The Costs of Government Regulation

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The United States is presently in the midst of the most rapid and pervasive expansion of government control over business in modern times. This may not be a revelation, but neither is it cause for complacency. For the future of the private enterprise system as we know it, public and private management needs to give careful attention to ways of dealing with the increasing expansion of government into internal business decisions.

Companies follow three basic patterns in responding to government regulation. The first is passive. Some corporate managements simply react to each new or expanded federal control. They gripe; they attempt to delay; but finally they go along. The second pattern is an anticipatory approach. Some companies try to predict in advance the new types of government intervention and to prepare for them. Still other business executives follow a third, active approach. They attempt to head off or shape the nature of government intervention and, as a result, they take a substantially more public role.

In practice, there is need for each of the three approaches. While a law or regulation is in force, it has to be obeyed. And some problems, meanwhile, can be anticipated. If we see that the environment is getting dirtier or the supply of energy is becoming tighter, there are sensible things that companies can do about these problems voluntarily.

But this report focuses on the third approach, trying to slow down and reform that rising trend of government regulation. The notion of eliminating all government regulation is viewed here as simply unrealistic as well as undesirable. It is a fact, however, that many businesses do not resist the expanding regulatory environment at all. Either they have become used to it or they are reluctant to enter a controversial area. Perhaps they hope that the critics will pick on somebody else if they maintain a low profile.

Some business executives seem to follow an even less productive course of humoring or attempting to placate the attackers of the business system by inviting them to company and trade association meetings at generous fees and at times by actually donating funds to their organizations. My counsel, instead, is not one of despair or surrender to the inevitable. I advocate a positive approach to govern-

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ment regulation, one that can provide fewer and more sensible regulations than recent experience.

The first step to changing the status quo is to understand what the regulatory process is all about — and then to communicate that understanding to the public and ultimately to government decision-makers. It is hard to effectively criticize government agencies which are trying to do something as worthy as assuring safer products or a cleaner environment. After all, who is against clean air and safe food? But the reality is so very different. We are talking about bureaucracies, with all of the faults and shortcomings of the bureaucratic mentality. The public responds sympathetically to problems encountered by business executives who must deal with the bureaucracy, especially when those problems are explained fairly and accurately. The volume of federal directives affecting a single industry is astonishing. For example, over 5,000 regulations from 27 agencies impact on the steel industry.

The Problem of Understanding Government Regulations

When asked for the introductory materials it supplies to a small businessman who wants to find out what his responsibilities are, the Occupational Safety and Health Administration (OSHA) provided a complex pamphlet containing 24 pages of fine print just listing the applicable standards for “general industry.” And the explanation of those standards? For this the reader was referred to 29 CFR 1910. How is the average businessman supposed to know that CFR is the Code of Federal Regulations, that 29 is volume 29 dealing with labor, and 1910 is section 1910, devoted to OSHA?

Let us suppose that someone tells him (the businessman) — probably his lawyer and for a fee — and that he gets a copy of 29 CFR 1910. He is in for some surprises. The document contains 455 pages of fine print, including algebraic equations and trigonometric functions, but no index. Let us assume, generously, that our small business executive skips over the obviously technical parts and turns to what seems to be a simple section — the definition of an exit. By way of reference, the dictionary tells us that exit is “a passage or way out.” For OSHA, however, defining exit is a challenge to its bureaucratic prerogatives, and it is not found wanting.

To OSHA, an exit is “that portion of a means of egress which is separated from all other spaces of the building or structure by construction or equipment . . . to provide a protected way of travel to the exit discharge.” Obviously, our business executive now needs to find out what is “a means of egress” as well as an “exit discharge.” Exit discharge is the easier term. It is defined merely as “that portion of a means of egress between the termination of an exit and a public way.” Now for OSHA’s definition of a means of egress: “a continuous and unobstructed way of exit travel from any point in a building or structure to a public way and consists of three separate and distinct parts: the way of exit access, the exit, and the way of exit discharge. A means of egress comprises the vertical and horizontal ways of travel [think about that for a moment] and shall include intervening room spaces, doorways, hallways, corridors, passageways, balconies, ramps, stairs, enclosures, exits, escalators, horizontal exits, courts, and yards.”

If you followed all this, OSHA is saying that an exit is an exit is an exit is an exit. Shades of Gertrude Stein. And exit is a comparatively easy section. Try the case of ladder, where you have to cope with three renditions of the same tedious set of definitions plus one trigonometric function.

The puzzlement over regulations is not limited to OSHA either. Try to read and understand — much less follow — the proposed regulations on job testing written by the Equal Employment Opportunity Coordinating Council. The guidelines were drafted with the best of intentions — to assure that tests do not discriminate on the basis of race, color, religion, sex or national origin. The objective surely is worthy. Yet the guidelines have been challenged by such professional organizations as the American Society for Personnel Administration and the American Psychological Association.

Reading the proposed regulations provides the basis for the objections. Here is a typical section — actually it is the part which tries to ease the burden on employers:

“A selection procedure has criterion-related validity, for the purpose of these guidelines, when the relationship between performance on the procedure and performance on at least one relevant criterion measure is statistically significant at the .05 level of significance . . . If the relationship between a selection procedure and a criterion measure is significant but non-linear, the score distribution should be studied to determine if there are sections of the regression curve with zero or near zero slope where scores do not reliably predict different levels of job performance.”

Should these guidelines be enforced, the result is not going to be fairer testing but a shift from what would be very costly and cumbersome procedures back to the simpler but far more bias-prone oral interview.

Frankly, ridicule of overregulation — based of course on carefully researched and accurate examples — can be far more effective than dull statistics in getting the public concerned about the excesses of government activity. After all, the public has the right to know that its tax dollars are being used by federal agencies that have time for such nonsense as dealing with the following questions: what size
should toilet partitions be? Are special women's lounges discriminatory? How big is a hole? When is a roof a floor? How frequently are spittoons to be cleaned?

The Inflationary Impact of Government Regulation

It is vitally important that those attention-grabbers be followed up with the fundamental truth, that it is the public who pays for the over regulation of business, and the public pays in many ways: higher taxes to support a veritable army of regulators; higher prices to pay for the more expensive production methods that are required by government agencies oblivious to the costs that they impose; more unemployment as companies are forced to close down or to reduce output because of the higher costs; and finally delay in the introduction of new and better products, as government reviews, postpones, and reviews again.

The direct cost of government regulation is substantial. The number and size of the agencies carrying out federal regulations are expanding rapidly, while the administrative cost of this band of enforcers is also growing. In the past decade alone, we have seen the formation of the Consumer Product Safety Commission, the Environmental Protection Agency, the Federal Energy Administration, the Cost Accounting Standards Board, the National Bureau of Fire Prevention, the Mining Enforcement and Safety Administration, the National Highway Traffic Safety Administration, and the Occupational Safety and Health Administration, to cite the better known ones in the alphabet soup.

The expenditures of the major federal regulatory agencies came to $2 billion in the fiscal year 1974. An 85 percent expansion has been budgeted over the following four years, with the total federal costs of these regulatory activities rising to $3.8 billion in fiscal 1978. The costs of government regulation are increasing far more rapidly than the sales of the companies being regulated. Regulation literally is becoming one of the country's major growth industries. The biggest regulatory budgets are not those for traditional independent regulatory commissions, such as the ICC or the CAB. Rather, the largest proportion of the funds is devoted to the broader regulatory activities of the Departments of Labor, Agriculture, and Health, Education and Welfare, and the Federal Energy Administration.

But the direct expenditures of the regulatory agencies represent only the tip of the iceberg. It is the costs imposed on the private sector that are really huge, the added expenses of business firms which must comply with government directives, and which inevitably pass on these costs to their customers. At first blush, government imposition of socially desirable requirements on business through the regulatory process may appear to be an inexpensive way of achieving national objectives. This practice would seem to represent no significant burden on the consumer. However, the public does not get a

free or even a low-cost lunch by imposing requirements on private industry. In large measure, the costs of government regulation show up in higher prices of the goods and services that consumers buy. These higher prices represent the hidden tax imposed on the consumer by government regulation. Moreover, to the extent that government-mandated requirements impose similar costs on all price categories of a given product (say, automobiles), this hidden tax will tend to be more regressive than the federal income tax. That is, the costs may be a greater burden on lower-income groups than on higher-income groups.

At times the impact of regulation on the prices that consumers pay is direct and visible. Purchasers of new cars produced in the United States in 1974 paid over $3 billion extra for the equipment and modifications needed to meet federal requirements. Mandatory auto buzzers and harnesses (the widely disliked "interlock" system) will rapidly fade into history due to recent congressional action, but not until after more than 40 percent of the owners of those expensive and annoying contraptions disconnected them or found other ways of avoiding their use. Nevertheless, the phenomenon of government adding to the costs of private production is continuing.

Another cost of government controls is the growing paperwork burden imposed on business firms: the expensive and time-consuming process of submitting reports, making applications, filling out questionnaires, replying to orders and directives, and preparing court appeals resulting from some of the regulatory rulings. There are over 4,400 different types of approved government forms, excluding tax and banking forms. Individuals and business firms spend over 143 million man-hours a year filling them out. That is the equivalent of a small army.

A few examples may convey a sharper impression of reality than the aggregate figures. A small, 5000 watt radio station in New Hampshire reported that it spent over $26 just to mail to the Federal Communications Commission its application for renewal of its license—and that was before the last rate increase. An Oregon company, operating three small television stations, reported that its license renewal application weighed 45 pounds.

At the other end of the size spectrum, a large corporation, Exxon, is required to file more than 400 reports to 45 federal agencies including the Department of the Treasury, the Federal Energy Commission, and the Bureau of Indian Affairs. In an 18 month period ending in August 1975, Exxon added 55 new reports to the list required by the federal government. Many agencies require the same data but in slightly different form. Exxon submits 50 reports relating to personnel, labor, and wages to 14 different federal agencies. In total, it devotes 112 man years annually to these reporting requirements at a cost of $3½ million.
The Relation Between Regulation and Unemployment

Workers and their families need to realize that many productive jobs are lost as a direct result of excessively costly government regulation. For example, hundreds of foundries have been closed down in the past few years because they could not meet the costs imposed by EPA, OSHA, and similar government agencies.

Our Center recently published a study which shows that one increase in the statutory minimum wage resulted in teenage employment in the United States being 320,000 lower than it would otherwise have been. As a result of that increase in the compulsory minimum wage law, the youth unemployment rate is 4 percentage points higher than would have been the case in the absence of that single expansion of federal regulation.

In the construction labor area, government regulation also acts to price the work force out of competitive labor markets. Under the Davis-Bacon legislation, the Secretary of Labor promulgates "prevailing" wages to be paid on federal and federally-supported construction projects. These federally-mandated wage rates are often above those that actually prevail in the labor market where the work is to be done. It is hardly surprising that unemployment in construction is substantially above the national average.

Also, a side effect of the equal employment opportunity program may be an increase in unemployment by delaying the filling of job vacancies. To the extent that employers must undergo more protracted job searches prior to hiring employees, the average length of unemployment is likely to be longer. It is not uncommon for a job to remain unfilled despite the presence of qualified and willing workers at the going rate, simply because the affirmative action requirements for advertising have not been met.

Regulation Versus Progress

The paperwork and ancillary requirements of federal agencies inevitably produce a "regulatory lag," a delay that can run into years and can be a costly drain on the time and budgets of private managers and public officials. The regulatory lag appears to be lengthening.

Ten years ago, the director of planning of one major West coast development company obtained a zoning approval for a typical residential development within 90 days. Currently, it takes two years of intensive work by a specialized group within the company to receive what is now called an "entitlement to build." The preparation of environmental impact statements has become a major source of paperwork. The statement for one off-shore oil field in the Santa Barbara channel, for example, covered nearly 1,300 pages and took two years to prepare.

Sometimes the delay by government agencies in approving new products can have serious consequences for the consumer. A case in point is the new asthma drug beclomethasone dipropionate (let us call it BD). Although this drug had been used successfully by millions of asthma patients in England, it took several years before the U.S. Food and Drug Administration decided to approve it for use in this country. BD is a safe and effective replacement for the drugs which are now given to chronic asthma patients, but without their adverse side effects. Unlike BD, the steroids that had been used in this country, such as prednisone, stunted growth in children, worsened diabetes, and increased weight through water retention. The delaying procedures of the FDA not only increased business costs but for an extended period of time also prevented American consumers from having access to the newer and better product. Unfortunately, the BD episode is not an isolated case. As a result in large part of the more stringent drug regulations, the United States was the thirtieth country to approve the anti-asthma drug metaproterenol, the thirty-second country to approve the anti-cancer drug cromolyn, the one hundred and sixth to approve the anti-bacterial drug co-trimoxazole.

The regulators really seem to have the private sector scared. An example was the report in the summer of 1975 by the National Cancer Institute that the solvent trichloraethylene, known as TCE, may be a possible cause of cancer. At the time TCE was used in decaffeinated coffee. It seems that the government used a rather generous dose of the chemical on the test animals. It was the equivalent of a human being drinking 50 million cups of decaffeinated coffee every day for an entire lifetime. What was the industry's reaction? To laugh at this example of government nonsense? Hardly. With the cyclamate episode still firmly in mind, one major producer merely changed to another chemical.

Regulation and Capital Formation

Government regulation also adversely affects the prospects for economic growth and productivity by levying a claim on a rising share of new capital formation. This effect of regulation is most evident in the environmental and safety areas, where federal regulation results in annual outlays equal to about one-tenth of new capital spending in the private sector. A case in point demonstrating the implicit trade-off between government-mandated outlays and traditional job-creating investments in new plant and equipment is the $175 million that DuPont scheduled for pollution control facilities in 1975. The company estimates that those outlays could have financed a fiber plant employing 2,500 workers.
Capital formation may be reduced by the uncertainty about the future of regulations governing the introduction of new processes and products. This problem is particularly pronounced in the efforts to develop new domestic energy sources. A technical task force of the U.S. Energy Resources Council, in evaluating the prospects for coal gasification and other innovative ways of supplying energy, concluded that regulatory requirements "could easily hold up or permanently postpone any attempt to build and operate a synthetic fuels plant."

Conflict and Duplication in Regulation

As would be expected, the proliferation of regulation has led to many conflicts between regulations with business and the public often getting caught in the cross fire. The simple task of washing children's pajamas in New York exemplifies how two sets of laws can pit one worthy objective against another, in this case ecology versus safety. Because of a ban on phosphates in detergents, the mother who launders her child's sleepwear in an ecologically sound way may risk washing away its required fire-resistant properties. New York State bans the sale of detergents containing phosphates in an effort to halt water pollution. And a federal regulation requires children's sleepwear to be flame-retardant. But New York housewives now face a dilemma, because phosphates are the strongest protector of fire retardancy. If they wash the pajamas in nonphosphate detergents, they are going to wash away the fire-resistant property. What does a conscientious mother do in New York to avoid dressing her child in nightclothes that could burn up? Smuggle in the forbidden detergents from New Jersey? Commit an illegal act of laundry?

A classic example of conflicting regulations occurs in the steel industry with regard to emissions from coke ovens. The Environmental Protection Agency, which is interested in reducing air pollution, has favored placing hoods over coke ovens to contain the pollutants. However, OSHA, which is concerned with worker health, opposes the hoods because they increase the concentration of coke oven emissions breathed by workers.

At present no mechanism exists to resolve these and other similar conflicts, so it remains inevitable that authority will overlap and regulations will conflict. Each regulatory agency is preoccupied with its own narrow interest, and it is oblivious to the effects of its actions on the company, an entire industry, or even society as a whole.

The Power of Government Regulation

The tremendous power exercised by government regulators often goes unappreciated by the public as well as by the regulators themselves. The case of the ban on spray adhesives is an example worthy of some attention. On the surface, it appears to have been at most only a matter of excessive caution on the part of the Consumer Product Safety Commission.

In August 1973, the commission banned certain brands of aerosol spray adhesives as an imminent hazard. Its decision was based primarily on the preliminary findings of one academic researcher who claimed that they could cause birth defects. After more thorough research failed to corroborate the initial report, the commission lifted the ban in March 1974. Why do I mention this case? Depriving consumers of spray adhesives for less than seven months does not seem to be too harsh in view of the desire to avoid serious threats to people's health.

In fact, the admission of error on the part of the commission is commendable. Its prompt rescission of the initial action would seem almost to break speed records for a government agency. But there is more to the story. It seems that at least nine pregnant women who had used the spray adhesives reacted to the news of the commission's initial decision by undergoing abortions. They decided not to carry through their pregnancies for fear of producing babies with birth defects. The sadness of this case is hardly reduced by the fact that everyone involved was trying to promote the public health and safety. The public must be made aware of the impacts on the average citizen that result from the massive expansion of government power over private activities—of the economic activities not only of business people, but of employees, shareholders, and consumers generally.

A ray of hope lies in the fact that the regulators are increasingly reaching out to and, in the process, upsetting other sectors of the society. It is not uncommon anymore to pick up an educational journal and read about the excesses of government agencies in their dealings with colleges and universities. One recent example is an editorial devoted to the case of the new walkway built by the University of Illinois. Its 37 inch railing did not meet the occupational safety regulations which require 42 inches. The University lamented that bringing this and other so-called "occupational hazards" into conformance—including replacing the toilet seats—would cost $24 million, at a time when colleges are hard pressed to stay within their budgets.

Witness also the academic backlash that is now occurring—by faculty members of all persuasions—against the excesses of the affirmative action program. A sensible effort to deal with the obvious effects of excessive regulation may find some unexpected allies. Certainly, there are academic institutions whose research and publications help to improve public understanding of the various effects of government regulation. That is a major purpose of our Center for the Study of American Business at Washington University.
Improving Public Policy

Let us now turn attention to the ultimate concern of this report, the possibility of improving public policy. Frankly, I urge setting some modest and sensible targets. The vast regulatory apparatus that has developed in Washington over many years is not suddenly going to be dismantled.

In fairness and to be credible, we must acknowledge that some of these programs have yielded important benefits— in terms of less pollution, fewer product hazards, ending job discrimination, and achieving other socially desirable objectives of society. We must also realize that these programs were established by the Congress both in response to rising public expectations about corporate performance and through a sincere desire to do something about a particular problem, such as job hazards or air pollution. But that admission need not justify government closely regulating every facet of society. Moreover, to ignore the negative aspects of regulatory activities is to fall unwittingly into the trap of adopting the totalitarian notion that the end justifies the means.

A good beginning to improving regulation might be based, oddly enough, on the environmental regulations. Organizations are now required to examine the impact on the environment of the major actions that are proposed. Surely a cleaner, and a safer, environment is an important national objective. But it is not the only national objective, and society has no reason to select the most expensive and disruptive ways of achieving the goal. Would it not be sensible to require each regulatory agency to assess the impacts of its actions on the nation as a whole and particularly on the economy? And to be forced to show that the benefits of its actions exceed the costs imposed on the public before it is allowed to proceed?

The approach suggested here will not be easy to legislate. Merely requiring the performance of some economic analysis by an unsympathetic regulator would only delay the regulatory process and make it more costly. But limiting government regulation to those instances where the total benefits to society exceed the costs would be a major departure. It could significantly slow down if not reverse the current rising trend of federal regulation of business, particularly if it were incorporated in the various sunset laws that are now becoming popular at state and federal levels. Under these statutes, the basic legislative authority for government regulations and other activities expires periodically, thus requiring a comprehensive review of the justification for these governmental programs.

Those who question the ability to make benefit/cost comparisons of regulatory activities should be required to justify taking these powerful government actions in the absence of adequate knowledge of their effects. A recent case in point is furnished by the perverse effects of the proposal to set safety standards for commercial under-water divers. On the surface, the proposed regulation would seem to be aimed at reducing risks in a hazardous occupation. The preliminary analysis by the Council on Wage and Price Stability, however, reveals that there is no evidence that the standards would measurably lower the industry's fatality rate and may even increase it due to a false sense of security that might result. Moreover, the costs are likely to fall hardest on small firms and on the divers themselves who in the main are professionals willing to undertake highly remunerative albeit risky work.

In a fundamental sense, it is a way of thinking that needs to be developed in public policymaking in the regulatory area, rather than a new concentration on statistical expertise. Regulation is a powerful tool. It must be used carefully and with full regard for its various impacts. For example, we hear about environmental impact statements that list every type of weed on the property to be developed, and also describe the measures suggested to preserve those weeds. Our concern thus need not be limited to what critics call the cold green eyeshade approach of benefit/cost accounting. Rather, we may mourn for all the trees that have been cut down to yield the paper for the proliferation of environmental impact statements.

Perhaps even more fundamental than developing technical benefit/cost analyses is getting the public to grasp the notion that government regulation is a potent and expensive medicine. It needs to be taken very carefully, in limited doses, and with full regard for all the adverse side effects— inflation, unemployment, loss of productivity, delay in getting new products, and loss of capital formation. We must avoid unwittingly overdoing the patient.

In the case of the traditional industry-type of government regulation (as of airlines, trucking, and railroads), a greater role should be given to the competitive forces and to the market system. Unlike the newer forms of regulation on which this paper concentrates, the older forms of regulation are often mainly barriers to entry into a given industry, protecting existing firms from competition by potential new entrants. It is in this limited sense that deregulation is a viable option. The elimination of the new types of regulation—as in the safety and ecology areas—is not a realistic alternative in view of the nation's long-term social concerns.

The bottom line in all of these regulatory fields is this—over-regulation of business is not in the public interest because it is the consumer who bears the costs of over-regulation, and usually without knowledge of those rising costs. I am urging balance and moderation in viewing the future of business-government relations. Public policy needs to be geared to enabling business to make a maximum contribution to the achievement of the nation's social goals. But—for the public good—business must simultaneously be permitted to fulfill its basic economic function of providing the consumer with
better and more efficiently produced goods and services. To restore common sense to government is a challenge to the economic education of the public — and thus it is a specific challenge to educators, business executives, and government decision-makers alike.