. Scholars have recently begun to rethink the rationale for national "one-size-fits-all" rules and are finding that in certain areas it is weaker than had been assumed over the past two decades. The argument that states will engage in a "race to the bottom" if given the power to set their own environmental or occupational safety and health standards has come into question.\textsuperscript{19} To the contrary, state governments have clear interests in ensuring that their citizens will not be harmed by lax standards, particularly given the strong public support for environmental protection. There is still, however, widespread agreement that federal intervention may be necessary in areas where activities in one location may adversely affect another, such as with some kinds of air pollution problems, and where consumers find it costly to obtain information, such as with potentially hazardous products.
Principles for Regulatory Reform

Traditionally, regulatory reform has been seen primarily, if not exclusively, as a "probusiness" agenda item, while opposition to reform—and benefit-cost analysis in particular—have been mounted in the name of "consumers." It is time to change the terms of the debate. We propose two principles of regulatory reform that will diminish the role of special interests and lead to a more informed debate over regulation. The first aims at promoting a more democratic process; the second aims at promoting economic well-being.

**Principle 1:** Regulatory reform should make it easier for voters to hold elected officials accountable for regulations imposed on the public. Regulations frequently involve decisions whose consequences can cost billions of dollars annually—more than is at stake in many direct government expenditure programs. At the same time, regulations can have an important impact on the well-being of the population. Many of those decisions are now made, to a large extent, by federal bureaucrats with the tacit acquiescence of legislators, the president, or both. We think Congress should be held more accountable for the effects of regulations, since the regulations are written using power delegated by Congress to administrative agencies.

**Principle 2:** Regulatory reform should advance the public interest by placing greater emphasis on protecting the economic well-being
of consumers and producers. As noted, agencies rarely deem the economic benefits and costs of a regulation a decisive factor in determining whether or not to implement the rule. We think it is critical for policymakers to highlight the importance of economic impacts when designing a regulation.

To ensure that regulatory reform serves the interests of all citizens, regulations should be required to pass a broadly defined benefit-cost test before being promulgated. To the maximum extent feasible, regulators should quantify and express all benefits and costs in monetary terms. We recognize, however, that some benefits can only be expressed in qualitative terms. But a benefit-cost analysis would at least require regulators to be explicit about what they count as benefits. Then voters could see for themselves what implicit values regulators and elected officials placed on those benefits when allowing regulations to be implemented.
Recent Progress in Congress

Congress has already enacted legislation that begins both to make legislators more directly accountable for regulation and to place more importance on improving the economic well-being of consumers and producers. Table 1 summarizes important recent legislation. Although it is too early to assess the impact of those statutes, the items in the table are promising in several respects.

In particular, the first three statutes in the table suggest that Congress will begin to acquire more information on the benefits and costs of regulations. Congress is also likely to increase oversight of regulatory activities, which should provide a systematic way to identify, and lay the groundwork for correcting, regulatory shortcomings that are driven by poorly designed statutes. The remaining three statutes mandate specific programs in which benefit-cost trade-offs will play a more central role in the formulation of regulations, although in only one case, the Pipeline Safety and Partnership Act, are the benefits of the proposed standard required to "justify" its costs.

We draw two conclusions from this cursory review of recent statutes. First, Congress is becoming more receptive to using economic analysis in regulatory decision making. Second, Congress is not prepared to let economic analysis fully supplant political and bureaucratic decision making.
TABLE 1
RECENT LEGISLATION PROMOTING REGULATORY REFORM

<table>
<thead>
<tr>
<th>Statute</th>
<th>Description</th>
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<tr>
<td>Unfunded Mandates Reform Act of 1995</td>
<td>CBO is required to estimate the costs of laws with new mandates in excess of $50 million in any one year on state, local, and tribal governments and in excess of $100 million in any one year on the private sector. Likewise, an executive branch agency must prepare a benefit-cost analysis of regulations with new mandates in excess of $100 million in any one year on state, local, and tribal governments or the private sector. The agency is required to choose the “least costly, most cost-effective, or least burdensome alternative,” unless the provisions are inconsistent with law or the head of an agency can explain why such an alternative was not adopted.</td>
</tr>
<tr>
<td>Small Business Regulatory Enforcement Fairness Act of 1996</td>
<td>An agency must submit each final regulation and the supporting analyses to Congress and the General Accounting Office. Congress has at least sixty calendar days to review major regulations before they can become effective. During that time, Congress can enact a joint resolution of disapproval that, if passed and then signed by the president, would void the regulation. In addition, strengthened judicial review provisions hold agencies more accountable for the impacts of regulations on small entities.</td>
</tr>
</tbody>
</table>
Regulatory Accountability Provision of 1996\textsuperscript{a} 

By September 30, 1997, OMB must submit to Congress an assessment of the annual benefits and costs of all federal regulatory programs and of each rule with annual costs over $100 million. OMB can also make recommendations to reform or eliminate inefficient programs.

Pipeline Safety and Partnership Act of 1995

The secretary of transportation must issue a pipeline standard "only upon a reasoned determination that the benefits of the intended standard justify its costs."

Food Quality Protection Act of 1996

This act eliminates the Delaney Clause for pesticides that set a zero-tolerance standard for carcinogens from residues in processed foods. In setting standards for raw or processed foods, EPA will now establish a tolerance level to ensure "a reasonable certainty of no harm" from pesticide residues. For pesticide products that exceed that negligible risk, EPA may consider the benefits of the pesticide to justify granting a tolerance.

Safe Drinking Water Act Amendments of 1996

Under the original act, the maximum contaminant level (MCL) was to be set as close to the maximum contaminant level goal as "feasible." Feasible was defined as using the best technology available "taking costs into consideration." Under the new act, the EPA administrator "shall publish a determination as to whether the benefits of the MCL justify, or do not justify, the costs."

\textsuperscript{a} Contained in the Omnibus Consolidated Appropriations Act (1997).

Policy Recommendations

To address the problems outlined above, we offer eight recommendations designed to improve regulatory policymaking.

**Recommendation 1:** Congress should rewrite key regulatory statutes, such as those related to environmental protection, consumer safety, and workplace regulation. The objectives should be to achieve better outcomes at lower cost and devolve responsibility to the states for problems that can be better handled there. Congress should require that all new regulations costing more than $100 million annually pass a broadly defined benefit-cost test. Congress should allow agencies to consider both quantifiable and nonquantifiable benefits in determining whether a particular regulation passes such a test. Where agencies cannot measure important benefits and costs, regulators should describe them as precisely as possible. Moreover, where there are significant redistributional impacts, agencies may include them in the analysis. The key objective, however, should be to require regulators to be as specific as possible in quantifying and justifying any regulations that they assert pass a benefit-cost test.

Congress should also move away from the uniform approach to standard setting. Instead of requiring specified technical controls for smokestacks or uniform rules regulating food safety, Congress should encourage flexi-
bility so long as the overarching social goals are achieved. Finally, Congress should return to the states responsibility for addressing issues that are primarily localized, such as waste disposal and safe drinking water.13

**Recommendation 2:** The president and Congress should adopt procedures to improve the quality of regulatory analysis, especially benefit-cost analysis. Such procedures include making key assumptions explicit (current regulatory impact analyses often fail to do so); using best estimates and appropriate ranges to reflect uncertainty; providing estimates of the net present value of benefits and costs; introducing peer review of the analyses; and summarizing sensitivity analyses and base-case results.14 The 104th Congress included some of those changes in the regulatory reform bills that it considered but did not adopt.

**Recommendation 3:** Congress should require regulatory agencies to report each year to the American public on the quantifiable and nonquantifiable benefits and costs associated with their rules. The report, which the Office of Management and Budget (OMB) would oversee and issue, would give the public the information it needs to be educated regulatory consumers. The report would complement existing efforts aimed at promoting a community’s right to know the impact of federal regulations on local economic activities.

Regulatory costs tend to be hidden from view. Consumers are rarely aware of the several hundred dollars they pay for pollution control equipment on a new car or the costs associated with recent proposals to improve airline safety. While the benefit and cost estimates may be subject to great uncertainties, even crude estimates of benefits and costs can help inform policymakers and the public. The recent regulatory accountability provision in the Omnibus Consolidated Appropriations Act of 1997, which requires OMB to report on the benefits and costs of regulatory programs by September of 1997, represents a step in the right direction.
**Recommendation 4:** Congress should expand the capacity of OMB and the Congressional Budget Office (CBO) to review important laws and regulations. This recommendation is consistent with recent legislation, such as the Small Business Regulatory Enforcement Fairness Act and the Unfunded Mandates Reform Act, as well as with proposals in Justice Stephen G. Breyer’s book, *Breaking the Vicious Circle.* The Office of Information and Regulatory Affairs (OIRA) within OMB (which carries out the oversight function) assigns about ten economists to review regulations and can thus do only a cursory evaluation of the most important regulations.

In the short term, Congress should allocate more resources to OMB for hiring scientists and economists who would improve the quality and scope of the regulatory review process. Congress may need to create a division in CBO, similar to OIRA within OMB, to address the economic impacts of both laws and major regulations. To those who might object to the cost of that additional analytical capacity, we say it is time to quit being penny-wise and pound-foolish. The added budgetary cost of the steps we propose can be measured in the millions of dollars, a small price to pay to ensure that the hundreds of billions of dollars of mandated costs are achieving useful results.

**Recommendation 5:** Congress should write into law a version of Executive Order 12866 dealing with OMB review of regulations. Lawyers serving in government are more likely to comply with a law that stresses selecting policies that are effective and do not waste resources. The law would highlight the importance of using benefit-cost analysis in developing regulations, identifying and evaluating realistic alternatives, and selecting those that maximize expected net benefits. Congress should also extend regulatory oversight to cover independent agencies, such as the Federal Communications Commission and the Federal Energy Regulatory Commission.

Such a law need not “overjudicialize” the regulatory process by having judges second-guess all regulatory deci-
sions. In particular, the benefit-cost instructions can be written in a way that requires agencies to pay serious attention to both benefits and costs (quantifiable and nonquantifiable) without subjecting analyses to detailed judicial review in every case.

**Recommendation 6:** Congress should encourage the courts to use a rough benefit-cost standard in judicial review for all regulations. Several scholars have argued that the courts are moving in that direction.\(^1\) Warren and Marchant argue that courts should judge the legality of regulations in the context of doing "more good than harm"—which is basically a layman's benefit-cost test.\(^2\) Warren goes further and argues for modifying the Administrative Procedures Act to encourage such a test.\(^3\) Initially, applying that test could increase court cases; as the case law settles, however, caseloads should not significantly differ from their current level.

**Recommendation 7:** Congress needs to scrutinize existing regulations as well as new ones. It should direct OMB and the rulemaking agencies themselves to review at least ten important existing regulations each year, with an eye toward modifying them to ensure that they are implemented in the most cost-effective manner and to ensure that they produce benefits in excess of costs. Those regulations that cannot be modified to pass such a test should be eliminated. OMB could report the findings on existing regulations in its annual report on the benefits and costs of regulation. It is not necessary, and indeed may be counterproductive, to allow anyone to petition the relevant agency or OMB to review any existing rule, as the 104th Congress was considering. Such a provision could paralyze the regulatory process and needlessly polarizes the debate over regulatory reform.

**Recommendation 8:** Congress should experiment with a regulatory budget for new regulations. Congress would set annual allowable limits for the regulatory costs imposed on society for different kinds of regulations, either by statute, by pro-
gram, by agency, or for all regulatory agencies. The regulatory budget would apply only to those rules for which the expected costs exceed the expected quantifiable benefits. Rules that would pass a benefit-cost test would be exempted (we would require quantifiability here to provide a sharper line between rules that would and would not be subject to the budget). The regulatory budget would thus increase accountability but would not stop implementation of rules that clearly are expected to improve the well-being of the average citizen. A neutral agency would determine whether regulatory cost limits are met by scoring the cost of each regulation and crediting it against the budgetary limit. One possibility would be to establish a new independent agency modeled after the Federal Reserve. In the short term, however, we would suggest first CBO, which already does scoring for the budget and has a reputation for impartiality, and, as a fallback, OMB. If the cost limits are exceeded, the president could submit a request to Congress for an increase in the regulatory budget authority, or Congress could choose to increase the budgetary authority on its own. We suggest the regulatory budget as an experiment to gain experience with implementing the concept. If the experiment is successful, Congress should adopt the regulatory budget permanently.

Some of our recommendations, such as revising many existing laws and experimenting with a regulatory budget, may be politically difficult. But several recommendations—routine reporting of the benefits and costs of federal regulation, improving regulatory analysis, increasing resources devoted to regulatory analysis, and codifying Executive Order 12866—could and should receive serious consideration in the 105th Congress. Ultimately, congressional reform of the statutes is the linchpin of the system. Agencies and the courts must work within the law; thus, there is a limit to what can be done in terms of reforming regulation without Congress’s playing a central role.
Conclusion

Federal regulation is in urgent need of reform. If Congress takes the lead in more effectively targeting social regulation at the nation's most important social problems, Americans can count on enjoying a high standard of living and continued social progress. If Congress continues to allow regulations to be produced without much attention to their full economic consequences, there is a very real danger that the standard of living that most citizens enjoy will slowly but surely erode. We offer this agenda for regulatory reform in hopes of engaging legislators and policymakers interested in constructive action.
Notes

10. See, for example, Morrall (1986), Tengs and Graham (1996), and Hahn (1996).
References


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Robert W. Crandall is a senior fellow in the Economic Studies Program at the Brookings Institution. He has published widely in the fields of antitrust, the automobile industry, competitiveness, deregulation, environmental policy, industrial organization, industrial policy, mergers, regulation, the steel industry, and, most recently, telecommunications policy. He is a former deputy director of the Council on Wage and Price Stability (Ford and Carter administrations) and a former faculty member at the Massachusetts Institute of Technology and George Washington University.

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