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The New Wave of Business Regulation

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Recommended Citation

Weidenbaum, Murray L., "The New Wave of Business Regulation", Contemporary Issues Series 40, 1990, doi:10.7936/K7XD0ZVJ.

Murray Weidenbaum Publications, https://openscholarship.wustl.edu/mlw_papers/21.

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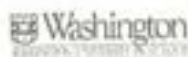
by Murray Weidenbaum

*Contemporary
Issues Series 40*

December 1990

Additional copies are available from:

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The New Wave of Business Regulation

by Murray Weidenbaum

You do not have to be a steady reader of the *Congressional Record* or even a C-SPAN junkie to spot the current upturn in federal regulation of business. Congressional action on well-intentioned but costly legislation is proceeding at a very rapid pace. The new Clean Air Act and the Americans With Disabilities Act are just two reminders of the fact that the regulatory reform movement of the 1980s is over. It is being followed by the regulatory expansion of the 1990s, and the decade has just begun.

Before I get into specifics, I would like to provide some overall perspective of the new trend. During the 1970s, the headcount of the federal regulatory agencies rose 62 percent. During the 1980s, the number of regulators dropped, from an all-time high of 119,000 in 1980 to 106,000 in 1989—a 12 percent decline. The 1991 budget shows an increase of 7,500 new regulators and that is before taking into account environmental and other statutes passed by the current session of the Congress. It hurts to say that once again we are seeing the expanding regulatory trends of the Carter years.

Regulation's Effect on Business

All of American business is feeling the latest response of the Congress to environmental and other social pressures during a period of budget squeeze. We hear a lot of talk in Washington about off-budget spending as a way of getting around Gramm-Rudman limits on the deficit.

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For government officials, regulation of business is a very neat way of advancing various public policy agendas without spending much federal money. Congress just imposes more burdens directly on firms. Remember the old saying, "The best tax is a hidden tax."

At first glance, government imposing socially desirable requirements on business seems to be a cheap way of achieving national objectives. Moreover, regulation appears to cost the government very little and therefore does not seem to be much of a burden on the public.

But the public does not escape paying the full cost. Every time a government agency—in its attempt to safeguard the environment or foster occupational health or promote product safety—imposes a more expensive method of production on business, the cost of the products being made will necessarily go up.

Cost to Consumers

If consumers knew how much they were paying for regulation, they probably would be very upset. Environmental regulations alone cost Americans more than a thousand dollars per family each year. But government agencies do not feel great pressure to worry about the expense. Those compliance costs do not show up in their budgets, but in the budgets of the private companies.

Regulation is a hidden tax with a double payoff for politicians. First, they can crow to their constituents that they voted for clean air and in favor of people with disabilities and so forth. It must be a lot of fun to be a Senator or Representative; you can do so much good with other people's money.

The second political payoff is that the same members of Congress can berate "greedy" companies for raising prices even though they are merely passing on the costs of complying with new federal mandates. Furthermore, it is the rare government official who acknowledges the connection between the high costs imposed

by government regulation and the difficulties that American businesses experience in trying to be competitive in an increasingly global marketplace.

Environmental Regulation

Twenty years after Earth Day 1970, the Environmental Protection Agency is king of the regulatory hill. The EPA alone accounts for nearly one-third of the total spending of all the federal regulatory agencies. That is double its share in 1970. The combination of President Bush's pledge to be the "environmental president" plus the emotional nature of the public reaction to any proposal with the word environment in it virtually assures EPA its place at the top of the regulatory agencies for the 1990s.

The new Clean Air Act will cost an added \$25-35 billion a year, over and above the more than \$100 billion spent annually on all pollution controls.

The fact is that regulatory growth is more tied to dramatic news events than to public health risks or shortcomings in the marketplace. Thus, EPA spending rises with reports of leaking dump sites. The Coast Guard budget benefits from oil spills. Food and Drug Administration outlays rise in response to shortcomings in approving generic drugs. The Securities and Exchange Commission grows following "insider trading" abuses and other Wall Street scandals.

Clean Air Act

The new Clean Air Act will cost an added \$25-35 billion a year, over and above the more

than \$100 billion spent annually on all pollution controls. President Bush's initial proposal was touted as incorporating economic incentives to make the legislation more cost-effective. Indeed, the final version does provide for creating tradeable emissions permits, which is a cost-minimizing approach long advocated by economists.

Unfortunately, these very same tradeable permit provisions became far more complex and far less economically sound as the Clean Air bill wended its way through the congressional committee process. Other costly and burdensome features of the new law include requiring many small companies to obtain emissions permits from EPA and to continuously monitor their emissions.

Indeed, the new Clean Air Act is riddled with numerous provisions that are needlessly costly. The smog provisions offer a particularly cogent example.

A substantial portion of the emissions that contribute to smog come about in refueling automobiles. One approach to control these emissions is to require that gas stations put special controls on their pumps. The other approach is to mandate that automobile manufacturers put special equipment on the cars ("onboard controls" is the jargon). Either approach could achieve the same reduction in overall emissions.

As you would suspect, there are pros and cons accompanying each of the two approaches. The gasoline producers favored onboard controls on the car, while motor vehicle manufacturers naturally wanted to see the burden placed on the service stations. That put Congress in a position where they had to make a tough choice.

Using somewhat twisted political reasoning, Congress chose the worst possible approach: They mandated *both* types of requirements. The legislation thus mandates two sets of costs to generate one set of benefits. It is like wearing a belt and suspenders at the same time.

Other Environmental Regulations

I wish I could say that the 1990 Clean Air Act is the end of the line. To the contrary, the legislative victory of the environmental activists only whetted their appetites. They are already gearing up for next year's legislative drive. According to their current plans, that includes tougher rules for toxic wastes.

The battle over the revised toxic wastes law (the Resource Conservation and Recovery Act) may focus more attention on small companies generating organic wastes from producing pesticides and paints. Municipal solid waste disposal may also be "federalized" to a much greater extent in the revised act—driving up disposal costs for residential, commercial and industrial non-hazardous waste management.

Other Federal Regulation

OSHA and MSHA

Environmental regulation is not the only area of increased burdens that Washington is imposing on business. Buried in the recently approved budget deficit reduction package is a sharp seven-fold hike in maximum penalties for civil violations of Occupational Safety and Health Act (OSHA) regulations. This means that the top civil penalty for a single repeated or willful violation of OSHA will rise to \$70,000; the compulsory minimum penalty for a willful violation is now \$5,000.

A parallel five-fold increase was mandated for civil violations of the Mine Safety and Health Act (MSHA). The Feds expect to raise more than \$1 billion over five years from the two sets of fine increases.

These onerous changes were a compromise. Some members of Congress were urging mandatory minimum penalties for all OSHA civil infractions, even the most trivial and unintentional. They dropped tougher criminal penalties only because they would not have raised much revenue. Pressure for revamping

the basic OSHA law continues and these issues will surface again.

Americans With Disabilities Act

The Americans With Disabilities Act is another law whose title made it hard to oppose. Yet some of the detailed provisions in the new law are likely to be needlessly burdensome.

The definition of disability is very broad, including drug addicts and alcoholics. It took a lot of doing to get Congress to write in a provision that this complex new law does not cover current illegal drug users and alcoholics who cannot safely perform their jobs. That sounds as if the law could be interpreted as covering drug addicts who can safely perform their jobs. The special benefits of the new law are definitely extended to addicts who participate in a supervised rehabilitation program and are not currently using drugs.

Employers must make a "reasonable accommodation" for an individual with a disability. This can include making existing facilities readily accessible, restructuring the job, modifying work schedules, changing training policies, and providing interpreters. Moreover, an interviewer may not ask a job applicant if he or she has a disability or how severe it is. The employment rules take effect on July 20, 1992, for companies with 25 or more workers. Two years later, the cutoff is lowered to companies with 15 or more employees.

Civil Rights Act

The President did veto the new Civil Rights Act and his veto was sustained. But in view of the large majority in both houses that voted for it, it is likely that an effort will be made to pass similar legislation in the next session of Congress. The vetoed version would have become a lawyer's happy hunting ground because so many of the provisions are vaguely worded.

Take the provision that "objective" evidence must be used to defend "subjective" hiring and promotion decisions. How can an employer

hiring someone for the first time provide objective evidence to prove that he or she is a better manager than someone else? Or better at dealing with the public? These decisions are matters of personal judgment. Executives get paid for using judgment. If they have to do it by the numbers, they can hire a brand new MBA at half the price of an experienced individual—but that likely would violate the age discrimination law.

Under the 1990 version of civil rights legislation, virtually the only way to avoid prolonged and costly litigation is to hire and promote on a racial quota basis.

Under the approach embodied in the 1990 version of civil rights legislation, virtually the only way for a company to avoid prolonged and costly litigation is to hire and promote on a racial quota basis. By the way, Congress itself would be exempt. That's not surprising because most regulatory statutes do not cover the legislative branch.

"Trust Busting" Returns

The enlightened merger attitude of the Reagan administration has been replaced by old-fashioned "trust busting," and that extends far beyond the corporate giants.

For example, take the proposed joint venture of the two remaining major U.S. producers of high-grade telescopes. Both of these medium-sized companies are operating in the red. One of the two firms said publicly that, if the government turned down the joint venture, they would move production overseas; the other is likely to close down. Nonetheless, the Federal Trade Commission recently rejected the proposed combination. The result is bound to

be fewer telescopes produced in the United States and more unemployment (albeit small numbers) of American workers—but big government can crow that it succeeded in stopping a phantom "monopoly."

Sauce for the Goose

Some people fall into the common trap of associating wrongdoers, such as polluters, exclusively with private business. Many companies in the private sector do generate lots of hazardous waste, and not all of them handle it properly. But the same can be said about federal government agencies, hospitals, schools, and colleges. Moreover, the regulatory agencies lack the enforcement power over the public sector that they possess over the private sector. Reports of plant closings because of the high cost of meeting environmental and OSHA standards are common. In contrast, there is no record of a single government facility closing down because it was failing to meet the requirements of social regulations.

Public Sector Abuses

It is not surprising that the General Accounting Office (GAO) says, in its understated way, that the regulatory performance of federal agencies "has not been exemplary." One recent GAO study reported that, of 72 federal facilities inspected, 33 were in violation of EPA requirements; and 22 of them had been cited for Class 1 (serious) violations. Sixteen of the 33 facilities remained out of compliance for six months or more. Three had not been in compliance for more than three years.

A follow-up report by the GAO showed little further progress. Only 4 of 11 federal agencies had ever completed the identification of hazardous waste sites and none had finished assessing the environmental problems they had uncovered. Of 511 federal sites failing to meet EPA standards, only 78 had been cleaned up.

The Department of Defense is a major offender. It generates over 500,000 tons of hazardous waste a year. That is more than is produced by the five largest chemical companies combined.

The Department of Defense generates more hazardous waste a year (500,000 tons) than do the five largest U.S. chemical companies combined.

The lax situation uncovered at Tinker Air Force Base in Oklahoma is typical of the way in which many federal agencies respond to the EPA's directives. Although Department of Defense policy calls for the military services to implement EPA's hazardous waste management regulations, Tinker has been selling waste oil, fuels, and solvents rather than recycling them.

Also, personnel at that air force base dump hazardous wastes in landfills that themselves are in violation of EPA requirements. In one case, the EPA had been urging the Oklahoma Department of Health for years not to renew the permit for the landfill. In another instance, the State Water Resources Board is seeking a court order to close the site. Civilian agencies, including those in state and local governments, continue to be reluctant to follow the same standards that they impose on the private sector.

To put it mildly, the federal government does not set a good example in complying with its own directives. It expects the private sector to take environmental, safety, and other social concerns far more seriously than it does itself. The late Admiral Hyman Rickover would toss inspectors from EPA and OSHA out of "his" Navy yards. What private company would dare to do that?

My point is not to let anyone off the hook. The solution is quite obvious: what is sauce for

the private-sector goose should also be sauce for the public-sector gander.

Business Strategies

What can private firms do about the continued rise of government intervention in business. Over the years, I have found that individual companies react to changing public policy in four basic patterns: (1) passive, (2) anticipatory, (3) accommodative, and (4) active.

At different times or in dealing with different agencies, some companies use all four. Let me elaborate on each of these approaches.

Passive Approach

Many corporate managements simply react to each new or expanded government initiative—the *passive approach*. Before the passage of the original Clean Air Act, many manufacturing firms merely stonewalled when criticized by citizen groups for the large amounts of air pollution they were generating. Those managements then criticized the government when the Act was passed.

When new laws were passed, the same companies tried to postpone the effects through litigation and administrative appeals. But, ultimately, they were forced to gear their operations to meet the new government requirements.

Anticipatory Approach

Because the passive approach means that the firm is always playing catch-up ball, some companies developed the *anticipatory approach*. In this case, corporate management tries to forecast likely further changes in government policies that affect business. The idea is to adjust operations ahead of time to minimize the impacts of regulation when it does hit. Thus, before Congress enacted tightened air- and water-pollution controls, some firms incor-

porated more stringent ecological standards in their own capital projects. The intent is to minimize the likelihood of subsequently running afoul of new federal regulations.

Some companies take socially responsible actions on a voluntary basis in an effort to reduce the likelihood of more stringent controls being enacted by government.

Some companies also take socially responsible actions on a voluntary basis in an effort to reduce the likelihood of more stringent controls being enacted by government. An example is the extent to which companies and business associations have adopted standards for advance notification of plant closings, together with private programs to reduce adverse impacts on employees and on the surrounding community. Nonetheless, in 1988 Congress did pass legislation mandating advance notice. Some companies supported the statutory requirement as a way of imposing costs on competitors that did not have voluntary programs.

As corporate executives become more alert to evolving social demands, they try to respond to some of the public's expectations as a normal aspect of conducting business. To the extent that this positive development occurs voluntarily, businesses themselves provide an offset to the political pressure that social activists can effectively exert against them.

Why should consumers go to Ralph Nader for help if someone in the company will handle their complaint? As a result, the consumer movement today lacks the dynamism of the 1970s. In part, this is because business firms have been better able to anticipate consumers' wishes and to respond to them.

Accommodation Approach

The *accommodation approach* is the one that companies often follow but are reluctant to admit to. Intentionally or unintentionally, they make generous financial contributions to activist groups that criticize their industry in the hope that they will pick on someone else.

By the way, the labor unions do not play that game. They are not shy about supporting consumer and other activist groups, but they receive a *quid pro quo*. Those groups give them a wide berth and practically never oppose or even criticize labor's public policy positions. That is not surprising because unions limit their funds to organizations which are sympathetic to their objectives.

The supposedly hard-nosed executives of many companies are far more naive. They contribute to the very organizations that sponsor the proposals that are creating the current new wave of government regulation. Paying "protection money" does not work. In fact, it is counterproductive because it strengthens the opposition.

The passive, anticipatory, and accommodating approaches all share a common shortcoming: the companies using this response are always on the defensive. They are constantly dealing with new or expanded forms of government intervention.

Active Approach

Under the circumstances, a growing number of companies attempt to head off or shape the character of government intervention by playing *a more active role* in the public policy arena. Thus, some companies have beefed up their Washington offices to deal with pending legislation and new regulation. Others have set up such operations if they did not already exist. They also have increased their support of trade associations that are active on Capitol Hill. In view of the restrictions on political contributions by corporations, many business executives, as individuals, attempt to exercise leverage on government decision making by partici-

pating more actively in the political process or by forming PACs.

A good knowledge of the public policy process enables businesses legally and legitimately to influence government policies that affect them.

These business firms also make extensive use of in-house publications, communications to shareholders and media to raise the public awareness of political issues that affect the future of the business community. Corporate executives increasingly volunteer to testify at congressional hearings.

Nonetheless, a recent survey of 150 CEOs reported that only one out of four even try to affect public policy. However, the same survey showed that more than 70 percent believe that government policies and attitudes are an important determinant of their competitive positions. It is intriguing to note that, of the CEOs who attempt to influence public policy, three-fourths believe that their efforts are successful.

A good knowledge of the public policy process enables businesses legally and legitimately to influence government policies that affect them. Often the most effective form of influence is making available to government decision makers prompt, factual, and detailed analyses of the impacts of proposed legislation. Every member of Congress listens when someone describes how a bill will affect his or her district.

Conclusion

This essay is hardly a plea to oppose all efforts to provide a safer environment or a healthier workplace. Contrary to rumors, economists breathe the same air and drink the same water as real people. The challenge is how to

achieve the nation's environmental objectives in the most efficient manner.

Society's bottom line is not the impact of regulation on government or on business—but the effect on the consumer, on the citizen.

As a first step, we all need to improve our understanding of the new wave of government regulation. There is no good reason why government should adopt the most disruptive and costly way of cleaning the air or the nation's rivers. After all, society's bottom line is not the impact of regulation on government or on business—but the effect on the consumer, on the citizen. It is consumers who wind up paying the cost of regulation every time they buy a product whose price includes the rising expense of complying with an ever-widening array of governmental directives.

Regulation also often generates unexpected negative effects, such as stifling innovation. I sincerely doubt that Henry Ford's original model T could have survived today's regulatory challenges. After all, it had no pollution gear and it was dangerous. Why, you could break your arm cranking it.

In any event, reducing the extent of federal regulation does not seem to have as much attraction for policymakers in the early 1990s as it did in the early 1980s. The best that we can hope for is to cool the regulatory fever by encouraging government, in the regulations that it does adopt, to rely more fully on economic incentives and to weigh more carefully the benefits they expect against the costs they are imposing.

It may sound technical, but imposing a benefit-cost test would do a great deal to slow down new regulation. So many of the federal agencies would be unable to show that their rulings

would meet the simplest benefit-cost requirement.

But perhaps the most powerful response to the new wave of federal regulation of business is to get consumers to understand that business is just a middleman. The cost of complying with regulations—like any other cost—shows up in the higher prices that people pay for the products that they buy.

Helping the public understand the limits of government regulation is another fundamental educational effort. Even if the EPA were staffed entirely with Newtons and Einsteins, it could not meet the present statutory expectations of cleaning all of the water, air, and land in and around the United States. Nor can the Consumer Product Safety Commission effectively regulate the 2 million companies producing the 10,000 products within its jurisdiction.

The need is not for greater compassion, commitment, or technological expertise—those we have in abundance. What is required now is the willingness and the courage on the part of Congress and the White House to make difficult choices among the overwhelming array of demands by interest groups for more government regulation of business.

To use a medical analogy, regulation is a very powerful medicine. The congressional doctor should prescribe it in small doses with full regard to all of the adverse side effects on employment, innovation, productivity, and competitiveness. Moreover, regulation is an expensive medicine and the consumer winds up paying the bill.