32. REGULATION: COSTS AND BENEFITS

Along with taxing and spending, the Federal Government makes policy through regulating—that is, generally, through Executive Branch actions to interpret or implement legislation. As with taxing and spending, the Administration carefully designs and implements regulations to provide the most public benefit for the least cost. The Office of Management and Budget (OMB), the White House office that sets regulatory policy, has adopted the following objective in its Strategic Plan: "Maximize social benefits of regulation while minimizing the costs and burdens of regulation."

The Government is still learning how to accurately estimate regulatory costs, such as how much the private sector spends to comply with regulations, and benefits, such as safer cars and food. For over 20 years, a series of Executive Orders has charged OMB with reviewing regulations and providing information on their costs and benefits. The President's September 1993 Executive Order, "Regulatory Planning and Review," directs agencies to assess the costs and benefits of available regulatory alternatives and to issue only regulations that maximize net benefits (benefits minus costs), unless a law requires another approach.

Developing and evaluating the best possible data on benefits and costs are central to the Government's ability to assess how well the regulatory system functions to fulfill public needs. To meet that goal, OMB works with the agencies to improve the quality of the data and analyses they use in making regulatory decisions for both proposed and existing regulations, and to promote the use of standardized assumptions and methodologies uniformly across regulatory programs.

Difficulties in Estimation: Estimating regulatory costs and benefits is hard for two reasons: the "baseline" problem and the "apples and oranges" problem.

To estimate how regulations affect society and the economy, the Government must determine the baseline against which to measure costs and benefits; that is, what would have happened if the Government had not issued the regulation? But, several problems arise. First, no one can craft such a hypothetical baseline with certainty. Second, measures of costs and benefits often vary, depending on who is measuring. Agencies generally support their regulatory programs and, thus, may understate costs or overstate the likely benefits; at the same time, businesses and others who bear the costs will likely do the opposite. Third, the timing of estimates also may make a difference. Most estimates are made before the regulation takes effect, but evidence exists that once regulations are in place, the affected entities find less costly ways to comply.

The "apples and oranges" problem derives from the nature and diversity of regulation itself. Over 60 Federal agencies regulate over 4,000 times a year for a wide array of public purposes. The Government must make decisions about the chemical composition and temperature of the atmosphere, the accessibility of public transportation, and safety of the Nation's food supply. Estimating the costs of such diverse activities is hard; estimating the benefits is even harder. Fortunately, the Government is working on this issue and is making steady progress on methodology and data collection.

Costs and Benefits of Regulation: A recent OMB survey, *Report to Congress on the Costs and Benefits of Federal Regulations*, presents estimates of the aggregate costs and benefits of Federal regulation, as well as the costs and benefits of major individual regulations issued in the last year. Despite the inherent problems, the report represents a good first step toward developing a system to track OMB and agency performance in minimizing costs while achieving social benefits.

The report uses information on costs and benefits that was published in peer-reviewed journals, or published for public comment by agencies and reviewed by OMB, to estimate aggregate costs and benefits for four categories: environmental, other social, economic, and paperwork/disclosure (see Table 32–1).

The estimates in Table 32–1 are very rough, particularly the benefit estimates. With that very important caveat, the numbers indicate that regulation has produced as much, if not more, in benefits as in costs, and that environmental and other social regulation, mainly health and safety regulation, has clearly produced benefits significantly greater than compliance costs.

The benefits of environmental regulations reflect the value that society places on improved health, recreational opportunities, quality of life, preservation of ecosystems, biodiversity, and so on. The benefits of other social regulation include the value attributed to reduced mortality and morbidity. Generally, the costs are the expenses incurred in compliance, based on engineering designs and current prices, although sometimes they properly include the opportunity costs of foregoing the benefits of what would have been produced in the absence of the regulation.

Economic regulation directly restricts business' ability to conduct its main economic activities—to set prices and decide what to produce. It may also limit business' ability to enter or leave certain lines of work. These regulations usually apply on an industry basis, such as agriculture, trucking, or communications. Often, economic regulation has protected business from competition, and economic loss comes from the higher prices and inefficiencies that result when competition is restricted. Sometimes, however, as in the case of natural monopolies, economic regulation simulates competition and, thus, produces benefits to consumers. Because the Government has no reliable quantitative estimates of the benefits of economic regulation, Table 32–1 includes none. Most economists, however, believe that because regulatory policy has been slow to adapt to rapidly changing technology, the costs of economic regulation have generally exceeded the benefits. The Federal Government has been deregulating key sectors of the economy over the past 20 years, and many other countries have followed its lead.

The fourth category, paperwork/disclosure, includes regulations requiring that information be disclosed about the characteristics of an economic transaction—e.g., financial, securities, and business transactions—so that both parties to the transaction will have the same information. Although the Government has no reliable estimates of the benefits of such disclosure, most economists believe that benefits exceed costs.

Although Table 32–1 shows that, in total and for important categories, Federal regulations have provided more benefits than costs, it says little about current regulatory policy or how to improve it. To address these issues, the Government needs estimates of the costs and benefits of the incremental changes to recent regulations. In its report,

Table 32–1. Estimates of the Total Annual Benefits and Costs of Regulations for 1997

(In billions of 1996 dollars)

	Benefits	Costs
Environmental	162	144
Other Social	136	54
Economic	*	71
Paperwork/disclosure	*	10
Total	>298	279

*Indicates that significant benefits remain to be quantified including the benefits of regulating local phone monopolies and the information disclosure requirements of the banking and capital market regulatory agencies. Note that financial safety and soundness regulation is not included in the above totals.

Source: OMB, *Report to Congress On the Costs and Benefits of Federal Regulations,* September 30, 1997.

OMB provided information on the costs and benefits of the 41 economically significant final regulations that it reviewed from April 1, 1996 to March 31, 1997. [1]

Twenty-one of these rules require substantial private sector spending, provide significant new social benefits, or both. The Environmental Protection Agency (EPA) issued seven of these rules; the Agriculture Department (USDA) issued four; the Health and Human Services (HHS) and Transportation Departments each issued three; and the remaining four were spread among the Commerce, Interior (DOI), and Labor (DOL) Departments.

For seven of the 21 rules, monetized benefits exceeded costs. For example, the Food and Drug Administration (FDA) estimated that its tobacco rule would provide net benefits of $9 billion to $10.2 billion a year. EPA estimated that its Accidental Release Prevention rule would generate $77 million a year in net benefits. For the remaining 15 rules, agencies did not provide enough information to estimate monetized net benefits. For five of the 15, the agencies quantified the expected benefits (e.g., tons of emissions reduced, number of injuries avoided), but they did not assign dollar values to these effects and, thus, could not calculate monetized net benefits. For five others, the agencies identified qualitative benefits associated with the rule, but did not develop any quantified estimates of the likely effects. For the remaining five, agencies had very little economic data on the effects of the rule.

Of the remaining economically significant final rules, 19 were needed to implement Federal budget programs. These rules generally create "transfers"—that is, payments from one group to another, such as from the Federal Government to beneficiaries, that redistribute wealth. Eight were USDA rules to implement Federal laws on agricultural and Food Stamp policies; seven were HHS and Social Security Administration rules to implement Medicare, Medicaid, and Social Security policy; two were Department of Housing and Urban Development rules linked to Federal mortgage protections; one was a DOL rule tied to Federal service contracts; and one was a joint HHS-Treasury-DOL rule setting standards for health insurance portability group health plans.

[1] For a copy of this report, see the web site http://www.whitehouse.gov/WH/EOP/OMB/html/rcongress.htm.

In the most basic case, transfers do not directly impose social costs or create social benefits, and do not reflect the "opportunity cost" of resources used or benefits foregone. Thus, OMB did not include transfers in Table 32–1 estimates of costs and benefits. Nevertheless, transfers can have important effects on the distribution of income. They may cause indirect social costs because they must be financed—for example, by income and payroll taxes—in ways that affect the use of real income. Similarly, transfers may generate social benefits if beneficiaries realize marginal benefits from the payments that are greater than the losses for taxpayers who finance them.

Further Action: The Government needs better data and analysis to determine whether proposed regulations maximize social benefits while minimizing cost. But agencies have legitimate reasons for their often incomplete estimates. In some cases, they face significant technical problems in assessing costs and benefits. In others, legal or judicial deadlines force the agencies to act within time frames that do not allow for adequate analysis. In still others, agencies may need to allocate their limited financial and human resources to higher priorities. Finally, in cases of emergencies, the public expects its elected leaders to respond without the delay that careful analysis would entail.

OMB is committed to improving the indicators to assess its performance in meeting the goal of ensuring that it is faithfully executing and managing regulatory policy. It will lead an inter-agency effort to raise the quality of analyses that agencies use in developing regulations, such as by offering technical outreach programs and training sessions on using OMB's "Best Practices" on economic analysis.

OMB also will:

- subject a select set of agency regulatory analyses to peer review in order to identify—based on actual experience—the methodological approaches that need improvement and to stimulate the development of better estimation techniques;

- continue to develop a database on benefits and costs of major rules, using consistent assumptions and better estimation techniques to refine agency estimates of incremental costs and benefits; and
- work on developing appropriate methodologies to evaluate whether to reform or eliminate existing regulatory programs or their elements.

Regulation and regulatory reform can do much good for society, depending on whether the Government has the needed information and analysis for wise decision-making. The steps outlined above are designed to continue the Government's efforts to improve its ability to make better regulatory decisions.