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Reducing the Hidden Cost of Big Government, Testimony before the Joint Economic Committee of the U.S. Congress Priorities in Tax Policy, Testimony before the U.S. Senate Committee on Finance

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The largest and most rapid increase in government power over the private sector is not in the areas of taxation or government spending. Rather, it is the expansion of government regulation of private economic activity which is affecting the citizen in so many important and costly ways. Although not generally appreciated, the process of government regulation generates many of the hidden costs of big government. It is a special source of concern in the present circumstances because excessive government regulation is increasing inflation and unemployment simultaneously.

Fundamental reforms of government regulation will be difficult. They will be opposed by a host of special interest groups, including many that have the conceit of automatically identifying their views as the sole expression of the public or consumer interest. But sensible reforms of government regulation could yield substantial benefits to the consumer, the motorist, the homeowner, the worker, the investor, and the taxpayer. It is the intent of this statement to lay the groundwork for such reform by showing how much is at stake for each of those major sectors of our society. Several initial reforms are suggested, not as panaceas, but as practical means of accelerating the process of constructive change.

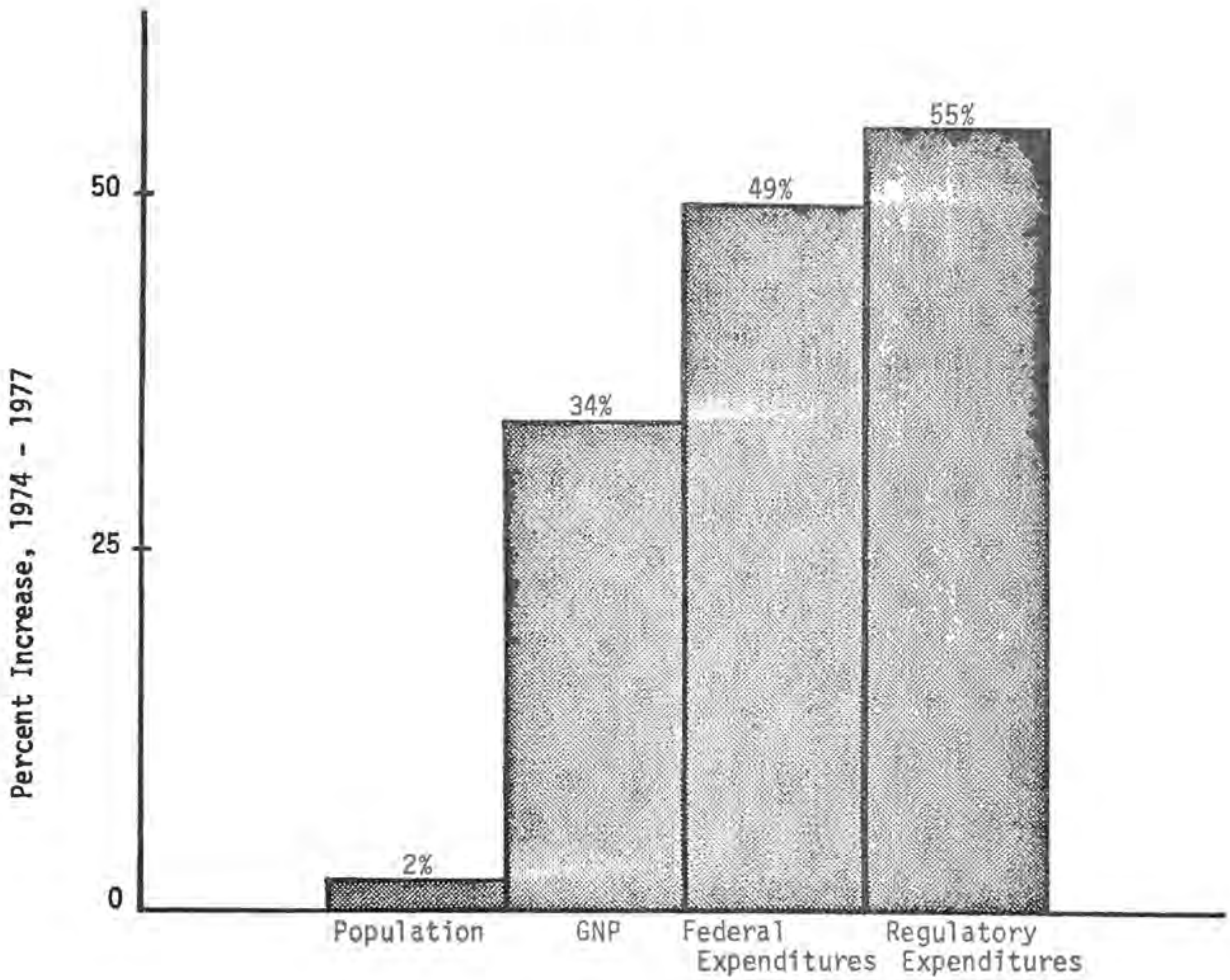
The Various Costs of Regulation

The impacts of government regulation of business are being felt in every part of the economy:

1. The taxpayer feels the effect. Government regulation literally has become a major growth industry, an industry supported by the taxpayer.

FIGURE 1

GROWTH OF FEDERAL REGULATORY EXPENDITURES
AND OTHER ECONOMIC INDICATORS
1974 - 1977



SOURCE: Center for the Study of American Business

The cost of operating federal regulatory agencies is rising more rapidly than the budget as a whole, the population, or the gross national product (see Figure 1). Outlays of 41 regulatory agencies are estimated to increase from $2.2 billion in the fiscal year 1974 to $4.8 billion in fiscal 1979, a growth of 115 percent over the five-year period.

2. The motorist feels the effect. Federally-mandated safety and environmental features increase the price of the average passenger car by $666 in 1978 (see Figure 2). When we consider that about 11 million cars are likely to be sold to Americans this year, that means that compliance with those regulations are costing American consumers $7 billion a year in the form of higher priced cars. In addition, the added weight of the cars is increasing fuel consumption perhaps by about $3 billion dollars annually. Thus, the American motorist is paying in the neighborhood of $10 billion a year to meet federal regulatory requirements in the two areas of environment and safety.

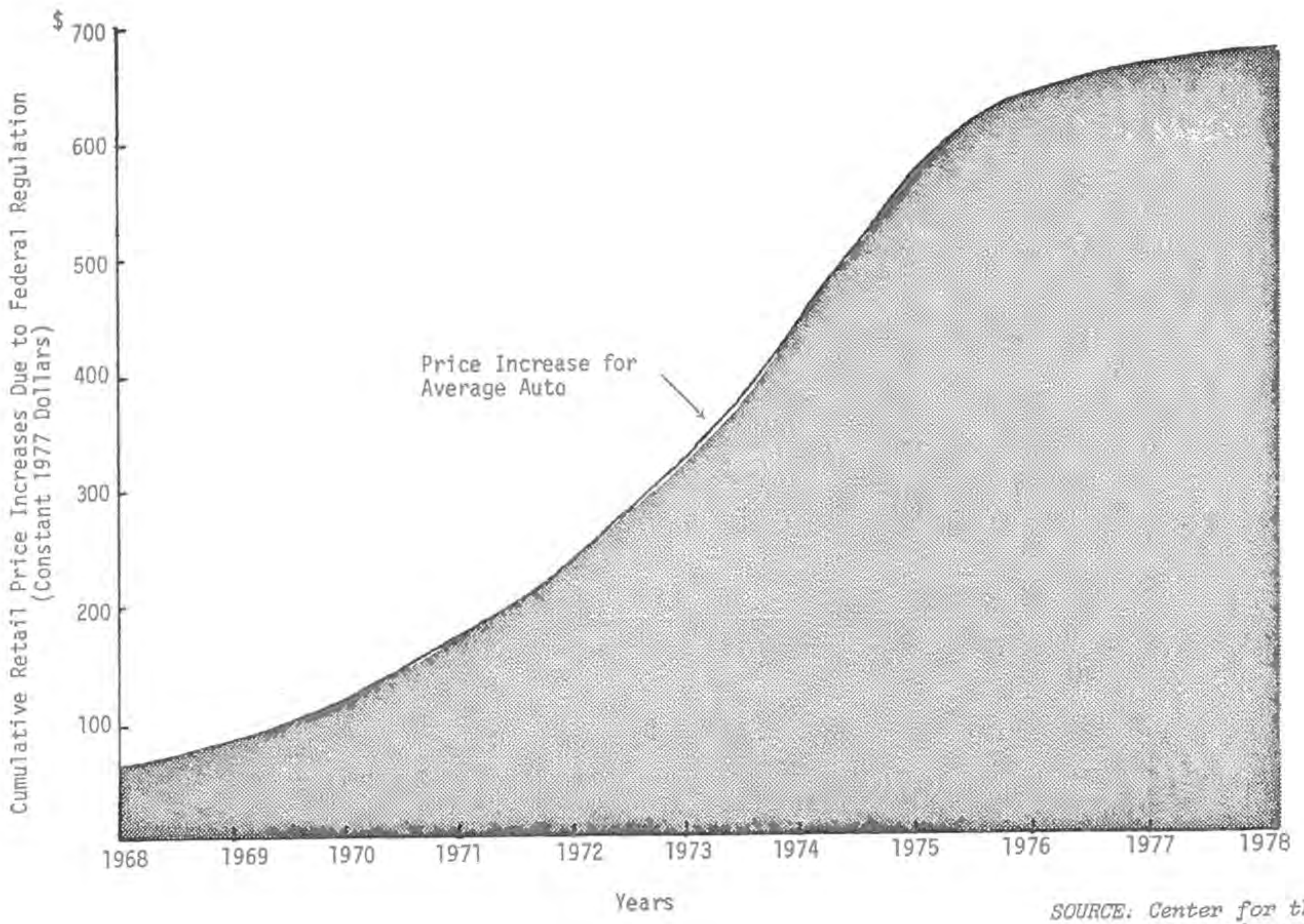
3. The businessman feels the effect. There are over 4,400 different federal forms that the private sector must fill out each year. That takes over 143 million man hours, the economic equivalent of a small army. The Federal Paperwork Commission recently estimated that the total cost of federal paperwork imposed on private industry ranges from $25 billion to $32 billion a year and that "a substantial portion of this cost is unnecessary."

It is hard to believe that most of those reports are even read by anyone in the government before they are filed in some federal storage area. Indeed, cases have been reported of a small company repeatedly sending in nonsense results, without receiving any criticism from the federal agency requiring the information. It is widely known, of course,

FIGURE 2

AUTOMOBILE PRICE INCREASES DUE TO
FEDERAL SAFETY AND EMISSIONS CONTROL REGULATION

(Retail Prices, Per Auto)



SOURCE: Center for the Study of American Business

that the smaller business is hit disproportionately hard by paperwork, as well as by other types of government regulation.

4. The homeowner feels the effect. Regulatory requirements imposed by federal, state, and local governments are adding between $1,500 and $2,500 to the cost of a typical new house. The government-imposed costs range from permit and inspection fees to wider and thicker required streets to time-consuming and excessively detailed environmental impact studies. Using the midpoint of the range of cost estimates ($2,000) and applying it to the two million new homes built in 1977 results in an added cost to the homeowner of $4 billion a year.

5. The consumer feels the effect. The costs of complying with government regulations are inevitably passed on by business to the consumer in the form of higher prices. On the basis of a conservative estimating procedure, the aggregate cost of complying with federal regulation came to $62.9 billion in 1976, or over $300 for each man, woman and child in the United States. The estimated $62.9 billion of costs imposed on the private sector is twenty times the $3.1 billion spent to operate the regulatory agencies in the same year (see Figure 3). If we apply the same multiplier of twenty to the amounts budgeted for regulatory activities for more recent years, we can come up with approximations of the private sector's cost of compliance and thus with the total dollar impact of government regulation. On that basis, it can be estimated that the costs arising from government regulation of business (both the expenses of the regulatory agencies themselves as well as the costs they induce in the private sector) totalled $79.1 billion in the fiscal year 1977 and may reach $96.7 billion in the current fiscal year ending September 30, 1978.

FIGURE 3

THE MULTIPLIER EFFECT:

The Cost of Compliance with Federal Regulation in Fiscal 1979

Regulatory Costs

Administrative	$ 4.8 billion
Compliance	97.9 billion
Total	$102.7 billion

SOURCE: Center for the Study of American Business

On the basis of the federal budget estimate for the fiscal year 1979, the aggregate cost of government regulation may come to $102.7 billion, consisting of $4.8 billion of direct expenses by the federal regulatory agencies and $97.9 billion of costs of compliance on the part of the private sector.

6. The worker feels the effect. Government regulation, albeit unintentionally, can have strongly adverse effects on employment. The minimum wage law has priced hundreds of thousands of people out of labor markets. One increase alone has been shown, on the basis of careful research, to have reduced teenage employment by 225,000, with a disproportionately large impact on non-white youngsters, precisely the group reporting the highest unemployment rate. In addition, many industry facilities and entire factories have been closed down -- with substantial but unmeasurable effects on employment -- because of the high costs of meeting environmental, safety and other regulatory requirements.

7. The investor feels the effect. Approximately $10 billion of new private capital spending is devoted each year to meeting governmentally mandated environmental, safety, and similar regulations rather than being invested in profit-making projects. Edward Denison of the Brookings Institution has estimated that in recent years these deflections of private investment from productive uses have resulted in a loss of approximately one-fourth of the potential annual increase in productivity. The result is to exacerbate the already strong inflationary pressures in the American economy.

8. The nation as a whole feels the effect of government regulation in a reduced rate of innovation and in many ways. The adverse consequences

of government intervention in business decision making range from a slowdown in the availability of new pharmaceutical products to the cancellation of numerous small pension plans. In total, the aggregate response to the proliferation of government regulation is a basic bureaucratization of American business. These undramatic but fundamental effects occur because of the diversion of management attention from traditional product development, production, and marketing efforts designed to provide new and better products and services to meeting governmentally imposed social requirements. It is not inevitable that these various adverse effects flow from every regulatory activity, but it will take serious efforts to avoid or reduce these adverse side-effects.

The Need for Regulatory Reform

There are no simple approaches to reforming government regulation. It surely is not a question of being for or against federal regulation of business. A substantial degree of governmental intervention is to be expected in a complex, modern society. The need, rather, is to identify those sensible changes that can be made in the regulatory process so as to achieve the desired social goals (less pollution, fewer product hazards, etc.) with minimum adverse impacts on other important goals (more jobs, less inflation, etc.).

1. A new way of looking at the effects of regulation is needed for public policymaking. The pertinent question is not whether there are shortcomings in the private sector. Of course, the human beings involved in the operation of the American business system are fallible and the results of their activities do not always conform to the prevailing notions of what is in the public welfare. The serious question is whether, in view of the many goals of our society, government regulation in a particular

instance is doing more good than harm.

A parallel can be drawn to macroeconomic matters, where important and at times conflicting objectives and trade-offs are made. Similarly, a cleaner environment is a very important national objective, but surely many sensible trade-offs must be made here, too (e.g., cleaner air versus cleaner water, ecological improvements versus energy conservation, etc.) Thus, the all or nothing approach, zero discharge of pollutants, is not a feasible objective or even a sensible goal to aim at. The same sense of balance is needed in each of the other regulatory programs.

2. An economic impact statement should be required prior to issuing each new regulation. The notion that policymakers should carefully consider the costs and other adverse effects of their actions as well as the benefits is neither new nor revolutionary. The Ford Administration's institution of economic impact statements for new regulations was an important and useful innovation. President Carter has recently made some changes in the procedures, particularly in providing more attention to existing as well as proposed regulations. Unfortunately, the Ford and Carter approaches are not up to the task.

The modest requirements currently imposed on some regulatory agencies need to be given a firm legislative mandate, and to be extended to all regulatory agencies of the federal government. The mere performance of benefit/cost analyses by a reluctant agency is not adequate. The key action needed by the Congress is to pass a law limiting the regulations of all federal agencies to those instances where the total benefits to society exceed the costs. Government regulation should be carried to the point where the added costs equal the added benefits, and no further. Overregulation -- which can be defined as regulation for which the costs exceed the benefits -- should be avoided. The failure to take those costs into account has resulted in the problem of overregulation that faces the United States today.

The implementation of benefit/cost analyses needs a great deal of attention. 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.

3. The federal budget process should focus more directly on regulatory activities. Unfortunately, because the requested appropriations for the regulatory agencies are relatively small portions of the government's budget, limited attention has been given to them in the budget preparation and review process. In view of the large costs that they impose on the American public, the appropriation requests of the regulatory agencies deserve far more attention than they are now getting. One possibility for making the regulatory agencies and their budget reviewers more sensitive to the costs being imposed on the public is for Congress to give the regulatory agencies "budgets" of private costs that they can cause to be incurred by their regulations.

Thus, not only would an agency be given a budget of $X million for operating costs, but also a ceiling of $Y billion of social costs that they can impose during the fiscal period. As a start, it would be helpful to include in the Special Analysis volume accompanying the federal budget, a section on the costs of government regulation similar to the existing special analyses on other extra-budgetary activities, notably "federal credit programs" and "tax expenditures." Such a special analysis would be an initial step toward incorporating regulatory costs into the federal government's annual budgetary and program review mechanism.

4. All government regulatory activities should be subject to a sunset mechanism. Each regulatory agency should be reviewed by the Congress periodically to determine whether it is worthwhile to continue it in light of changing circumstances. Many government programs, regulatory or otherwise, tend to prolong their existence far beyond their initial need and justification. In a world of limited resources, the only sensible way to make room for new priorities is periodically to cut back or eliminate older, superseded priorities. In the case of the older, one-industry regulatory agencies, such as the Interstate Commerce Commission and the Civil Aeronautics Board, the sunset mechanism could be an effective way of pursuing a "deregulation" approach.

Very frankly, it may be relatively easy to get the members of the Congress interested in correcting the shortcomings of the federal bureaucracy. Those shortcomings are real and important. Nevertheless, many of the fundamental problems in the regulatory area can be traced back to the legislation enacted by the Congress -- the maze of overlapping, conflicting, and excessive regulation. Legislative changes are a key part of any serious regulatory reform effort.

5. Alternatives to regulation should be carefully considered. Government has available various powers other than regulation. Through its taxing authority, government can provide strong signals to the market; pollution control taxation may indeed provide a more effective and less costly

mechanism than the existing standards approach in achieving desired ecological objectives. In the case of the traditional one-industry type of regulation of business (as of airlines, trucking, railroads, and natural gas), a greater role should be given to competition and to market forces. 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.

Surely, as we have found out, it just is not practicable for government to attempt to regulate every facet of private behavior. This statement, however, is not a plea for anarchy. Indeed, it is important that government do well the various important tasks that it undertakes. That makes it essential for the Congress to choose carefully those tasks that it does assign to government.

5. The role and importance of individual decision making should not be ignored. We all need to be cognizant of the fact that the massive extent of federal intervention in the economy -- high levels of taxation, expenditures, and regulation -- makes it difficult for the private sector to perform its basic functions. In important ways, the major contribution of the Congress could be in the form of reducing those burdens rather than adding to them, albeit with the best of intentions.