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REGULATING THE DEREGULATORS

Remarks by
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REGULATING THE DEREGULATORS

Recently, an incident in my office caused me to go to the reference shelf and get out the Declaration of Independence. As I was skimming though the text, my eyes fell on a long-forgotten phrase, one that I believe deserves greater recognition in this day and age. In the part of the Declaration in which the Colonists particularize their grievances against the King of England, they say:

> "He has erected a multitude of New Offices, and sent hither swarms of Officers to harrass our people, and eat out their substance."

In the opinion of many people today, these words could have been written, not 200 years ago, by colonists complaining of a distant and tyrannical king, but in our own time, by businesspersons complaining about their own elected but overzealous government.

As the nation turns now to the tasks of deregulation and regulatory reform, I think we can feel considerable pride, and not a little relief, that the American people today have the fortitude to recognize and react against the same abuses that stirred the Founding Fathers. But, I think we must also ponder a bit on exactly how and why, in regulating our society, we came to repeat a mistake that was well known to people 200 years ago.

As some of you may be aware from my recent speeches and writings, I am something of a maverick on the subject of deregulation and regulatory reform. I do believe very strongly that we must proceed quickly to overhaul our current regulatory system, and wherever possible to reduce the burdens that regulation imposes

on legitimate business. However, I do not believe that the regulatory "reform" proposals currently in vogue in Washington are likely to bring about any kind of real reform; indeed, in some respects they actually will hinder reform and deregulation.

I would like to expand on these themes today, primarily by sharing with you some of my recent experiences as a newly-appointed government official and the insights I have gained from them.

As many of you know, before my appointment to the Securities and Exchange Commission, I worked for over a decade as a corporate and securities lawyer, counseling clients on how to conduct their business within the confines of the law. I thus had an opportunity to view first hand the impact that government regulations have on the conduct of business.

I came away from that experience an ardent supporter of regulatory reform. Many were the times, in private practice, that I felt that regulations were imposing unnecessary burdens on legitimate enterprise. I have seen perfectly legal business transactions restructured in circuitous and costly ways because of the perceived need to avoid various regulatory pitfalls. Worse, I have seen potentially profitable enterprises abandoned, because business people were afraid to proceed in the face of legal uncertainty. These enterprises could have provided the jobs and productive capacity that this country so badly needs, yet -- for wholly unnecessary reasons -- they were abandoned.

I suspect that, before this audience, I need not dwell on this point at any length. Most, if not all, of you have shared the experiences of which I speak.

It now seems that society as a whole has come to share these concerns. There is a broad recognition that regulation imposes costs of a sort not previously recognized; and that it can be counterproductive to the goals it is intended to achieve. We now understand that regulation may erode individual responsibility and, in addition, exalt form over substance.

There is also a broad recognition today that the costs associated with regulation are not only borne by the regulated industry. They are spread throughout the society in the form of higher prices, higher taxes and reduced productivity. These costs are sometimes far in excess of the benefits provided by a particular regulation. In this respect, an unwise regulation may actually contribute to frustrating the regulator's hope for a more just and humane society, because it necessitates the diversion of scarce resources from other societal interests.

All of these factors have contributed to a powerful movement aimed at deregulating much of the nation's business and reforming the federal regulatory establishment generally. The present Administration, as well as its immediate predecessor, and many members of Congress, both before and after the recent election, have shown a keen interest in regulatory reform. There is good reason to hope that over the long term, some significant improvements in the federal regulatory system will be made.

Nevertheless, I am extremely concerned about the direction that the regulatory reform movement has now taken. In Congress, the major vehicle for this reform effort is the pending Regulatory Reform Act of 1981. It would require agencies to follow numerous

additional procedures before they could issue any new rules. All rulemaking would be required to be accompanied by a statement of the data and methodology upon which the agency promulgating the rule is relying, a memorandum of law describing the agency's authority to issue the rule, and an explanation of how the agency's factual conclusions are substantially supported in the public record.

If the rule is deemed to be a "major" rule, by reason of its having a substantial adverse effect on the economy, the agency also would have to prepare a cost-benefit analysis, as well as a discussion of alternative approaches. Agencies would be required to review their existing regulations every ten years, and to renew, amend, or withdraw them, as appropriate. Another pending measure would add to all of this the possibility of a legislative veto of agency rulemaking.

I have, in some of my recent speeches and writings, characterized the Regulatory Reform Act as little more than an effort to "regulate the regulatory agencies into deregulation." The more I consider this proposed statute, the more apt seems the phrase. As I have stated before, the Act would impose on all government agencies a host of detailed procedural requirements, precisely the same sort of requirements that the agencies, over the years, have imposed on business. "Here is what you must do." "This is what you must think about." "Here is what you must say." "And, when you've done it all, here are two more layers of government bureaucracy that will do it over again, to make sure you've done it right."

Some of you may be chortling at the thought of the regulatory agencies getting back so much of what they have been giving out over the past years. It may, indeed, be ironic, but it's not reform.

If the nation has learned one thing from its experience with government regulation, I would hope that it is that there are real limitations on the ability to achieve substantive reform through the imposition of detailed procedural requirements. In most circumstances, regulation is a poor substitute for increased sensitivity. Indeed, the need to comply with regulatory requirements frequently diverts attention from the substance of the problem at issue. Yet Congress, which theoretically wants to encourage the regulatory agencies to carry out their mandates in a manner more sensitive to the costs and other problems they might create, has once again sought the answer in a new form of regulation.

There are other ironies in this effort to "regulate the regulators." Already, it is characterized by some of the same excesses that have characterized government regulation of business. For example, critics of the current regulatory process frequently point out that there ought to be a government agency to monitor all of the numerous regulations being imposed by the various other agencies, as a means of containing the aggregate costs imposed on business by such a variety of agencies, each pursuing its own mandate.

But, have these same critics even thought about the aggregate costs imposed on government agencies by the various reform initiatives of recent years? At the current time, we already have the Freedom of Information Act, the Government in the Sunshine Act, the Right

to Financial Privacy Act, the Equal Access to Justice Act, the Paperwork Reduction Act, and the Regulatory Flexibility Act. Soon, we may have the Regulatory Reform Act as well.

Each of these statutes imposes new costs and new administrative responsibilities on the regulatory agencies at the very time when the Administration is advocating budgetary restraint throughout the government and the nation. At the Securities and Exchange Commission, the Freedom of Information Act required approximately 30,000 man-hours of work last year. I am told that the Regulatory Flexibility Act and the Right to Financial Privacy Act will cost our agency $607,000 to administer next year. Moreover, these costs are duplicated throughout the government, as each agency or department is developing its own "reform" staff, and the Executive Branch is putting in place its staff to review the "reform" efforts of the operating agencies.

As critics of the regulatory system have frequently pointed out, regulation can have unintended negative effects that seriously distort the priorities of our society. Indeed, the current effort to "regulate the regulators" also is having such effects. For example, we have noticed in recent years a dramatic increase in the number of businesses and individuals that decline to produce information voluntarily for use in Commission investigations. There is also a like increase in those who resist even our subpoenas.

Frequently, we are told, it is not the SEC investigation that concerns these people. They would voluntarily give <u>us</u> the required information, but they fear the Freedom of Information Act, under which their confidential business and personal information, once in

the hands of a government agency, may become readily available to the world at large. Accordingly, that Act, as an unintended side effect, is frustrating the SEC's pursuit of its primary and legitimate goals.

I believe that not only will the Regulatory Reform Act not bring about considered deregulation, it may very well prevent other genuine efforts at deregulation. In order to understand the effect of this Act, it is important to remember that, just as regulation is accomplished by the enactment of agency rules, deregulation can only be accomplished by the enactment of other rules that amend or repeal the existing regulations. The Regulatory Reform Act would impose added procedures on all rulemaking, including that which simplifies or eliminates existing regulatory burdens.

At the current time, some agencies are already well on the road to reform and deregulation. At the SEC, for example, we have been in a deregulatory mode for at least three years. We are pursuing a vigorous program to review and simplify our myriad disclosure requirements. We have also broadened substantially the small-issuer exemptions from Securities Act registration, simplifying their use and raising to realistic levels the dollar amount of securities that can be sold without registration.

These reforms grew out of detailed studies and hearings on these subjects, initiated by the agency, in which we were careful to insure that our critics would be heard. We now have in progress a similar examination of the Commission's regulation of investment companies, also aimed at devising ways to reform our regulation of this area.

It is clear that the Regulatory Reform Act, and other measures of this kind, will require the Commission to expend a great deal of added time and money before it can carry out such reforms, despite widespread agreement that they are necessary.

At the SEC, for example, the Paperwork Reduction Act, a regulatory "reform" measure passed by the last Congress, is currently causing a substantial delay in a project to survey certain securities issuers. The survey, which will be entirely voluntary, will help the Commission to determine whether a number of exemptions from registration under the Securities Act, intended to aid small business in raising capital, are actually performing their intended function. We suspect that these rules are not working well, but we require some empirical evidence before we amend or repeal them. Unfortunately, the Paperwork Reduction Act requires that all forms to be completed by the public, whether voluntary or not, must be submitted to OMB for approval. The resource allocation required by such submission process, including the time and manpower necessary to explain our forms and the securities laws to OMB personnel, has proved to be a substantial deterrent to this deregulatory project of the Commission, which has now been significantly delayed as a result.

Furthermore, we must also remember that adding numerous layers of required procedures creates additional opportunities for those who would invoke the aid of the courts to obstruct or delay agency actions. All agency rulemaking is subject to challenge in court by persons claiming that the agency has not followed the procedures required by law. The greater the number of required

procedures and the more complex they are, the greater is the likelihood that such challengers will be successful in finding some area in which even the most conscientious agency may arguably not have done everything required of it. The Regulatory Reform Act will add to agency rulemaking a number of new and very complex procedures. Thus, one result of this Act will be to increase tremendously the opportunities of affected individuals and groups -- who in this case may wish to halt deregulation -- to delay agency action.

No doubt you are familiar with Environmental Impact Statements. Under the National Environmental Policy Act, all significant actions by federal agencies have to be accompanied by detailed analyses of the impact the action will have on the environment. When Congress in 1969 first passed the law requiring such statements, there was virtually no discussion and probably no conception of the statements' potential use as a tool to invoke the power of the courts to delay government action. Yet, today, that seems to have become one of the primary uses to which Environmental Impact Statements are put. Hundreds of major federal or federally-funded projects of all sorts have been delayed by citizen lawsuits claiming that the required Environmental Impact Statements for those projects were inadequate. The requirements that the Regulatory Reform Act would impose on government agencies have the potential to equal Environmental Impact Statements as a tool for challenging agency actions in court.

If it were only an agency's <u>regulatory</u> actions that could be so challenged, you might say, "all well and good." But, again, <u>deregulatory</u> actions will be open to challenge too, because

they are carried out by precisely the same rulemaking process as the initial regulatory action.

This entire concept, that Congress can run the agencies effectively by imposing on them a host of detailed procedural requirements, already has been tried elsewhere in the government and found severely wanting. Recall, if you will, the federal civil service system. Acting in the name of fairness and efficiency, Congress and the Civil Service Commission imposed on the government a huge number of rules that covered every area of personnel management.

The civil service system became a notorious example of just how dysfunctional it is to run the entire government by rigid rules imposed from on high. Although each of the many rules was intended to achieve some laudable purpose, the overall results were frequently quite problematic. In practice, government agencies found that they simply did not have the flexibility they needed to implement modern management techniques.

Congress and the Executive Branch finally realized several years ago that, in personnel matters, the agencies were overregulated. The Civil Service Reform Act of 1978 removed some of the old narrow prescriptions, and substituted flexible incentive programs. Contrast with that approach the current Regulatory Reform Act, where Congress proposes to "reform" the regulatory system by imposing a host of new procedural requirements.

It is time we recognized that in both areas of government -- personnel management and program management -- the basic question is the same: Will managers be allowed to manage? Will we trust

people enough to allow them to carry out a program? Will we trust ourselves enough to believe that we can select good people, give them the tools to do the job of reform and deregulation, and then give them the freedom to do it?

This is not to say that we do not need checks and balances on the power of administrative agencies. We most certainly do need them. But they ought to be in the form of broad boundaries, rather than detailed narrow procedures.

Within those broad boundaries, at the level of detail that Congress is considering in the Regulatory Reform Act, we ought to be considering the use of incentives, rather than prescriptions, as our primary means of influencing agency behavior. Agencies and officials who turn in good results ought to be rewarded for doing so. This is a technique that has been put to good use in private industry, but is only finding its first acceptance in government personnel management, and no use at all in government program management.

Indeed, the detailed prescriptions of the Regulatory Reform Act tend in exactly the opposite direction. Incentive management is possible only where managers have both responsibility and flexibility. It is not possible where statutes and rules specify in detail one's every move.

We also should be experimenting vigorously with new techniques for agency management. We are far from knowing everything there is to know about how best to achieve results in government. We will learn only if we give ourselves the freedom to try reasonable new ideas.

Indeed, I believe that this is a particularly opportune time

to commence experimentation in agency management. The current Administration has made a point of bringing into the top levels of government people with experience in business. Generally, these people have been selected because their basic attitudes toward government are the same as those of the Administration. These same people, because of their business experience, no doubt also form a reservoir of managerial talent such as the government may not have seen for decades.

Let us not waste this opportunity. I propose that the Administration, the Government Accounting Office, and the heads of the congressional oversight committees set to work now to identify those agencies with good infrastructures, and those small enough to make an experiment manageable. Then we can get to the real business at hand, which is to learn new and more effective ways of going about the necessary tasks of government, so that we need not continue to apply to new problems the solutions that a previous generation has already found wanting.

A number of political commentators have compared and contrasted the current political climate to that of the New Deal. Now, as then, there was widespread disillusionment with the old methods, and hope that the new administration would bring something that worked. It seems appropriate, therefore, that I should close with a quotation from a speech that President Franklin D. Roosevelt gave during his first, momentous hundred days in office:

> "The country needs and, unless I mistake its temper, the country demands bold, persistent experimentation. It is common sense to take a method and try it. If it fails, admit it frankly and try another. But above all, try something."

The energy unleashed through that philosophy carried our nation through some trying times and a long way beyond. Perhaps it could do the same for us.