Public Policy and the Business Firm: Proceedings of a Conference

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PUBLIC POLICY AND THE BUSINESS FIRM

PROCEEDINGS OF A CONFERENCE

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needed to justify a far-ranging modernization and revitalization program.

What does all this have to do with you, and your attendance at this particular conference?

First, I think all of you will agree that steel and other basic industries are essential to the economic and social well-being of our nation. Therefore, however you feel about the remedies to our problems that I've outlined to you, this is a subject area that's worthy of close attention at your schools.

Second, I think that all I've said confirms the point that's implicit in the overall theme of this conference -- that the environment for business is closely intertwined with public policy. You might say that today the "political marketplace" is as important to corporate management as the financial marketplace, or the marketplace for our products.

And third, it follows that any business school curriculum must fully reflect these realities if it is to prepare students adequately for today's real world of business.

THE CHANGING IMPACTS OF GOVERNMENT REGULATION OF BUSINESS

Murray L. Weidenbaum

The rapid and pervasive expansion in government regulation of business which has been occurring in the United States in recent years is altering fundamentally the relation between business and government. To begin with, I suggest that the concept of a regulated industry has become archaic. We now live in an economy in which every industry is feeling the rising power of government regulation in each major aspect of its day-to-day operations. Virtually every company in the United States knows the impacts of a vast array of government involvement in its internal decision making.

If we could accurately measure the pervasiveness of government intervention, I doubt that we would find the economists' favorites -- electric utilities and railroads -- at the top of the list. More likely, we would encounter such giants of the manufacturing sector as automobile, aerospace, and chemical companies, with the oil industry and health services not too far behind. Because of the rapid proliferation of government regulatory activity in the past two decades, it is difficult to understand the totality of the process which is still under way. This presentation is an attempt to provide an overview.

The limitations of this paper should be noted. This is not an attempt to evaluate the worthiness of the regulatory programs themselves. Rather, the impacts are examined from the viewpoint of the business firm. The costs of business compliance with government regulation are a factor that properly enters any reasonable benefit/cost analysis of regulation. But surely it is only one factor among many that must be weighed in the policy process.

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THE PERVASIVE IMPACTS ON THE BUSINESS FIRM

It is hard to overestimate the rapid expansion and the great variety of government involvement in business now occurring in the United States. The major growth of governmental regulation is not in the traditional independent regulatory agencies, such as the Interstate Commerce Commission and the Federal Communications Commission. Rather, the expansion of government power over business is occurring by use of the operating bureaus of government -- the Departments of Agriculture, Commerce, Energy, Health and Human Services, Interior, Justice, Labor, Transportation, Treasury, and via new operating units such as the Environmental Protection Agency. Table 1 shows that 85 percent of the budgets for federal regulation is assigned to social regulation and only 15 percent to the older forms of economic regulation.

A very substantial further expansion of regulation is in the government pipeline. Many of the laws passed in recent years are in the early growth stages of development. As the U.S. Council on Environmental Quality pointed out in a recent annual report, current estimates of the burden of regulation "do not yet include many costs associated with the hazardous waste section of the Resource Conservation and Recovery Act of 1976, the Toxic Substances Control Act of 1976, and 1977 Amendments to the Federal Water Pollution Control Act, and the 1977 Amendments to the Clean Air Act." For most of this legislation, the Council pointed out, EPA is still in the process of developing its final regulations, and the effects will not be felt until business and government begin to implement the regulations.

Similar patterns prevail in other areas. The Occupational Safety and Health Administration has recently issued a generic carcinogenic standard, which it has been estimated, will generate compliance costs greater than the

TABLE 1

Expenditures on Federal Regulatory Activities

(Fiscal Years, Millions of Dollars)

Area of Regulation	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979	(Estimated) 1980	1981	% Change 1970 to 1979	% of 1981 Budget
Social Regulation														
Consumer Safety and Health	$ 392	$ 593	$ 948	$1059	$1251	$1347	$1464	$1772	$2261	$2474	$2606	$2857	+531%	41%
Job Safety and Other Working Conditions	62	104	124	227	310	379	447	492	544	642	742	800	+935%	12%
Environment and Energy	85	146	493	585	759	967	1026	1047	1296	1517	1688	2217	+1685%	32%
Total Social Regulation	539	843	1565	1871	2320	2693	2937	3311	4101	4633	5036	5874	+760%	85%
Economic Regulation														
Finance and Banking	106	123	134	142	158	186	211	240	273	296	294	352	+179%	5%
Industry-Specific Regulation	125	151	166	140	203	220	251	286	297	318	377	384	+154%	5%
General Business	96	105	120	133	153	169	199	225	245	271	316	327	+182%	5%
Total Economic Regulation	327	379	420	415	514	575	661	751	815	885	987	1063	+171%	15%
Grand Total	$ 866	$1222	$1985	$2286	$2834	$3268	$3598	$4062	$4916	$5518	$6023	$6937	+537%	100%
Annual Nominal Increase		41%	62%	15%	24%	15%	10%	13%	21%	12%	9%	15%		
Annual GNP Deflator		5.1%	4.1%	5.8%	9.7%	9.6%	5.3%	5.5%	7.3%	8.9%	8.9%	8.8%		
GNP Deflator Index[1]	100	105.1	109.4	115.7	127.0	139.2	146.5	154.6	165.9	180.7	196.7	214.0		
Total in 1970 $	$ 866	$1163	$1814	$1976	$2231	$2348	$2456	$2627	$2963	$3054	$3062	$3242		
Annual Real % Increase		34%	56%	9%	13%	5%	5%	7%	13%	3%	0%	6%		

NOTE: [1]GNP Deflator figures for years 1971-1977 are taken from *Statistical Abstract of the United States, 1978.* Figures for 1978-1981 are taken from the *Budget of the United States Government, Fiscal Year 1981.*

Source: Center for the Study of American Business total existing array of OSHA standards. The National Highway Traffic Safety Administration is pursuing mileage goals at a pace which will test the outer limits of the survival capacity of the relatively few American companies that still produce motor vehicles.

Indeed, when we attempt to look at the emerging business-government relationship from the business executive's viewpoint, we find a very considerable public presence in what historically have been private matters. No business, large or small, can operate without obeying a myriad of government restrictions and regulations. Entrepreneurial decisions fundamental to the business enterprise are increasingly becoming subject to governmental influence, review or control -- decisions such as: What lines of business to go into? What products and services to produce? Which investments to finance? How to produce goods and services? Where to make them? How to market them? What prices to charge? What profit to keep?

Virtually every major department of the typical corporation in the United States has one or more counterparts in a government agency that controls or strongly influences its internal decision making. There is almost a "shadow" organization chart of public officials matching the organizational structure of each private company. For example, the scientists in corporate research laboratories now do much of their work to ensure that the products they develop are not rejected by lawyers in regulatory agencies. The engineers in manufacturing departments must make sure the equipment they specify meets the standards promulgated by Labor Department authorities. Marketing staffs must follow procedures established by government administrators in product safety agencies. The location of business facilities must conform with a variety of environmental statutes. The activities of personnel staffs are increasingly geared to meeting the

standards of the various agencies concerned with employment conditions. Finance departments often bear the brunt of the rising paperwork burden imposed on business by government agencies.

In short, there simply are few aspects of business activities that escape some type of government review or influence. Moreover -- and most important -- the impacts of regulation go far beyond general requirements for corporate results; they increasingly permeate every facet of internal business operations.

Important internal adjustments are taking place in the structure and operation of the typical corporation. Each of the major business functions is undergoing an important transformation. These changes tend either to increase the overhead costs of doing business or to deflect management and employee attention from the conventional tasks of designing, developing, producing, and distributing new and better or cheaper goods and services. As Arthur F. Burns stated in his Frances Boyer lecture in December 1978, "As things stand, many corporate executives find so much of their energy is devoted to coping with regulatory problems that they cannot attend sufficiently to the creative part of their business...."

The role of top management is undergoing a fundamental metamorphosis as it responds to the changing external environment. The outlook of key corporate executives is shifting from primary concern with conventional production and marketing decisions to coping with a host of external and often strange policy considerations, frequently motivated by groups with non-business and non-economic priorities. Members of the senior management group may become as attuned to the desires of those new interests as to their traditional accountability to shareholders.

It is not surprising that numerous chief executives report that one-third or more of their time is now devoted to governmental and public policy matters -- dealing with the many federal, state, and local regulations that affect the company, meeting with a wide variety of civic and special interest groups that make "demands" on the organization's resources, and increasingly participating in the public policy arena. Donald Rumsfeld, Chief Executive of a major pharmaceutical company and former Secretary of Defense, has described very personally the pervasiveness of government involvement in business:

> When I get up in the morning as a businessman, I think a lot more about government than I do about our competition, because government is that much involved -- whether it's HEW, IRS, SEC, FTC, FDA. I always understood the problem intellectually, but the specific inefficiencies that result from the government, injecting itself into practically every aspect of our business -- that is something one can feel only by being here.

Some of the most fundamental impacts of governmental intervention are discernible in the research and development area, although the ramifications are likely to unfold only over a long period of time in the form of a reduced rate of product and process innovation. A rising share of corporate R&D budgets is being shifted to so-called defensive research, that is, to meeting the requirements of governmental regulatory agencies, rather than to designing products with greater customer appeal. The trend is most advanced in the automotive industry, where the head of General Motors' research laboratory has stated: "We've diverted a large share of our resources -- sometimes up to half -- into meeting government regulations instead of devoting better materials, better manufacturing techniques, and better products...."
A similar trend is now occurring in the chemical industry, in response to a plethora of new laws and regulations, all ostensibly designed to yield a cleaner or safer environment. The government, via the regulatory process, is

building what amounts to a "legal envelope" around existing technology. A former assistant administrator of the Environmental Protection Agency, Glenn E. Schweitzer, points out:

> Most research directors are clearly becoming more conservative in their approaches to new chemicals. They are not eager to become embraced in hassles with the regulatory agencies....

The combined impacts of the rulings of EPA, OSHA, the Food and Drug Administration, and the Consumer Product Safety Commission are also altering major aspects of the manufacturing function of the typical American business firm. One result of the pressures for production processes to meet government environmental and safety requirements is that a major share of company investment -- about one-tenth at the present time -- is being devoted to these required social responsibilities rather than to increasing the capacity to produce higher quantities or an improved quality of material output, at least as conventionally measured. Coupled with the many factory closings due to regulation, the result of these socially-imposed requirements is a smaller productive capacity in the American economy than is generally realized.

Moreover, we cannot always assume that the loss of private productivity is offset by an improvement in some area of social concern. For example, Armco Steel Corporation was required to install special scrubbing equipment at one of its plants to reduce the emission of visible iron oxide dust. The scrubber does succeed in capturing 21.2 pounds per hour of the pollutant. However, it is run by a 1,020-horsepower electric motor. In producing the power for that motor, the electric utility's plant spews out 23.0 pounds per hour of sulfur and nitrogen oxides and other gaseous pollutants. Thus, even though Armco is meeting government regulations on visible emissions, the air is actually 1.8 pounds per hour dirtier because of the government's regulatory requirement.

Virtually every aspect of the marketing function of business is affected by government. Advertising and product warranties are now subject to increasing regulation by the Federal Trade Commission. Labeling and packaging is now regulated by the Federal Trade Commission, the Food and Drug Administration, the Consumer Product Safety Commission, and the Department of Agriculture. Motor vehicle producers must include mileage ratings in advertising; cigarettes must display statements about their probable link to cancer; appliances must be labeled according to energy usage; and processed foods must list ingredients in specified order. The most severe restrictions, however, relate to the increasing power of government agencies to refuse to permit the production of products not meeting their standards or requiring the recall of products already sold. The latter is a process which is often euphemistically referred to as "reverse distribution."

The primary thrust of many personnel departments has shifted from serving the staffing needs of their companies to meeting the requirements of and pressures from government agencies. Maintaining complete familiarity with applicable regulations, filling out agency forms, and preparing reports to the government literally have been elevated to major end products of this traditional corporate function. One astute observer of the Washington scene has pointed out the adverse albeit unintended impact of these regulatory activities: "It has become considerably more expensive to employ anyone."

It is finance departments that often bear the brunt of the almost insatisable demand for paperwork from government agencies. To an increasing extent, corporate finance units are reacting to external demands for information, rather than primarily meeting the corporation's own data requirements for internal planning, reporting, and control. This reflects the change in

the focus of corporate decision making whereby a variety of outside organizations and considerations figure so actively.

Expansions in specialized staff operations often constitute the most direct company response to the widening role of government in business. Virtually every company is developing some capability to inform itself about and evaluate present and future government developments as they relate to its activities. Firms of substantial size generally maintain headquarters planning staffs and Washington offices, while smaller companies rely primarily on their trade associations and on Washington-based attorneys and consultants. In some cases, substantial changes are made in the corporate organizational structure. A major headquarters office on government relations may be established by a company, with direct ties to each of its operating departments, as well as offices in Washington and state capitals.

Professor Douglas North of the University of Washington contends that the key margin of decision making in our society today is access to government influence. As he describes the matter, the predictable result "is to shift the focus of the investment of resources into attempts to favorably influence the strategic government official or to prevent the enactment of governmental policies that will adversely affect the interest of groups." The point may be overstated. There are still many more opportunities for private undertakings. Moreover, the adverse public reaction to massive use of business resources in politics would, under present circumstances at least, be overwhelming. Nevertheless, North is indicating an important emerging development, especially in the case of the larger business organizations.

MEASURING THE EFFECTS OF REGULATION

Let us take another look at the phenomenon of regulation. Government imposition of socially desirable requirements on business through the regulatory process may appear at first 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 when government imposes 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 public by government regulation.

First-order effects

The phenomenon of the regulatory tax is most visible in automobile regulation. The newly produced automobile in the United States carries a load of equipment which the federal government has mandated must be installed, ranging from catalytic converters to heavier bumpers. All in all, there was approximately $666 in government-mandated safety and environmental control equipment in the typical 1978 passenger automobile. But examination of the visible costs, such as to the motorist, provides only the initial or "first-order" effects of government regulation.

Second-order effects

It is the indirect or second-order effects that are truly huge -- the various efforts involved in changing a company's way of doing business in order to comply with government directives. One indirect cost of regulation is the growing paperwork imposed on business firms: the expensive and time-consuming process of submitting reports, making applications, filling out questionnaires, and replying to orders and directives.

Government regulation can also have strongly adverse effects on employment. This fact has been demonstrated in the minimum wage area where teenagers increasingly have been priced out of labor markets. One study has shown that the 1966 increase in the statutory minimum wage resulted in teenage employment in the United States being 225,000 lower in 1972 than it otherwise would have been.

It is difficult, of course, to obtain an aggregate measure of the total cost involved in complying with governmental regulations. A pioneering effort along those lines was made at the Center for the Study of American Business at Washington University in St. Louis. We culled from the available literature the more reliable estimates of the costs of specific regulatory programs. Using a conservative procedure, we put the various dollar figures on a consistent basis and aggregated the results for 1976. The total annual cost of federal regulation was shown to be approximately $66 billion, consisting of $3 billion of taxpayer costs to operate the regulatory agencies and $63 billion (or twenty times as much) for business to comply with the regulations. Thus, on the average, each dollar that Congress appropriates for regulation tends to result in an additional $20 of costs imposed on the private sector of the economy.

If we apply the same multiplier of twenty (between the amounts budgeted for regulatory activities and the private cost of compliance) to the budget figures which are available for more recent years, we can come up with more current approximations of the private sector's cost of compliance. On that basis, the costs arising from federal regulation of business in the United States (both the expenses of the regulatory agencies themselves as well as the cost they induce in the private sector) come to a total of $121 billion in 1979, consisting of $6 billion of federal budget costs and approximately twenty times that amount in private sector expenses of compliance. That is a substantial hidden tax imposed by federal regulation, of about $500 per capita.

Third-order effects

Yet, the most fundamental impacts of governmental intervention are what we can call the third-order or induced effects on the corporation. These are the actions that the firm takes to respond to the direct and indirect effects of regulation. These responses often include such negative actions as cutting back on research and development and on new capital formation because of the diversion of funds to meet government-mandated social requirements. The basic functioning of the business system is adversely affected by these cumulative impacts, notably in the reduced pace of innovation, the lessened ability to finance growth, and ultimately the weakening of the capability of the firm to perform its central role of producing goods and services for the consumer. These difficult-to-measure induced impacts may, in the long run, far outweigh the more measurable direct costs resulting from the imposition of government authority over private sector decision making.

For example, the government decision making process can have adverse effects on capital formation by introducing uncertainty about the future of regulations governing new processes and products. It is becoming increasingly difficult for American companies to move ahead with building any new energy facilities. A cogent example is furnished in the report by a task force of the President's Energy Resources Council dealing with the development of a new synthetic fuel industry.

The task force stated, for example, that a major uncertainty was the length of time that a project would be delayed pending the issuance of an environmental impact statement that would stand up in court. They noted that

the cost of such delays -- additional interim financing and further cost increases in labor and equipment -- is an obvious potential hazard for any new project. The task force provided the following evaluation of the overall impact of government regulatory activity: "In summary, some of these requirements could easily hold up or permanently postpone any attempt to build and operate a synthetic fuels plant."

Consider the innovative product research and development that is not performed because corporate research and development budgets increasingly are being devoted to what is termed "defensive research." A number of companies report that they devote large and growing shares of their scientific resources to meeting regulatory requirements or avoiding running afoul of regulatory restrictions. One hidden cost of government regulation is a reduced rate of introduction of new products.

Where the impact of government is less dramatic, it may be no less profound. A significant but subtle bureaucratization occurs in the corporate activity that is undertaken. The Employee Retirement Income Security Act of 1974 (ERISA) has shifted much of the concern of the management of pension funds from maximizing the return on the contributions to following a more cautious approach of minimizing the likelihood that the fund managers will be criticized or sued for their investment decisions. It thus becomes safer, although not necessarily more desirable to the employees covered, for the pension managers to keep more detailed records of their deliberations, to hire more outside experts (so that the responsibility can be diluted), and to avoid innovative investments. The federal rules also tend to make the pension fund manager unwilling to invest in other than blue-chip stocks, thus depriving smaller, newer, and riskier enterprises of an important source of venture capital.

From such regulatory experiences, we can see that the nation is paying yet another price for the expansion of government power -- the attentuation of the risk-bearing and entrepreneurial characteristics of the private enterprise system.

THE IMPLICATIONS FOR ACADEMIC THINKING

It needs to be recognized that impetus for most of the expansion in government power over business is not being provided by the industries being regulated; generally they have shown minimum enthusiasm for EPA, OSHA, EEOC, ERISA, etc. If anything, they claim that the "benefits" to them of these regulations are negative. The pressures for the new style of regulation come, rather, from a variety of citizen groups concerned primarily with non-economic aspects of our national life -- environmentalists, consumer groups, labor unions, and civil rights organizations.

To talk or write about the regulated industry "capturing" its regulators is, to put it kindly, a rather quaint way of viewing the fundamental shift in business decision making now taking place, the shift of power from private managers to public officials. Yet, the core of the economist's version of the "capture" theory still holds -- public policy tends to be dominated by the organized and compact pressure groups who attain their benefits at the expense of the more diffused and larger body of consumers. But the nature of those interest groups has changed in recent years. Rather than the railroad baron (a relatively easy target for attack), the villain of the piece often has become a self-styled representative of the public interest who has succeeded so frequently in identifying his or her personal prejudices with the national well-being. In contrast, the business firm, in performing the traditional middleman function, typically serves the unappreciated and involuntary role of proxy for the overall consumer interest.

The changing nature of regulation can be seen with reference to Figure 1. The vertical lines show the traditional relationship between the old-style of regulatory commission (the Interstate Commerce Commission, the Civil Aeronautics Board -- while it is still in existence -- etc.) and the specific industry that it regulates. However, the great bulk of the economy -- the manufacturing, trade, and services sectors -- is virtually exempt from that type of regulation.

In contrast, the horizontal lines show the newer breed of regulation -- the EPA, OSHA, CPSC, etc. In the case of these relative newcomers to the bureaucracy, their jurisdictions extend to the great bulk of the private sector and at times to activities in the public sector itself. It is this far-ranging characteristic that makes it impractical for any single industry to dominate these regulatory activities in the manner of the traditional model.

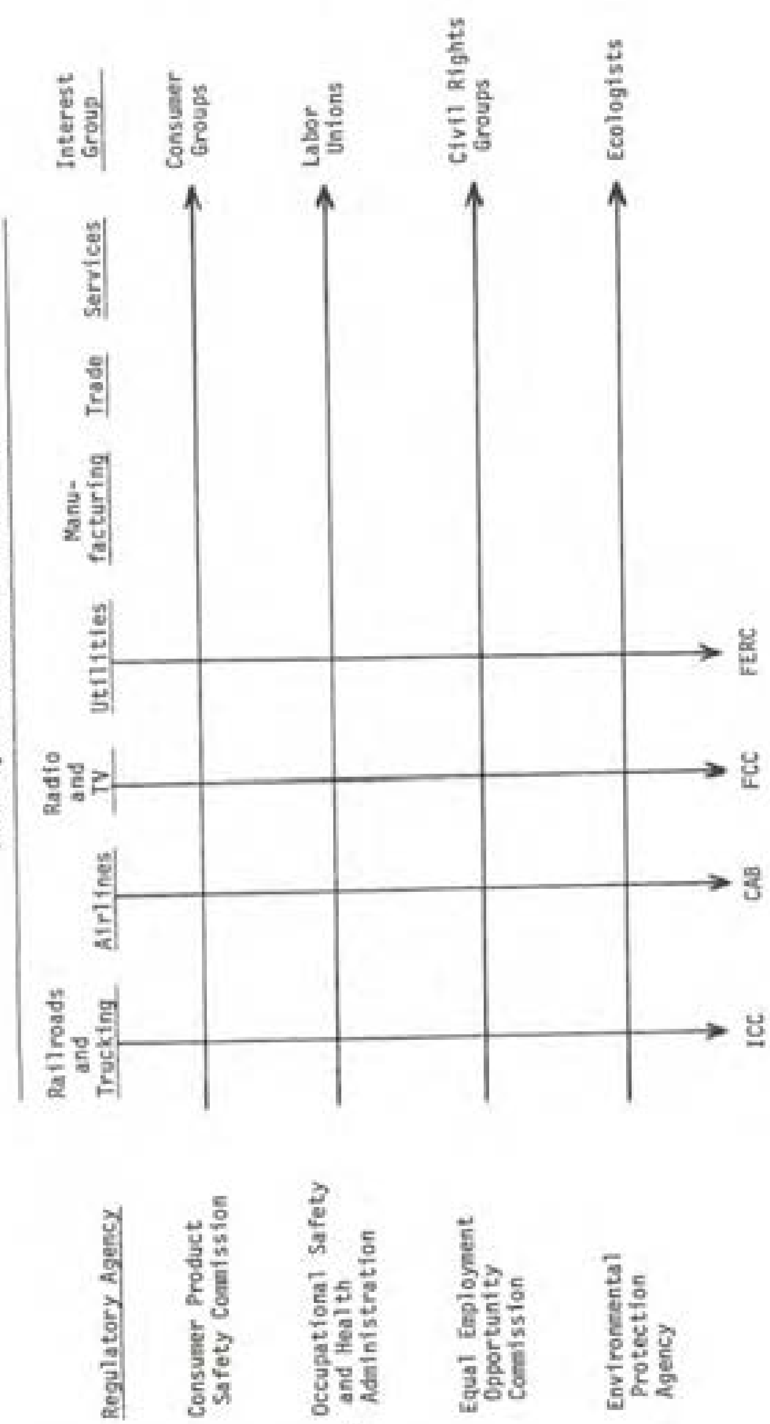
Yet, in comparison to the older agencies oriented to specific industries, the newer regulators operate in a far narrower sphere. They are not concerned with the totality of a company or industry, but only with the limited segments of operations which fall under their jurisdiction. If there is any special interest that may come to dominate such a functionally oriented agency, it is the one that is preoccupied with its specific task -- ecologists, unions, civil rights groups, and consumer organizations.

Approaches to Regulatory Reform

Economists are prone to take measurements of economic phenomena. The numbers, of course, are not an end in themselves, but an input to decision makers. The measurement of the costs and related impacts that flow from government regulation is no esoteric matter. This information can be used in many ways. First of all, the cost data show the public and the government the

FIGURE 1

VARIATIONS IN FEDERAL REGULATION OF BUSINESS



economic importance that regulation has assumed, especially as measured by the large dollar amounts of resources that are required to be devoted to meeting federal mandates.

Secondly, this information helps to shift the public dialogue onto new and higher ground. The pertinent policy questions are no longer, "Are you for or against clean air or safe products?" or other such absolutes. Increasingly, the public discussions are in terms of such less emotional and long-neglected questions as, "How well is the regulatory process working?" and, "Are there better ways of achieving the public's desires?"

Finally, the availability of information on the costs of regulation is an important step in reforming the regulatory process. The presence of the cost data inevitably leads to proposals for benefit/cost analyses, cost-effectiveness studies, risk-benefit evaluations, and similar analytical approaches to what in the past too often had been viewed as emotional issues. Hopefully, legislation reforming regulatory practices will mandate such analytical techniques and thus improve the cost -- and benefit -- data that are used in the regulatory process.

A new way of looking at the microeconomic effects of regulatory programs is needed. A parallel can be drawn to macroeconomic matters, where important and conflicting objectives are recognized and attempts to trade off are made (for example, as between economic growth and price stability). At the microeconomic level, it likewise is appropriate to reconcile the goals of specific government programs with national objectives. Environmental protection, product safety, and other regulatory efforts should be related to costs to the consumer, availability of new products, and employment. In part, this reconciliation can be made at the initial stages of the government process, when the president proposes and the Congress enacts new regulatory programs.

Benefit-Cost Analysis

One device for broadening the horizons of government policymakers and administrators is the economic impact statement. Policymakers could be required to consider the costs (and other adverse effects) of their actions as well as the benefits. This is not a novel idea. In November 1974, then-President Gerald Ford instructed the federal agencies under his jurisdiction to examine the effects of the major regulatory actions on costs, productivity, employment, and other economic factors. President Carter has continued this effort, with some modifications.

This first step is subject to several shortcomings. Many of the key regulatory agencies -- ranging from the Consumer Product Safety Commission to the Federal Communications Commission -- are so-called "independent agencies," which are beyond the President's jurisdiction in these matters. Even in the case of the regulatory activities that come within presidential oversight, the agencies covered by the Executive Order are required only to examine the economic aspects of their actions; the weight they give to economic factors remains in their discretion -- to the extent that Congressional statutes permit them to give any consideration to economic influences at all.

A broader approach is needed, one with a strong legislative mandate. In the fashion of the environmental impact statements (but without as much of the trivia), Congress should require each regulatory agency to assess the impact of its proposed actions on the society as a whole, and particularly on the economy. Much would depend on the "teeth" put into any required economic impact statement. Merely legislating the performance of some economic analysis by an unsympathetic regulator would serve little purpose beyond delaying the regulatory process and making it more costly. But limiting

government regulation to those instances where the total benefits to society exceed the costs would be a major departure from current practice.

Government regulation should be carried to the point where the incremental costs equal the incremental benefits, and no further. Indeed, this is the basic criterion that is generally used to screen government investments in physical resources. Overregulation is not an emotional term. It is the economist's shorthand for regulation for which the costs exceed the benefits.

The critics of the analytical approach to evaluate government regulation tend to forget that benefit/cost analysis is a neutral concept. It gives as much weight to a dollar of benefits as to a dollar of costs. And in a broader sense, the estimation of benefits and costs need not be necessarily viewed in dollar terms. The costs as well as the benefits may at times properly be measured in terms of human life. For example, the Occupation Safety and Health Administration regulations may have a very high opportunity cost when they divert professional safety staffs of the companies from their traditional duty of training workers in safer procedures. The "benefits" of following the <u>Federal Register</u> may be far more illusory and surely fewer.

The implementation of benefit/cost analyses needs a great deal of attention. After all, a reluctant agency can merely go through the motions of studying the effects of its actions on the economy and proceed as it originally intended. An agency not directly involved in regulation -- such as the General Accounting Office or the Office of Management and Budget -- should set government-wide standards, concepts, and methods of performing economic evaluations of regulations, including the estimation of benefits and costs. The determination of the interest rates to be used in discounting future costs and benefits, for example, should not be a matter left to the judgment of the agency which is attempting to justify its own action. Where a dollar sign cannot be placed on the benefits, reliance can be placed on cost/effectiveness analysis, which is a search for least-cost solutions.

As a minimum, the Congress should endorse the kind of common sense that was embodied in the recent court decision which stopped OSHA from issuing new benzene regulations. The court's language is instructive: "Although the agency does not have to conduct an elaborate cost/benefit analysis . . . it does have to determine whether the benefits expected from the standards bear a reasonable relationship to the costs imposed by the standard."

The ability of the executive branch to change the basic regulatory system is limited. Each regulation is issued in accord with a law passed by Congress. Reform measures cannot simply be "proclaimed," they must be legislated. Many of the proposals to reform government regulation involve the "sunset" mechanism -- the compulsory periodic review of each major regulatory program to determine whether it is worthwhile to continue it in the light of changing circumstances. This procedure would provide Congress with a formal opportunity to revise the underlying regulatory statutes or to determine that a given regulatory program is no longer needed and that the "sun" should be allowed to "set" on it. A benefit/cost analysis would provide a quantitative mechanism to aid in making those value judgments.

<u>Budgeting as a Management Tool</u>

Greater attention should be given to the role of the budget process in managing regulation. In those cases where an agency's regulations generate more costs than benefits, the agency's budget for the coming year should be reduced, and perhaps vice versa. Because the appropriations for the regulatory agencies are small portions of the government's total budget, limited attention

has been given to them in the budget process. In view of the large costs that they often impose on the society as a whole, greater attention is warranted to the reviews of their appropriation requests via a regulatory budget.

<u>Changing Attitudes Toward Regulation</u>

Fundamentally, regulatory reform is not a concern with technical measurements or administrative procedures. Rather, government decision makers need to take a very different view of the regulatory mechanism than they do now. Rather than relying on regulation to control in detail every facet of private behavior, the regulatory device needs to be seen as a powerful tool to be used reluctantly and with great care and discretion. Basically, it is attitudes that need to be changed. Experience with the job safety program provides a cogent example. Although the government's safety rules have resulted in billions of dollars in public and private outlays, the goal of a safer work environment has not been achieved.

A more satisfying answer to improving the effectiveness of government regulation of private activities requires a major change in the approach to regulation, and one not limited to the job safety program. Indeed, that program is used here merely as an illustration. If the objective of public policy is to reduce accidents, then public policy should focus directly on the reduction of accidents. Excessively detailed regulations are often merely a substitute -- the normal bureaucratic substitute -- for hard policy decisions.

Rather than placing emphasis on issuing citations to employers who fail to fill forms out correctly or who do not post the required notices, stress should be placed on the regulation of those employers with high and rising accident rates. Perhaps fines should be levied on those establishments with the worst safety records. As the accident rates decline toward some sensible standard, the fines could be reduced or eliminated. But the government should not be much concerned with the way a specific organization achieves a safer working environment. Some companies may find it more efficient to change work rules, others to buy new equipment, and still others to retrain workers. The making of this choice is precisely the kind of operational business decision making that government should avoid, but that now dominates many regulatory programs.

Alternatives to Regulation

The promulgation by government of rules and regulations restricting or prescribing private activity is not, of course, the only means of accomplishing public objectives. Codes of behavior adhered to on a voluntary basis can be effective. Moreover, government has available to it various powers other than the regulatory mechanism. Through its taxing authority, the government can provide strong signals to the market. Rather than promulgating detailed regulations governing allowable discharges into the nation's waterways, the government could levy substantial taxes on those discharges.

The use of taxation would be meant neither to punish polluters nor to give them a "license" to pollute. Rather, it would be using the price system to encourage producers and consumers to shift to less polluting ways of producing and consuming goods and services. Price incentives tend to force the environmental agencies to consider explicitly the cost of cleaning up pollution, while direct controls make it very easy to adopt extremely expensive if not unrealistic goals, such as zero discharge.

In the case of the traditional one-industry type of government regulation (as of airlines, trucking, and railroads), a greater role should be given

to the competitive process and to market forces. Unlike the newer forms of regulation, the older forms of regulation are often mainly barriers to entry into a given industry, protecting existing firms from competition by potential new entrants. To date, none of the procedural reforms previously described has been enacted by the Congress. Perhaps the most significant single legislative action in the regulatory reform area in recent years was the law phasing out the Civil Aeronautics Board over a seven-year period.

With reference to consumer protection, an information strategy can provide a sensible alternative to compulsory product standards. For the many visible hazards that consumers voluntarily subject themselves to, the most important consideration in public policy is to improve the individual's knowledge of the risks involved rather than limit personal discretion. In their daily lives, citizens rarely opt for zero risk alternatives but trade off between speed and safety, for example.

The more widespread provision of information to consumers on potential hazards in various products may, in many circumstances, be far more effective than banning specific products or setting standards requiring expensive alterations in existing products. The information approach takes account of the great variety of consumer desires and capabilities. Interestingly enough, this approach often is favored in consumer surveys, although not by some of the most vehement representatives of the so-called public interest groups.

Any realistic appraisal of government regulation must acknowledge that important and positive benefits have resulted from many of the regulatory activities -- less pollution, fewer product hazards, reducing job discrimination, and other socially desirable goals of our society. But the "externalities" generated by federal regulation do not justify governmental attempts to regulate every facet of private behavior. A reasonable approach to this problem requires great discrimination in sorting out the hazards that are important to regulate from the kinds of lesser hazards that can best be dealt with by the normal prudence of consumers, workers, and business firms.

The serious question, of course, is not whether government should deal with those market failures, but which techniques and approaches are most effective. To an eclectic economist, government regulation should be carried to the point where the incremental costs equal the incremental benefits, and no further. Those who are concerned that this approach justifies a considerable amount of government intervention in the economy may find some solace in the words of Friedrich von Hayek in his <u>Constitution of Liberty</u>: "...a free market system does not exclude on principle ...all regulations governing the techniques of production.... They will normally raise the cost of production, or what amounts to the same thing, reduce overall productivity. But if this effect on cost is fully taken into account and it is still thought worthwhile to incur the cost to achieve a given end, there is little more to be said about it. The appropriateness of such measures must be judged by comparing the overall costs with the gain; it cannot be conclusively determined by appeal to a general principle."

COMMENTS ON PERSONNEL

Carolyn Eskew

It has been 16 years since Title VII of the 1964 Civil Rights Act became a part of our lives, and we're still passing acts to make it work and issuing guidelines. In 1967, the Age Discrimination in Employment Act was passed; in 1973, the Rehabilitation Act; in 1974, the Vietnam Era Veterans Readjustment Assistance Act; and prior to these was the 1963 Equal Pay Act.

Two major agencies were established under Title VII of the Civil Rights Act and Executive Order 11246. They are the Equal Employment Opportunity Commission, known as EEOC, and the Department of Labor's Office of Federal Contract Compliance Programs, known as the OFCCP. Both agencies are designed to enforce antidiscrimination and affirmative action requirements. The EEOC deals with individual job bias complaints, while the OFCCP focuses on classwide or "systemic" discrimination by federal contractors.

These are the acts that affect all companies today. And whether the results are good or bad really remains to be seen, I think. The companies that are affected the most are those which are probably already making the best efforts and would continue to do the most. But somehow, that's how things seem to work. Those firms that are doing, or trying to do, the right thing are those which are usually penalized by new laws.

An order of the Equal Employment Opportunity Commission concerning sexual discrimination now forbids sexual harassment of employees by employers. The order makes employers responsible for any sexual harassment by its supervisory personnel, regardless of whether the employer knew or should have known of such harassment. Three criteria will determine whether an action constitutes unlawful sexual harassment. Unwelcome sexual advances become illegal

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