Warring Critiques of Regulation

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CRITICS OF REGULATION charge that it is both politically unresponsive *and* economically inefficient. While these two criticisms are often voiced in the same breath (for example, some commentators argue that the inefficiencies are due to the agencies' being captured by regulated industries or by a "new class" of policy professionals), the two are in fact quite distinct. Indeed they are based on different theories of what regulation ought to be and how the public good is to be determined. And as the courts, the Congress, and the White House initiate reforms seeking both political responsiveness and economic efficiency, the conflict between the two is beginning to show.

The Political Responsiveness Critique

The underlying premise of the "political responsiveness" critique is that regulatory agencies are or should be in the business of reconciling the diverse and often conflicting demands of competing interest groups. Accordingly, administrative law and procedure should have as their aim the adequate representation of all interests affected by the agency, and agency policy-making should reflect adequate consideration of all these interests.

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The intellectual foundations of this premise lie deep in democratic theory. Not only is it assumed that regulatory decisions will better match the "public interest" if those whose interests are affected participate in them, but the very process of public involvement and scrutiny is deemed to be a public good, encouraging confidence in regulatory fairness and reducing the sense of alienation and helplessness that bureaucracies inspire. Moreover, fundamental principles of fairness dictate that individuals should be represented in decisions that seriously affect their own welfare.

The courts in particular have championed public participation. For example, as early as 1966, the Court of Appeals for the District of Columbia Circuit ruled that, within a license renewal proceeding, the FCC was obligated to permit the intervention of spokesmen for significant segments of the listening public (*Office of Communication of the United Church of Christ* v. *Federal Communications Commission*). The basis for the ruling was that, since consideration of such viewpoints was necessary to ensure a decision responsive to public needs, failure to allow intervention rendered decisions arbitrary and capricious. The court noted that in "recent years, the concept that public participation in decisions which involve the public interest is not only valuable but indispensable has gained increasing support."

Public participation has been further aided by several recent statutes that provide funding for interest groups to be represented in agency

proceedings. The Federal Trade Commission Improvement Act of 1975 authorizes the FTC to pay attorneys' fees and costs of rulemaking participation to any group representing an interest that "would not otherwise be represented in such a proceeding" and whose representation "is necessary for a fair determination of the rule-making proceeding." A bill that received wide support during the last session of Congress—the Public Participation in Government Proceedings Act (S.2715)—would extend similar provisions to proceedings before most other federal agencies.

As opportunities for participation have been enlarged, administrative decision-making has become more open to public scrutiny. Courts have required, for example, that all relevant information in agency files or consultants' reports be disclosed to all participants for comment, that agency announcements of proposed rulemakings give the agency's view of the issues, and that agency decision-makers generally refrain from communicating in secret with particular claimants. Moreover, Congress, in the 1976 Government in the Sunshine Act, has declared it "the policy of the United States that the public is entitled to the fullest practicable information regarding the decisionmaking processes of the Federal Government." And this act requires that, with limited exceptions, agency decision-making be undertaken in public.

Many proponents of political responsiveness also advocate vigorous congressional oversight of agency proceedings (in the form of "sunset" provisions and the legislative veto). They assume that congressional oversight will make regulatory agencies more sensitive to the public generally and more responsive to the parties directly affected by agency action. One of the leading congressional supporters of this view, Rep. Elliott Levitas (Democrat, Georgia), has said that "by giving the elected Congress the right to veto a rule or regulation, we'll have returned to the people the control over these regulations and at the same time sensitized the bureaucracy." (Others, however, argue that the legislative veto will have the opposite effect, since it will enable powerful interests to affect the regulatory process in secret, behind the closed doors of legislative committees and individual members.)

In its purest form, then, the political responsiveness critique assumes that the regulatory process should mirror the best aspects of the legislative process, in miniature. The idea is that regulatory proceedings are properly a struggle among conflicting interests, reflecting varied intensities of concern about the issue and with the preferred outcome being an accommodation among those affected. (It would thus be unnecessary to quantify values like health or safety, inasmuch as difficult trade-offs involving these values would be reflected in the preferences of all participants.) In short, broad public participation and vigorous legislative oversight should render the regulatory agencies more responsive to the will of the people.

The Economic Impact Critique

The premise of the "economic impact" critique of regulation is quite different. It holds that regulatory agencies are or should be in the business of seeking "efficient" policies which maximize public welfare—to be determined by a systematic assessment of the costs and benefits of regulatory action rather than by the clash of political pressure groups. Costs and benefits are measured by assigning values to goods, services, or "qualities of life" produced or foregone as a result of the proposed regulation. Through this process an "optimum"—or at least a more efficient—policy will emerge.

The intellectual foundations of this premise lie in traditional microeconomic theory, which supplies the idea of allocative efficiency. Under this view regulation is justifiable primarily when it is likely to result in an allocation of goods and services better matched to what people want than the result generated by market forces alone, such as under conditions of natural monopoly or other forms of market failure. But even when allocative efficiency is not the goal of a given regulation, consideration of economic effects can also lead to a more efficient regulation, one that achieves its goal at minimal cost.

Those who make this criticism acknowledge that the income or wealth distribution consequences of a proposed action can and should be considered, and they believe that economic analysis will yield an efficient solution for any desired distribution, or at least reveal the magnitude and direction of the distributional effect. They also contend that values

which are difficult to quantify, like health or safety, should not be ignored, but they insist that these values be assessed in as much detail as reasonable. And they recognize that any decision based on today's assessment of costs and benefits may itself have an effect on future technology and future tastes. But they argue that this merely shifts the time horizon from the short run to the long, and the necessary analysis from static to dynamic.

In recent years, the Congress has passed approximately forty new laws—on health, education, transportation, housing, the environment, and agriculture—that call for evaluation of the economic impact of regulations proposed under them. Six of these laws specifically authorize funding of, or require that a fixed percentage of the agency program budget be set aside for, these evaluations. Similarly, the White House (both Ford's and Carter's) has actively pursued economic impact analysis. By an executive order of 1977, agencies must subject major regulations to a "regulatory analysis" that contains a succinct statement of the problem requiring federal action, the major ways of dealing with it, analysis of the economic effects of the proposed regulation and of alternative approaches considered, and a justification of the approach selected. These analyses are reviewed by the White House Regulatory Analysis Review Group to ensure that major regulations are justifiable in terms of costs and benefits.

Understandably, the courts have embraced the economic impact critique with reluctance, given that judicial review of the wisdom of particular regulations would intrude directly into agency discretion. Still, with increasing boldness, the courts have deemed evidence "insufficient" or the process of decision-making "arbitrary and capricious" when the agency disregarded important economic effects of its actions. For example, in a 1973 case, the Court of Appeals for the District of Columbia Circuit reviewed a refusal by the administrator of the Environmental Protection Agency to postpone (for one year) the application of certain pollution standards. On reviewing evidence on the costs of the decision for the companies involved and for the economy generally, as well as on the likely ecological benefits to be gained by one year's imposition of the standards, the court ruled that the administrator had not introduced sufficient evidence to support his decision *(International Harvester* v. *Ruckelshaus)*.

In two recent cases, the Court of Appeals for the Fifth Circuit overturned two separate safety standards on the grounds that they were not "reasonably necessary" to reduce risks under the relevant statutes *(Aqua Slide 'N' Dive* v. *Consumer Product Safety Commission*, 1978, and *American Petroleum Institute* v. *Occupational Safety and Health Administration*, 1978). In both cases, the court found insufficient evidence that the likely benefits of the standards (one requiring that swimming pool slides be equipped with chain barriers and warning labels, the other that worker exposure to benzene be sharply reduced) justified their probable costs.

Conflicting Processes

The two critiques suggest different decision-making processes. The political responsiveness critique emphasizes participation and accommodation, whereas the economic impact critique emphasizes analysis. Thus, the two suggest markedly different approaches to regulatory objectives, fact-finding, and decision-making.

Objectives. The political responsiveness critique assumes that the objectives to be sought in a particular regulation emerge only from the interactions of divergent participants and are not fully defined in advance. This lack of definition enables each of the participating groups to believe firmly, or say credibly to its clients and constituents, that the regulation serves its own purposes, and it means that the objectives are established after the fact. But assessing the economic impact of regulations requires that objectives be articulated as specifically and narrowly as possible, so that alternative (and less costly) means of attaining them can be considered in advance.

Evidence. The political responsiveness critique assumes that the facts at issue are the articulated preferences of parties likely to be affected by the rule. Politically responsive rulemaking would therefore be likely to entail a substantial amount of anecdotal testimony by individuals (including representatives of groups)

about their wants and needs. The agency might also consider opinion surveys that purported to measure the preferences of larger groups.

The economic impact critique, however, does not generally concern itself with articulated preferences, except as they are included in some form of general equilibrium analysis. The facts at issue are the potential overall costs and benefits of both the proposed rule and its alternatives. To present such facts, expert analysts, armed with economic models, often would suffice. Regression models would estimate the degree to which various changes produced by the regulation would affect other variables. To be sure, different participants might come armed with different models and might attempt to challenge the data, assumptions, or methods of deduction upon which the models of the other participants are based. But the evidentiary value of these presentations would depend on accuracy in description and prediction. And it would be understood that there was an efficient solution, meaning one that maximized benefits or minimized costs. Questions would turn on whose data and analyses pointed to the more efficient solution.

These two different notions about what is at issue in a given proceeding—whether articulated preferences or economic effects—have caused confusion. In recent hearings on a proposed Federal Trade Commission rule to eliminate certain allegedly unfair provisions from consumer credit contracts, some consumers testified about the hardships the provisions had caused them, and various lenders showed how the rule would make it more costly for them to carry on their businesses. Opinion surveys were introduced, showing how consumer law specialists felt about the rule. Other participants presented their own subjective estimates of the rule's overall economic effects. And others introduced economic models purporting to show how the rule would affect the price and availability of credit (FTC Proposed Trade Regulation Rule on Credit Practices, *Public Record 215-42*, 1978). What then are the grounds for deciding on the rule—that its benefits exceed its costs, or that most people think the contractual provisions at issue are unfair?

Decision-making. How is a decision to be made? Under the political responsiveness critique, the "best" decision would be the one that was most politically acceptable (or least politically objectionable)—to which the greatest number of the various participants ultimately would subscribe most enthusiastically. Thus the decision would tend to reflect a compromise among competing preferences. Once the range of preferences was determined, the agency would act, in effect, as an arbiter or referee. Under the economic impact critique, however, the "best" decision would be the efficient one, the one that maximized benefits for a given cost or minimized costs for a given benefit. Negotiation and compromise would have nothing to do with it, and an efficient solution might be unpopular with many participants.

It is not surprising that—except where costs of regulation have clearly outweighed benefits (as now with airlines)—the decision-making process has tended toward a commingling of the two approaches. Often the agency undertakes what amounts to a compromise among competing estimates of costs and benefits (thereby avoiding an explicit choice about whether the substance of the rule is to reflect political accommodation or cost-benefit analysis). For example, in one industry-wide rate proceeding, the Civil Aeronautics Board was presented with two conflicting estimates of the potential changes in air traffic that would flow from a fare increase then under consideration. The CAB staff offered estimates based on an analysis of air traffic and prices over the previous twenty years. The industry, using an analysis that omitted certain years considered to be unrepresentative, offered a very different estimate. The CAB ultimately accepted neither estimate completely but found it could "form the basis for a reasonable judgment on the issue." Its "reasonable judgment" fell between the two positions (Domestic Passenger Fare Investigation Phase 7, April 9, 1971).

But such commingling of approaches is at best dubiously rational, from the standpoint of both political responsiveness and economic impact. On the one hand, it offers participants no effective opportunity to articulate and attempt to justify their own preferences, to exchange views and negotiate over substance, or to air their concerns in public. Certainly participants are apt to have little sense that positions have been understood and tested in debate, and the public is apt to gain little insight into what is actually at stake. In short, in no real sense will

the public have participated in the formation of policy.

Nor, on the other hand, does this approach necessarily enable the agency to reach an efficient solution. Compromises among competing estimates are inappropriate means for predicting economic impact. Each party's choice of the data, method, or valuation underlying its analysis is based on certain assumptions about the way the world works. By their very nature, these assumptions normally do not lend themselves to compromise, to "splitting the difference." They are either correct or incorrect; they stand or fall on their own. And the relationship between each set of assumptions and its resulting estimate may be unique. Thus, any compromise among choices of data, methods, or valuations may well be inconsistent with the assumptions of all of them, and therefore lack any support in the real world. The resulting solution likewise would be unrelated to the facts and, therefore, worthless in measuring economic impact.

Conflicting Outcomes

The conflicting processes would be of less consequence if they yielded the same outcome, but they do not. From a strictly theoretical perspective (though it may assume a world more perfect than ours is) there should be no difference in outcome whether the agency emphasizes political responsiveness or conditions its regulations on their economic impact. After all, any regulatory "solution" whose benefits exceed its costs will enable those who gain from it to compensate those who lose (or who receive none of the benefits) and still come out ahead. Whenever such compensation is theoretically possible, the regulation will result in a net social benefit. Thus (again in theory), since actual compensation will cause losers and nongainers to acquiesce in the regulatory change, the mere fact that there is unanimous agreement to a compromise will signal that it is economically efficient.

But both conditions—unanimity and actual compensation—are difficult to arrange. Unanimity is rare, if for no other reason than the fact that those who know their acquiescence is needed will find it in their interest to hold out for better terms from everyone else. Actual compensation is often impossible because benefits are not easily exchangeable: it would be prohibitively expensive to exclude noncontributing beneficiaries of clean air or safe products, or to identify and compensate all those who directly bear the cost (such as employees laid off because their polluting factory has to close).

Not only does the possible reconciliation of the two critiques founder on these theoretical points, but in reality an accommodation or compromise among participants, even if unanimously agreed upon, will bear no necessary resemblance to an economically efficient solution. This is because the access that affected parties have to the regulatory process is not necessarily proportional to their potential stake in the outcome. A large and amorphous group, each of whose members is likely to be affected to a very small extent by the proposed regulation (such as all potential beneficiaries of safer automobiles), will have difficulty organizing itself to participate. While its total stake may be very high, the cost of trying to summon resources from its far-flung and relatively disinterested members may be even higher. Conversely, a small group, each of whose members has a high individual stake in a regulatory outcome (such as a trade association bent on gaining a subsidy or antitrust immunity for its industry), can organize itself with relative ease—notwithstanding the fact that its total stake is lower than that of the larger group. The vigor and extent to which specific interests participate in the regulatory process therefore may have little relation to overall gains or losses from the particular proposal.

It could be argued that by rendering explicit certain advantages and disadvantages of the proposed regulation, economic impact analysis helps alert the larger and less organized group to the importance of proffering its own views. But this argument ignores the fact that the very insistence upon economic impact analysis alters the rules of the game; proffered "views" are no longer assertions of preference for certain outcomes, but predictions about economic effects. The resulting issues—what universe is to be analyzed, what variables are to be included, what values are to be measured—are not the sort of questions around which large and otherwise indifferent interest groups are easily (or, probably, ever) mobilized. Indeed, the analysis is apt to be so complicated

that many individuals or groups may feel that they lack the necessary expertise to participate.

Finally, even if participation were proportional to stake in the outcome, there is no reason to suppose that agreement by a simple majority of participants will be a proxy for unanimity over the long term. Shifting coalitions help ensure that participants in the minority eventually will become part of a majority coalition (and therefore will be given full consideration in the current bargain) only when majority and minority have the same long-term stake in future regulations. But in reality, participants are unlikely to have the same long-term stake or the same ability to see what the stakes are. While trade associations, large companies, and certain public interest groups established to monitor the agency all are likely to be long-term participants, that is not true of smaller companies and individual citizens who are affected only by a particular proposed rule. Not only do they have less bargaining power over the long term, but they also are less familiar with the process. For these reasons, too, outcomes fashioned in accord with political responsiveness will bear little necessary resemblance to outcomes derived from assessments of economic impact.

The Future of the Two Critiques

The primary institutions that shape the regulatory process—the Congress, the courts, and the White House—will continue to clamor for more political responsiveness, while at the same time (I believe) demanding that agencies take more account of the economic impact of their actions. The inevitable tensions between these two critiques will become more visible as agencies seek to respond in greater measure to both.

Legal technicians can be expected to design certain procedural palliatives in an attempt to reconcile these inconsistencies. Perhaps the regulatory process could be arranged in such a way that economic impact and political preferences are assessed in separate proceedings. The first proceeding, which might be subject to legislative veto, would aim to reach consensus about the nature of the problem to be remedied and about the range of politically acceptable remedies. Once these matters were resolved (in a politically responsive way), the agency would begin a second, more technical, proceeding in which it analyzed the various alternatives for their economic impact. Or the agency might use the initial proceeding to generate various efficient analytic solutions to a perceived problem, each of which was based on a certain set of assumptions about relevant variables, measures, and objectives. The second proceeding would then subject these premises to political scrutiny and select the most acceptable efficient solution.

But such procedural niceties probably would fail. It is naive to assume that ends can so neatly be divorced from means. Every analytic input invariably raises issues of participation (for example, should economic analyses of the actual impact of regulations after promulgation be subject to public notice and comment?); and every move toward political responsiveness raises analytic issues (for example, should the effects of congressional vetoes be subject to cost-benefit analyses?). The underlying tensions between the two critiques cannot so easily be avoided.

Then which critique (if either) will prevail? My guess is that this will depend upon the nature of the interests at stake. Where the benefits of the regulation are apt to be spread widely and thinly over the population while the costs initially fall on a smaller group—as with much environmental, health, and safety regulation—there will be a strong demand for economic impact analysis. This is because those who bear the costs will assume that they cannot look to the political process to guard their interests (after all, that process imposed the costs in the first place); they therefore will demand that all such regulations are at least economically justifiable. Indeed, the White House has focused its recent economic impact reviews exclusively on just such sorts of regulation.

Conversely, where the benefits of the regulation are narrowly focused while the costs are spread more widely and thinly—as with price supports, marketing orders, tariffs, and licensing—the strongest demand will be for political responsiveness. Those who enjoy the benefits will know that they can rely on the political process to guard them. They therefore will insist on participation in the regulatory process, along with congressional oversight, to ensure continued protection of their special interests. And they will successfully avoid analysis of economic effects. ■