

THE CLINTON REGULATORY LEGACY

BY WILLIAM A. NISKANEN

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The regulatory record of the Clinton administration was better than that of George H. W. Bush, primarily because relatively little new regulatory authority was approved on Bill Clinton's watch. That is the good news. You already know the bad news: The Bush record was *awful*. The Bush administration endorsed more costly regulatory legislation than any other administration since Nixon. (Yes, dear reader, the modern regulatory state was largely created during Republican administrations.)

The Clinton record could have been much worse: Clinton's health care plan of 1993 would have been the single largest expansion of regulatory authority since the New Deal. But the plan never reached a floor vote in a Congress controlled by Clinton's own party. The ratification of the Kyoto global warming treaty and proposed tobacco legislation would have imposed similarly comprehensive regulation on the energy and tobacco industries, but Congress would not give approval to those efforts.



Congressional reform As it turned out, Congress had a full regulatory agenda during the Clinton years, without much input from the administration. Most of Capitol Hill's attention was focused on older forms of regulation: Congress initiated and approved the most important agricultural, telecommunications, and financial services deregulation bills in 60 years. Other changes included ending restrictions on interstate banking, deregulating trucking, and terminating the Interstate Commerce Commission.

The only new laws that significantly increased federal regulatory authority were the 1993 Family and Medical Leave Act, the 1996 Health Insurance Portability and Accountability Act, and 1996 legislation that produced a two-step increase in the minimum wage. Also, the 1974 Safe Drinking Water Act and comprehensive pesticide regulation were reauthorized without much change during the Clinton presidency.

Clinton and his administration did battle with Congress over proposed changes in the regulatory review process. Clinton opposed an omnibus regulatory reform bill, but he later accepted many of the bill's provisions as parts of other legislation.

Agencies and regulation The record of administrative regulation on Clinton's watch is more complex. Clinton issued

a 1993 executive order, similar to two Reagan orders that it replaced, requiring most proposed regulations to undergo economic and risk analyses. In 1996, the Office of Management and Budget issued more detailed guidelines on how to conduct those analyses, consistent with the Clinton order. Those measures would have provided an adequate basis for review of agency-proposed rules if the administration had consistently reinforced them.

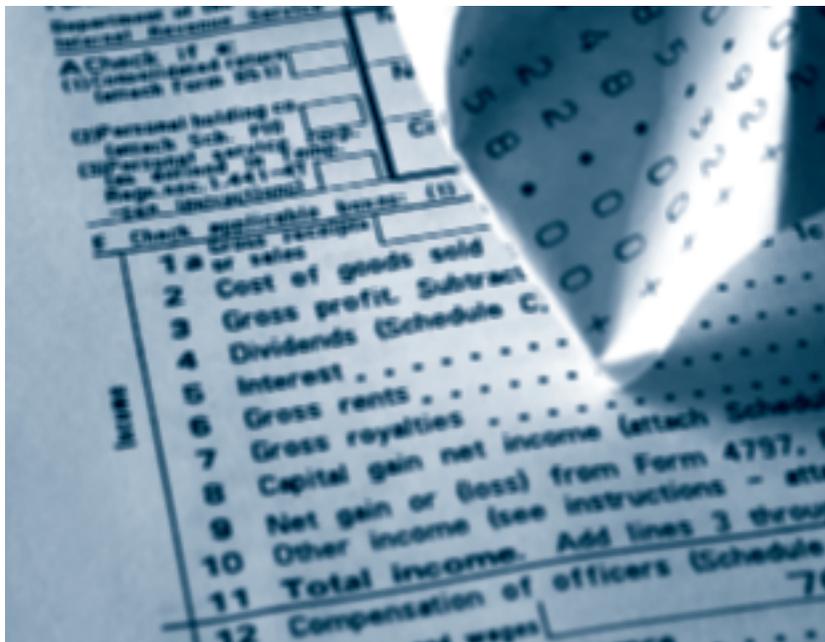
At the same time, several regulatory agencies pressed the limits of their statutory authority, with Clinton's apparent approval. The Environmental Protection Agency (EPA) sought authority to set pesticide standards without regard to their economic benefits. EPA also wanted authority to set cancer-risk standards without a test of statistical significance.

The Occupational Safety and Health Administration (OSHA) issued draft guidelines on how to reduce violent crime in retail establishments that are open at night. OSHA justified that move by claiming that the "general duty" clause of its enabling legislation provides sufficient authority to issue the guidelines, even without promulgation of a formal regulation. The Food and Drug Administration used similar logic to justify its announcement of major restrictions on tobacco marketing, but a federal appeals court rejected that logic.

The general lesson from those examples is that neither good executive guidance nor clear statutory language is sufficient to constrain an aggressive regulatory agency unless both the president and Congress reassert their joint authority to approve final rules.

As many of the authors of the ensuing articles discuss, the Clinton record would have been much better if the administration had recognized that, more often than not, "smart" regulation means less regulation. As in other policy areas, Clinton's regulatory legacy was one of casual administration and missed opportunities for reform. In the end, sadly, nothing so characterized the administration as the way it left office: issuing thousands of pages of costly regulations in its final hours. **R**

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CLOSING THE SHELTERS

BY DANIEL SHAVIRO
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"We need a tax system that rewards people who work hard and play by the rules."
—Bill Clinton, 1992

DESPITE THE FORMER PRESIDENT'S STATED DESIRE for a tax system that rewards hard work, we will never have a system that does so — at least, not in more than a limited number of cases. Even if the nation converts to a flat tax scheme, people who work harder and earn more money will pay more taxes. As long as Americans want a system that takes more from Bill Gates than, say, the readers of this magazine (and that, in turn, takes more from the readers of this magazine than from homeless people), working harder and earning more will not, in general, be rewarded by the tax system.

But what about Bill Clinton's desire for a tax system that rewards playing by the rules? Whatever you think of his own propensities in this regard, Clinton's Treasury Department took steps in its income tax regulation to ensure that more taxpayers follow the rules. And in both court action and regulation issuance, the Clinton administration energetically combated one of the gravest forms of not playing by the tax rules: the corporate tax shelter.

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SHOULD WE OPPOSE TAX SHELTERS?

Why should we want government to effectively combat transactions dubbed "corporate tax shelters"? After all, is the corporate income tax not supposed to be a terrible thing? If we believe that taxpayers ought to keep more of what they earn, why should we approve of efforts to increase the effectiveness of tax collection?

To answer those questions, we must recognize that allowing companies to zero out big portions of their tax liability is not the same as fixing the Internal Revenue Code's unlevel playing field for business income. And allowing the more brazen among us to shift their tax burden to the more scrupulous is not the same as lowering taxes for everyone. So, even if we disagree with much about the federal tax system, it does not follow that we should support the efforts of some companies to skirt tax law.

LOOKING INSIDE A SHELTER

Consider a typical shelter scheme: the corporate-owned life insurance (COLI) shelter. To take advantage of this shelter, a company formally buys life insurance for its employees but, at the same time, the company borrows back from the insurer the issue price and all subsequent appreciation

of the life insurance contracts. Apart from promoters' fees, no money need ever change hands between the company and the insurer, although there will be offsetting entries in both companies' accounting books. Voila; the employer now has tax-free appreciation and deductible interest expense. So, without really doing anything, the company has generated huge tax losses.

Fortunately, the scheme does not really work under the tax laws unless the company succeeds in throwing sand in the eyes of the Internal Revenue Service and the courts. COLIs are pretty much dead because the Treasury Department has beaten them through litigation. But it is just one of dozens, if not hundreds, of recently popular and ever-evolving schemes to eliminate tax liability by shuffling paper.

There are many reasons why we should dislike those schemes. Among the reasons:

- Companies that aggressively try to employ tax shelters divert effort away from creating wealth.
- Most of the more aggressive shelter schemes do not work under the law, so taxpayers who use them are taking questionable reporting positions.
- Efforts to employ tax shelters can breed an attitude of contempt for the law.
- Government will collect revenue in some manner, so a preponderance of shelters will only lead to the establishment of more revenue instruments that could be worse than the current slate of instruments.

CLOSING THE SHELTERS

Clinton officials initially sought legislation to increase the

penalties for unlawful sheltering schemes. They also wanted Congress to grant the Treasury Department broad discretion to define abusive transactions after the fact. But the administration was not able to secure passage of that legislation, so Clinton officials turned to other tactics.

In 1997, Congress gave IRS the authority to require companies under specified circumstances to disclose the key details of suspect transactions on their tax returns. Agency officials carefully defined suspect transactions to include those with such features as confidentiality agreements, large fees for promoters, and large tax effects relative to economic efforts.

The requirement of the disclosures has helped to deter corporate tax sheltering because companies can no longer "hide the ball." With the information disclosed, companies face the prospect of having to defend questionable tax planning in court. If a scheme, no matter how artful, actually works under the current rules, then the company employing it can, and should, win in court. But companies that are tempted to employ schemes with little legal merit will not relish having to defend those tactics on their merits.

Restricting tax sheltering shifts societal resources away from the fundamentally nonproductive industry of shuffling paper and throwing sand. That restriction, in turn, probably keeps business executives focused on making money rather than figuring out how to game the income tax system. And making money, presumably, is what we want businesses to do. The Clinton corporate tax shelter regulations may have actually helped to push businesses in that direction. **R**

CIVIL RIGHTS

DISTORTING 'EQUAL OPPORTUNITY'

BY ROGER CLEGG
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IN ITS EIGHT YEARS IN WASHINGTON, THE CLINTON administration stretched and distorted the notions of "equal opportunity" and "civil rights" to such a degree that they bore little resemblance to the ideals that underlay them. Then, in the name of those ideals, the administration employed the full panoply of devices to harass the private

sector: It regulated, it litigated, it issued executive orders, and it proposed new legislation.

The administration's civil rights endeavors resulted in a series of initiatives that often defied common sense. The Justice Department, for example, pressured fire departments to hire firefighters with such medical conditions as lung disease, back problems, missing eyes, and hearing impairments. The Equal Employment Opportunity Commission issued such decisions and rulings as the 1997

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“enforcement guidance” concerning “individuals with psychiatric disabilities.” The guidance required such “accommodations” as time off from work, a modified work schedule, physical changes to the workplace and equipment, adjusted supervisory methods, and provision of a “job coach.” Even the Federal Trade Commission (FTC) got in on the act, forcing the Ford Motor Company to pay \$650,000 and stop the “discriminatory” practice of considering the aggregate income of married couples who apply for auto loans, but not the aggregate income of unmarried couples. Apparently, the Clinton FTC did not believe it germane that married couples might be less likely to divide their assets in the future.

Another result of the Clinton administration’s civil rights policies was a staggering increase in the filing of discrimination claims and lawsuits. According to the Bureau of Justice Statistics, the number of employment discrimination claims nearly tripled over the past decade, from 8,413 in 1990 to 23,735 in 1998. The number of civil rights lawsuits more than doubled over the same time span, from 18,793 to 42,354. Of course, the government did not instigate many of those actions, but Clinton policies certainly contributed to the amount of litigation.

DISPARATE IMPACT

It would have been one thing if the cases brought by the administration had been limited to claims of true discrimination in which people were treated differently because of their race, ethnicity, gender, age, and so forth. But the administration claimed that even if no intent to discriminate could be alleged, let alone proved, a practice should still be considered a violation of equal opportunity law if there was a disproportionate effect, or “disparate impact,” on some demographic group. Clinton officials used that notion to pressure potential defendants into either implementing quotas or throwing out perfectly sensible selection criteria.

The disparate-impact approach originated in the 1970s, when it was given the Supreme Court’s stamp of approval. But the notion was tethered to employment practices during the Reagan and Bush administrations. Under Clinton, “disparate impact” was not only pressed aggressively against employers, but also expanded to new areas like housing, credit, and even pizza delivery. That’s right: In June of 2000, the Justice Department reached an agreement with Domino’s Pizza over a complaint that the company’s policy of providing limited pizza delivery in high-crime areas had a “discriminatory effect” on African-Americans.

The administration pushed the disparate-impact approach outside the litigation context, too. In 1994, Attorney General Janet Reno sent a memorandum to the “heads of departments and agencies that provide federal financial assistance,” instructing them to “ensure that the disparate impact provisions in your regulations are fully realized.” And they did. For instance, the Department of Education’s Office for Civil Rights issued guidance discouraging the use of

standardized tests that had a disparate impact on different races or ethnic groups.

Clinton, himself, expanded the disparate-impact approach with two executive orders that took the concept to new extremes. E.O. 12,898 (“Federal Actions to Address Environmental Justice in Minority Populations and Low-Income Populations”) was in large measure aimed at ensuring that environmental actions not have a disparate impact on the basis of race or ethnicity. Of course, given residential demographics in the United States, nearly any permitting decision will have a disparate impact on some racial or ethnic group. E.O. 13,166 (“Improving Access to Services for Persons with Limited English Proficiency”) required federally conducted and assisted programs and activities to be made available in languages other than English. Thus, for example, doctors must now provide translators for all patients. Over 40 medical societies have complained about the new regulation, and the Association of American Physicians and Surgeons plans to challenge it.

Even as the Clinton administration claimed to promote “equal opportunity,” it also defended the use of racial, ethnic, and gender preferences in employment, education, and contracting. For instance, two Clinton executive orders advanced government preferences on the basis of race, ethnicity, and sex in its contracting with the private sector. E.O. 12,928 gave preference to “small businesses owned and controlled by socially and economically disadvantaged individuals, historically black colleges and universities, and minority institutions,” while E.O. 13,170 awarded preferences to other “disadvantaged businesses.”

WHAT COULD HAVE HAPPENED

Besides dramatically reinterpreting the civil rights laws already on the books, the Clinton administration supported a number of so-called “equal opportunity” bills that would have further regulated the workplace. Clinton officials backed the proposal of an Employment Non-Discrimination Act that would have banned private employers from discriminating on the basis of sexual orientation. The Paycheck Fairness Act was designed to smuggle the concept of gender “comparable worth” into the law. The administration also supported the Ending Discrimination Against Parents Act that would have made it illegal for employers to discriminate on the basis of parental status. Finally, Clinton urged Congress to pass legislation that would have banned discrimination by private employers, health insurance companies, and managed care plans on the basis of genetic make up.

Fortunately, none of that legislation passed. But Clinton did sign executive orders that banned discrimination in the federal workforce on the bases of sexual orientation, genetic make up, and parental status. So, fortunately, only the federal government carries the heaviest burden from Clinton’s strained notion of “equal opportunity.” Unfortunately, some of that burden has also fallen on the private sector. **R**

CLINTON'S MUDDLED TALE OF TRADE

BY DANIEL T. GRISWOLD

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TRADE POLICY DURING THE CLINTON PRESIDENCY resembled a bookshelf: It was bracketed with sturdy legislative accomplishments that stand like bookends at either end, with a lot of words and not much action in between. But through the ups and downs and ups of President Clinton's trade policy, the U.S. economy reached a new level of integration with the global economy.

A FREE-TRADE START

Trade was an early priority on the Clinton agenda. Although negotiations for the North American Free Trade Agreement (NAFTA) between the United States, Canada, and Mexico began in earnest under the previous Bush administration, the deal was signed, sealed and delivered under President Clinton. After negotiating what proved to be largely cosmetic labor and environmental "side agreements," the administration lobbied hard for passage of NAFTA and ultimately won approval from Congress in November 1993.

Beginning January 1, 1994, NAFTA committed the three countries to achieve zero tariffs on trade. Tariffs were eliminated between the United States and Canada by 1999, and are scheduled to reach zero between the United States and Mexico by 2004, although a few U.S. tariffs on "import-sensitive" items will remain until 2009. Pre-NAFTA tariffs on U.S. exports to Mexico had averaged 10 percent, while tariffs on Mexican exports to the United States had averaged 2 percent. NAFTA also reduces or eliminates a number of non-tariff barriers to trade, liberalizes investment flows and trade in services, and enhances rules on intellectual property.

The Clinton administration's other early accomplishment on trade was completion and enactment of the Uruguay Round Agreement through the General Agreement on Tariffs and Trade (GATT). More than 100 countries signed the agreement in April 1994 in Marrakesh, Morocco, and Congress ratified it in December of that year.

The Uruguay Round Agreement commits its members to cut global tariffs by more than one-third, and to reduce or eliminate numerous non-tariff measures such as quotas,

"voluntary export restraints," restrictive licensing systems, and discriminatory product standards. It also ventured beyond classic market access concerns to create a new system to enforce trade-related aspects of intellectual property rights. The agreement commits its members to further negotiations to reduce still-high global barriers to trade in agricultural goods and services. Since passage of the agreement, other negotiations have led to liberalization agreements on financial services, basic telecommunications services, and information technology goods. Finally, the agreement transformed the GATT into the World Trade Organization (WTO) on January 1, 1995, and vested it with a more decisive dispute settlement mechanism.

MANAGED TRADE

After NAFTA and the Uruguay Round, Clinton trade policy seemed to backslide. The administration threatened Japan with punitive tariffs over its alleged lack of automobile imports, but then backed down when Japan refused to embrace "managed trade." The administration also refused to allow Mexican trucks to enter the United States, as had been agreed under NAFTA — a decision that has since been successfully challenged by Mexico before a NAFTA arbitration panel. In 1996, the administration bullied Canada into agreeing to a Softwood Lumber Agreement that limits imports of Canadian lumber to the United States. The nadir came in December 1999, when the WTO ministerial meeting in Seattle collapsed due in large part to the administration's refusal to even talk about new limits on antidumping laws and President Clinton's public comments that sanctions should be used against less developed countries to enforce labor and environmental standards.

On an administrative level, the Clinton presidency presided over the continued abuse of U.S. antidumping law against allegedly "unfair" imports. From 1993 through 1999, an average of 18 antidumping orders were imposed per year, about the same rate as during the previous Reagan and Bush administrations. Beginning in 1998, and with the Clinton administration's blessing, the domestic steel industry filed a flurry of cases in the face of declining global prices. The one bright spot on antidumping was the record pace of duty revocations. From 1993 to 1999, 126 antidumping duty orders were revoked, compared to 77 dur-

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ing 1980-92. But even that modest achievement was driven by WTO-mandated sunset reviews, not by any compassion on the part of the administration for consumers and businesses hurt by dumping duties.

A FINAL ACHIEVEMENT

President Clinton did have one final, major free trade accomplishment when, in May 2000, his administration persuaded Congress to approve permanent normal trade relations with China, America's fourth largest trading partner in terms of two-way trade. The legislation commits the United States to continue allowing Chinese-made products to enter the U.S. market under the same tariff rates imposed on goods from other U.S. trading partners with which we enjoy "normal trade relations." That means that, upon China's entry into the WTO (expected sometime in 2001), the United States must end its annual review of China's NTR status. While the legislation was obviously good news for Chinese exporters, it is also good news for American producers and consumers who benefit from the \$100 billion in goods we import annually from China.

CLINTON'S LEGACY AND THE FUTURE

Despite the backsliding and missteps, U.S. trade regulation

in the last eight years has been conducive to expanding trade. Between 1992 and 2000, imports of goods and services to the United States grew from \$653 billion to \$1,438 billion, while exports grew from \$617 billion to \$1,068 billion. As a measure of American integration with the global economy, combined two-way trade (imports plus exports) as a percentage of GDP rose during that same period from 20.1 percent to 25.2 percent.

Despite that growth, there are still major unresolved issues in U.S. trade regulation. One of those issues is whether to condition future trade agreements on foreign governments' adherence to certain labor and environmental standards. The Clinton administration was a cheerleader for tying such language to trade agreements, beginning with NAFTA, but less-developed countries rightly suspect that those conditions could be used as a cover for rich-country protectionism. By backing the inclusion of labor and environmental language in future trade agreements, the Clinton administration has made such agreements more difficult to achieve.

The Clinton administration's legacy in trade regulation is a mixture of major triumphs, wasted opportunities, and muddled rhetoric. In the end, the administration did not get in the way of the bigger story being written everyday in the global marketplace. **R**

TRANSPORTATION

FORWARD MOMENTUM

BY LAURENCE T. PHILLIPS
U.S. Department of Transportation

IN THE AREA OF TRANSPORTATION POLICY, PRESIDENT Bill Clinton and his administration supported the further deregulation of domestic and international transportation markets, achieving some notable successes. Although the administration missed some opportunities to adopt further free market reforms, President Clinton and his appointees continued a trend of improved competition, lower transportation costs, and increased usage.

AVIATION

The Clinton administration inherited an airline industry in financial distress, having lost \$10 billion between 1990 and 1993 and having accumulated \$35 billion in debt. Faced with an impending crisis, Clinton resorted to a hoary Washington custom: he appointed a study commission, chaired by former Virginia governor Gerald Baliles. Unlike the typ-

ical commission, however, the Baliles commission produced a report that was truly influential and formed the basis for much of the administration's subsequent policy toward aviation.

As recommended by the commission, Clinton officials supported further liberalization of our international aviation relationships, signing over 50 "open skies" agreements with foreign governments. For the most part, the agreements eliminated restrictions on airline services and fares between the signing countries. Consider the 1995 agreement between the United States and Canada, the largest bilateral air passenger market in the world. Before the agreement, the number of passengers flying in the market increased at an average annual rate of 1.4 percent; afterward, traffic grew at an annual rate of more than 11 percent. In November 2000, the United States and four Pacific countries signed the first-ever multilateral open skies agreement, a significant policy achievement and, hopefully, a harbinger of future regional and multi-regional agreements.

To promote competition between airlines, the Clinton

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administration and the Department of Transportation (DOT) supported eliminating the High Density Rule at three of the four U.S. slot-constrained airports (Chicago O'Hare and New York's La Guardia and JFK). The rule, which was imposed on certain airports more than 30 years ago, implemented a quota system to reduce congestion by restricting the number of flights that can occur during the day. The Clinton DOT further promoted competition by requiring "dominated" airports (airports in which one or two carriers control more than 50 percent of passenger enplanements) to file "competition plans" with the agency before they receive federal monies or authority to raise passenger-enplanement fees.

The Clinton administration attempted to resolve another problem identified by the Baliles commission: the inability of the Federal Aviation Administration (FAA) to adopt new air traffic control (ATC) technologies in a timely manner. To deal with that problem, the administration proposed that the ATC system be operated as a not-for-profit U.S. government corporation. The corporation would achieve financial self-sufficiency by imposing cost-based user fees (augmented by a contribution from the federal government's general fund) that would supplant aviation taxes.

But while Congress granted the FAA flexibility in the areas of personnel and procurement, it was unwilling to consider establishing either private non-profit corporations or self-supporting government corporations to operate the ATC systems. Shortly before the end of his administration, President Clinton issued an executive order creating a performance-based organization to manage the ATC system. Nevertheless, the failure to reform the FAA and impose cost-based fees for the ATC services provided was, perhaps, the administration's biggest policy failure in transportation.

A second failure could have resulted from DOT's development of "pricing guidelines" for air carriers. In April 1998, DOT published in the *Federal Register* proposed guidelines that

were intended to prevent large incumbent air carriers from engaging in unfair exclusionary practices against smaller carriers, especially new entrant airlines. The proposed guidelines specified three pricing and capacity responses that could, under certain circumstances and unless there was a "reasonable alternative response" available to an incumbent, trigger a DOT investigation. Many economists contended that, if adopted, the guidelines would have stifled airline competition. Fortunately, they were not adopted.

The Clinton administration passed on some opportunities to incorporate free market reforms into U.S. air travel. One such failure was the administration's refusal to push for changes in federal statutes that prohibit foreign ownership of U.S. airlines or foreign carrier service between U.S. cities (i.e., cabotage). Removing those prohibitions could provide substantial benefits for air travelers, especially if the airline industry consolidates further, which now appears to be inevitable.

RAILROADS

The 1980 Staggers Rail Act led to a more efficient and financially healthier railroad industry. The Clinton administration supported the goals of Staggers and worked to sunset the Interstate Commerce Commission, which occurred in December 1995.

The administration also recommended that many of the ICC's regulatory responsibilities be terminated or transferred to other federal agencies. One such set of responsibilities was the ICC's authority over railroad mergers, which the administration wanted to be governed by established DOJ standards. That transfer of responsibility did not occur; instead, the Surface Transportation Board was created, and it now holds authority over rail mergers. The board subsequently approved two transactions – the Union Pacific-Southern Pacific merger and the breakup of Conrail – that

have resulted in major service problems for shippers over large geographic regions.

Faced with growing shipper discontent and pressure from some large railroads to defer future mergers, the board instituted a “merger moratorium” while it developed new rules to govern mergers. The proposed rules, which have not been finalized, would make it much more difficult for rail carriers to merge. Under the rules, merging rail carriers would have to demonstrate that the proposed transaction would “enhance competition” (as opposed to demonstrating that it would not be anticompetitive, if appropriately conditioned) and that they have adequate “service assurance plans” (which could be handled through private contractual agreements). The board also proposes to consider the hypothetical “downstream effects” of possible future mergers in reaching a decision on the merits of a particular transaction, and proposes that merging rail carriers explain how subsequent mergers, taken together, “could affect the eventual structure of the industry and the public interest.” If adopted, the board’s rules would limit opportunities for rail firms to compete more effectively by restructuring their service networks.

MOTOR CARRIERS

When the Clinton administration came to office, motor carrier shipment rates in regulated intrastate markets were often 40 percent higher – or more – than rates on similar shipments moving in deregulated interstate markets. To enable private competition and lower intrastate rates, Congress passed federal legislation in 1994 that preempted regulations over motor carrier rates and services in 41 states.

But as the intrastate market benefits from deregulatory reform, the newly created Federal Motor Carrier Safety Administration threatens to increase regulation on the interstate market. To improve highway safety, the agency recently proposed changing hours-of-service regulations for commercial truck drivers. If adopted, the proposed regulations would be the first major changes to the rules since 1962 and would impose substantial costs on trucking firms by requiring them to alter their operating and scheduling practices. Because of their cost and their uncertain justification, the proposed rules are highly controversial.

The Clinton administration also left an important motor carrier issue unresolved when it left office. The administration supported the international truck and bus provisions of the North American Free Trade Agreement (NAFTA) but suspended their implementation because of safety concerns with Mexican motor carriers. The Bush administration is moving to implement the NAFTA provisions while ensuring compliance with U.S. safety standards.

MARITIME

In 1998, Congress enacted maritime reform legislation that permits liner-shipping companies to enter into confidential service contracts with shippers. Before that legislation, ocean carriers had to share information about rates and services with all shippers. The shippers could then demand

similar terms, which reduced liner companies’ incentives to cut rates selectively. Early studies indicate that confidential contracts and other market reforms are making the liner shipping industry more competitive.

Congress and the Clinton administration missed an opportunity to bring further market reform to maritime shipping when, in 1998, the U.S. Supreme Court declared the Harbor Maintenance Tax, as applied to exports, to be unconstitutional. The high court’s ruling did not affect the tax’s application to imports, which the Clinton administration allowed to continue. A better strategy might have been for the administration to push for repeal of the tax in favor of a system of cost-based user fees, which would be a more efficient way to finance future harbor dredging and port-expansion projects.

Clinton officials also left unchanged the Jones Act (part of the Merchant Marine Act of 1920) that requires that only U.S.-built, -owned, and -registered vessels be used in U.S. waterborne commerce. Because the law raises shipping costs and, thus, makes U.S. products less competitive, economists repeatedly have called for its elimination. However, given entrenched political opposition and the small likelihood of success, the Clinton administration, like previous administrations, never seriously considered proposing its elimination.

PUBLIC PERCEPTION

Numerous studies have documented the substantial and widespread benefits of transportation deregulation. However, in the final years of the Clinton presidency, the free market reforms came under repeated attack from airline customers, some shipper groups, and numerous members of Congress.

Two factors are primarily responsible for the “disconnect” between the studies and a growing public hostility toward deregulation. First, antiquated federal laws and regulations, including such items as the current statutory prohibition that prevents the FAA from even *considering* imposing user charges for air traffic services or those that prevent foreign transportation firms from acquiring and operating U.S. transportation companies, continue to restrict competition among transportation firms and reduce market efficiency. Second, transportation infrastructure remains improperly priced, resulting in congestion, poor service, and, in some markets, too little competition. Much of the blame for that rests with the failure to use the price mechanism to allocate infrastructure services efficiently, ensure that all private and social costs are recovered, and signal when, where, and what type of additional infrastructure is needed. Put simply, the way we price our public transportation infrastructure — the fees and taxes imposed on those who use our airways, airports, highways, and ports — bears little resemblance to the economic ideal. Until that problem is fixed — and it will require great political courage to fix it — the full benefits of transportation deregulation will not be attained. **R**

POLITICS OR SOUND POLICY?

BY RICHARD L. STROUP
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THE CLINTON ADMINISTRATION'S ENVIRONMENTAL policy, steered by Vice President Al Gore and aided by Environmental Protection Agency (EPA) Administrator Carol Browner and Interior Secretary Bruce Babbitt, did much to meet the demands of environmental activist groups at the national level. The administration's environmental highlights included supporting and signing the Kyoto treaty on carbon dioxide, designating 10 new national monuments in the West, and issuing thousands of pages of environmentally oriented "midnight regulations" at the very end of the administration.

Among the new national monuments is the Grand Staircase-Escalante in southern Utah, encompassing 1.9 million acres – more than the combined total of Utah's five national parks. One of the midnight regulations, enacted last January 18 by EPA, forces fuel producers to remove 97 percent of the sulfur in diesel fuel. Another rule set aside 58.5 million acres of "roadless" area in various national forests, eliminating the great majority of management options there, including most forms of fire management. (See "The Forest Service's Tinderbox," *Regulation*, Vol. 23, No. 4.)

The activist groups were pleased. Dan Weiss, political director of the Sierra Club was quoted as saying, "The Clinton-Gore administration has a very good record on the environment. It's not perfect, but they've made some real accomplishments."

PLAYING POLITICS

Not all the activist demands were met, but the administration often

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pushed right up to the apparent political limits. The midnight regulations, for example, were generally taken to be end runs around the Congress. Clearly, Congress would have failed to ratify the Kyoto treaty had it been sent to the Senate, and it would not have enacted laws consistent with the midnight regulations.

Saving those regulations until the end was convenient politically because each is costly and controversial. Publication of the final rule on arsenic in drinking water systems, for example, which would tighten the current arsenic standard from 50 micrograms per liter down to 10 micrograms, was put off until the new president's Inauguration Day. The rule was, and is, opposed bitterly by many of the municipal water companies that would pay the costs, which would be especially large for smaller cities and towns. The controversy brought on by the measure is providing much grief for the new occupant of the Oval Office.

COSTS AND BENEFITS

While political costs and benefits may have played a large part in the decisions of the Clinton administration — as they must for any successful politician — total costs and benefits to society of the policy options seemed to

have been another matter entirely. Consistent with the desires of activist environmental groups, the administration showed little interest in serious cost-benefit analyses.

In its first year, the Clinton administration replaced Executive Order 12,291, requiring that all new regulations be reviewed by the Office of Management and Budget (OMB), with one requiring only that regulations expected to impose costs of more



than \$100 million needed review. Specifically, administration officials made little use of the skills and experience of the Office of Information and Regulatory Affairs (OIRA), descended from Alfred Kahn's days in the Carter White House.

Clinton officials touted the benefits of restrictive environmental regulations, but the costs were consistently ignored, particularly when they could be passed on to industries that would absorb the blame when prices rose. The administration did occasionally modify the regulations to ease their costs on citizens and raise their net benefits, but those changes seemed to occur most often when the costs were being felt strongly by other units of government, which by their nature are politically organized and endowed with high credibility in Washington.

SUPERFUND

A classic case of a program needing serious modification – if not a wiping clean of the program slate – is EPA's Superfund program. In the first 12 years following its 1980 establishment, the Superfund program spent \$20 billion, and its costs were growing along with delays in its cleanups of hazardous waste sites.

Despite the expenditures, the program showed little gain in the way of human health benefits. In their 1996 study *Calculating Risks* (Cambridge, Mass.: MIT Press) researchers James T. Hamilton and W. Kip Viscusi reported a number of discouraging findings from their analysis of the Superfund program in general and 150 Superfund hazardous waste sites in particular. Among the findings:

- Average cleanup cost per site in the study was \$26 million (in 1993 dollars).
- Most assessed Superfund "risks" do not pose a threat to human health now; they will do so in the future only if people violate common-sense precautions and actually inhabit contaminated sites. And even if exposure did occur, there is less than a one-percent chance that the risks are as great as EPA estimates.
- At the majority of sites, each cleanup is expected to avert only 0.1 cases of cancer. Without any cleanup, only 10 of the 150 sites studied were estimated to have one or more expected cases.
- Replacing extreme EPA assumptions about cancer rates at the sites with more reasonable figures revealed that the estimated median cost per cancer case averted is over \$7 billion. Other federal programs commonly consider a life saved to be worth about \$5 million.
- Diverting expenditures from most Superfund sites to other sites or other risk-reduction missions, using more realistic analyses, could save many more lives or save the same number of lives at far less cost.

Tunnel vision Why do we observe such apparent inefficiencies in environmental programs? EPA site managers have little reason to worry about whether, in forcing others to spend more money at Superfund sites to reduce environmental risks there, other important social goals consequently receive less money. As Supreme Court Justice Stephen Breyer put it in his 1993 book *Breaking the Vicious Circle: Toward Effective Risk Regulation*, each agency has "tunnel vision."

Agency and program officials will try to push beyond the efficient point of cleanup. In Breyer's words, tunnel vision is a "classic administrative disease" that arises "when an agency so organizes or subdivides its tasks that each employee's individual conscientious performance effectively carries single-minded pursuit of a single goal too far, to the point where it brings about more harm than good." Breyer calls this trying to achieve "the last 10 percent." Indeed, Hamilton and Viscusi estimate that 95 percent of Superfund expenditures are directed at the last 0.5 percent of the risk.

Brownfields President Clinton said of the program in 1993, "Superfund has been a disaster." Yet his administration firmly rejected the serious reforms that were suggested, including those proposed by Congress. Instead, the administration opted for a "brownfields" program aimed at small, piecemeal mitigation efforts. The motivation was primarily to assist cities hardest hit by the unwillingness of investors to redevelop contaminated areas for fear of Superfund's enormous costs.

The Clinton-Gore brownfields program involved little loss of the draconian authority that EPA had written into the rules for itself, and had little effect. EPA's own inspector general audited the programs in 1998 and concluded, "While the enthusiasm for EPA's brownfields initiative was readily apparent, the impact was less evident," and the program was actually having "little impact on actual redevelopment."

CONCLUSION

Conducting and acting upon serious cost-benefit analyses could save far more lives at far smaller cost. Instead, the Clinton administration focused narrowly on policy results immediately at hand and on pleasing its environmental activist constituents. That approach may have long-term negative impacts on environmental policy. After all, the public will buy more of what it wants, including environmental quality, when the cost of doing so is lower and when the public is richer. A policy stance that exploits economic reasoning and better analyses can reduce the price of better environmental quality while avoiding the waste that saps wealth.

Will the Bush administration do better? We shall see. Their intention to make John D. Graham, the current director of Harvard's Center for Risk Analysis, administrator of OMB's OIRA seems a good start. R

OPENING THE MARKETS

BY S. CRAIG PIRRONG

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THE VOLUBLE BILL CLINTON TALKED EXTENSIVELY about a lot of topics during his years in the Oval Office, but one topic that he did not say much about was securities regulation. A Lexis-Nexis search on “Clinton” and “securities regulation” reveals only 194 hits between 1992 and 2000, and most of those are generic references to Clinton administration policy rather than to statements on the subject by the president himself.

Clinton’s only substantive personal contribution to securities regulation as president was to veto 1995 legislation that imposed some modest restrictions on class action lawsuits by shareholders. Congress overrode the veto, so even that action had no lasting impact. (Ironically, Clinton later gave a speech condemning a California proposition designed to reverse the effect of the federal law that was passed over his veto.)

In spite of — or because of — the president’s benign neglect, securities regulators did implement some beneficial policies during the Clinton presidency, and they avoided making any egregious errors. Clinton was in office during a period of amazing dynamism in the American securities markets. For the most part, the Clinton Securities and Exchange Commission (SEC) allowed the markets to evolve with little interference. Moreover, the SEC, in combination

with the Justice Department (DOJ), took some actions that made the securities markets more competitive.

BREAKING UP THE SECURITIES “CLUBS”

Securities markets have always been very clubby, and often operated for the benefit of the club members rather than investors. Although competitive pressures certainly constrain the ability of securities brokers and dealers to extract too many rents, the network aspects of securities trading do provide some shelter from competitive forces. That has permitted some collusive practices to persist in securities markets. During the Clinton years, the SEC and the DOJ successfully attacked some of those practices.

The most well known effort was the assault on allegedly collusive practices by NASDAQ dealers. Those firms make markets in stocks; that is, they quote prices at which they are willing to buy and sell. A 1994 academic study found curious behavior in dealer quoting behavior that the study’s authors explained as potentially arising from collusion among NASDAQ dealers. That research set off a firestorm of debate involving both academics and practitioners, and the DOJ and SEC launched an investigation. Evidence of collusive behavior contained on tapes of conversations between dealers was sufficiently compelling to induce NASDAQ dealers to enter into a settlement with the government and pay a billion-dollar settlement in a private class action lawsuit.

The DOJ and SEC also attacked the practice of options

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exchanges refusing to list options traded on other exchanges; for instance, the Chicago Board Options Exchange would not list options on Dell stock because Dell was traded on the Philadelphia Exchange. In a 2000 settlement with the government, the exchanges agreed to cease their tacit market division arrangement. The exchanges have subsequently competed directly for listings. The initial evidence suggests that this has led to lower costs for options traders in the short run. The long run effect of the settlement is harder to gauge, as the nature of liquidity in financial markets may eventually lead to either merger between exchanges or the gravitation of trading of options on a particular stock to a single exchange even absent an attempt by exchanges to divvy up the market.

The SEC undertook other initiatives intended to reduce investor-trading costs and reduce the advantages of market professionals. The so-called "Order Handling Rules" implemented in 1997 made it easier for investors to post limit orders in NASDAQ stocks. That allowed individual investors to compete with NASDAQ dealers in supplying liquidity. The rules facilitated the entry of electronic communications networks (such as Island) that serve as portals for investors to enter limit orders. Trading costs in the NASDAQ market fell sharply and permanently after the rules were implemented, and the evidence suggests that virtually all of the decline in trading cost was due to a decline in NASDAQ dealers' profits, thus benefiting investors.

LESS EFFECTIVE "REFORMS"

Other SEC initiatives have been more problematic. The agency unveiled Regulation FD — for "Fair Disclosure" — in 2000. Reg FD was intended to level the informational play-

ing field by prohibiting companies from selectively disclosing information to analysts. There is no strong theoretical reason to believe the regulation would have a significant positive impact; if firms released information to multiple analysts prior to the regulation, competition between them would tend to reduce their trading profits substantially. More widespread dissemination would have modest effects on investor trading costs. Moreover, selective disclosure may be efficient; it could be a means of compensating analysts for services rendered to the corporations they cover. Finally, Reg FD may raise the cost of disclosure, leading some corporations to reduce their dissemination of information. Indeed, recent news reports suggest that this has occurred. Thus, the actual effects of the regulation may be quite different from the intended result.

Another recent SEC initiative has been "decimalization" — changing price quotations from eighths of a dollar to pennies in an effort to narrow bid-ask spreads and thus reduce trading costs. This has imposed substantial compliance costs on exchanges because of the demands it places on exchanges' communications infrastructure. Moreover, it has had the unintended effect of giving advantages to floor traders on the New York Stock Exchange. The jury is still out on the wisdom of this endeavor.

In sum, the Clinton regulatory legacy in securities markets is benign, and arguably favorable. On the whole, the SEC and DOJ have adopted pro-competitive policies that have benefited investors and harmed some market professionals. This is most likely due to the growing importance of both institutional and individual investors. That growth has served as a counterweight to the broker-dealer interests that have historically influenced SEC policy. **R**

BANKING & FINANCE

A NEW ERA FOR BANKING

BY JOSEPH F. SINKEY JR.
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THE CLINTON PRESIDENCY SAW THE PASSAGE OF several key pieces of banking and finance legislation that helped to modernize an industry that had been controlled by regulations dating back to the Depression era. The new laws allowed the banks and other financial institutions to employ modern business practices and to further benefit from new technologies that, together, helped to create a more stable and healthy industry.

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BANKS IMPROVE LOAN QUALITY

In the early 1990s, the U.S. banking system was in deep trouble. That was especially true of the larger banks, which were heavily burdened with bad commercial real estate loans and the effects of the 1980s international debt crisis. In addition, the international Basle Accord on risk-based capital requirements took full effect at the end of 1992, further sapping the 1,000 largest U.S. banks of equity capital.

Faced with those difficulties, U.S. banks began cleaning up their loan portfolios and raising new capital. That led to a period of lower and less volatile interest rates in the 1990s

that, in turn, began to restore bank profitability and permitted expanded lending.

MODERNIZATION

But antiquated finance laws such as the McFadden Act of 1927 and the Glass-Steagall Act of 1933 continued to saddle the industry. The information age, characterized by globalization, securitization, and electronic funds transfer, rendered those laws' geographic and product restrictions obsolete.

President Clinton and Congress were forced to address the outdated laws and, to their credit, they worked to bring about badly needed reform. The Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994 eliminated geographic restrictions by permitting holding companies to acquire banks in any state and to merge banks located in different states into a single branch network. The Graham-Leach-Bliley Act of 1999 (also known as the Financial Modernization Act) removed product restrictions across banks, securities firms, and insurance companies, allowing them to affiliate under a financial holding company (FHC) structure. Under the new law, the Fed is the "umbrella supervisor" of an FHC while industry-specific regulators monitor the company's individual subsidiaries.

In all, President Clinton signed five major pieces of banking reform legislation into law during his eight years in office. (See Table 1.) Describing the new laws as "Clinton's regulatory legacy" is an overstatement, of course; politics is the art of compromise and passing laws requires the same type of artistry. In addition, market forces in the form of technology, quests for transparency, and risk exposures moved so quickly over the past decade that the president, lawmakers, and regulators were more reactive than proactive. But the changes that occurred did happen on Clinton's watch and, because of that, he and his administration deserve credit.

THE FUTURE

Even though the banking and financial industry is now more stable than a decade ago and banking regulation has been significantly modified, further regulatory reform is needed.

There are many questions about how the emergence of FHCs will affect the federal safety net. (See "The New Safety Net," p. 28.) The safety net encompasses a combination of deposit insurance, the discount window, and the doctrine that some banks are "too big" for the government to allow them to fail. Although the 1991 FDIC Improvement Act attempted to curb the too-big-to-fail doctrine and to get bankers to take "prompt corrective action" against troubled banks, the expectation still exists that "big banks" (which now include FHCs) are too big to fail. Hence, the implicit too-big-to-fail guarantee may encourage risk-shifting behavior that adversely affects both community banks and taxpayers.

The safety net is a complex system of explicit and implicit guarantees. How the guarantees are delivered, the subsidies they provide, and the behaviors they induce are important issues facing regulators. For example, government-sponsored enterprises (GSEs) such as Fannie Mae and Freddie Mac have lines of credit with the U.S. Treasury. Those lines of credit, in turn, create the perception that the GSEs' debts have a U.S. government guarantee. The benefits and costs of GSEs, in terms of competition and taxpayer backing, have come under the microscopes of both the financial services industry and Congress.

The effects of globalization and systemic risk are big-picture issues that regulators will likely face in the future. Driven by advances in technology, the financial world has become more integrated. Revisions to the original

Table 1

Major Legislative Developments for Modernizing the Financial System, 1993-2000

Reigle Community Development and Regulatory Improvement Act of 1994 Authorizes funding for community development projects in neighborhoods with low-to-moderate income and contains provisions to streamline the regulatory process and ease a number of regulatory constraints.

Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994 Allows bank holding companies to acquire banks in any state (after September 29, 1995) and to merge banks located in different states into a single branch network (after June 1, 1997), unless a state opts out of this branching authority.

Economic Growth and Regulatory Paperwork Reduction Act of 1996 Relaxes or eliminates numerous regulatory provisions associated with application, approval, and reporting requirements.

Gramm-Leach-Bliley Act of 1999 Allows affiliations among banks, securities firms, and insurance companies under a financial holding company (FHC) structure. Within an FHC, industry-specific regulators supervise individual subsidiaries while the Federal Reserve, as "umbrella supervisor," regulates the overall organization. This financial modernization act or omnibus banking bill represents de facto repeal of the Glass-Steagall Act of 1933.

Electronic Signatures in Global and National Commerce Act of 2000 Provides the basic legal foundation for electronic commerce contracts in the United States. The act gives contracts created on-line the same binding authority as written contracts with written signatures. It also allows consumers and businesses to sign checks and complete applications for loans or services without affixing a paper signature. The act, which is similar to existing laws in numerous states, requires that consumers consent to doing business on-line and assures them of consumer protections equivalent to the paper world. (When Clinton signed the law, he used an electronic card and his dog's name as a password to "E-sign" the bill into law. As a backup and safety measure against a legal challenge, he also signed the "digital-signature bill" the old-fashioned way — with a pen.)

Basle Accord risk-based capital requirements have been proposed. (See "The Dilemmas of International Financial Regulation," *Regulation*, Vol. 23, No. 4.) Regulators must be careful that the revisions do not increase the risk in portfolios and reduce the amount of capital available in world markets.

On the domestic level, financing for small businesses and the effects of subprime lending will be important concerns in terms of who gets credit and the ability to repay. (See "Renovating the CRA," p. 8.) Regulators are pushing for higher capital requirements for banks that emphasize such lending. Because capital requirements act as a tax and higher capital requirements mean higher implicit taxes for banks and thrifts, what is the likely incidence of the higher tax for high-volume lenders? Will they pay it in full? That seems highly unlikely, which leads us to expect that part or all of the higher cost will be passed on to subprime borrowers. Thus, those citizens most in need of financing could face higher costs in the future.

Another key domestic issue is transparency and how to achieve it. The issue can be viewed in terms of market-

value versus book-value accounting and its focus on how bank loans are valued. Last December, the Financial Accounting Standards Board (FASB) suggested that bank loans held to maturity should be booked at fair value. (See "The Fallout from FAS 133," *Regulation*, Vol. 23, No. 4.) The debate over accounting standards is a hot one, as opponents of fair-value accounting argue that it will make bank stock prices and uninsured liabilities more volatile. A Catch-22 exists, however, because nonbanks such as insurance companies and corporate conglomerates buy and trade loans without as much regulatory scrutiny and with lower capital standards than banks. Thus, the net cost of achieving greater transparency may come at the expense of further erosion of bank franchise value.

In addition, players and regulators face challenges related to risk exposures and how to measure and manage them; information technology and how to apply it in a secure environment that is operationally efficient and instills user confidence; and, last but not least, consolidation within and across the financial services industry and how increased concentration will affect market performance. **R**

HEALTH & MEDICINE

A TROUBLING DIAGNOSIS

BY WALTON FRANCIS

LIKE MOST OTHER ASPECTS OF THE CLINTON ADMINISTRATION, its record on health regulation is more opportunistic than thematic, more hubristic than measured. However, the record has two consistent subtexts: a steady expansion of the federal government's role, and a remarkable lack of common sense or restraint in regulatory decisions and in review of patently flawed regulations.

FOOD AND DRUGS

Regulatory decisions reflect the personalities and prejudices of those making the decisions. David Kessler, whose tenure began during the George H. Bush administration and continued over half of the Clinton administration, was

the strongest Food and Drug Administration (FDA) commissioner ever to hold the office. The routine FDA actions during his tenure showed no clear pattern and, from a free market perspective, several surprisingly sound decisions.

Reducing "risk" The agency's decision tendencies are historically paternalistic. For example, over a decade ago FDA banned the interstate sale of "raw" (unpasteurized) milk. To aficionados, raw milk tastes distinctly different and better than the pasteurized product, but it also carries a tiny but discernible risk of poisoning from listeria and other bad bugs. That risk proved too high for FDA.

Continuing that paternalism, the agency recently ordered the pasteurization of fruit juices, thereby ending the sale of unpasteurized apple cider. The agency is reported to have set its sights next on unpasteurized cheeses, a category encompassing many of the world's greatest cheeses.

FDA also recently banned blood donations from any American who spent six months or more in Britain since

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PHOTODISC

1980, in order to provide a purely theoretical protection of the blood supply from mad cow disease. That measure will have no measurable safety benefits and will reduce the availability of blood, thereby creating real, rather than hypothetical, risks.

Tobacco The flashiest FDA initiative involved tobacco. Under President Clinton's direction, the agency proposed a scheme for regulating cigarettes as drug delivery devices. But, in a five-to-four decision, the Supreme Court derailed the scheme.

The proposal rested on a tortured interpretation of the Food, Drug and Cosmetics Act, reversing a decades-long position that FDA had no authority to regulate tobacco. Regardless, the proposal was essentially political and rested on the twin pillars of the gargantuan harms of tobacco products (dwarfing, for example, the morbidity and mortality caused by guns and automobiles) and the obvious venality and prevarication of the tobacco companies. "Doing good while demonizing" was an oft-repeated strategy of the Clinton administration and one followed on tobacco.

Better efforts On the other hand, FDA has substantially liberalized its oversight of prescription drug advertising, which accounts for the surprisingly widespread advertising of newer and better drugs in print and broadcast media. What is more, the agency now requires that pharmacies give customers handouts with each prescription that explain, in plain English, how to take the drug and important side effects. That regulation has low costs and important health benefits. And FDA recently proposed revising its prescription drug labeling requirements for health care professionals, to simplify, highlight key infor-

mation, and delete essentially useless information.

Concerning foods, the agency now allows scientifically based health claims for products. Nutrition labeling has — generally speaking — been sensibly and inexpensively implemented. What is more, FDA and its sister Health and Human Services (HHS) agencies have delisted saccharin as a carcinogen, though FDA has not removed its ban of cyclamates, a sweetener preferred by most consumers and one for which the alleged evidence of carcinogenicity was overcome decades ago.

HEALTH INSURANCE

Over 50 years ago, Congress enacted the McCarran Act that, in effect, said insurance regulation is the business of the states. Whatever the merits of that decision, it largely prevailed as a statement of federal policy and practice until the Clinton administration. Eight years ago, the federal role in health insurance regulation was negligible. Today it is ubiquitous, heavy handed, and routinely preempts the states.

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) mandated a good part of the new body of regulations. Today, employers must offer insurance to new employees without regard to preexisting conditions, insurers must offer individual policies to those previously insured under group policies without regard to preexisting conditions, insurers may not discriminate against some small employers if the insurers sell in that market, and mental health coverage must have "parity" with physical health coverage.

Medical records In addition, HIPAA required the establishment of medical privacy standards and electronic data

standards for health records and health claims. The data standards are intended ultimately to make every American's lifelong medical record available electronically. The privacy standard is intended to strengthen protections for those records.

The final privacy rule does modestly increase protections. However, it allows virtually unfettered access to health records by insurance companies and by government agents and auditors. That enables hundreds of thousands of federal workers and insurance company employees to use sophisticated data mining techniques to examine millions of records. A few of the examiners will find it profitable to sell the information. Thus, HIPAA will substantially erode personal privacy by making both legal and illegal access to medical records far easier than it is today.

Using existing statutory powers, the Clinton administration also put in place most of the features of the so-called "Patients' Bill of Rights." Regulations have been issued by the main regulatory agencies: the Department of Labor for ERISA plans (i.e., most large employer health insurance), HHS for Medicare and Medicaid HMOs, and the Office of Personnel Management (OPM) for federal employee plans. The regulations impose informational requirements, appeals and grievance procedures, the "prudent layperson" standard for emergency care, and other requirements for health plans that cover more than ninety percent of all working Americans. Thus, as the surreal debate over new legislation continues, the bulk of the provisions are already in place.

MEDICARE REGULATION

The big news in Clinton-era Medicare regulation was a substantial ratcheting up of requirements for, and enforcement of, fraud and abuse provisions. Rates of conviction and monetary recoveries have doubled and redoubled and redoubled again in recent years. Most of that effect results from higher standards of documentation and essentially unlimited enforcement resources, rather than any real change in the already low incidence of true fraud.

Under the new standards, the time-hallowed doctor's scribbled note in a patient's medical record is defined as fraud, if detailed diagnostic words from an approved list are not written out in full detail. Fighting the government in such cases is expensive — so expensive that it is generally cheaper to "pay up." So substantial has been the effect on medical care providers that many insurance experts believe providers now bill the government less than they are legally allowed. They attribute a sharp reversal in the rate of growth in Medicare spending to fear of accusation of fraud.

HCFA Through the Health Care Financing Administration (HCFA), HHS also expanded regulations that give its bureaucrats discretion to evict from Medicare (i.e., put out of business) health providers that have ever broken any federal, state, or local law — even if the cognizant enforcement agency has already imposed the legally allowed penal-

ty. In addition, HCFA imposed a burdensome set of requirements on Medicare-participating insurance plans. For example, HCFA requires insurance companies to pay for "treatment plans" for persons with serious illnesses, and to pay for bilingual interpreters during medical visits. However desirable such practices may sometimes be, the legal foundations for their requirement are tenuous at best. They and other rules have substantially decreased the number of health plans willing to do business with HCFA.

THE FUTURE

What is to be done? The Bush administration should require every department and major subunit that issues more than a dozen rules a year to establish an analytic staff whose pay and promotion depend on removing regulatory excess in existing and new rules. The administration should also require every agency to participate in a government-wide online database of costly and burdensome rules, and some fraction of those rules should be reopened for public comment every year.

For unreasonable provisions that absolutely cannot be fixed under current law, the Bush administration should require agencies to identify the provisions' costs and propose ameliorative legislation. It should adopt selectively the use of review panels involving affected entities, similar to those now required for the Environmental Protection Agency and the Occupational Safety and Health Administration under the Regulatory Flexibility Act. Those panels have proven very effective in removing regulatory excess. President Bush should also establish an unambiguous duty on every agency official involved in regulatory development or review to reduce the burden of regulation.

What is more, the administration should beef up Office of Management and Budget (OMB) review, requiring OMB to examine every rule and to reinstitute the Reagan-era practice of returning inadequately lean and poorly analyzed rules to agencies until they get them right. Every regulatory impact and flexibility analysis should be published as part of the regulatory preamble, not only to prevent the current practice of hiding weak analyses in the docket room, but also because the essence of public participation is to understand costs, benefits, and options.

If the Bush administration follows those suggestions, there is at least a probability of rolling back many unreasonably burdensome regulations while preventing new excesses. For example, the administration could eliminate the HCFA authority to ban providers that have broken laws unrelated to patient health, and prevent FDA from implementing a staff plan to regulate the accuracy of health information provided on the Internet.

There is no reason that most of the worst problems cannot be removed or proposed for removal within the first year of the new administration. Some reforms may require legislation, and take longer. But the legislative and regulatory proposals themselves would be evidence of a good faith effort. R