A Strategy for Regulatory Reform

Christopher C. DeMuth

IN THE MODERN STATE, to borrow from Oakeshott, we try to govern as the crow flies. We imagine we can go, straight and free, from wherever we are to anyplace else. When we set off, however, we are buffeted by powerful currents we cannot see and often cannot feel. Outside the Bill of Rights, we (meaning most judges, public officials, and citizens) no longer recognize any formal limits on what the two political departments of the federal government together may do. The business of governing has been entirely deregulated, so to speak. Any faction able to organize itself to solicit the favors of the state is within its rights to do so, and indeed would be negligent not to. This is a system that supplies the friends of liberty with an endless array of adversaries, as well as full-time employment simply resisting economic decline. In this environment, a strategic plan to make way against the forces of political supply and demand is about as likely as a strategic plan to make way against the forces of the New York Stock Exchange.

I believe the difficulties of acting strategically are especially great in the world of regulation. Where taxing and spending are concerned, at least the flow of resources in and out of Washington can be measured and aggregated for purposes of political debate. Budget and revenue figures are good summaries of what is happening in welfare, defense, or tax policy, and can be used to communicate efficiently with the general public over the fray of program-by-program interest-group contention. Ronald Reagan has mastered this strategy more thoroughly than any other President, using general accounts of taxing and spending trends to overwhelm a host of narrow programmatic pleas and build public support for important shifts in federal policy.

In the world of regulation, however, where the government commands but nearly all the rest takes place in the private economy, we generally lack good aggregate numbers to describe what is being "taxed" and "spent" in pursuit of public policies. Instead we have lists—endless lists of projects the government would like others to undertake. Naturally, the projects always sound worthwhile in the abstract—and, as I said, it is no longer asked whether they might nonetheless be outside the traditional or prudent bounds of government. How then does one deal with the circumstance that the list of worthy projects is in fact endless, as is the government's appetite for expansion? Can one do better than to compile

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a counterlist and argue, according to the particular contingencies of each case, that many seemingly worthy projects are likely to be failures or worse?

ONE GENERAL STRATEGY for deregulation is to stick to principle. I can think of cases where this has worked. Consider the nondiscrimination policy of the Civil Rights Act of 1964, which was effectively reversed over the years by court decisions, executive orders, and administrative rules, resulting in explicitly racialist policies in several areas of strong federal leverage, such as hiring by universities and government contractors. President Reagan's views on the subject have long been known to be a matter of simple principle. No well-informed voter in 1980 could have doubted that he meant to try to end official race quotas and to return civil rights policy to policing against racial and other discrimination.

Yet our initial efforts to put the President's vision into effect were plagued by uncertainty and vacillation. At the Office of Federal Contract Compliance Programs (OFCCP), our essential reform proposal was to replace an eight-factor statistical test for determining whether contractors were meeting their race and gender hiring goals with a simpler, four-factor test. And whenever we proposed to tinker, ever so slightly, with some aspect of the "goals and timetables" programs, the reaction from the press and lobby groups was as if we had issued a notice to rescind the Emancipation Proclamation, and we retreated in some disarray.

Then, last fall, in connection with appointments to the Civil Rights Commission, we settled back to the stick-to-principle approach, nominating individuals whose civil rights credentials could not reasonably be questioned, but who were also articulate and unyielding foes of racial (and other) quotas in any disguise. The ensuing political battle was difficult and contentious—but the attacks were not, in general, any stronger than when we had proposed taking OFCCP paperwork down a notch or two. And in the end we substantially won. The Civil Rights Commission is not a regulatory or policy-making body, but it has substantial moral and suasive authority, and under its new majority holds greater promise for rectifying this area of labor regulation than anything else we have done.

Sticking to principle worked in this case because a simple and comprehensive principle was available—the government should not discriminate one way or the other—that was supported by a huge popular majority. But almost all other areas of regulatory policy are more complex, and it is more difficult to explain what we would like to do in a way that is understandable and politically compelling. The general public desires clean air and an absence of poisonous chemicals seeping through basement walls. The economist-reformer knows that the environmental statutes are shot through with waste and special preferences for particular regions and industries, but his reform proposals are complicated and resist summary for purposes of political mobilization. "Save the Bay *Efficiently*" is an unlikely bumper sticker. Even in the simpler area of price and entry regulation, where so much positive reform has been accomplished recently and where the lessons of President Carter's energy program are so conspicuous, the easy popular slogans often work against us, as our current difficulties in abolishing natural gas regulation attest.

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THIS BRINGS ME to the centerpiece of the Reagan administration's regulatory reform program, Executive Order 12291, which the President signed shortly after taking office. The order builds on earlier efforts of Presidents Carter and Ford but goes beyond them in two fundamental respects. First, it requires not only that the regulatory agencies assess the social costs and benefits of each of their rules, but that their rulemaking decisions follow the results of the economic assessments to the extent the regulatory statutes permit. Second, it requires that each proposed and final rule be "cleared" by the Office of Management and Budget (OMB) as being consistent with the order's cost-benefit tests.

It is implicit in this approach that overarching, politically resonant principles are often lacking in the world of regulation. "Maximize net social benefits" is of course a general principle that is difficult to quarrel with, but it is also highly abstract and malleable, as I will argue in a moment. The procedures of the President's order—requiring his own staff to evaluate each regulation, relatively free of the interest-group pressures faced by the regulatory agencies—are at least as important as the maximum-benefit principle. Our strategic posture toward the health, safety, and environmental programs is about the same as Vince Lombardi's strategic posture toward the football season: we play one game at a time, and do the best we can within the factual and statutory context of each individual case.

Measured by the criteria of restraining the growth of federal regulation and improving the quality of administrative decisions, this approach has been a clear success. The size of the *Federal Register* has shrunk for three consecutive years since Executive Order 12291 was issued—the first time this has ever happened. Fewer new rules are being issued, and an increasing proportion of rules are aimed at reforming or eliminating existing requirements rather than laying on new ones. New health, safety, and environmental requirements have been substantially more measured and cost-beneficial than in the past. The OMB review program has, of course, been highly controversial, especially in Congress—but no more so than President Taft's order requiring the agencies to submit their budget proposals to him rather than directly to the Congress.

It needs to be said, however, that the cost-benefit test of the President's executive order, standing alone, is ambiguous with respect to economically sound regulatory policy. After all, to say that the best regulation is the one that produces the greatest benefits for society is about as close to tautology as a policy pronouncement dares to get. The Naderite attacks upon cost-benefit analysis have obscured this. Cost-benefit argumentation, while admittedly more confining than lamenting a problem and demanding action, is in fact entirely consistent with populist politics and regulatory expansion. If you read congressional debates on whether to pass new legislative programs, you will rarely find advocates saying that a program will help some groups but harm others more, even when this is rather obviously the case: democratic politics and legislative coalition-building require that laws be justified in terms of the broadest plausible characterization of their benefits. Indeed, as we know from the progression of Jeremy Bentham's thought, the utilitarian principle is easily transformed into an argument for full-force socialism.

At the same time, the most important modern strains of classical economics (and here I have in mind the works of Friedrich Hayek and Thomas Sowell) emphasize that the first and foremost virtue of private markets is their ability to draw out and apply knowledge when and where it is needed. It is precisely in the accumulation and use of information about the costs and benefits of various approaches to a problem that the government bureau is at greatest disadvantage relative to the sum of a million spot decisions by differently situated firms and households. There has not been a commissioner of the Food and Drug Administration or an administrator of the Environmental Protection Agency who has not been staggered by the paucity of useful information on hand as he or she approaches one after another momentous decision.

Thus, the Naderites are right in saying that the government often lacks the information necessary to do complete cost-benefit analyses of regulatory questions; their error is in assuming that the burden of proof should lie in *favor* of every new regulatory venture, so that uncertainty itself justifies regulation. The President's executive order and many recent regulatory statutes reverse this burden of proof. But one must expect that, just as the Corps of Engineers became adept at demonstrating that every dam that could be built would pay for itself, so the regulatory agencies will learn to demonstrate, with increasing analytical verve, that every new regulation is cost-beneficial.

WE HAVE BEEN WELL AWARE of this difficulty within the administration and have emphasized at every opportunity that the executive order requires economic rather than arithmetical reasoning on the part of regulatory officials. The cost-benefit test, correctly understood, is not a matter of comparing sums, but rather of asking why a supposed problem exists in the first place—whether and why private markets and other voluntary arrangements are working unsatisfactorily—and whether a uniform government rule is likely to improve the situation.

In our review of individual rules and in the Regulatory Policy Guidelines we issued last August, we have gone further and have suggested that there is a continuum of regulatory policies ranging from those that are analytically interesting to those that are not. The new policy guidelines are as close as we have been able to get to a stick-to-principle reform strategy—one that goes beyond case-by-case, open-minded utilitarianism and attempts to apply broad (and we hope appealing) economic principles to the existing array of regulatory programs.

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At one end of this continuum are price, output, and entry controls in competitive markets. We think these kinds of regulations are empirically uninteresting and are per se violations of the executive order. Early in the administration, when we objected to some of the Agriculture Department's "orderly marketing" rules for certain kinds of produce, we were greeted by a team of helpful economists from the department who had put together a cost-benefit analysis showing that withholding a substantial share of this year's harvest would be good for producers and consumers. They were taken aback when we said we knew the analysis was wrong without reading it: the workings of the price system and the behavior of producer cartels were well enough understood to say that a government-enforced rule of this nature could not possibly be worthwhile. Here, our resolute, stick-to-principle strategy was not quite as successful as in the case of hiring quotas. With little ado, Congress passed an appropriations rider, supported by overwhelming majorities of both parties, forbidding OMB from even reviewing agricultural marketing orders for the rest of this year.

At the other end of the spectrum are most forms of environmental regulation, where the very problem being addressed is the lack of well-functioning markets, and the abstract case for some sort of government action is strongest. Unfortunately, as one moves to this end of the spectrum, the information problem I mentioned earlier becomes increasingly severe: the same "market imperfections" that cause the problems deny us the information to know how to solve them. The economist cannot give a crisp, a priori answer to the question whether a given air pollution rule is too strict, too lenient, or about right, and his ability to assemble information to help answer the question is limited; knowledge about the benefits of pollution control is slim and incorrigibly so, since the benefits are substantially subjective and variable.

Yet it is in this area that the executive order process has probably had its greatest effect at the margin. If we cannot say whether \$6 or \$600 is the "right" amount to spend on removing a pound of a given pollutant from the water, we can say that requiring one firm to spend \$6 and its neighbor to spend \$600 is certainly wrong. By reallocating control requirements between two firms, we could remove more pollution for the \$606 or the same pollution at less cost. Yet differential control requirements such as these have been routine at EPA over the years, reflecting statutory and institutional biases for engineering-design standards and for tighter standards on newer, growing industries than for older, declining industries. During the past two years, EPA and OMB have worked closely at reducing these biases through the adoption of cost-effectiveness benchmarks in dozens of new air and water pollution rules. More important, EPA has launched a series of general policies permitting firms to trade privately in pollution control obligations within airsheds; years hence, these policies will be seen as the first steps in the devolution of pollution control from an administrative system to a market system. Here, case-by-case tinkering has been effective and will continue to be.

Between agricultural marketing orders and air pollution regulations there lies a broad expanse of regulatory programs aimed at alleged and occasionally plausible problems in otherwise well-functioning markets. Here we have tried to make careful distinctions—for example, between the Occupational Safety and Health Administration's safety rules (which appear to have nothing to add to private market incentives for workplace safety) and its health rules (which are more justifiable, since problems of causation and long time-lags between exposure and health effects weaken or eliminate private incentives).

Other than where long-term and potentially serious health problems are concerned (the temporal equivalent of the pollution problem), our Regulatory Policy Guidelines come down very hard against proposals that would standardize goods or services or production processes. Is it beneficial for the government to require every car buyer in the United States to purchase the same bumper? Or to prescribe recipes for sausages or cranberry drinks? We think questions such as these deserve a confident "no," just as surely as the questions about limiting sales of lemons and almonds.

Politically, however, product standardization is midway between the polar cases described above. On the one hand, the economist's a priori confidence is less likely to be shared by the general public than in the case of selling fruit without government permission; on the other hand, the political support for product standardization is usually less nakedly protectionist than the support for output and price controls. As a result, while a detailed cost-benefit analysis may not be essential to help us decide the policy issue (as in the case of pollution controls), it is very helpful in demonstrating to the open-minded that our general principle is correct, at least in the case at hand. We had little doubt about the conclusion of our study of the costs and benefits of the Carter administration's five-mile-per-hour automobile bumper, even before we did it. The study showed that the extra costs of purchasing these bumpers, of purchasing extra gasoline to transport them, and of repairing them after major collisions, substantially exceeded the repair savings following minor collisions *for most drivers*. Outside of Washington, D.C., I have yet to encounter anyone, of any political persuasion, who does not understand this issue within five minutes' conversation.

WHILE WE HAVE MADE some steady progress during President Reagan's first three years, I do not wish to appear sanguine about the future. I do think we will see continued withering of overt economic controls in particular industries, such as transportation, communications, energy, and financial services. Deregulation will be helped along by economic arguments and analyses and heads-up political strategizing; but the motive force, as in the past, will be technological and demographic changes beyond anyone's control. There is, for example, a venerable old law prohibiting interstate banking, yet the Citibank people, in full compliance with this law, are now offering fairly complete banking services in forty-four states. At some point, the political process will get around to ratifying what the market process has wrought, and we deregulation proponents will claim our share of the victory and then some.

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But there are grave dangers ahead in the "social" regulatory programs, where simple formulations such as "clean air" and "women's equity" have broad general appeal and can provide cover for the state to do what it does best —regimenting the economy at the behest of politically effective groups. The marginal improvements we have made in the administration of the Clean Air Act could, like the actions of the Civil Aeronautics Board and the Interstate Commerce Commission in the 1970s, get picked up and expanded in subsequent statutory revisions. But statutory change is just as likely to work in the opposite direction. Every time the Clean Air Act has been amended so far, it has become less an environmental statute and more a regional development and industrial supervision bill. The last such round—the "steel stretchout" amendments negotiated by the Carter administration's labor-management-government committee—was explicit in using EPA authorities for purposes of capital and employment allocation at the *expense* of pollution control. Students of occupational safety and health regulation have seen similar tendencies in OSHA rulemaking and enforcement for many years. And the various "comparable worth" proposals now wending their way through the courts and the administrative agencies would have, as their natural result, public officials sitting in judgment on the intrinsic "worth" of every job category in the economy

—just as medieval priests, and more recently the ICC, sat in judgment on the "just price."

Now, the reformer-economist who believes in at least a modicum of intellectual progress thinks that some questions were answered long ago. Such as: why does water, whose intrinsic worth is very great, fetch less in the market than diamonds, whose intrinsic worth is very small? It is a little dispiriting to see this puzzle raised as a pressing political issue centuries after economists answered it correctly. It could put greater pressure on the deregulators—both the stick-to-principle libertarians and the case-by-case economists—than anything we have seen to date, and make our occasional successful strategies seem very frail indeed. ■

The Reagan Record

Where's the Reform?

Walter Olson

I THINK IT WOULD BE fair to say that the Reagan administration has a fine record on regulatory reform. The only problems it has are in areas like agriculture, international trade, trucking, education, the environment, health and safety, civil rights, and so on.

And that's the whole problem: almost every regulatory issue leads a double life—because it is also some other kind of issue. Almost no regulation got on the books because some official took sheer joy in regulating; it is there because it served the purpose of some group or other, some group that is probably still around to defend it.

That is why we should remember that although the White House appointed the OMB officials who went to bat against agricultural marketing orders, it also appointed the Department of Agriculture officials who fought the OMB officials, and it was the Agriculture officials who wound up winning. This is certainly progress of a sort, since many administrations would never have let OMB get involved in the first place. But it does suggest that an administration should be judged not only by how many reformers it hires but by how far it lets them reform things.

I DO NOT WANT to take away from the Reagan administration its genuine accomplishments, such as stopping the Carter administration's midnight regulations and speeding up the deregulation of the oil industry. (One might wish, of course, that the high-water mark of deregulation had not come in the first six weeks after the inaugural.) But a commitment to regulatory reform ought to go beyond slowing down the flow of new regulation and simplifying compliance with existing regulations, if for no other reason than that it is not very inspiring to march into battle under the banner of reducing the rate of growth of something. Nor would I leap to the barricades to fight for a four- instead of eight-factor test on job quotas.

DeMuth suggests that we can expect more modest reform efforts in areas where the re-

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