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Regulation and the Public Interest

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Washington University in St Louis

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Regulation and the Public Interest

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It is useful to examine government regulation from the viewpoint of the American consumer. Like anyone who has ever breathed dirty air or smelled contaminated water, I am concerned about what our business sector does to society. Of course, I am equally concerned about pollution by government and consumers, which often can be as bad if not worse. But as a purchaser of goods and services, I also care a great deal about what business firms do for us as consumers. What is the central role of the business system? Surely, it is to satisfy consumer demands and to create jobs and income by producing and selling goods and services.

I find it fascinating that this basic function of the business firm is so completely ignored by those who call themselves corporate activists. By the way, as a small shareholder in some large firms, I bristle at that self-designation. I usually find the activities of these people anti-corporate. In any event, these activists deserve much of the credit or blame for the largest and most rapid increase in regulatory controls that our nation has ever experienced. In the past two decades, we have seen a proliferation of government intervention in the private sector, dwarfing the actions taken even in the 1930s.

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A Hard Look at the Effects of Regulation

However, it is not the sheer number of these regulatory activities that should concern us, but rather their impact on the ability of the economic system to perform its central function. If we look at the modern regulatory phenomenon from the viewpoint of the average firm, the nature of the problem becomes apparent. For each box on its organizational chart, there are one or more government agencies that are counterparts to that box, each of them heavily involved in the company's internal decision making. The impact is in one predictable direction: to increase the company's overhead and operating costs, and to reduce the resources available to perform the company's major task of producing goods and services for the consumer. To the economist, this is the "opportunity cost" of government regulation; it shows up in what I call the hidden tax of regulation—the higher prices that we consumers pay to cover the cost of compliance with regulation.

The basic function of the business firm is ignored by those who call themselves corporate activists

I have not yet mentioned the benefits of regulation. To the extent that we have cleaner air, cleaner water, and so forth, these benefits are real. Please note that I have chosen my words carefully. The mere presence of a government agency does not guarantee that its worthy objectives will be achieved. The serious question—which I will cover in a moment—is whether the regulation produces benefits and whether they are worth the costs. Society's bottom line is not the impact of regulatory actions on the government or on the business system, but the effect on the consumer, on the citizen.

Clearly, an important effect of regulation is the increase in the price of goods and services. However, when we go beyond the dollar signs, more subtle and often far more serious burdens emerge. Central among these are the effects on research and development, productivity, and capital formation—basic functions so often adversely affected by regulation. Regulation has reduced the flow of innovation, the production of new and better products, because so many government regulatory agencies have the power—which they frequently exercise—to decide whether or not a new product will go on the market.

The justification for this power is that it keeps unsafe products off the market. Unfortunately, the reality is often different. Consider drug regulation by the Food and Drug Administration (FDA). If we look at mortality data—rather than the rhetoric—we find that, for decades, the leading cause of death in this country has not been cancer, but cardiovascular disease—heart attacks and strokes. There is a series of new drugs for these illnesses called beta blockers. They are in widespread use in the

The mere presence of a government agency will not guarantee that its objectives will be achieved

United Kingdom and other developed nations. The United States, however, has lagged in the introduction of these drugs because of the antiquated procedures of the FDA. According to the research of Professor William Wardell at the University of Rochester Medical School, one of these beta blockers, practolol, currently in widespread use in Western Europe, would save 10,000 lives a year when introduced in the United States.

Society's bottom line is the effect of regulatory actions on the consumer

Beta blockers are not the only drugs whose use has been delayed by the FDA. Dr. Wardell has examined the list of drugs actually approved as safe and effective. In case after case, the United States was one of the last countries to permit their introduction. We are the twenty-second country in the case of the anti-inflammatory drug fenoprofen, the thirty-ninth country for the oral cephalosporin cephalexin, and the fortieth country for the anti-tubercular antibiotic capreomycin.

These delays are not surprising, given the cardinal rule for bureaucratic survival: Do not stick your neck out. If you were an FDA reviewer and you were to approve practolol, you would be taking a risk. If anybody should suffer any adverse reaction, you may well bear the responsibility. On the other hand, if you do not approve the drug, the potential users are unlikely to complain, since they do not know about it and they will soon pass from the scene. As a result, you ask for more studies, you delay.

Delays in drug approvals are not surprising, given the cardinal rule for bureaucratic survival: Don't stick your neck out

Consider the results bluntly: if 16 people are harmed by side-effects of a drug in use, that becomes front page news. If 10,000

people die prematurely because approval of a new drug has been delayed, the public is unaware. Do not misunderstand my point: it is a plea for balance and for effectiveness, not for the elimination of FDA regulation. By the way, this is one example among many where the real costs of regulation are not expressed in dollars but in terms of lives.

The sad reality is that government intervention often does not work—or it works against the interest of the consumer

I do not believe that the issue before us is as philosophical as, "Are you for or against government intervention?" Rather, it involves a very practical question: "Does this specific type of government intervention work?" The sad reality is that, so often, it does not—or it works against the interest of the consumer. This reality has been recognized in some areas. Deregulation of the airlines has benefited the traveling public as well as the airlines and their employees. Deregulating trucking will do the same.

But, on the other hand, in the case of environmental regulation, every economic study I have ever seen has shown that there is a different way of achieving at least the same amount of clean air or clean water at a small fraction of the current costs. That other way involves working through the price system by means of pollution taxes or pollution permits or property rights. Economists are belatedly gaining support for that position from some of the more enlightened environmentalists. Unfortunately, business generally takes an adamantly negative position. Perhaps many companies do not want regulation but, once they become regulated, they become staunch advocates of the status quo—preferring familiar inefficiency to unfamiliar but more efficient regulation.

This leads me to a fundamental point overlooked in so many discussions of regulation: we cannot assume that specific regulations will necessarily produce any consumer benefits at all. Take the example of environmental regulation. One of the 1977 amendments to the Clean Air Act was written solely to protect the jobs of approximately 10,000 Midwestern mine workers. Section 125—euphemistically titled "Measures to Prevent Economic Disruption or Unemployment"—gives the President the power to prohibit major fuel-burning stationary sources from using any fuel other than local or regionally available coal, "to prevent or minimize significant local or regional economic disruption or unemployment." Once the Governor of any state has obtained the President's consent under Section 125, he can even require coal-burning utilities to enter into long-term contracts (ten years or more) for supplies of local coal. The governor of Ohio requested authority to require the use of local coal in his state some four years ago, but his request has never been acted upon. Nonetheless, the Clean Air Act could potentially be used to mandate dirtier air for millions of citizens in order to protect less than 10,000 people from competiton.

Government intervention is a very powerful but extremely imperfect tool. We must use it carefully, with full awareness of all side effects.

Another 1977 amendment to the Clean Air Act shows why government regulatory statutes rarely conform to the spirit of "truth-in-labeling." The BACT (best available control technology) requirement, which applies to all new sources of potentially significant pollution, is a cogent case. The effect of this provision is to force all new coal-fueled power plants to use scrubbers—even if the air would be cleaner if they did not. How does this ridiculous result come about? Simple: *the focus in the statute is not on achieving clean air.* Rather, it is on imposing the onerous requirements of scrubbing "coal," whether high or low in sulphur. The results are ironic: Since utilities are required to use the scrubbers anyway, it is often cheaper to use high-sulphur (high polluting) coal because it costs less. It is sad to note that the air in many regions would be cleaner if the utilities were given a choice between (a) cheap and dirty coal plus scrubbers, and (b) expensive and cleaner coal without scrubbers. The cynical explanation is the correct one: the motive in this environmental statute is to encourage the use of high-sulphur coal.

The tendency for the regulatory process to be used by small groups to extract benefits from society as a whole is not a recent phenomenon. Peter Aranson of Emory University has brought to my attention the following quotation:

> Every new regulation . . . presents a new harvest to those who watch the change, and can trace its consequences; a harvest, reared not by themselves, but by the toils and cares of the great body of their fellow citizens. This is a state of things in which it may be said with some truth that the laws are made for the few, not for the many.

That quotation is taken from the *Federalist Papers*, No. 62, by James Madison.

All this demonstrates that government intervention is a very powerful but extremely imperfect tool. We must use it carefully, with full awareness of all side effects. Certainly, there are problems in society, and some regulatory activities do generate benefits. The serious concern is to balance the benefits against the costs and side effects of regulatory actions. The result, we must hope, will identify the most efficient way of meeting society's goals—and, thus, also help to maintain support for them.

I have never met a mortal man or woman who truly represented the public interest

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At this point, let me issue a disclaimer. I do not claim to represent the public interest. I have spent many years in government, helping to make public policy. I have never met a mortal man or woman who truly represented the public interest. Good government policy, if we ever get it, reconciles a variety of bona fide, legitimate interests. Is clean air a legitimate interest? Of course. Is high employment legitimate? Is bringing down inflation legitimate? Is producing safer products legitimate? The answer to each of these questions is yes. They are all important interests. However, we need a mechanism for balancing them—rather than taking the simple-minded approach of automatically labeling one set of interests "public interests," which are supposedly good, and labeling the other set "special or business interests," which are presumably bad.

The Role of Benefit/Cost Analysis

This important aspect leads me to a second point, the role of benefit/cost analysis in regulation. Let us remember that benefit/cost analysis has been used for decades in examining government spending programs. It is neither a revolutionary, new idea nor an invention of the far right. It has been attacked by both ends of the political spectrum—by the far left because not every proposal for government intervention passes a benefit/cost test, and by the far right, who oppose it because benefit/cost analysis can be used to justify government intervention. No analytical approach is totally value free, but I suggest that benefit/cost analysis has less ideological baggage than most alternatives.

The simple-minded approach to reconciling legitimate, competing concerns is to automatically label one set of interests "public interests," which are supposedly good, and label the other set "special or business interests," which are presumably bad

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The motive for incorporating such analysis into public-sector decision making is to lead to more efficient use of government resources by subjecting the public sector to the same type of quantitative constraints as those in the private sector. In making an investment decision, for example, business executives compare costs with expected revenues. If the costs exceed the revenues, the investment is not considered worthwhile.

The government decision maker, however, does not face the same economic constraints. If the costs to society of an agency action exceed the benefits, that situation does not usually have an adverse impact on the agency. In fact, the administrators may not even know about it. The aim of requiring agencies to perform benefit/cost analysis is to make the government's decision making process more effective. It also helps to counterbalance the strong attraction toward regulatory activity on the part of government agencies and their supporters, who can crow about the benefits and ignore the costs—because the costs are transmitted to the consumer not by the government but by business. In fact, regulatory activists can have some fun needling business about price increases even when they result from the costs of complying with regulation.

Applying Analysis to Regulation

Let us analyze benefit-cost analysis. A basic relationship of costs and benefits tends to hold for many regulatory programs. Typically, the initial regulatory effort—such as cleaning up the worst effects of pollution in a river—may generate benefits significantly greater than costs. But the resources required to achieve additional cleanup become disproportionately high. At some point the added benefits are substantially less than the added costs. There are many examples. A study of environmental controls on the fruit and vegetable processing industry shows that it costs less to eliminate the first 85 percent of the pollution than the next 10 percent.[1]

Likewise, the pulp and paper industry spent $3 billion complying with federal clean-water standards, and achieved a 95 percent reduction in pollution. But to reach 98 percent would cost $4.8 billion more, a

160 percent increase in costs to achieve a 3 percent increase in benefits.[2]

Benefit/cost analysis is viewed as a tool for identifying the optimum amount of regulation. To an economist, "overregulation" is not an emotional term; it is merely shorthand for regulation for which the costs to the public are greater than the benefits.

"Overregulation" is not an emotional term; it is shorthand for regulation for which the costs to the public are greater than the benefits

In addition, when there is more than one way of attaining a regulatory goal, benefit/cost analysis can compare the various methods and help select the most attractive. Please note, I did not say that benefit/cost analysis will select the *least* expensive alternative. Rather, it will identify the most efficient one in meeting regulatory goals.

Sometimes the indirect effects of regulation are as important as the direct. Consider the question of mandatory standards to ensure the production of less hazardous consumer products. From time to time, suggestions have been made to require more protection in football helmets. Those using the safer helmets would be expected to receive the benefit from fewer injuries. But in practice, the standards might well contribute to more injuries, since the price increases to cover the new regulatory requirements might result in more people playing football without any protective equipment at all. That example illustrates another basic thrust of benefit/cost analysis—to examine the proposed government action not from the viewpoint of business or government but from the vantage point of the consumer.

When it is not feasible to put a dollar sign on the benefits, the analytical approach still can help by ranking the cost-effectiveness of alternatives. In essence, the analysis estimates the costs of different ways to accomplish the same objective.

Critics who are offended by the notion of subjecting a regulation to a benefit/cost test must fear that their pet rules would flunk the test

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These studies help policymakers to identify least-cost solutions. This approach can be particularly useful in programs to reduce personal hazards. Instead of dealing with such an imponderable question as the cost of a human life, the emphasis shifts to identifying the regulatory approach that maximizes the number of lives saved from use of available resources.

Uses and Limitations of Benefit/Cost Analysis

Reliable measures of costs and benefits are not easily achieved. However, the difficulties involved need not deter the pursuit of analysis. Merely identifying important and overlooked impacts can be useful. Examples on the cost side include the beneficial drugs not available because of regulatory obstacles, the freight not carried because empty trucks are not permitted to carry backhauls, investment in new plants not made due to more stringent environmental requirements for new sources, and the television and radio stations not broadcasting because they are not licensed. On the benefit side, examples include a more

productive work force that results from fewer accidents on the job, reduced illness because of safer products, and a healthier environment resulting from compliance with governmental regulations.

The painful knowledge that resources available to safeguard human lives are limited causes economists to become concerned when they see wasteful use of those resources because of regulation

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Critics who are offended by the notion of subjecting regulation to a benefit/cost test unwittingly expose the weakness of their position. They must fear that their pet rules would flunk the test. After all, showing that a regulatory activity generates an excess of benefits is a strong justification for continuing it. Benefit/cost analysis is a neutral concept, giving equal weight to a dollar of benefits and to a dollar of costs. The painful knowledge that resources available to safeguard human lives are limited causes economists to become concerned when they see wasteful use of those resources because of regulation.

A Personal Note

I have tried to provide serious, although spirited responses to those who criticize the efforts of economists to examine, and to quantify, the costs of regulation. I find many arguments by certain members of the legal profession more in the nature of debaters' points rather than serious responses. For example, much is made of the point that the cost estimates are gross and that the benefits have not been deducted. This may have a plausible ring initially, until we reflect on the world around us. When my wife reports angrily that the price of bread has risen to $1.50 a loaf, do I cavalierly dismiss her concern by telling her she has forgotten to deduct the benefits? Implicitly, we assume that the value to us of the bread we buy is at least $1.50 a loaf. Similarly, I pay a considerable amount of taxes to the government. I hope that the benefits justify those payments. But I know of no taxpayer who refers to his or her tax burden on an after-benefit basis. I see no reason to ignore or minimize the information on the costs imposed by government on the public. Indeed, I find it intriguing that economists can write whole books on the benefits of regulation without generating the slightest criticism. But try writing a report on the costs, and you literally take your professional life in your hands, although I prefer to feel that you are belling the cat.

A final note of irony concerns the histrionics that I have observed from time to time when a lawyer comments on attempts by an economist to estimate the hypothetical value of human life for purposes of regulatory analysis. The irony arises when we consider the frequency with which members of the legal profession place a very specific value on an individual human life. But they do

that typically in a courtroom when a generous retainer or contingency fee is at stake. At least we can come to understand the high principle involved.

Notes

1. U.S. Congress, Joint Economic Committee, *The Economic Impact of Environmental Regulations* (Washington, D.C.: U.S. Government Printing Office, 1971), p. 118.
2. Murray L. Weidenbaum, *Benefit-Cost Analysis of Government Regulation,* Formal Publication No. 37 (St. Louis: Center for the Study of American Business, 1981), p. 4.