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Testimony before the Senate Committee on Commerce, Science, and Transportation: Consumer Subcommittee; by Harry S. Havens, Director, Program Analysis Div.

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An analysis of costs and benefits of government regulation dealt with the various types of regulatory costs to society, alternatives to regulatory methods, and the need for coordination of regulation. Regulatory costs include direct costs of compliance such as costs of paperwork, equipment modifications, and testing procedures. Indirect costs result from the redirection of industrial research and development efforts and from conflicting regulations and goals. Alternatives to current regulatory methods include lowering the cost of regulation through administrative improvements, regulation which specifies results without specifying methods, use of financial incentives, selective exemptions, eliminating unnecessary regulation, and eliminating the use of regulation to achieve goals which can be met by more direct means. There is a need for Government-wide coordination in order to establish regulatory priorities. (HTW)

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of the
United States Senate Committee on Commerce,
Science and Transportation

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Mr. Chairman and Members of the Committee:

We welcome this opportunity to discuss with you the costs and benefits of government regulation to the consumer and society. Our testimony today will examine the different ways in which regulatory costs fall on society; we will suggest some alternatives to current regulatory methods which might ease the costs to consumers and businesses of attaining the goals of regulation; and we will discuss the growing need for government-wide coordination of regulation and other government programs. Although regulatory costs tend to be more visible than benefits, and have received much attention, it is important that in making policy decisions, the costs of regulation be considered in the context of the social goals to be achieved, and the social costs of not regulating.

WHAT ARE THE COSTS OF REGULATION?

The growth over the past decade of safety, health and environmental regulation reflects a growing concern over the social costs of worker and consumer injury and illness, and environmental degradation. There is little doubt that the United States, in pursuit of health, safety and environmental goals, is incurring substantial costs. Many consumers, businessmen and government leaders are questioning whether the costs of these regulations are too high, compared to the benefits which they provide. An answer to this question depends both on the cost of regulation, and on the level of benefits which it provides.

Regulation differs from other types of government activity in that most of the cost to society does not show up in the government's budget, but rather is borne by individuals and firms in the private sector. The administrative and enforcement costs of regulation are only a relatively small part of the Federal budget. One estimate places the expenditures on Federal regulatory activities at $4.8 billion for the 1979 fiscal year. However, much regulation places costly requirements or constraints on regulated firms and individuals. The costs imposed on the private sector appear to be many times larger than the government's own expenditures on regulation. They include the direct costs of complying with regulation, as well as complex indirect consequences which are difficult to accurately measure.

<u>Direct Compliance Costs</u>

Many regulations in the safety, health, and environmental areas impose substantial direct compliance costs on those regulated. For example, they may require additional paperwork such as recordkeeping and reporting; mandate the development and installation of new or modified capital equipment; or, require firms to follow prescribed, rigorous testing procedures. These direct compliance costs must be absorbed by the firm in the form of lower profits, or passed on to employees in the form of lower wages, or to consumers. Regulatory costs are borne by consumers not only in the form of higher prices, b also in greater personal inconvenience, and a reduction in product variety.

Indirect Costs

One of the most troublesome aspects of the proliferation of regulation in the 1970's is the inability of regulators to adequately foresee all of the consequences of new regulation. One such unintended result of increased regulatory activity has been a reported reduction and redirection in industrial research and development efforts. Regulations, such as some developed by OSHA, which require the adoption of a specific technology, discourage firms from developing other methods of meeting the goals of the regulation. There are also other ways in which regulation can discourage new ideas. For example, EPA grant programs for municipal waste-water treatment plants require that the plant's equipment be obtainable from more than one source. This requirement discourages suppliers from developing new types of equipment to do the job.

Regulation also can reduce or redirect research and development efforts by increasing uncertainty. Research and development has always been a risky form of investment, but the threat of regulatory delay, or changes in regulations has increased the risk. Investors are less willing to commit funds to long term R&D projects when uncertainty as to ultimate costs and profitability increases. It is difficult to assess the social cost of these effects, since it cannot easily be quantified, but society pays a price in terms of lost opportunities.

Another unresolved and growing source of indirect cost is the conflict of regulations with one another, or with other government programs. For example, the program to promote energy self-sufficiency may conflict with the desire for a cleaner environment, since it includes a shift to the abundant domestic supplies of relatively dirty coal. There is also a tradeoff between automobile fuel economy standards, another attempt to conserve energy, and occupant safety. Environmental, safety, and health regulations among others are reportedly weakening the competitiveness of domestic U.S. firms in international markets, and in turn contributing to a worsening balance of trade. Another conflict that is currently receiving much attention is the tradeoff between regulation and price stability. Some research has suggested that regulatory compliance may be easier for larger firms than smaller ones. Such bias would weaken the viability of smaller firms and would contribute to increased concentration and reduced competition in the economy. The list could easily be expanded. The social cost of regulations which conflict with each other or with other government programs cannot be measured in dollars. However, these conflicts make regulations more difficult to enforce and less effective, and they raise the level of frustration and resentment on the part of regulated individuals and firms.

ARE THERE LESS COSTLY WAYS TO REGULATE?

Lower the Cost of Individual Regulations

Government leaders and regulators should look for regulatory methods which combine a high degree of social benefit with the lowest possible social cost. In some cases, existing regulatory benefits could be achieved at lower cost. In others, a regulatory goal may be simply too expensive to pursue with regulation. Some regulatory alternatives and reforms which could lower the cost of regulation include:

--Administrative improvements. Perhaps the easiest and most obvious source of regulatory cost cutting is in the area of government administration. Where ever possible, agencies should reduce paperwork, adopt streamlined decision making processes, provide more and better information to those regulated, promote regulatory mediation, reduce the potential for court challenges, provide sufficient lead time for firms to comply with new regulations in the least costly manner, and hold regulations constant for a long enough time that firms can effectively make investment decisons.

-- <u>Performance oriented regulation</u>. Regulation which specifies a desired outcome without specifying the methods by which that outcome must be achieved, offer regulated bodies an opportunity to devise their own means of compliance, which may be less costly than one uniformly imposed technological solution.

-- <u>Use of incentives</u>. There are several approaches to regulation which rely on the use of financial incentives to bring about compliance. A schedule of fines, penalties, or taxes can be arranged to achieve any desired level of aggregate compliance. Under one method, regulation is phased in with a series of fines for non-compliance which increase over time until some point is reached when compliance is universal because the fine is prohibitively high. This approach allows firms to plan, and choose the best time for them to comply. Alternatively, fines for non-compliance can depend on the degree of non-compliance. This approach allows firms to choose the most efficient degree of compliance.

-- <u>Selective exemptions</u>. Agencies may find that regulatory costs could be reduced by exempting some of the population from regulation. For example, in some data gathering, not all regulated bodies need to supply responses.

-- Eliminate unnecessary regulation. Some regulations may be unnecessary, or may have outlived their usefulness. If so, they should be eliminated. For example, OSHA has recently eliminated many requirements that do not contribute materially to worker health and safety.

-- Use of the most direct policy tool. Regulation has occasionally been used to achieve a variety of non-market failure policy goals, including income redistribution, price stability, protection of small business, and others. Use of regulation to achieve such goals frequently introduces market distortions, and results in unintended effects. These other policy goals could be more directly met through direct expenditures, taxes, or subsidy programs.

Need for Government-wide Coordination

We have discussed the costs of regulation, and how individual regulations might be made more cost effective. One major issue remains, that of setting government-wide regulatory priorities. As noted, the benefits of regulation cannot be attained free of charge, but must be purchased at some cost to society. Even though the government's administrative costs of regulation are relatively small, the full social costs of that regulation can be quite high. Just as the government is constrained by a limited budget, so society is constrained by limited resources, and it is not possible to pursue all regulatory goals at the same time. Priorities based on consideration of the full impact of all regulation--that is, its benefits as well as its costs--should specify which regulatory goals our society will pursue, and which goals are too expensive even using the least costly regulatory methods. Factors such as the level of risk to individual health and safety, environmental quality, and economic security and stability must be weighed along with regulation's dollar costs and benefits. In addition, conflicts among different regulations, and between regulations and other government programs should be resolved, so that they do not defeat one another.

At present, there is some coordination on administrative matters, but there is no unified system for priorities to be set, or to resolve policy or goal based conflicts. There is a growing diffusion of responsibility for Federal interagency coordination with the proliferation of limited purpose groups such as the Regulatory Analysis Review Group, the Regulatory Council, and the Interagency Regulatory Liaison Group.

Alternatives which would facilitate setting priorities and the resolution of policy conflicts need to be more thoroughly explored. One such alternative is the concept of a regulatory budget which would consolidate both the governmental and private sector costs and benefits of all regulation. Organizational alternatives that would consolidate selected regulatory coordinating activities or otherwise minimize their proliferation should similarly be explored.

Until greater coordination is achieved, Congress may wish to consider in its oversight of regulatory agencies, the extent to which these agencies meet government-wide as well as agency specific goals.

We will be happy to try to answer any questions which you might have.