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REGULATORY BUDGETING AND THE NEED FOR COST-EFFECTIVENESS IN THE REGULATORY PROCESS

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HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

NINETY-SIXTH CONGRESS

FIRST SESSION

AUGUST 1, 1979

Printed for the use of the Joint Economic Committee

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CHAPTER 10

THEORY

10.1

The first part of the chapter discusses the basic concepts of the theory of the firm. It begins with a review of the production function and the cost function. The production function shows the relationship between the inputs of labor and capital and the output of the firm. The cost function shows the relationship between the inputs and the total cost of production. The chapter then discusses the theory of the firm, which is the study of the behavior of the firm in a market economy. It begins with a discussion of the profit function, which is the difference between total revenue and total cost. The chapter then discusses the theory of the firm in a competitive market, where the firm is a price taker. It shows that the firm's profit is maximized when it produces the quantity where marginal revenue equals marginal cost. The chapter then discusses the theory of the firm in a monopoly market, where the firm is a price maker. It shows that the firm's profit is maximized when it produces the quantity where marginal revenue equals marginal cost, and then charges a price that is higher than marginal cost.

10.2

The second part of the chapter discusses the theory of the firm in a competitive market. It begins with a discussion of the firm's profit function, which is the difference between total revenue and total cost. The chapter then discusses the firm's profit maximization problem, which is to choose the quantity of output that maximizes profit. It shows that the firm's profit is maximized when it produces the quantity where marginal revenue equals marginal cost.

10.3

The third part of the chapter discusses the theory of the firm in a monopoly market. It begins with a discussion of the firm's profit function, which is the difference between total revenue and total cost. The chapter then discusses the firm's profit maximization problem, which is to choose the quantity of output that maximizes profit. It shows that the firm's profit is maximized when it produces the quantity where marginal revenue equals marginal cost, and then charges a price that is higher than marginal cost.

REGULATORY BUDGETING AND THE NEED FOR COST-EFFECTIVENESS IN THE REGULATORY PROCESS

WEDNESDAY, AUGUST 1, 1979

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 10:03 a.m., in room 1202, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Present: Senator Bentsen.

Also present: John M. Albertine, executive director; Louis C. Krauthoff II, assistant director-director, SSEC (Special Study on Economic Change); William R. Buechner, professional staff member; Douglas N. Ross, senior economist, SSEC; Mark Borchelt, administrative assistant; Charles H. Bradford, minority counsel; Timothy P. Roth, senior economist, SSEC; and Carol A. Corcoran, minority professional staff member.

OPENING STATEMENT OF SENATOR BENTSEN, CHAIRMAN

Senator BENTSEN. The committee will come to order.

The purpose of this hearing is to consider some of the issues raised by the proposal to establish a regulatory budget. We will also look into whether or not Congress should enact a cost-effectiveness requirement, under which all major Federal regulations would be required to meet their statutory objectives in the least costly manner.

During the 1970's, the pace of government regulation of our economy skyrocketed. Many regulations, particularly in the areas of health, safety, and environmental protection, provide important benefits to the vast majority of American consumers and workers.

We have no intention of rolling back the clock. Many of these regulations, however, impose substantial compliance costs—as much as \$100 billion per year according to a study prepared last year for the Joint Economic Committee.

Much of this cost is necessary and beneficial. Much, however, is unnecessary, the result of excessive and duplicative regulations that produce little more than higher business costs and higher prices.

In its 1979 annual report, the Joint Economic Committee made two recommendations for improving the management of our regulatory programs that could significantly reduce the unnecessary and inflationary costs of regulations that are excessive, ineffective, duplicative, and conflicting.

Let me read these two recommendations:

Recommendation No. 21: All government regulations should accomplish the statutory objective in the most cost-effective manner. When alternatives exist, each of which clearly would achieve a particular regulatory goal, the least costly way should be adopted unless an overriding statutory goal requires the adoption of a less cost-effective alternative.

I introduced cost-effectiveness legislation earlier this year, and I know the administration agrees with this recommendation, since President Carter's regulatory reform bill also emphasizes cost-effectiveness.

I intend to work closely with the administration to assure that any regulatory reform bill considered by the Senate later this year contains a cost-effectiveness requirement.

Recommendation No. 22: The committee believes that the Congress and the executive branch should begin to work on developing the methodology necessary to make a regulatory budget a reality in the future. A regulatory budget could be used to encourage government agencies to reduce the costs or regulations and could provide an additional incentive for agencies to develop cost-effective regulations. In addition, a regulatory budget would supplement the annual fiscal budget to give the public, Congress, and the President a more comprehensive view of the Federal Government's command over resources for public purposes.

Full implementation of a regulatory budget is a long-run prospect.

First, a methodology for making accurate compliance cost estimates will have to be developed. The Joint Economic Committee has recommended that Congress and the administration move quickly to develop the necessary methodology, and I support that recommendation.

Our witnesses this morning are regulatory experts who have given a lot of thought to the issues raised by a regulatory budget. I am not looking for a love-in, but for a thoughtful evaluation of some of the ways in which a regulatory budget could improve our regulatory programs, as well as some of the problems we will face in implementing a regulatory budget.

Our first witness will be the Honorable George C. Eads, member of the Council of Economic Advisers.

Then we will have a panel, with Robert Crandall of the Brookings Institution, James Miller of the American Enterprise Institute, and Arthur Wright of Purdue University, who has coauthored a major paper on the regulatory budget for the special study on economic change, which will be released shortly. Christopher DeMuth of Harvard University and Richard Shackson of the Mellon Institute for Research are accompanying Mr. Wright.

Mr. Eads, will you proceed?

STATEMENT OF HON. GEORGE C. EADS, MEMBER, COUNCIL OF ECONOMIC ADVISERS

Mr. EADS. Mr. Chairman, members of the committee, I am pleased to appear before you today to present my views on the feasibility and desirability of requiring that the Government prepare a regulatory budget.

My interest in regulatory reform extends well beyond the scope of my present job. Throughout my professional career, I have been a student of the regulatory process and have made modest contributions toward the development of tools to enable us to understand better the consequences of government regulatory policies.

As an official in two administrations, I have been involved in implementing a series of Executive orders designed to move such tools into general use.

As executive director of a Presidential commission, I have had the opportunity to evaluate the Government's ability to conduct analysis of its impact on basic industry. And finally, as a government contractor, I have faced living with the consequences of the programs I helped to put into place—I have had to estimate the economic impact of proposed regulations.

All this experience confirms to me both the wisdom of regulatory reform and the necessity of proceeding cautiously with it. I believe that measures already taken represent steps in the right direction:

Issuance of Executive Order 12044, requiring systematic regulatory analysis of major proposed regulations including alternatives.

Establishment of a collegial body to study and develop policy positions on generic issues that cut across several regulatory agencies—the regulatory council.

Establishment of a group involving the economic and regulatory agencies to review and comment on regulatory analyses of proposed rules—RARG.

Legislation submitted by the administration to the Congress would codify and extend the requirements of Executive Order 12044, and I strongly support enactment of that legislation. I particularly support the proposal in this legislation that would require agencies either to adopt the least burdensome alternative or state clearly why this has not been done.

The proposal we are discussing here today, the regulatory budget, is intended to move the process of regulatory reform forward still further. But it would not be a substitute for the actions I have just described; it would complement them. It has considerable intellectual appeal because, for all their value, none of the steps taken to date—

Address the impact of a proposed regulation relative to other regulatory actions taken with respect to affected industries or sectors.

Provide a control mechanism capable of keeping the level of private sector expenditures resulting from Federal regulatory requirements in line with alternative uses of the same resources to attain other national objectives.

Require that the Federal Government establish priorities both within and between its various regulatory programs.

Nevertheless, while the regulatory budget is an extremely interesting and potentially useful tool, well worth additional study and serious debate, I do not believe that we are now in a position to adopt it as a governmentwide requirement.

I am not alone in this assessment. But I believe my reasons are somewhat different from those advanced by others who similarly have urged caution.

To date, criticism of the regulatory budget has focused primarily on our limited ability to measure the costs and benefits of regulation. As both a developer of such measurement tools and a practitioner, I admit to certain qualms here.

Measuring even the direct costs of regulation—that is, the costs of compliance—and apportioning such costs accurately by year is al-

ways likely to be a difficult task—a task that, for all our recent progress, we are not now equipped to undertake on a routine basis.

We will have to accumulate somewhat more experience before we will have any hope of being able to reduce what is now a complex analytical process to more-or-less mechanical procedures.

Also extremely troubling to me is the relatively primitive state of our ability to measure either the cumulative costs of a series of regulations proposed by one agency affect the costs of complying with regulations proposed by another. But I am convinced that both these problems will also prove to be tractable in time.

It may surprise you to learn that I do not view either our present inability to measure the indirect costs of regulations—the impact on productivity or innovation, for instance—or our present inability to assess the benefits of regulations as absolute barriers to the development of a regulatory budget.

We produce expenditure budgets without being able to measure the indirect impacts of the programs included in them. Congress routinely votes funds for programs—defense, social programs, and expenditures on basic R. & D.—in the face of an admitted inability to quantify benefits.

This is not to say that rational decisionmaking would not be well served by improving our ability to estimate either the indirect costs or the benefits or regulation. It is just that these objections are, in my opinion, irrelevant to the issue of whether it is possible to prepare a meaningful regulatory budget.

No; neither mechanical estimating problems nor an inability to estimate indirect costs and benefits is likely to prove the major stumbling block in moving forward eventually to develop a regulatory budget.

Indeed, if I considered them thus, I would have little hesitation in urging you to move forward now to require the development of such a budget on a pilot basis. There are deeper issues that need to be explored. These issues are of two types:

We are not presently able to define an optimum level of regulatory expenditures or to state the consequences for the economy of deviating from such an optimum.

The implementation of a regulatory budget process might imply major changes in the perceived relationship between government and business and in the balance of power between the various branches of government.

I have remarked earlier that we do not now have the ability to evaluate each of the Government's expenditure programs on a cost-benefit basis, yet we routinely prepare expenditure budgets.

Neither is there any universally accepted notion as to the optimum proportion of society's resources that government ought to be permitted to appropriate to its uses, yet budget totals embodying such decisions are voted each year.

There is, however, a substantial consensus to the effect that, except at times of slack demand, attempts by the Government to spend more than it takes in in the way of taxes will lead to inflation.

To the best of my knowledge, no analogous commonly accepted wisdom exists that would allow Congress or the President to determine the proper level of regulatory expenditures or the consequences for the economy if this proper level were exceeded or not reached.

This is not to say that it would be impossible to develop such knowledge. However, full implementation of a regulatory budget will require progress here.

The second set of concerns relate to what the implementation of a full-scale regulatory budget process might imply for the perceived relationship between the Government and the private sector and between the various branches of government.

One of the key features of the recent growth in social regulation has been the extreme compartmentalization of the problems being dealt with. Each piece of regulatory legislation has been viewed in legal terms—as a targeted response to particular conduct we as a society find objectionable.

Automobiles have not been as safe as we would like. We have passed a law creating an agency whose mandate is to make them safer and have given this agency power to write rules requiring this. Automobiles have not achieved as high a level of fuel economy as we would wish.

We have passed another law, and created more rulemaking authority. Automobiles have been found to emit substances we consider harmful to health.

As long as the problems we are seeking are few enough, and the impact of the resulting rules and regulations are sufficiently peripheral to the main business of the firm or industry in question, this approach might conceivably prove feasible. But once the degree of governmental influence required to deal with the problems mentioned reaches the point where its actions being to exert such a pervasive influence on a firm's or an industry's key decisions that they become in a real sense controlling, then the legal approach breaks down and it becomes necessary to think of regulation as a planning and management problem, with government, for better or worse, exercising a degree of managerial responsibility for the firm or industry.

We have already passed this point. It can now be said that the Government in a real sense is managing the automobile industry, the steel industry, the chemicals industry, the electric power industry, et cetera. But it is managing these industries in an uncoordinated and ad hoc way.

A regulatory budget, together with such other tools as the regulatory calendar and regulatory analyses, for major proposed regulations, would provide the tools required to bring some degree of order to this involvement.

Let me sound a note of caution here. I have referred to the type of regulation we now engage in as being akin to planning and management of industry. While this, in my opinion, only describes an incontrovertible fact, admitting it openly has certain important political implications that need to be carefully considered.

More to the point, they need to be considered in the context of the debate over the regulatory budget, because the creation of such a budget would make much more explicit the planning and managerial aspect of regulation.

It is ironic that while the public seems to oppose "planning," at least when engaged in by government, the effective management of the regulatory apparatus we have put into place during the last decade or so requires a significantly greater capability to understand complex

interactions and to make detailed long-term projections of effects—that is, a greater capability to “plan”—than has ever been contemplated in any version of national economic planning seriously considered by the Congress.

Those who advocate the regulatory budget would do well to ponder this paradox.

I do not necessarily find this frightening, for I believe that forcing ourselves to view regulation as a planning and management problem rather than as a legal problem is the first step toward bringing it under control.

The implementation—as opposed to the development—of a regulatory budget might also require a recasting of our basic regulatory statutes in order to give more explicit authority to make tradeoffs among various regulatory objectives.

Inherent in the responsibility for the preparation and execution of any budget is the authority to make tradeoffs. Although in a few instances, Congress has directed that agencies submit their expenditure budgets simultaneously to OMB and to the Congress, thus limiting the President’s power to control these agencies through his control of their purse strings, this has been the exception, not the rule.

More generally, the power to determine an agency’s budget has carried with it the power to set that agency’s priorities. Congress continues to occupy an important place in this picture, since it can alter these Presidentially set priorities and conduct continuing oversight of agency activities.

However, the power of the President to set the basic revenue and expenditure agenda for the Government is substantially different from his current power to set the basic regulatory agenda.

Enactment of a regulatory budget requirement would inevitably move the regulatory case closer to that of the financial case.

Given the sharp rise in governmental regulatory activity over the past decade, the appeal of the regulatory budget as a management tool is understandable. Ironically, it was a similarly sharp expansion in governmental activity that finally induced the Congress and the President, after debate and formal study going back nearly a decade, to agree in 1921 to the creation of the Federal expenditure budget.

In that case, as in this, mechanical estimating problems were rightly perceived as creating barriers to the effective implementation of the particular budget concept. But an examination of the debates of the period reveals that, again as now, the fundamental issues ran somewhat deeper.

It is my belief that the time is now ripe to begin a serious national debate on these deeper issues. It is also ripe to encourage further efforts to surmount the mechanical estimating problems.

That completes my statement. I will be happy to answer any questions you might have.

Senator BENTSEN. Thank you very much, Mr. Eads.

Let me ask you, what’s so different about preparing a regulatory budget? You expressed a concern about planning. What’s so different about preparing a regulatory budget from preparing a fiscal budget?

Is there any serious further involvement or influence on business decisions? It seems to me what you’re trying to do is make govern-

ment involvement more rational and I would hope less wasteful and inflationary. Would you comment on that?

Mr. EADS. I would agree with your objective, but I think there is a difference. In the case of preparing the expenditure or financial budget, you are trying to determine how the Government will spend moneys that it has taxed or borrowed. The act of taxing or borrowing obviously affects the way that private business operates, but you have a process where you're dealing with a reasonably well-defined metric, and you're also dealing with resources that the Government has, in effect, already decided to move out of the private sector.

The major difference I see in the regulatory budget is that you're dealing with the diversion of resources that, in fact, never leave the private sector; what you're doing is trying to influence how business decisions will or ought to be made in terms of investment.

To me, that gets much closer to a planning and management function. Those are precisely the decisions that a board of directors makes, for example, in talking about what a company's future investment stream will be.

I agree with your objective. I agree that it may be possible to surmount estimation problems. What I am saying is that conceptually I see it as a somewhat touchier problem. I think the question of how deeply and openly the Government wants to get involved in managing industry should be debated as much as the issue of whether we can make these estimates.

Senator BENTSEN. When you talk about developing the optimum level of regulatory expenditures, I would think you'd need a regulatory budget. Otherwise, I don't know how you arrive at that decision. Would you comment on that?

Mr. EADS. Well, obviously, you can't make that decision operational unless you have a budget.

What I am saying though is that I can lay out for you the wisdom of economists—and you may disagree with it—some wisdom as to what is or is not inflationary concerning the governmental fiscal stance.

I don't know what level of regulatory expenditures automatically is right or not right. And I think that parallel with the better development of the estimating tools should be some effort to discuss what would be and how one would determine the right level. How much can the Government, whose regulatory decisions direct the private sector, put into regulatory activity or regulatory compliance activities without being inflationary?

I think it's something that hasn't been discussed very much, and it certainly doesn't necessarily relate to a balance of costs and benefits. As the Joint Economic Committee's document quite rightly pointed out, it might be that all the regulations we're proposing to do in a year are cost-effective. But the total resource drain implied might somehow exceed our ability to deal with it. I don't know what "exceed our ability to deal with it" means at this point. I don't know what is too much or what is too little. I don't know what the proper pace is. I am saying that that is an aspect of this that really needs to be debated. And debated before you can have a formal "regulatory budget" process.

I imagine, for example, that in voting budget totals—I've never been at markups; I've never been at committee deliberations—there are two things that occupy the committee:

First: What do these budget totals imply for the total level of resources the Government is going to draw from the economy?

Second: How do expenditures relate to revenues?

Senator BENTSEN. I'm sure that second one is very much in the thought process. I hope the first one is.

Mr. EADS. With respect to item one, it is not clear to me just what the consequences are for the economy of the Government drawing 10 percent of the resources versus 20 percent versus 30 percent. That's really what we're talking about when we talk about a regulatory budget.

Senator BENTSEN. Again, I hope they probe for the answer and try to get a feel for it as they arrive at these goals. Your predecessor, Mr. Nordhaus, gave an interview to the *National Journal*, in which he said the main problem is that regulatory agencies are outside the control of both the economic and political systems. They're not subject to any outside checks. First, the regulatory agencies don't have to pay the cost of the regulations they issue. Second, most agencies are not responsible either to Congress or the President. And thus, there is ultimately no accountability. As a result, he says, we are likely to get regulations that are not terribly sensible.

Now, do you agree with that analysis?

Mr. EADS. I think Mr. Nordhaus goes a little bit further than I would. Certainly the perception that you are not appropriating "real money" would be helped by a regulatory budget.

As I said before, I think one of the major things a regulatory budget would do would be to focus attention on the relationship between the President and the Congress and the regulatory agencies. But I don't agree that the regulatory agencies are totally out of control.

I do agree, however, that the fact that they are, in effect, directing the expenditure of other people's money, rather than making a request for appropriations that they have to go up and defend, does tend to lower the degree of control.

Senator BENTSEN. How do you think tax incentives differ from regulatory budgets in their effect? How do they differ in their influence of behavior in the private sector?

Mr. EADS. My personal view of regulation is that it encompasses virtually every attempt of the Government to influence the behavior of the private sector. And so it doesn't matter much whether you attempt to do it through a tax incentive versus direct regulation. Both are regulatory actions. To me, there are alternative ways of accomplishing sometimes the same end.

Senator BENTSEN. From the behavioral side though, doesn't the private sector—with tax incentives—have a right to measure the consequences and decide to comply or not to comply?

Mr. EADS. I am saying that they are alternative ways to achieve similar ends. As to which one one uses, I tend to favor market-type incentives, which might include tax incentives. It might also include pollution fees and things of that sort.

What I am saying though is that I see them both as regulatory tools. I see a difference between them, however, in that under current

Treasury practice, tax incentives at least have to be factored into the budget. So if you're trying to achieve a regulatory goal through a tax incentive, it has to be shown on the budget in some way. If you're trying to achieve it through direct regulation, it doesn't get shown on the budget.

Senator BENTSEN. You touched on the question of cost-effectiveness. Don't you think there's a need for a provision on all major Federal regulations that they be cost-effective? If you have alternatives, to accomplish a particular social goal, shouldn't they be required to take the most cost-effective route?

Mr. EADS. I strongly believe that the agency should be required to take the most cost-effective alternative within the bounds of their statutes. If they believe that they are somehow precluded from doing that, I think they should explain why. That's what we're proposing in the administration's bill. As you said, it's consistent with what you're supporting.

Senator BENTSEN. Do you think there's any one particular agency that has stood out from the others in being more cost-effective with their regulations, more concerned about it, paying more attention to it.

Mr. EADS. I don't think it's appropriate for me to try to grade them here.

Senator BENTSEN. I just want you to say a nice thing about one agency. [Laughter.] I find, you know, that if they get a compliment once in a while, they might try to do more of it.

Mr. EADS. We try to compliment them.

Senator BENTSEN. Can't you think of one that you feel kindly about, that has paid some attention to cost-effectiveness?

Mr. EADS. As I say, for all the complaints about it, I think the EPA, because of the breadth of its activities, has become more interested earlier than other agencies.

Senator BENTSEN. That may be because they get more static.

Mr. EADS. That may be, and we've certainly been trying to encourage their interest for a long time. But I'd hate to single them out one way or the other.

Senator BENTSEN. Is there anything the administration can do without legislation to make them be more cost-effective?

Mr. EADS. In the work we're doing in the regulatory analysis review group we're trying to bring these matters to the attention of the agency.

In the work we do, as the Council of Economic Advisers, in dealing with the agencies, we're trying to bring it to their attention. We're working closely with the regulatory council in their activities. I think all of these things help.

However, as I said in my statement, the regulatory budget is a supplement to these actions not a substitute for them. And if the difficulties we were discussing can be overcome, it would be a very useful supplement and process. Together, all of these activities—the budget, having people in the Government raise the questions—would begin to bring some degree of discipline to the process.

I do fear, however, that the issue of the basic statutory authorities and of the authority of people to make tradeoffs, would have to be addressed sooner or later to certainly in deciding when we want the

regulatory budget. It will come at some point, and I think the sooner it's discussed, probably the better.

Senator BENTSEN. If you were choosing between cost-benefit ratios and, on the other side, cost-effectiveness, what would be the problem and the advantages of each, and which would you choose?

Mr. EADS. I would choose cost-effectiveness over cost-benefits.

Senator BENTSEN. Because it's easier to figure out?

Mr. EADS. Because it's feasible or at least potentially feasible. I do not now know, and I don't know that we ever will know, how to assess benefits well enough so that we can apply a strict cost-benefit test.

I'm a student of previous government attempts to introduce cost-benefit calculations into decisionmaking, and I guess you can say that they have helped advance cost consciousness in the Government. They've also helped advance the ability to create imaginary benefits.

I think you get a lot further by holding fairly strictly to a cost-effectiveness standard. It's a standard you can enforce. It's a standard you can describe. A cost-benefit standard I think would rightly be viewed as a real attempt to rollback progress and social regulation. It's not something that I could support. It's not something that I could handle.

Cost-effectiveness is different. I think we're at a place where we can use it.

Senator BENTSEN. Well, I would think cost-benefit would depend on who did the figuring.

Mr. EADS. It depends on who does the figuring and whether one has any hope of dividing out unjustified claims from reality.

Senator BENTSEN. That's why I say it depends on who did the figuring, who did the evaluation.

I can imagine someone doing the evaluation who would include all kinds of benefits.

Mr. EADS. That's one thing that frightens me.

Senator BENTSEN. That's one of the problems in trying to arrive at a cost-benefit ratio, isn't it—trying to quantify it?

Mr. EADS. And I don't see the kind of progress that we can make being sufficient to move that kind of a standard within the foreseeable future. I do see cost-effectiveness as something we could really do.

Senator BENTSEN. You know, it's interesting to watch this process develop on something like the regulatory budget. I really believe that it's something we're going to develop and we're going to have. I think it's going to be helpful.

But it germinates some rather dry proceedings, like this, as we probe very good minds, people with experience in the field, to try to find out what they think will work and what won't work. That's one of the great things about this process of ours, using our best process to hear all of the conflicting views and finally come down to something we think can be effective.

And I also find you have to say things 14 times at least—and I hope not 14 years—before they finally begin to fit into the consciousness of people and they finally begin to make some headway.

I suppose the best way to start would be with one agency.

Mr. EADS. I don't think so.

Senator BENTSEN. You don't; why?

Mr. EADS. One of the reasons I don't think so is that there would be too much of a tendency to hold only that agency to a tough standard. I would prefer, if we started it, to start with three or four agencies. Another reason I would prefer to start it that way is that it is not all clear to me that the proper organization for a regulatory budget is along agency lines. I understand why it's proposed that way, because that's the way we do expenditure budgets. But another critical cut I see—and this is a cut which can begin to include several agencies—is how regulations of several agencies together may be affecting a given industry.

Thus, I would see the regulatory budget as consisting of two sets of cuts—one cut along agency lines, and the other cut along industry lines. And that becomes far more meaningful if you include a couple or three agencies in even a private budget.

It's true that in certain areas we seem to be a little bit further advanced in being able to do the cost-effectiveness work in others, but I think we would be buying more trouble than it is worth from picking on just one agency.

Senator BENTSEN. Mr. Eads, thank you very much. I think your testimony has been helpful to us, and we appreciate it.

Mr. EADS. Thank you.

Senator BENTSEN. Can we have Mr. Crandall and Mr. Wright now take the stand, and Mr. DeMuth and Mr. Shackson? We had one more participant but we understand he's fogged in this morning.

Mr. Crandall is from the Brookings Institution. Would you proceed first with your statement?

STATEMENT OF ROBERT W. CRANDALL, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. CRANDALL. Thank you, Mr. Chairman. You've already warned us that this is a dry proceeding, so I don't think I'll read anything. I have a short statement which I have prepared for the record, and I'll summarize that, perhaps offering additional comments based upon—

Senator BENTSEN. I want to say I am not putting it down by saying it's dry. I think one of these days people will look back at this and other hearings we have and it will have a very, very major impact, of course, on the country's effectiveness.

Mr. CRANDALL. Well, I hope we all share your optimism. Before I begin, may I say that I appear here to testify on my own behalf. What I'm about to say does not reflect the viewpoint of the Brookings Institution, its trustees or other staff members.

About 1½ years ago, I did a little study for Brookings to try to analyze how the Government contributes to the price level. In the course of doing that I came across the phenomenon of government regulation, of course. I have been a student of government regulation for some time, and I have even been on the Council on Wage and Price Stability, attempting to do something about it.

As I was writing this article it occurred to me that the regulatory budget provided a useful vehicle for attempting to bring some rationality to the regulatory process, that is, principally to the social

regulatory process, the regulation of health, safety, and environment. And I thought it was a useful mechanism because it provided a budget constraint to one institution in our society and perhaps the only institution which does not have a budget constraint.

The reasons for advocating such a regulatory budget is to confront regulators with tradeoffs. Earlier today there was a discussion of the difference between cost-effectiveness and cost-benefit analysis. In fact, those analyses would have to be undertaken by any regulator in making decisions if he were subject to a budget constraint.

Let me give you an example. Recently the Administrator of EPA had to set again the primary ambient air standard for ozone. He was being persuaded by environmentalists that it should stay at the current level of 0.08 part per million. Many, such as myself, argued that perhaps it ought to be as high as 0.16 part per million because there is simply no health evidence that would suggest anything close to 0.08 or even 0.12, where he finally set it, was warranted. However, he finally set it at 0.12, because the cost to him, in terms of his latitude in any other decision was not affected.

Senator BENTSEN. The cost to him is what?

Mr. CRANDALL. The cost to him in terms of his latitude on any other decision was not affected.

It might cost several billion dollars a year more and enormous public relations problems for his successors because of the vehicle inspection and maintenance programs that the decision is going to entail, but in no way did it reduce his ability to set tight standards on SO₂, on particulates, on hazardous wastes discharged into water, or on toxic substances.

That is, anything he spent on ozone was essentially a definite good to him, because it didn't reduce his ability to maneuver in any other area of regulation. Were the Congress to give him a regulatory budget he might ask his staff to carefully analyze what each regulation is going to cost, because it would reduce his ability to set tight standards elsewhere. He would have to balance the benefits of spending another billion dollars on ozone protection against the value of spending another billion dollars, say, on SO₂ or particulates protection, for which there are much sounder health reasons.

So I think that in effect the regulatory budget serves as a way of forcing cost-effectiveness and cost-benefit comparisons upon agencies. They will have to do it, because any action they take in one area will reduce their ability to act in another area.

Second, the regulatory budget would greatly enhance, I think, the attempts to develop the art of benefits estimation. To set a regulatory budget implies that someone, presumably it would be the Congress, has to decide that EPA, for instance, shall have \$30 billion or \$40 billion per year to spend. It seems to me it's very difficult to legislate a precise number like that without having some estimate as to what it is that we're going to get for that \$30 or \$40 billion.

How can you defend the proposition that it shouldn't be \$20 billion, for instance, except by showing that in fact that EPA has done, or prospectively will do something which is worth that extra \$10 or \$20 billion. It seems to me that the mere existence of a regulatory budget puts considerable pressure upon advocates for regulation to develop an

estimation of the benefits of regulation. At the present time, you will hear from those people advocating strict health, safety and environmental regulations that they've in favor of the use of cost-effectiveness or cost-benefit analysis, but you should remember that you can't do a benefit analysis when you're dealing with human health and life. They will tell you that it is very difficult to do such analyses.

Therefore they don't see how such an analysis ever can come about, but if, in fact, they are to be limited by a budget, and must plead for a budget, it seems to me they would be very interested in developing measures of benefits and costs.

Finally, it seems to me that just simply this discussion is useful because the opposition to a regulatory budget is going to have to take the form of: (a) We cannot estimate the benefits, and (b) perhaps we can't even estimate the costs. And if we're to have a public debate about where we're going in regulation, in which the opponents of some reform such as the regulatory budget, have to argue that we can measure neither the benefits nor the costs of what we're doing, it seems to me that the public will be educated as to what the problem really is.

So I've been a proponent of the regulatory budget as, at least a threat, if not a reality, to get us moving in the right direction. Now, I do understand there are significant problems in promulgating the regulatory budget. The problem of measuring indirect cost has been focused on substantially by Professor Wright and earlier by Mr. Eads.

I think it's a real and significant problem. I don't think at this point that we can look very quickly toward a regulatory budget in which indirect costs are included in the budget. That, I think, tells me that we cannot apply a regulatory budget to EPA or the Department of Interior, because I think a very large proportion of the costs of that type or regulation are indirect costs. I think this share will become even greater with time, given the statutes that are on the books. Even worse, I think that the imposition of a regulatory budget will move these agencies more and more toward programs in which indirect costs predominate.

And it will move the legislative committees in the Senate and the House to passing laws which will force more of the regulatory costs to the indirect, rather than the direct side of the ledger.

Let me give you an example. Whenever you're controlling the emission of anything into the environment, what you're concerned about mostly, except for highly toxic substances, is the total loading in the overall environment of, say SO₂ sulfates, particulates, or maybe lead. Therefore, the problem is to determine the ideal level and second to determine who gets to emit these pollutants into the environment.

Now, there are obviously two choices. One: You can allow existing sources to emit. Two: You can allow new sources to emit, or you can constrain one or the other. At the present time, we constrain new sources much more tightly than we do existing sources.

I can see a movement even further in that direction, to the point where EPA simply shuts down virtually all new plant construction in an effort to control the emissions of the particulates or SO₂ and comes to the Congress and says that the costs of this program in terms of direct plant costs are close to zero.

The real cost in this program is the reduction in innovation, the reduction in productivity which comes about through the failure

to develop new technologies and new plants where they make the most economic sense. So I'm concerned that if we're to develop a regulatory budget for an agency like the Environmental Protection Agency, at least in many of its programs, or for the Department of Interior in its land-use programs, strip mining regulation and the like, that we include indirect costs and that we develop very carefully the methodology for including these costs. I don't think that this is an impossible task.

I just think that probably if you were to promulgate a regulatory budget in the next year or two that we would have considerable difficulty in measuring indirect costs with any precision.

A second problem is that almost all existing statutes are going to have to be revised somewhat, because the requirements in the statutes for various regulatory agencies are fairly absolute. The agency generally is instructed to proceed with regulations to protect human health and safety to the maximum extent reasonable or feasible.

Obviously, if a budget constraint is going to limit the ability of agencies to move in particular areas, it will be in conflict often, with those statutes as I understand them. Yet if this budget constraint is not binding, it will simply have no effect. It will simply become an exercise for accountants and economists but have no social benefit. This budget has to be binding to have any social benefit. If it is binding it may well limit regulators, and in that sense I think that existing legislation would have to be changed.

Finally, as to problems, I must submit that I don't agree with George Eads, who testified earlier today. He talked about economists' wisdom. I don't know that they convey much wisdom, but I'm not even sure they can convey a consensus. I don't think that the fact that the Congress has moved us more and more into government regulation and essentially government planning of business argues that we must go further down that route.

As a matter of fact, I would argue that if you look at various areas of regulation, you can simplify the process and provide much more simplified economic incentive systems which would get us to the same result without any requirements for planning. There is no need to have agencies planning the varied details of a new industrial plant in order to make sure that it complies with Clean Air Act standards.

At the present time, in the Clean Air Act we have requirements for the best available control technology standard, the lowest achievable of emission rate standards, and reasonably available control technology standards across all industries. This detail is not required. All that is required is that we have some system for allocating the scarce rights to emitting SO_2 or particulates or ozone into the environment. We don't need to have all of that planning.

So, I don't see that moving towards a regulatory budget necessarily requires us to hold back until we develop a means for effective planning. In fact, I would like to see the regulatory budget go forward at the same time that we attempt to induce simplification and simpler incentive programs for regulatory agencies such as OSHA and EPA.

Finally, on the regulatory budget, let me warn you that one of the major debates on health, safety, and environmental regulations, as I'm sure you're aware, is the debate over how any mortal can set a value on

a human life or on human health. If in fact the Congress moves toward a regulatory budget, it will be determining implicitly the value of human health and life. You will have to defend these judgments to your constituents as you vote for only a \$30 or \$40 billion budget. I think that's as it should be. I think we ought to have those decisions made legislatively, rather than informally and not in any rigorous fashion, by regulators.

So I think that the regulatory budget moves us four-square into the arena of cost-benefit analysis, and I think the benefits particularly will be debated within the Congress. Part of that debate will be over what value do you place upon reducing the chances of illness or death from particular hazards.

Thank you. That concludes my statement.

[The prepared statement of Mr. Crandall follows:]

PREPARED STATEMENT OF ROBERT W. CRANDALL¹

For nearly two years, I have been advocating the introduction of a regulatory budget for at least one federal regulatory agency as a trial measure. My reasons for doing so are not necessarily to reduce the scope of regulation nor to shackle existing regulatory authorities. Rather, I believe that some form of overt, measurable social control over our regulators is imperative if we are to obtain benefits from government regulation which are commensurate with the costs. I continue to believe that a trial of the regulatory-budget concept would be merited, but I am fully cognizant of the difficulties in measuring costs in any precise fashion. Before proceeding to discuss some of these problems, however, I would like to indicate why some new mechanism is required to save us from mindlessly wasting our resources in the pursuit of noble objectives.

Social regulation: The only institution without a budget constraint.—In virtually every major institution which controls a share of our society's resources, the use of these resources is limited by a budget. Households, firms, most government agencies, and even the military services are operated with a budget limitation. Only regulatory agencies—such as EPA, OSHA, CPSC, or FDA—are not limited by such a device in their discretion to command our society's resources to protect the public. Regulatory standards or rules may have to be "reasonable" or "feasible", but there is no mechanism which forces the decisionmakers in these agencies to trade off expenditures on one goal for outlays on another. If, for example, the Administrator of OSHA is persuaded that 1 parts per million standard is safer than a 5 parts per million standard for benzene, she need not ask if setting the tighter standard impedes her ability to spend resources on, say, the lead, or the noise standard. She knows that it does not. Her budget is, in a sense, unlimited. As long as she does not bankrupt a number of firms or otherwise overstep her legislative mandate, there is virtually no limit to her ability to command resources from the private sector.

In the absence of a regulatory budget, regulators may proceed as if the resources they command have no other social value. How, they would ask, can you question virtually unlimited spending for reducing cancer in the work place, exposure to Love Canal, or prevention of an infinitesimal probability of a nuclear melt down? The answer, of course, is that the resources they command could also enhance the quality of life by increasing the number of refrigerators, Big Mac's, automobiles, yacht trips, and disc roller rinks available to consumers. They might also increase the potential supply of such goods as food, clothing, and shelter. In short, regulation affects the human condition by reducing the cancer rate and by the reduction in social output which is occasioned by the very attempt to reduce the cancer rate. We need some mechanism to make sure that we do not lose too many loaves of bread or Big Mac's in the pursuit of a long life free of cancer. Alternatively, we need this mechanism to make sure that we have enough cancer protection or that we are getting as much

¹ The views expressed are my own and are not necessarily those of the officers, trustees, or other staff members of the Brookings Institution.

cancer protection as we possibly can from the regulatory expenditures we bear.

The benefits of a regulatory budget.—I see at least two major benefits from utilizing a regulatory budget to limit the total value of resources commanded by a social regulatory agency in a given year. In the first place, the imposition of a regulatory budget would require Congressional action on the size of the budget. This would require some attention to the benefits of regulation. How would EPA be given the right to command, say \$30 or \$40 billion per year without some evidence that it is providing the public with commensurate value in the form of a cleaner, safer environment. Without some attempt to measure benefits, it would be difficult to argue for \$30 billion rather than perhaps \$25 million. In short, I would think that the art of benefits estimation would be greatly enhanced by the need to persuade Congress of the appropriate limit to regulatory outlays. This would, in turn, provide regulators with better estimates of the value of alternative regulatory policies, and the public would be provided formal evidence of the value of the programs for which it pays.

Secondly, a regulatory budget would force each regulator to make tradeoffs across various policies. Pursuing very tight standards for ozone, which is not very harmful to humans at low concentrations, would reduce EPA's "budget" allocation for toxic substances and carcinogens which are more harmful. Very soon, each agency's management would begin demanding staff estimates of alternative standards and of the cost of different degrees of regulatory stringency because each decision would affect the value of regulatory options available elsewhere. This would make regulators more like ordinary mortals—aware of the finite limits of nature's resources and man's ability to harness them. Cost-benefit analysis would become an important tool for regulators, not just a concept grudgingly given lip service.

Finally, the debate over a regulatory budget is likely to be illuminating in itself, even if the regulatory budget proves to be a concept without a political constituency or hope of practicality. The public will learn from regulators that they cannot support such a concept because costs are "impossible" to measure. If regulators find the measurement of these costs so difficult, how can the public be sure that it is being well served by regulation? Is it not time to spend a few resources upon the science and techniques of cost and benefits measurement before proceeding blindly to extend regulation in new directions?

Problems of implementation.—There can be little doubt that most social regulation creates impacts which are sufficiently far reaching that they may be difficult to measure. It may be simple enough to measure the cost of the experimentation required to prove the safety or efficacy of a new drug. But how can the cost of delaying its introduction be measured? People may die or suffer great distress because the drug is not available. This suffering is the "cost" of regulation just as much as the outlays for experimentation. But these "secondary" effects of regulation are not measured systematically by any decisionmaking element of our society. Therefore, their extent must be assessed by the regulatory agency itself or by a government agency entrusted with supervising the application of a budget.

The fact that most social regulation has secondary impacts should not dissuade us from seeking to measure them or to use the measures in some technique of control over the regulators. To ignore these costs because they are difficult to measure is to invite disastrous consequences because indirect or secondary costs are likely to become much more important in future years. A short list of some of the more important secondary costs of regulation would include:

(I) The reduction in new-plant investment caused by nonattainment and PSD regulation under the Clean Air Act.

(II) The decline in productivity in coal mining created by mine-safety regulation.

(III) The reduction in coal output due to strip-mining regulation.

(IV) The effect upon the introduction of new technology caused by lengthy licensing procedures.

(V) The reduction in product diversity caused by mandated fuel-economy, safety, and emissions standards for automobiles.

(VI) The general reduction in innovation caused by uncertainty over current and future regulations.

(VII) The absence of new-plant investment caused by paucity of sites for disposing of hazardous wastes.

Each of these effects—like my earlier drug example—entails a social cost which is not likely to be recorded directly by anyone. It therefore requires analytical skill and ingenuity to quantify them.

It might be argued that a regulatory budget should exclude indirect costs and include only directly-measurable "compliance costs". This would eliminate a difficult problem and focus upon a set of outlays which are recorded by entities in the private (and public) sector. Such a strategy might be appropriate for the first implementation of the regulatory budget, but it could induce an undesirable change in regulatory strategy.

In part, the regulatory budget is supposed to provide a modicum of social control which zealous Congressional committees have been unwilling to include in the enabling legislation for EPA, OSHA, CPSC, or the FDA. These committees, with strong constituencies interested in securing health and safety benefits without much attention to costs, could be expected to fend off a compliance-cost budget by changing legislation in predictable ways. Proscriptions on new health-endangering activities would substitute for requirements that existing economic agents incur compliance costs. This is already beginning to occur in environmental regulation where new sources in nonattainment areas or PSD areas are to be sharply limited by government fiat, regardless of the equipment they promise to install while existing sources in nonattainment areas receive more lenient treatment. Moreover, this strategy is likely to have considerable acceptance among businessmen with existing plants. They would prefer proscriptions on new entry to heavy compliance costs for obvious reasons.

There are fewer opportunities for this type of evasion of measurable compliance costs in the occupational health and safety or product safety areas, but all of the social costs of regulation in these areas are probably substantially less than the cost of environmental regulation. Hence, any regulatory budget which skews the choice of regulatory technique in protecting the environment is to be seriously questioned.

If a regulatory budget focused solely upon direct compliance costs is to be enacted, I would suggest that it be attempted for one agency at first and that the agency not be EPA or the Department of Interior because of the importance of indirect costs in their approach to regulation. It would be better to try a limited regulatory budget in an area where it has a reasonable opportunity to work and have an effect upon the regulatory program. Perhaps OSHA would be the ideal choice for this limited trial.

A second major problem involves the linkage between a regulatory budget and existing statutes which the agencies must implement. Unless each of the statutes is amended to allow for deferred compliance schedules or failure to achieve the full objectives originally specified, the regulatory budget will emasculate in its first year. A regulator would be able to plead that exceeding the budget allocation was required by "the law". Therefore, the budget constraint should be considered primary, perhaps with carryover or carryback provisions. Regulators must be encouraged to satisfy their regulatory objectives within this binding constraint or it will have no effect on anything. If year after year, the Congress observes that desirable objectives are not being met because of the budgetary limitation, the budget can be increased or Congress can exercise its oversight responsibility to spur on better regulatory performance. But the regulatory budget must always be a binding constraint—otherwise it is nothing but a superficial *ex post* accounting service.

Finally, there is the political and organizational problem of determining the arbiters or administrators of the regulatory budget system. Some organization must have final jurisdiction in determining whether the regulators have remained within their budgets. This is especially important since there is no automatic limitation of the form found with traditional budgets. No one will fail to authorize the checks to pay for excessive expenditures since regulatory compliance costs are not paid for by the regulator. Moreover, the calculation of regulatory costs will necessarily generate considerable differences of opinion between the regulators, their auditors, and the regulated firms. For instance, EPA's inspection and maintenance program for motor vehicle emissions is likely to be much more costly than the \$5 per vehicle EPA has often quoted as its cost. The cost of driving to the inspection station is likely to be at least \$5, a fact which OMB and the industry will recognize even if EPA does not.

I know of no easy solution to the budget control problem. S. 51 requires reports by the agency to the President, the Congress, and the Comptroller General.

This statute apparently gives to the Comptroller General the final authority for assessing the costs and reporting them to Congress. Perhaps this should be a combined responsibility of the Comptroller General and OMB, but whatever the structure of the final review, one can be sure that heated disputes will develop.

Summary.—I continue to believe that a regulatory budget can be a useful tool for social control of regulatory agencies. It will not be easy to implement, however, and it may never be workable for every agency. If it is to be a useful tool, it must include indirect compliance costs for agencies controlling environmental damage and land use. Otherwise, policies shifting the cost from direct compliance outlays to indirect costs will be devised to circumvent the regulatory budget. These policies would have disastrous implications for productivity growth, competition, and general economic prosperity.

If the regulatory budget concept is to be developed sensibly without undue fanfare and exaggerated expectations, it should be limited at first to perhaps one agency which promulgates rules whose costs are largely direct compliance outlays. This would avoid the political risk of dashed expectations caused by the failure of a grand, sweeping program to achieve results—precisely the problem with zero-based budgeting and government reorganization under this Administration. We should see if a regulatory budget can work in a limited arena before drowning the public, the Congress, the vast federal bureaucracy, and business firms in a new sea of paper floated by hungry accountants and economic consultants. A prudent movement towards rationality is likely to be a good antidote to unwise, inefficient regulation. But the system of control should be launched in such a manner as to provide the public with the perception that it can work rather than competing with the regulatory agencies themselves for ridicule from the press and the public in general.

The commitment by the Congress to a regulatory budget would be an indication that it now wishes to take cost-benefit analysis seriously. The budget must be a binding constraint upon regulators' ability to command resources; therefore, it must lead regulators to choose to sacrifice a little in one regulatory area in order to mandate greater expenditures in another. The size of the budget would be debated and voted by Congress, implying that it is Congress which would determine the value of human health and safety. The regulators' decisions will give us a reading on just how high this value is, but since these decisions would be constrained by the budget, the arbiter of the "value of life" would in fact be the Congress. This is probably as it should be, but the Congress should recognize that it will now have to make difficult choices. It can no longer invite regulators simply to serve "the public interest" through "feasible" or "reasonable" regulation. The reasonable degree of regulation would be determined instead by our elected representatives.

Senator BENTSEN. Mr. Wright. You may proceed with your testimony and then we'll ask questions of the panel.

STATEMENT OF ARTHUR W. WRIGHT, ASSOCIATE PROFESSOR OF ECONOMICS, PURDUE UNIVERSITY, ACCOMPANIED BY CHRISTOPHER DeMUTH, DIRECTOR, FACULTY PROJECT ON REGULATION, HARVARD UNIVERSITY, AND RICHARD SHACKSON, DIRECTOR FOR TRANSPORTATION OF THE ENERGY PRODUCTIVITY CENTER, MELLON INSTITUTE FOR RESEARCH

Mr. WRIGHT. Thank you, Mr. Chairman. My name is Arthur W. Wright. It's a privilege for me to testify before your committee on the subject of the regulatory budget.

This testimony is based on a study entitled "The Regulatory Budget as a Management Tool for Reforming Regulation." An interdisciplinary team of Christopher DeMuth, Richard Shackson, Eric Stork, and I prepared that study on commission from your committee.

Before summarizing the principal conclusions of the study, it is useful to sketch the qualifications of our team. We formed this team

because of the need for diverse training and experience to thoroughly analyze the complex subject of a regulatory budget.

Christopher DeMuth is an attorney who has had experience as a White House staff member and as a corporate counsel. He is currently director of the faculty project on regulation at Harvard University.

Richard Shackson is a graduate engineer who has extensive experience as a policy analyst in industry. He is currently director for transportation of the Energy Productivity Center, Mellon Institute for Research.

Eric Stork is a senior Federal regulatory official; most recently, he was a Deputy Assistant Administrator at EPA. He is currently on assignment from EPA as a visiting professor at Purdue University.

I am an economist, with a particular interest in the economics of regulation. My professional experience is mainly academic, although I have also been a consultant and member of several government task forces. At present I am at Purdue University, but this fall I shall move to the University of Connecticut as head of the economics department.

Messrs. DeMuth and Shackson are here with me today. Mr. Stork wanted to be here very much, but regrets that he had a long-standing speaking engagement today that he could not cancel.

The principal points of our study to this committee on the regulatory budget are as follows:

Regulation is one method by which the Federal Government claims resources to achieve its goals. The share of the Nation's resources claimed by regulation has grown rapidly in recent years.

At present, there are only weak constraints on the Government's use of resources through regulation, and there is no procedure for incorporating the full cost of regulation into government decisionmaking. A system for budgeting regulatory compliance costs has significant potential as a management tool for bringing the economic impact of Federal regulation under control.

It might be possible, on strictly legal grounds, to establish a regulatory budget system by administrative action. However, the political significance of a regulatory budget suggests that it should be established by legislation. There appear to be no constitutional barriers to including the independent regulatory commissions in such a budget, along with the regulatory agencies in the executive branch.

The organization and management of a regulatory budget system could conveniently and effectively be patterned on the process currently used for the fiscal budget. Enforcement of regulatory budget ceilings would pose no unusual problems. In the initial stages, it would appear expedient to focus on the compliance costs of new and revised regulations. Coverage of existing regulations could be added subsequently.

The ability to make reliable estimates of the costs of regulation is essential to the operation of a regulatory budget. While existing techniques for cost estimation need improvement, the very existence of a regulatory budget system would stimulate work on new or improved methods. A methodology recently applied by Arthur Anderson & Co. to quantify the costs of existing regulations would be a useful point of departure for developing the precise, consistent and trans-

parent estimates of compliance costs that would be required for a workable regulatory budget.

Mr. Chairman, this completes our prepared testimony. My colleagues and I will be glad to respond to any questions the committee may have.

Perhaps I should add, Mr. Chairman, that our study focused on how a regulatory budget would work, on what possible procedures could be used and on problems of implementation. We expressly did not address any particular bill to establish a regulatory budget in the study; however, I think it can safely be said that there is no inconsistency between our report and Senate bill 51, at least in broad outline.

We would like to mention one caveat. Senate bill 51 envisions a rather ambitious startup of a regulatory budget. It starts off with total regulatory costs in the internal logic of the bill, and it would have a relatively tight timetable compared with the one that we tried to estimate in our study. We believe that the perceived burden of starting with total costs would be a possible obstacle that would be unrelated to the substance of a regulatory budget, and that the perceived burden of implementing a budget would be directly proportional to the rate of introduction.

For that reason, we suggest in the study that staged implementation of some kind might be more appropriate. We do conclude—this is subject to discussion and revision, of course—that it would be unwise to start off with one agency or even a few agencies because of the connotation of experiment and the dangers following therefrom in implementing the whole system itself. We would, however, suggest that the staging apply to the types of costs covered rather than singling out one agency or a few agencies.

Thank you, Mr. Chairman.

Senator BENTSEN. Mr. Crandall, you've hit on a sensitive nerve in your prepared statement and in your oral testimony. Your discussion of human life and health and cancer illustrate your point that you have to make tradeoffs in our resource use. We can have excellent housing for everyone if we devoted all our resources to it.

But we don't. We recognize we have limited resources and we have to make tradeoffs. Can you think of any way that we could have rational tradeoffs in our regulatory programs without some kind of comprehensive listing of regulations and their costs as provided for in the regulatory budget?

Mr. CRANDALL. Well, I guess the answer to that depends upon whether you're trying to reform the entire regulatory process or bring the reform to a particular area. It seems to me that there is no alternative but to list the effect of a regulation and perhaps of all regulations. We can show individually what we are doing by writing down the costs and benefits of a particular regulation; however, we cannot reach much of a judgment as to the efficiency of regulation without knowing what we're doing in another area, which addresses a very similar problem.

For instance, it doesn't make much sense to look at the technology for controlling SO₂ emissions from copper smelters and come to a judgment based in part upon political pressure that will only require copper smelters to control SO₂ emissions up to the level where it costs

them about \$40 per ton removed. Next week we make a decision on the performance standards for electrical utilities some of which are in the same area, which results in a cost that is variously estimated to be between \$800 and \$2,000 per ton of SO₂ removed. That cannot be a set of sensible decisions. You have to analyze the cost and indeed the benefits of a variety of regulations addressing the same generic set of problems before you can determine how efficient the regulatory system is.

Senator BENTSEN. Each of you refers to some testing and you talked about different approaches to it, but when I think how long it took for the Congress to get to a budget process and how important it was—it's having some major effect now on spending by the Congress—I'd like to see this process moved along.

Do you think—any one of you—do you think that within a year that we'll be in a position to do some testing? If not, what should we do prior to that time?

Mr. CRANDALL. Well, I think it's possible to begin on a limited scale. I do advocate trying it for a particular agency or maybe a small set of agencies. I fear that if we were to make this requirement comprehensive across all agencies that we would have major implementation problems and spend a lot of resources fine tuning the idea and making a lot of errors to begin with.

I also suggest that we go to those agencies for which the compliance costs are mostly in the direct category. In my prepared statement, I suggest that OSHA is a possibility but I haven't given that enough thought to conclude that OSHA is necessarily the optimal one. I am sure in my own mind that EPA and the Department of Interior are not the best places to begin.

Senator BENTSEN. Because they would be indirect.

Mr. CRANDALL. Because of the indirect cost problem, right. But I do think that because of the attempts that have been made in measuring costs in various parts of the Government and by the private sector, most recently in the business roundtable study done by Arthur Andersen, to which Professor Wright referred, I think it is possible to begin now with a budget addressed to direct costs.

I think the businesses that did that learned a lot about the process of trying to estimate these costs and are quite willing to share it with officials within government and indeed, officials within government were informed and briefed on the entire process so it would not be that difficult to get started. I think it could start in very short order.

Senator BENTSEN. Would any of you other gentlemen care to comment?

Mr. DEMUTH. Yes, Mr. Chairman, I would like to note that the executive branch regulatory agencies are already preparing fairly exhaustive cost estimates of their major regulatory proposals at present, under President Carter's regulatory review program. Under legislation which you have introduced, which the President has proposed as well, these analyses would be done by the independent agencies as well.

So the first step toward a regulatory budget, presumably, would be for some group at OMB or COWPS to collect these cost analyses and consolidate them as part of a special analysis of the budget.

So most of the work of cost analysis is being done, at least in rudimentary form as to the major regulatory divisions right now. To begin

working toward a regulatory budget requires a process of consolidating and bringing together all of these studies.

Senator BENTSEN. It's been interesting to see the administration pick up some of these ideas. We've introduced legislation on it, bills on it, and we've seen them adapting some of those bills.

Mr. SHACKSON. One further point, Mr. Chairman, on what might be done when. In view of the fact that there is progress being made in estimation of costs by individual agencies, I'd like to reiterate what we suggested in the report—namely, that one should probably make a start much more broadly with regard to agency coverage, perhaps not in such depth with regard to type of costs, for two reasons. One reason is, it avoids the connotation of an experiment and the singling out of the individual agency.

Second, one of the major benefits to be derived would be the ability to assess the cumulative impact of a number of agencies' actions on a particular segment of the economy. And we suggested that a start might be made by requiring only the assessment of costs of new or proposed regulations in a given year, which is essentially being done now under present Executive orders over a period of a few years.

Later, the costs of existing regulations could be picked up, so that after a period of time the full compliance impact would be assessed.

I think there's a second point that needs to be made in this regard and that is that frequently the primary economic impact of a particular regulatory proposal is not experienced in the year in which the proposal has been located and in some way ought to be arrived at.

We've made a couple of suggestions in the study for anticipating the stream of impacts over the life of the regulation and reflecting an annualized estimate of this in the budget, so that the regulation which in its first year might have only minor impact but 3 or 4 years down the stream might have very substantial impact would be properly regarded in the regulatory budget, and this might be part of the start-up activity.

Senator BENTSEN. Mr. Crandall, the current inflation rate on an annualized basis is up to about approximately 13 percent. In your Brookings study, were you able to arrive at a percentage that regulation contributed to that inflation rate?

Mr. CRANDALL. I was really examining how government activities have added to the overall price level. Here, there is a bit of a misconception and something perhaps to which I contributed when I was in the Government on the Council on Wage and Price Stability. There is a difference between once and for all changes in the price level and the rate of inflation. Clearly, in internalizing external social costs through, say, environmental regulation, land use regulation, strip mining regulation one adds to the cost of doing business. It adds to the cost while the regulations are being put in place, but thereafter, the costs do not rise any further. There's a once-and-for-all shift in the price level.

So the inflationary effect in terms of percentage points on the CPI in a year is a function of how fast you move in promulgating regulations. It's hard to estimate that for all regulation. I think you can probably say that for EPA, it's been in the range of 0.2 to 0.3 percent on the CPI per year.

This is one of the reasons why central control of government decisionmaking processes is often very difficult. When contemplating these impacts, you rarely can come across a government program or proposed policy which is going to have as much effect as 0.1 percent on the CPI.

But when you add up the score of the policy decisions they add up to a big impact on the CPI; 0.2 or 0.3 percent sound like small numbers, but indeed if this goes on for 10, 15, 20, it cumulates to a very large number.

SENATOR BENTSEN. I noticed in your prepared statement, Mr. Crandall, that you said, in effect, the budget of a regulatory agency is unregulated. We don't have any way of limiting the ability of regulators to command resources from the private sector.

Let me ask some of the others, how do you react to that? Do you find that government agencies behave as though the resources at their command are unlimited, or do they sense resource constraints? Could any of you comment on that?

MR. SHACKSON. Just one comment. From the perspective of being in the private sector, the awareness of resource constraints seems to be a direct function of the ability of the regulated segment of the economy to point out quantitatively what resources are giving problems.

The hearing process at the time of the notice of proposed rulemaking can be an effective discipline to the extent that the regulated industry is prepared to quantify and argue about it; however, this frequently is too late in the regulatory process to have a strong influence on budgeting of the entire agency's activities, and is certainly a function of the ability of the regulated sector to amass arguments.

SENATOR BENTSEN. One of the charges against the regulatory budget is that it would put a limit, that it would impair the ability of regulatory agencies to carry out their statutory mandates. I'd like to hear one of you respond to that.

I know we put fiscal limits on money the Government spends on various programs. The program objective might be very worthy, but we'll put fiscal limits on them. Now what would you say about the charge that you limit the ability of a regulatory agency to carry out their statutory mandate?

MR. DEMUTH. Senator, I think you in a sense have just answered the question, by pointing out that the regulatory agencies presently operated under a fiscal budget, and the same argument could be made with respect to a fiscal budget.

Why should they operate under a fiscal budget? It limits what they can do. It's conceivable that the Food and Drug Administration would exhaust its fiscal budget a few weeks before the end of a fiscal year and suddenly discover that some food additive was carcinogenic and couldn't take any action—despite the Delaney clause—because it had no more funds to pay people to do what was necessary. Well, such a situation would never come up. A supplemental appropriation would have been arranged for, and such procedures could be followed under the regulatory budget as well.

So I disagree with Mr. Crandall that we would have to make important changes in all of the regulatory statutes in order to implement a regulatory budget, no more so than we have to change them to enforce the current fiscal budget.

Mr. CRANDALL. I don't want to respond to that point, but I simply wish to say that whether this puts a severe limitation upon carrying out the legislative mandate of the regulatory commission depends upon the stringency of the budget to start with.

Second, it's not clear what the regulatory mandate is in some cases. In fact, we perhaps don't know what OSHA's mandate is until the Supreme Court decides on the benzene decision because there are words like feasible and reasonable in the statute, which nobody clearly understands right now.

The Administrator of OSHA in this particular example, had to set a standard for the control of benzene. How did she determine that it should be 1 part per million rather than 5 parts per million or zero part per million?

The answer is there is no clear instruction on how to do that other than that she must not bankrupt firms in doing so, or that the regulation must be reasonable. I would think that there is a wide range to reasonableness, therefore, that a reasonable set of regulations which would emerge from a particular budget constraint could hardly be argued as not meeting the legislative mandate.

I think in other cases, it may well be possible that certain objectives have to be postponed because they cannot be met within the stringency of the budget set by the Congress.

Senator BENTSEN. Mr. Miller, we are glad to have you. We're glad you made it. Would you care to add your comments at this point?

STATEMENT OF JAMES C. MILLER III, CODIRECTOR AND RESIDENT SCHOLAR, CENTER FOR THE STUDY OF GOVERNMENT REGULATION, AMERICAN ENTERPRISE INSTITUTE FOR PUBLIC POLICY RESEARCH

Mr. MILLER. Thank you, sir. I am delighted to be here, for two reasons. First, because this is such a distinguished committee; and second, because your staff executive director, Mr. Albertine, and I were colleagues in graduate school.

I have a prepared statement which you may wish to have put in the record.

Senator BENTSEN. It will be.

Mr. MILLER. Regulatory reform by such means as a regulatory budget is, of course, no cure-all for inflation. Yet it's very, very important. I once had the opportunity of visiting with Prof. Paul McCracken shortly after I became Assistant Director of the Council on Wage and Price Stability. He asked me if the Government adopted all the things I had recommended at that point in time, how much difference would it make in the CPI? I said perhaps "0.00." He said, "I think you're being too modest. It would probably be 0.002." Of course, we were talking about rather ballpark figures.

But I think something needs to be stressed in this context. Although macroeconomics is not really my specialty, I am quite sure you wouldn't go wrong in the long run if you characterized the cause of inflation as too much money chasing too few goods. This raises immediately two alternative policy approaches to the inflation problem. The first is restraining aggregate demand by retarding the rate of growth

of the money supply and by conservative fiscal policies. As you know, that approach often has an adverse effect on aggregate supply.

The other approach is increasing aggregate supply. Removing the artificial inefficiencies imposed by unwise regulation has the effect of increasing aggregate supply.

The importance of this point, in this context, is as follows.

As Adam Smith said, "The objective of production is consumption." What we're most interested in is increasing the supply of goods and services for everybody; therefore, a very small percentage reduction in the rate of inflation brought about by an increase in aggregate supply is many more times desirable than the same decrease in the rate of inflation brought about by restraint on the demand side.

Thus, regulatory reform and tax policies meant to increase productivity are so much more important, it seems to me, than policies meant to restrain aggregate demand. This is not to say that in the short run we shouldn't use both. But we should really focus on the supply side. And that's one reason I was very impressed with your recent annual report, which addressed the productivity issue.

Now, just a few notes on my prepared statement. It seems to me that we need to continue to draw analogies between the financial budget and the regulatory budget. Where would Congressmen, Senators, the President, and other policymakers be today, in terms of allocating resources in the public sector, if we didn't have a financial budget?

Government can obtain resources in three ways: Taxing and using those proceeds to buy things in the private sector; printing money and using the money to pay for such resources; and conscripting resources outright. In essence, regulation to accomplish social ends is not unlike conscription, and I think we need to have a handle on the size of that bundle of goods and services that we're conscripting, to know what size it is and to know to whom those resources are being allocated and from whom they're being taken.

And it seems to me the regulatory budget would accomplish that in great measure.

Now, the arguments against a regulatory budget are precisely those arguments against the financial budget. You know, one is that it's antiregulation. Well, I guess having a budget, by itself, is antispending, but that's not all bad, it seems to me. While I don't think we necessarily want to be antiregulation, we do want to make sure that we know and discuss the size of the resources being spent. Moreover, it seems to me that having a regulatory budget can be an important discipline to the management of our regulatory procedures and processes. Because of this, perhaps we could even increase our pursuit of regulatory objectives while realizing a lower total cost. That seems to me something very desirable.

The second thing you will hear is that it's immoral to deal in a budgetary way with these issues involving human health, safety, and well-being. But we do that now when we consider the financial budget, as when we talk about spending so much money to repair roads or to support cancer research and that sort of thing.

I am not saying that the regulatory budget would solve all the problems of regulation. The regulatory budget would be open to some of the

same problems that plagues the financial budget. Columnists and political scientists have written about how agencies manipulate budgets in order to expand them, how bureaucracies have their own objectives, how they play the "Washington Monument game" and that sort of thing; they would do this under the regulatory budget. But it seems to me that we would be a lot better off if this mechanism were put in place.

Let me say, finally, that I suggest in implementing a regulatory budget the Congress consider crawling before we walk and walking before we run. What you might want to consider, Senator, is implementing a regulatory budget for an agency or two for a short period of time—to give it a dry run, a shakedown cruise. I think a lot could be learned from such an experience—the things we need to avoid and opportunities we could seize upon in implementing the program on a broad scale.

Thank you, sir.

Senator BENTSEN. Thank you very much, Mr. Miller.

[The prepared statement of Mr. Miller follows:]

PREPARED STATEMENT OF JAMES C. MILLER III

Mr. Chairman and Members, I very much appreciate this opportunity to present before this distinguished committee my views on the proposal for a Regulatory Budget. I should stress, of course, that these views are my own and do not necessarily reflect those of the American Enterprise Institute, with which I am associated.¹

The Regulatory Budget would seem to be an idea whose time has come—or at least is coming and coming soon. Certainly, those of us who have labored in the regulatory vineyards are convinced that more rationality needs to be imposed upon our federal regulatory activities. In my judgment the Regulatory Budget represents an efficient device for accomplishing this goal. What appears now to be the major issue is not whether some type of regulatory budget needs to be enacted, but just what form it should take and how it should be implemented.

In these brief remarks, I would like to comment on the need for analyses of the benefits and costs of regulatory activities, the appropriateness of a Regulatory Budget, and how such a budget might be initiated.

THE NEED FOR ANALYSIS OF BENEFITS AND COST²

Regulation of the U.S. economy to promote certain "social" goals like a cleaner environment, safer products, and a healthier workplace is not new. What is new is that during the 1970s the federal government's regulatory role has greatly expanded. Indeed, the rate of growth and all-pervading nature of regulation has raised another serious concern: the stubborn flames of inflation may have a new source of fuel. In fact, there is a growing awareness of a linkage between regulation and inflationary pressures. Because of this linkage, the benefits and costs of government regulatory actions must be considered with extreme care.

Consider the growth of the new regulation just during the decade. In 1970, the Environmental Protection Agency was established, followed by the Occupational Safety and Health Administration in 1971, and the Consumer Product Safety Commission in 1972. Between 1970 and 1977, the number of major federal social regulatory agencies rose from twelve to seventeen, total budgeted expenditures increased fivefold, and the number of pages printed annually in the Federal Register more than tripled. Of course, these indicators of cost merely begin to identify the full impact of regulation. Available estimates suggest that regulatory costs to the private sector may now exceed \$100 billion annually.³

¹ The American Enterprise Institute for Public Policy Research (1150 Seventeenth Street, N.W., Washington, D.C. 20036) is a non-profit, non-partisan research and educational organization which does not itself take position on public policy issues.

² This section is adapted from James C. Miller III and Bruce Yandle, "Benefit-Cost Analyses of Social Regulation: Case Studies From the Council on Wage and Price Stability" (Washington: American Enterprise Institute for Public Policy Research, 1979), pp. 1-5.

³ See Murray L. Weidenbaum, "The Costs of Government Regulation to Business" (Washington: Joint Economic Committee, April 10, 1978) and Murray L. Weidenbaum and Robert DeFina, "The Cost of Federal Regulation of Economic Activity," American Enterprise Institute, Reprint No. 88 (1978).

This growing edge of federal regulation is not only large, it is different in character from that of the past. Instead of the more traditional economic regulation dealing with rates and services of specific firms and industries (for example, airlines, truckers, broadcasters, telephone and power companies), the new social regulation covers a broad range of industries and types of commercial activity. Moreover, it is highly specific in terms of its requirements. For example, regulations dictate the contents of labels attached to consumer products, prescribe in minute detail a multitude of work practices, mandate specific processes for the treatment of industrial wastes, and establish uniform designs for products as simple as book matches or as complex as automobiles.

If one theme underlies the statutory approach to social regulation, it is the desire for perfection—for a world without risk. While everyone dreams of Utopia, at some point society is forced to ask, "Is such perfection in fact feasible?" And if so, "Is a step in that direction worth the cost?" In short, social problems and their solutions take on an economic dimension. The old problems of scarcity and necessary trade-offs cannot be avoided.

This is where benefit-cost analysis comes in. Although much maligned by its detractors, benefit-cost analysis can be most useful to a policy maker. Basically, all it entails is weighing the benefits and costs of a proposal before action is taken. At one extreme, the analysis might be no more quantitative than the policy maker's concluding that he or she "feels" the benefits of an action outweigh the costs (or the other way around). At the other extreme are the highly sophisticated estimates of benefits and costs usually conjured up at the mention of the term "benefit-cost analysis."

Without question, estimating benefits and costs is often difficult, especially in the areas of social regulation, where the benefits may be in terms of lives saved or pain and suffering avoided. Some say this means putting a value on human pain, suffering, and death, which is not only ludicrous, but downright immoral. If anything, we would argue, the reverse is true. Since resources are limited, we cannot avoid the need to identify—and, in some way, to estimate—benefits and costs. The more compassion we have for our fellow human beings, the more important this becomes. For benefit-cost analysis is merely a shorthand summary expression of who would benefit by how much from a proposed policy change, and who would be forced to sacrifice, at what cost. Indeed, benefit-cost analysis can point the way toward increasing the degree of perfection by identifying ways to minimize costs. Whether or not benefit-cost studies are used, however, every policy action reveals that, in the mind of the decision maker(s), benefits do exceed costs and that the distribution of benefits and costs is socially desirable. Thus, all policy decisions—whether to adopt a new initiative, to modify it, or to accept the status quo—reveal an implicit benefit-cost analysis.

Benefit-cost analysis really has two dimensions. The first is that of aiding the decision maker in deciding whether a given proposal should or should not be adopted. That is, "Do the benefits (somehow measured) exceed the costs (also somehow measured)?" In practice, this may simply be a listing of the measurable benefits on one side of the ledger and the measurable costs on the other, and then noting the various subjective benefits and costs to be weighed in the balance. The second dimension of benefit-cost analysis has to do with analyzing alternatives. That is, are there alternative ways of securing the same social regulatory objective that impose lower costs on society, or at least distribute the costs differently? Or, for a given cost, are there alternatives that would come closer to the goal of perfection, or at least result in a different distribution of the benefits and costs when issuing standards, even those concerning consumer exposure "cost-effectiveness analysis." Basically, it is nothing more than an application of the efficiency axiom: maximize production for a given total cost; or minimize total cost for a given level of production.

THE NEED FOR A REGULATORY BUDGET

As is well known, regulatory agencies have been extremely reluctant to employ benefit-cost analysis as a decisionmaking tool. To be quite frank about it, much of the problem derives from the heterogeneity of the various legislative mandates. At one extreme is the Delaney Amendment to the Food, Drug, and Cosmetic Act, which precludes any weighing of benefits and costs: if there is any evidence that a food additive is carcinogenic, it must be banned. (The recent Congressional dispensation given to Saccharin is, of course, an exception.) At the other extreme is the Consumer Product Safety Act, which requires the agency to consider bene-

fits and costs when issuing standards, even those concerning consumer exposure to carcinogens. One might ask why there exists such variability in federal policy.

Another problem has to do with the agencies themselves. Despite best-faith efforts by two Presidents—Ford and Carter—and several laudable programs (Inflation Impact Statement, Economic Impact Statement, and Regulatory Analysis), the experience to date leaves much to be desired.⁴ For a number of reasons, agencies drag their collective feet when it comes to a benefit-cost requirement.

In my opinion, a Regulatory Budget would turn this around because each agency would have to establish clear priorities so as to maximize benefits within its (regulatory) budget constraint.

Of course, the Regulatory Budget is no panacea. Much has been written about the shortcomings of the ordinary financial budgetary process and how agencies play the "Washington Monument Game" and choose other strategies which do not necessarily lead to the most efficient allocation of resources. But one thing seems clear: if agencies were given regulatory budgets, the Congress of the United States, the President, and others would have a much clearer idea of the ramifications of agency decisions and therefore more information on which to base judgments of agency effectiveness. In addition, the Regulatory Budget would give the President and the Congress much more control over agency behavior.

No doubt this committee and others that have discussed the Regulatory Budget have heard numerous criticisms of the concept. These criticisms tend to be of two types: first, that regulatory cost analysis cannot be done, and second, that a focus on cost generates an inherent bias against regulation. As to the first of these, there is no question that in many cases an analysis of cost is something difficult to accomplish (although arguably less difficult than measuring benefits).

While the performance of many agencies in measuring costs has been less than exemplary, over time agencies have gained a great deal of experience—at least in estimating the costs of individual regulatory initiatives. The bottom line seems to be that while many would disagree over the precise estimates, in most cases fairly good approximations can be developed if the agencies go about the task with determination and employ competent analysts.

As for the bias point, the opponents of the Regulatory Budget are probably correct in that more concern over costs will reduce the pace of regulatory activity. However, such proponents of regulation should not lose sight of the fact that adoption of the Regulatory Budget might well cause agencies to become more effective in achieving their goals. The reason is that the Regulatory Budget could be an extremely useful management tool. But we should also ask the question: if a regulatory initiative cannot be defended on the basis of a proposed budget, does this not reveal that the goal itself is not worth the opportunities forgone in achieving it?

It seems to me that in assessing the Regulatory Budget we should draw analogies from the financial budget. For example, who is to say that agencies having responsibilities for non-regulatory programs would be more efficient in allocating resources if relieved of the obligation of meeting a financial budgetary restraint? Indeed, with regard to many programmatic areas, we find that some problems of ordering priorities in sensitive areas that critics allege make application of a Regulatory Budget infeasible. It is often said, for example, that it is difficult to establish priorities in the "social" regulatory areas because they deal with matters involving human suffering, pain, and death. But we do the same thing with programmatic areas that have ordinary financial budgets. The funding of cancer research is one example. What about programs to reduce infant mortality? The funding of railroad overpasses to increase highway safety? Dams constructed by the Corps of Engineers to reduce the danger of floods? The list could go on and on.

IMPLEMENTING THE REGULATORY BUDGET

Now, if a Regulatory Budget is such a good idea, should not Congress move forward with it expeditiously? Frankly, I recommend caution. The reason is that with any program of such magnitude, unanticipated problems, as well as unanticipated opportunities, are bound to arise. Thus, it would seem advisable to initiate the problem slowly and deliberately in order to learn from experience.

⁴ See, for example, James C. Miller III, "Lessons of the Economic Impact Statement Program," *Regulation: AEI Journal on Government and Society* (July/August, 1977), pp. 14-21.

What I would suggest the Committee consider is an "experiment" under which a single agency, or perhaps a few agencies, would be given Regulatory Budgets for all or even part of their programs. Prime candidates would be agencies that have a reasonably good track record in producing good analyses of the costs of regulatory initiatives. One possibility is the Environmental Protection Agency. If a smaller agency were to be chosen, consideration should be given to the Consumer Product Safety Commission. In any event, such an "experiment" would generate a great deal of information that would be useful in structuring a Regulatory Budget program applied on a broader scale.

Mr. Chairman, Members of the Committee: that completes my prepared statement. I shall be happy to address any questions you might have.

Senator BENTSEN. There have been a number of comments on that particular point, the last one. Practically everyone talks about including certain regulatory agencies, such as OSHA and EPA, and having their costs in the regulatory budget. It seems to me there's a controversy about economic regulatory agencies, such as the ICC. You get into the question of rates or entry into an industry.

I would like your comments about that, from any of you. Should that type of agency be included in a regulatory budget or not? If so, why?

Mr. WRIGHT. Mr. Chairman, we addressed this point in the study. Our conclusion is that the answer is "Yes," that the distinction that is sometimes drawn between economic and social regulation has become increasingly blurred; if it ever really existed in fact, and that, even if we confine the regulatory budget only to the compliance costs, the economic regulatory agencies do have substantial compliance costs; and to ignore them or to leave them out would be to invite a reallocation of effort toward those agencies.

There doesn't seem to be any compelling case to make the distinction. I am impressed with the distinction that Mr. Crandall raised, for example, the problems that you get into with EPA. I would point out that that's a different kind of distinction from the usual one.

The distinction between social and economic regulation would have included, I would have thought, EPA in the social category. He is suggesting that EPA has a very high proportion of indirect costs and that we might want to look at that. I think that's a very telling point, but I would not think that the conventional distinction between economic regulation and social is very helpful, so I would argue against making that distinction.

Mr. CRANDALL. I guess here again we are going to disagree somewhat. My view on economic regulation is that for the most part it's misconceived, redundant if it's done right, and socially counterproductive if it isn't. And I think it's mostly in the latter category.

In fact, what economic regulatory agencies are for the most part trying to do—and I am speaking of Federal regulatory agencies for the most part—is to somehow set rates for what people can charge for providing service. That's their ostensible mandate. In fact, there are some redistributive goals which are often asserted but never measured. Now, if you want to apply something like the regulatory process to the ICC to get them to try to quantify how much more they're allowing carriers to charge between two major nodal points in order to subsidize a small town, this might make some sense.

I was suggesting a more sensible procedure is to require the ICC to set the right rates—that is, those which are set by a competitive

marketplace—and then allow it to expire. I think that's the direction we're heading in hopefully on the ICC.

You almost have to look at these independent regulatory agencies individually. Look at the Federal Communications Commission. The regulatory budget might be useful in broadcast regulation to limit the FCC so that they can only require so much in the way of compliance costs. But this would require the FCC to measure what the opportunity cost is of denying of a considerable amount of diversity in national programming in order to subsidize local programming while, by the way, at the same time, so limiting the supply of national programming that the average rate of return on assets before taxes in broadcasting is a mere 100 percent.

If you want to look at FCC common carrier regulation, they're just simply involved in a struggle of trying to figure out what the costs of Bell System services are. And I think you might be chastened by any attempt to apply the new budgetary concept to this endeavor by the knowledge that the Federal Communications Commission, I think, has been trying to measure costs of Bell System private line service for 14 to 18 years without success. They go through sort of a biennial rite: Bell brings in a rate; they suspend the rate for 90 days; they have hearings; they determine they can't figure out what the costs are; and they come back again.

I don't see what benefit putting a regulatory budget on the FCC would bring, other than to show that, in fact, their broadcasting policy is basically bankrupt. But the Congress is now grappling with that problem and, in fact, Congressman Van Deerlin who has been a very strong supporter of broadcast deregulation, recently dropped that project.

If you can reform it through the regulatory budget, I would welcome you to try, but I think it's probably a futile endeavor.

Mr. MILLER. I would like to disagree somewhat with my distinguished colleague, Mr. Crandall, from the Brookings Institution. Maybe I should amplify my testimony to indicate that I am speaking for myself, of course.

Senator BENTSEN. You have both qualified your testimony in that regard.

Mr. MILLER. Thank you. I think it would be a good idea to require a regulatory budget for some of these economic regulatory agencies. Such agencies tend to hold down competition among firms. To some extent, their mission is to protect those firms already in the industry by keeping the outs out. So, there is some transfer of resources from consumers and people who would like to get into industry to those producers who are already inside.

It is also alleged that there is a great deal of cross-subsidization going on to small towns, and small shippers, or whatever. The work that I and Professor Douglas have done on the airlines, and a small amount of work on this particular issue I have done in the case of trucking, indicates to me quite clearly there is actually very little cross-subsidy going on. But it is an argument used to justify continuation of regulation and particular regulatory goals.

Imposing upon these agencies a regulatory budget would turn up the amounts, resources being spent and would cause agencies to justify what is happening. Also, as important as it is to get a handle on how

much resources are being spent, it is equally important to determine who is bearing the burden of these costs—who is actually paying for these resources that are being expended for the national good.

Mr. CRANDALL. It seems to me what you are doing when you're applying a regulatory budget to these independent regulatory commissions, ratesetting commissions, is indeed trying to put a limit on how much they misallocate resources by creating monopoly profits. If that is most of the cost of these regulatory agencies, then perhaps in keeping with my earlier suggestion that you try and experiment, I suggest if you wish to extend this experimentally into one area of Federal regulation, such as Federal maritime regulation and see exactly what that is doing in terms of monopoly profits and redistribution of rents.

Then, if you are persuaded that you like that exercise, then I would perhaps extend it to the ICC and other regulatory—

Senator BENTSEN. I would try something politically a little easier the first time. [Laughter.] Mr. Wright, would you like to make a comment?

Mr. WRIGHT. I have to agree with my two esteemed colleagues on the primary purpose of economic regulation. However, I think their comments are muddying the waters regarding the purpose of the regulatory budget and the process of setting it up.

It doesn't seem to me, given the way the regulatory budget has taken shape, that the intention is to reform economic regulation. And while I would agree that reform is needed, I don't think that this would be the proper vehicle.

My argument for including the economic regulatory agencies does not extend to any inefficiencies introduced by the ICC. I would like to couch the position as follows, and use the Department of Energy as an example. It's not thought of typically as an economic regulatory agency or as a social one, but, in fact, it is very heavily involved in both.

I would not like to debate the regulatory budget, or the merits of whether or not we should adopt it, bearing the political freight of the economic costs or benefits of economic regulation. I would like to think of posing the issue this way:

Suppose, given that we're going to do as a nation what we have been doing in, let's say, energy price regulation, then the question arises: Are there substantial compliance costs with that regulation? I think the answer will be "Yes." Aside from setting optimal or pessimal natural gas prices or crude oil prices, we also have an enormous framework that requires companies to comply with the letter of the law and with the regulation. I would like to think of the regulatory budget as looking at that set of issues, and I guess I would shrink from trying to add on the inefficiencies or alleged inefficiencies of economic regulation regarding the price side.

Mr. CRANDALL. I just have one caution there again on that. When the business round table did its study on regulation, it asked its member firms to try to identify the cost areas of regulation which imposed the greatest burdens upon them. They came up with about six, one of which was the ERISA pension law. They found that the compliance costs, in terms of simply the costs of reporting their compliance to the

Government were very, very small relative to the actual compliance costs of expending resources for, say, EPA regulations.

So, it may be required to get a handle on those sorts of administrative regulation, but clearly DOE, the cost of keeping imports of OPEC oil—the misallocation involved there swamps any costs that Exxon or Gulf have of complying with the regulation.

Senator BENTSEN. Having thought of that originally as a hangover from the regulation of petroleum, we made some major changes in the reporting requirements after we had filed a strong protest.

Gentlemen, I think we have covered the subject fairly well this morning. I am very appreciative of your contribution. You have pointed out some of the minefields we have and, in turn, some of the great advantages that would accrue if we are able to bring it off.

Thank you very much.

[Whereupon, at 11:35 a.m., the committee adjourned, subject to the call of the Chair.]

