PROMISE AND PERIL

IMPLEMENTING A REGULATORY BUDGET

by Clyde Wayne Crews Jr.

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EXECUTIVE SUMMARY

The size of the federal budget tells only one part of the tale of government's presence in the market economy. The enormous amounts of *non-tax* dollars government requires to be spent on regulation — estimated at $647 billion per year — powerfully argue for some sort of regulatory scorekeeping. Regulatory costs are equivalent to over one-third of the level of government spending. A regulatory budget can be an effective tool both for spurring reform and monitoring regulatory activity.

At bottom, today's rulemaking process is plagued by the fact that agency bureaucrats are not accountable to voters. And Congress — though responsible for the underlying statutes that usually propel those unanswerable agencies — nevertheless can conveniently blame agencies for regulatory excesses. Indeed, Americans live under a regime of "Regulation Without Representation."

A regulatory budget could promote greater accountability by limiting the regulatory costs agencies could impose on the private sector. Congress could either specify a limit on compliance costs for each newly enacted law or reauthorization of existing law, or Congress could enact a more ambitious full-scale budget paralleling the fiscal budget, a riskier approach. A comprehensive budget would require Congress to divide a total budget among agencies. Agencies' responsibility would be to rank hazards serially, from most to least severe, and address them within their budget constraint. In either version of a regulatory budget, any agency desiring to exceed its budget would need to seek congressional approval.

Regulatory costs imposed on the private sector by federal agencies can never be precisely measured, and a budget cannot achieve absolute precision. Nonetheless, a regulatory budget is a valuable tool. The real innovation of regulatory budgeting is its potential to impose the consequences of regulatory decisionmaking on agencies rather than on the regulated parties alone. Agencies that today rarely admit a rule provides negligible benefit would be forced to compete for the "right" to regulate. While agencies would be free to regulate as unwisely as they do now,

the consequences could be transfer of the squandered budgetary allocation to a rival agency that saves more lives.

Budgeting could fundamentally change incentives. Under a budget, adopting a costly, but marginally beneficial, regulation will suddenly be irrational. Congress would weigh an agency's claimed benefits against alternative means of protecting public health and safety, giving agencies incentives to compete and expose one another's "bogus" benefits. Budgeting could encourage greater recognition of the fact that some risks are far more remote than those we undertake daily. In the long run, a regulatory budget would force agencies to compete with one another on the most important "bottom line" of all: that their least-effective rules save more lives per dollar spent (or correct some alleged market imperfection better) than those of other agencies.

There are clear benefits to regulatory budgeting, but there are also pitfalls. For instance, under a budget, agencies have incentives to underestimate compliance costs while regulated parties have the opposite incentive. Self-correcting techniques that may force opposing cost calculations to converge are only at the thought-experiment stage. However, limitations on the delegation of regulatory power and enhancing congressional accountability can help.

Certain principles and antecedents can help ensure that a regulatory budgeting effort succeeds. Explicitly recognizing that an agency's basic impulse is to overstate the benefits of its activities, a budget would relieve agencies of benefit calculation responsibilities altogether. Agencies would concentrate on properly assessing only the costs of their initiatives. Since an agency must try to maximize benefits within its budget constraint or risk losing its budget allocation, it would be rational for agencies to monitor benefits, but Congress need not require it.

Other ways to promote the success of a budget are to: establish an incremental rather than total budget; collect and summarize annual "report card" data on the numbers of regulations in each agency; establish a regulatory cost freeze; implement a "Regulatory Reduction Commission;" employ separate budgets for economic and environmental/social regulation; and control indirect costs by limiting the regulatory methods that most often generate them.

A regulatory budget is not a magic device alone capable of reducing the current $647 billion regulatory burden. Yet a cautious one deserves consideration. Having good information is an aid in grappling with the regulatory state just as compiling the federal fiscal budget is indispensable to any effort to plan and control government spending.

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THE ROLE OF REGULATORY BUDGETING

Since the 1970s, efforts to supervise the behavior of regulatory agencies and control the federal regulatory burden have produced mixed, typically uninspiring results. Aside from the appropriations process itself, the primary regulatory control has been centralized executive branch review of agency regulations, a process first carried out to a limited extent by the Council on Wage and Price Stability and the Regulatory Analysis Review Group in the 1970s.[1] These bodies selected for review a mere handful of regulations out of the total produced each year. Centralized review was expanded and continued during the 1980s and early 1990s and administered primarily by the Office of Management and Budget. The downward trend in regulatory activity of the early 1980s reversed around 1986, reflecting the limits of centralized review. Review has never wielded the force of law; it has simply meant that an agency's initiatives may be subject to audit. Thus, review might be expected to aid a slightly more rational regulatory process under a reform-minded administration, but not otherwise.

Theoretically, by providing a single gatekeeper to which those subjected to regulation might appeal during the rulemaking stage, centralized review could be expected to aid consumers by increasing marginal returns to less powerful interest groups participating in the regulatory process.[2] In other words, where regulatory decisionmaking is scattered among many federal agencies, tightly organized interest groups have an advantage over the dispersed, non-organized "rationally ignorant" general public, a condition potentially leading to "capture" of the regulatory agency by the regulated party. Costs to the unorganized of influencing outcomes are high. But a central clearinghouse for regulations could reduce the cost of "lobbying" and strengthen the relative influence of less-well-organized parties. For consumers, the potential gains for lobbying increase, while expected gains for entrenched groups may remain the same or even decrease. Centralized review can thereby help balance the power of competing interest groups.

There have been other narrower reform efforts. A 90-day moratorium on and review of regulations was announced by President Bush during his 1992 State of the Union Address and then articulated directly to agency heads. Exempted were regulations "subject to a statutory or judicial deadline" and those "that respond to emergencies such as situations that pose an imminent danger to human health or safety."[3] But the freeze had little lasting effect even though it was extended through the remainder of Bush's term. Other more sweeping reforms attempted have featured statutory, not merely administrative, requirements for review of federal paperwork burdens (primarily paperwork associated with income tax filing), and for limitations on unfunded mandates. Passed during the last year, the jury is still out on the success of these reforms, particularly the mandate bill, which failed to address the existing mandates that created the regulatory backlash responsible for the bill's passage in the first place.

The failure of these various procedural reforms to slow regulatory growth over the past decade is partly explained by the fact that such reforms do not change the fundamental regulatory structures and incentives. The key reason for the regulatory state's growth is that government exercises too much power over the public in the first place. Another reason is that voters do not elect the bureaucrats who impose regulations. Congress has adopted a convenient system of delegation of power that allows it to beam proudly when regulations do good things, but to scapegoat agencies and avoid blame when rules do bad things — a situation well documented by New York Law School professor David Schoenbrod.[4] The best and most direct brake on excessive regulation would be a prohibition, or at the very least a dramatic scaling back, of the delegation of power to agencies, thus ending "Regulation Without Representation."

Though no silver bullet, establishing a regulatory budget can improve upon earlier procedural reforms and also enhance congressional accountability. Even a republic enjoying minimalist government and zero delegation would benefit from knowing the impacts of the mandates it imposes on its citizens. In the simplest form, Congress could set a regulatory cost cap for each mandate contained in new and reauthorized law, and if an agency desired to exceed that limit it would need further regulatory authorization and appropriation from Congress. A stronger form of regulatory budget would limit the total regulatory costs individual agencies could impose on the economy, with agency tallies adding up to a total regulatory budget paralleling the fiscal budget.

Regulatory budgeting is not a new idea. Robert Crandall of the Brookings Institution first mentioned the use of "shadow budgets" for expenditures required of the private sector in 1978.[5] In the 95th Congress, and again in the 96th, a regulatory budget was proposed by Senator Lloyd Bentsen (D-TX), who recently served as Secretary of the Treasury in the Clinton Administration.[6] Bentsen told the Senate chamber on March 5, 1979:

> A regulatory budget would put an annual cap on the compliance costs each agency could impose on the private sector through its rules and regulations. The process for establishing the annual regulatory budget would resemble the process currently used to set the fiscal budget — we would have a proposed budget from the President and annual budget resolutions from the budget committees. This would make it possible to coordinate the regulatory and fiscal budgets. We need a regulatory budget in order to reduce the impact of unnecessary, excessive and conflicting Government regulations.[7]

Full-fledged budgeting should establish an overall cap paralleling the fiscal budget, and would assign maximum compliance costs within each agency such that the overall cap is not exceeded. This process could be thought of as mirroring the fiscal budgeting process, with its requirements for authorization and specific appropriation for various spending programs. More modest versions should be attempted first because of a number of potential risks of implementing a regulatory budget. As America's runaway deficit proves, formal budgeting is no guarantee of fiscal sanity. But to the extent that it is reasonably possible, Congress should ensure that there's no such thing as an off-budget, government-mandated expense.

Agencies inevitably believe that all of their regulations confer net benefits. To remedy this, agencies subject to a budget would not be allowed to offset regulatory costs with benefits, since no regulation would fail to qualify under agencies' internal criteria. Instead, for a sound regulatory budget, Congress would specify the total budget and divide it appropriately among agencies based on potential effectiveness, such as estimated lives saved. Budgeting would create an agency responsibility to rank hazards from most to least severe, before applying regulations.

A regulatory budget is only one tool. It is not a magical device capable of sufficiently reducing the regulatory burden. More important than budgeting or any other administrative reform is limiting government's regulatory power. As economist William Niskanen put it, "More promising than any identifiable change in the regulatory process would be a revival of the constitutional doctrines limiting restraints on interstate commerce, restrictions on private contracts, the uncompensated taking of property rights, and the undue delegation of policy decisions to regulatory agencies."[8]

REGULATION IN SOCIETY: TWO VIEWS

Setting aside for a moment the question of whether political markets can or do serve the public interest better than the private sector does, there are only two public interest justifications for regulation: (1) to approximate competition where markets are allegedly inadequate; and (2) to protect public health and safety. One justification is purely economic, the other social. Health and safety concerns usually dominate today's debate over regulatory process reform, thus most regulatory reform efforts stress risk assessment and cost-benefit analysis. Economic deregulation typically involves introducing competition in one industry or sector at a time, such as trucking and banking, and more recently, telecommunications and electricity — thus the reforms are not of general applicability.

Considerable research in the public choice and Chicago traditions of economics has shown that regulation typically benefits not the public, but the very business entities subject to regulation. This insight points to another reason for imposing regulations, a reason that stems from less-noble *private* interest motivations: to protect firms from competition by raising competitors' costs or excluding them from the marketplace altogether.[9] Like taxes, regulations involve the transfer of wealth from one party to another, and these transfers can be cloaked in public interest rhetoric. Such "regulatory pork" harms rather than helps the public for the sake of the regulation's beneficiary.[10] Uncertainty about the extent of regulation is an important reason to consider a budget. But the fact that poorly controlled regulation often does more harm than good and can even derive from ill motives makes harnessing the regulatory state all the more urgent.

INADEQUATE REGULATORY CONTROL

Rising Costs

A widely cited 1992 study by Thomas Hopkins pegged the cost of regulation at $400 billion in 1988 dollars "over and above those costs of government that show up in the budget."[11] More recently, a General Accounting Office regulatory report updated the Hopkins figures for inflation, and put 1994 regulatory costs at $647 billion (in 1995 dollars).[12] That figure can be compared to on-budget spending. The federal government's fiscal year 1994 spending (outlays) was $1.461 trillion, just over twice the level of the GAO-estimated regulatory burden (see chart). While policymakers wouldn't dream of doing away with the fiscal budget that tracks government spending, the lack of accountability for regulatory costs, on the other hand, has caused little concern except as those costs apply to lower-level governments.[13] Added to federal spending, regulation brings the federal government's presence in the economy to $2.1 trillion, nearly one-third of GNP.

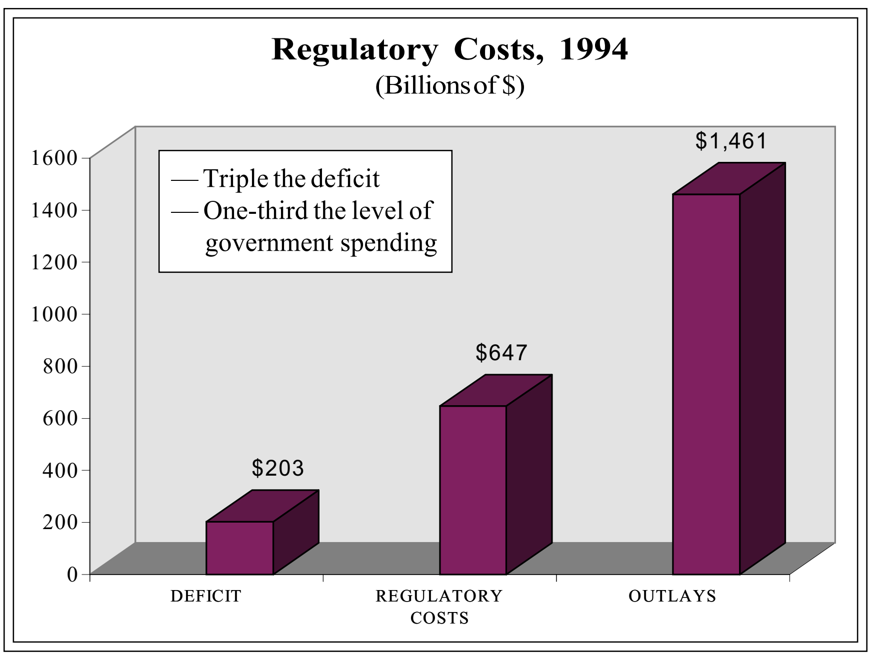
The 1994 deficit of $203.2 billion — a prominent concern of policymakers who desire to see it eliminated by 2002 at the latest — amounts to less than one-third of the cost of regulation, as the chart also shows. Regulation's $647 billion annual cost comfortably outstrips the GNP of Canada ($563 billion) and the combined economic outputs of Australia and Mexico ($288 billion and $276 billion, respectively). Because they are derived from pre-1990 programs, the Hopkins/GAO figures actually understate regulatory costs. Left out are big-ticket regulations enacted since that time, such as the Clean Air Act Amendments of 1990, the Americans with Disabilities Act, the Family and Medical Leave Act, a 27 percent hike in the minimum wage, and the Nutrition and Food Labeling Amendments.

Regulatory Burden's Impact on Consumers

Although regulatory costs are imposed directly on firms (and governments), firms pass much of these costs to customers, who may see increases in grocery, utility, health, housing, and local tax bills. The average two-earner family of four's 1994 after-tax income is approximately $34,541 according to the Tax Foundation.[14] For perspective, the $647 billion in federal regulations imposed on the economy amounts to about $6,457 per family of four, or 18 percent of the family's after-tax budget. If regulation is added to the amounts families pay in federal, state, and local taxes, more than half of the family's paycheck is absorbed by governments at various levels. In fact, assuming families pay all costs of government before keeping a dollar for themselves, the average family in 1995 did not begin working for itself until July 9th.[15]

Lack of Coherence and Perverse Outcomes

The central facts about regulation are its haphazard, unmanaged character and the split between rulemaking and responsibility that leaves no one available to hold accountable for poor policy. The aggressive Office of Management and Budget regulatory review function maintained by Presidents Reagan and Bush has been scaled back by President Clinton. During that effort's final year (between 1990 an 1991) the number of major rules reviewed jumped 73 percent, from 82 to 142.[16] (Major



rules are those that cost at least $100 million annually.) It would be useful to know what has happened to reviews of major rules more recently, but that information has not been published since 1991. The Reagan/Bush cost-benefit review effort, which had been based primarily upon Executive Order (E.O.) 12291, was replaced by a Clinton executive order that "reaffirm[s] the primacy of Federal agencies in the regulatory decisionmaking process."[17]

The fiscal year 1993 federal budget solicited cost-benefit data from agencies for the first time with the aim of assembling a rudimentary regulatory budget database, but this effort also withered with the changing of administrations. This is unfortunate, since that initial survey data revealed that few agencies perform cost analyses, let alone benefit analyses.[18] In practice, therefore, "reaffirming primacy" of agencies means agencies are to be relieved of accountability for regulatory excess. Ranking and making rational choices does require an outside auditor or a budget that rewards agencies based on quality of decisions. Without oversight, rational priorities can't be set even *within* agencies, among competing agencies.

In other words, we regulate in the dark. The cost-benefit assessments necessary to demonstrate the need for regulation rarely exist at all. In an analysis by Federal Focus, Inc. of 222 substantive rulemakings between April and September 1994, only six determined that benefits justified the costs, and only 14 evaluated potentially cheaper alternatives for achieving the regulatory goal. Of those 14, only eight adopted the most cost-effective approach.[19] Rules are implemented regularly without concern for calculating costs, let alone far more nebulous benefits which are correspondingly more difficult to quantify.

Even under Reagan's E.O. 12291, only about six percent of agency rules reviewed at OMB were "required" to feature cost-benefit assessments, according to data from the final edition of the *Regulatory Program of the U.S. Government*.[20] (The *Program* was published annually between 1981 and 1992.) Cost assessments were required to accompany major rules, but not the minor rules that accounted for the other 94 percent of rules. The final *Regulatory Program* revealed that a total of 2,523 rules were reviewed. Of these, 142, or only six percent, were categorized as major and thus required by Executive Order to carry cost assessments. Moreover, major and minor rules presented in the *Program* were merely a subset of the total number of rules in play at federal agencies: the October 1991 Unified Agenda listed 4,863 rulemakings under consideration or recently completed.

High numbers of regulations can take a toll on economic performance. A. B. Laffer, V. A. Canto & Associates projected a negative correlation between the number of population-weighted *Federal Register* pages and the Standard & Poors 500 index (weighted by GNP).[21] In other words, the higher the level of regulatory activity — proxied by pages in the *Federal Register* — the worse the economy's performance. There are of course methodological problems in using *Federal*

Register pages because its required daily content has changed over time, but the correlation does deserve further examination, as would tests for correlations of economic performance and other proxies for regulation. The Center for the Study of American Business has shown a similar negative correlation between regulation as proxied by the *Federal Register*, and job creation.[22]

According to Thomas Hopkins, environmental regulation cost about $116 billion annually in 1992 (1988 dollars). Environmental regulation represented 23 percent of total regulatory costs in 1988, up from only 9 percent of the total in 1977.[23] But despite swelling environmental costs, EPA has recognized that environmental policy often does not address the most serious hazards.[24]

Yet the problem is more fundamental than one of simply regulating the wrong hazards. Some regulations threaten to cost more lives than they save by creating perverse behavioral incentives. An example is the recent Federal Aviation Administration finding that by requiring children to wear seatbelts on airliners, a strong possibility existed that parents would forego the required purchase of an extra ticket and simply take to the highways instead. Since highways pose a greater risk than air travel, the regulation could potentially cause more deaths than it prevents. Corporate Average Fuel Economy standards are another example of ill-conceived regulation in which individuals pay for the arrogance and control mentalities of bureaucrats. These standards require automobile manufacturers to increase gas mileage in automobiles. But the result has been smaller, lighter cars that lead to up to about 2,000 additional highway deaths each year.[25]

Other regulations may cost more lives than they save, not by generating unintended behaviors and perverse outcomes, but by reducing incomes. To the extent regulation reduces productivity and costs jobs in the aggregate economy, it also reduces incomes and the ability to afford a healthier, more secure life-style. To the extent they are made poorer, consumers may forego preventive health care, healthier food, bigger cars, air bags, safety apparatus like smoke detectors and fire extinguishers, and adequate insurance coverages. One study finds that every $7.5 million in regulatory costs may result in an additional statistical death.[26]

PROPOSED VERSIONS OF A REGULATORY BUDGET

Controlling the regulatory state by means of a regulatory budget is not a new idea: several versions have been offered at least since Lloyd Bentsen's 1979 proposal. Yet different things are meant by the term regulatory budget. During the 103rd Congress, Senator Orrin Hatch (R-UT) proposed S. 13, a simple three-year regulatory "cost cap" version of a regulatory budget.[27] Hatch's budget was basically a freeze: it would have capped regulatory costs at the level prevailing at the time of adoption by requiring any new regulation to be offset by repeal or modification of an existing one. An agency would be free to issue any new regulation, but it would have to offset the cost by eliminating one or more existing regulations of roughly equal cost, or by negotiating with another agency to eliminate a regulation on its behalf. This relatively simple, low-risk procedure would be a sensible way to establish the rudiments of a regulatory budget before adopting a more complicated procedure.

The Contract with America supported and signed by House Republican candidates prior to the 1994 elections featured a regulatory budget among the reform provisions contained under the "Job Creation and Wage Enhancement Act." They would have required agencies to issue an annual report illustrating the cost of regulations to the private sector. Regulatory costs would have been capped below the current level to induce agencies to design more cost-effective regulation and ensure that benefits exceed costs.[28] Yet, as the bill made its way through the House, the regulatory budget provisions ultimately were not included

Representative Lamar Smith (R-TX) has been a serious proponent or regulatory budgeting. He introduced his first regulatory budget bill (H.R. 3005) in the 103rd Congress. His bill explicitly noted that regulation in general cost $580 billion in 1993, or over 9 percent of GDP. Smith sought to halve that level over seven years.

Smith's regulatory budget bill would have required a 6.5 percent annual reduction in regulatory costs for each of seven years (roughly a $38 billion annual reduction) to bring costs down to five percent of GDP. The bill would have instructed the House and Senate Budget Committees to allocate regulatory costs allowances to the relevant authorizing committees, who in turn would allocate costs among agencies. The bill would have strengthened points of order against committees exceeding their budget allocation, and would have allowed any member to offer legislation under an expedited procedure to freeze regulation within an offending committee's jurisdiction. Separately, the bill required proportional reductions in agency overhead totalling $2.2 billion over seven years, and required cost-benefit analysis of any new initiative costing $10 million annually. (The threshold triggering cost-benefit analysis since Reagan's Executive Order 12291 had been $100 million.) Smith's bill was never voted on during the 103rd Congress.

A regulatory budget proposal introduced by Rep. Smith in the 104th Congress, called the "Regulatory Accountability Act, is a scaled down bill that would be easier to implement and test, presenting fewer risks. The new bill would build upon S. 1, the 104th Congress' Unfunded Mandate Reform Act of 1995, a bill whose popularity with legislators was apparent given the bill number. However, the unfunded mandates bill is actually quite weak: It provides for only a simple majority — not supermajority — point of order to any mandate contained in a bill or amendment that imposes unfunded costs of $50 million or more annually on state, local, or tribal governments. The Congressional Budget Office (CBO) is charged with making the cost assessment. The lack of a supermajority point of order notwithstanding, the starting point for Smith's regulatory budgeting bill is the fact that the mandate bill also requires a separate congressional vote on legislation that imposes costs of $200 million or more on the *private* sector. Smith's bill would simply lower the threshold at which the requirement to conduct a cost analysis kicks in from $200 million to $100 million, for all new and reauthorized mandates (any given statute can contain a number of mandates). Once Congress explicitly approved a level of regulatory costs, that would serve as an upper bound on the costs that agencies could later impose when implementing the mandates. OMB would be responsible for ensuring that the costs of an agency's rules fall within the congressional caps. Should OMB determine that an agency bumped up against its ceiling before full implementation, the agency would need to secure explicit regulatory authority from Congress before imposing additional regulatory costs.

Smith's bill does not create an overall regulatory cap: it works incrementally and establishes a budget for each new law and for each piece of reauthorized regulation. The advantage of the approach is its building on existing legislation and the fact that it avoids most of the potential problems and dangers that a regulatory budget could create if enacted carelessly (see below). Smith also avoids setting up a complicated parallel budgeting process and bureaucracy at the Office of Management and Budget, although more manpower would likely be needed.

Rep. Thomas J. Bliley, Jr. (R-VA) introduced H.R. 1636, the Regulatory Accounting Act of 1995 on May 15, 1995. This type of introductory reform effort was one that even reform opponents would likely be able to credit. This budget's role would be informational only. It would not set or enforce a maximum budget. It would merely require the President, after a notice and comment period, to report to Congress on the total costs and benefits of agency regulations for the current and upcoming five fiscal years. This accounting statement would include "the annual expenditure of national economic resources for the regulatory program," and "other quantitative and qualitative measures of costs as the President considers appropriate." Where actual cost figures are not available, costs would be explained qualitatively. The President would also submit a companion statement describing the general affects of regulation on job growth, competitiveness and other measures of economic health. The downside of Bliley's bill is that it would not forbid agencies from offsetting their calculated costs with benefits. This bill did not move in the first session of the 104th Congress.

POTENTIAL BENEFITS OF A REGULATORY BUDGET

Full Accounting of Government's Presence in the Economy

The threat posed by unaccountable regulation is that many government initiatives that would otherwise exist as observable fiscal budgetary items may be shoved off-budget as regulation. For example, tax dollars can be used to pay for a public waste water treatment — or alternatively, firms can be required by regulation to treat their waste before dumping. Spending is an observable outlay, capable of being added up across the economy, but regulatory costs are not as easy to track. As fiscal budget deficits mount and as pressure increases to balance the federal budget, the necessity to choose between direct spending and regulation to achieve governmental ends will create a tendency toward regulation.[29] A regulatory budget, however, would lessen the potential for transferring expenses off-budget. Since regulation and direct taxes both are means of achieving governmental ends, and since both have effects on employment, output and prices in the aggregate, the goal should be to tolerate no such thing as an off-budget expense whether fiscal or regulatory.

Better Ranking of Risks and Forced Recognition of Opportunity Costs

Agencies lack a budget constraint when issuing regulations, and thus lack the resulting forced recognition of opportunity costs. "Opportunity cost" is economic jargon for the most highly valued alternative given up when one makes a choice. Cost, properly construed, as economist James Buchanan put it, "is that which the decision-taker sacrifices or gives up when he makes a choice."[30] Proper agency decisionmaking requires a linkage between choosing and bearing the consequences of choice. Unlike private entities, agencies' future actions are not limited upon making any particular choice: there is no trade-off. Each agency can regulate with no concern for the cost of its regulations, and with no worry that regulating one aspect of the economy or public health will impact its ability to regulate another. Agencies regulate heedless of what other agencies are doing as well, and thus make no interagency trade-offs.

But a regulatory budget imposed on agencies would change behavior. If limited by a budget constraint in the total regulatory costs that it may impose, suddenly an agency would need to rank risks serially and target the most pressing ones first. Regulating one hazard could mean not regulating a different one. Therefore, outside a statutory requirement that an agency regulate a lower-ranking risk, there would be fewer such irrational cases as the Environmental Protection Agency's overregulating asbestos even though it ranked low on a scale of peril.[31] Without a budget, only regulated entities face costs: with a budget, however, an agency's own choice will constrain it in the future, which may help induce it to make wiser choices.

An agency cannot itself account for "societal" opportunity costs. Agencies typically operate under conditions such that only the risks under their particular jurisdiction are relevant to their decisionmaking process. There is no effort to rank risks relative to those overseen by other agencies. This is why Congress must set each agency's budget. The Food and Drug Administration for example, could analyze the relative merits of regulations under its jurisdiction under a budget, but it could not evaluate its own rules in relation to, for example, EPA's. This tunnel vision is one of the primary pitfalls of cost-benefit analysis and risk assessment as regulatory control tools, despite their popularity among reformers today. Cost-benefit analysis in the private sector is primarily an internal evaluation device rather than one that makes sense in the context of agency decisionmaking. There is no single end of the political process: rather, there are conflicting goals among agencies.[32] The private sector asks, "what is the impact on our bottom line if we do X?" But such constraints are alien to agencies. Even assuming agencies would not overstate benefits, cost-benefit analysis has nothing to say about superior benefits that may have accrued if an agency's budgetary allocation had belonged instead to another agency. But Congress, in a budgetary oversight capacity, can at least attempt to incorporate societal opportunity costs.

By overseeing the regulatory structure with a budget, Congress could evaluate aggregate risks broadly construed by asking, "What are people dying of or harmed by that is *genuinely* within the various federal agencies' jurisdictions?" Congress could then use that knowledge to distribute appropriately limited budgets among agencies. At that point, each agency may pursue its own ends with as much tunnel vision as it likes, but it can expect to be "audited." If a regulatory budget is capped at a given amount and allocated among agencies roughly in proportion to potential lives saved, any agency that overspends could be viewed by competing agencies as extracting an allowance from them, an allowance they could have used to save more lives. Under an (obviously unachievable) "ideal" regulatory budget, any reshuffling of agency budget allocations could not save more lives.

Under a constrained regulatory budget, the decision about whether to adopt a new regulation that may offer a minuscule improvement in lives saved will be directly weighed against the much greater and more cheaply achieved benefits of, for example, painting lines down the centers of country roads. There will be greater recognition of the fact that some risks are undertaken willingly. Some may conclude that government ought not to worry so much about regulating risks that are far more remote than those undertaken daily. For instance, many individuals fail to buy even inexpensive smoke detectors, continue to purchase cars without airbags, use knives, live in disaster-prone areas, ski, hang-glide, and so on, despite the measurable risks of these activities.

Though it must oversee a regulatory budget, Congress itself has an unfortunate history of short circuiting rational regulation. While it is a legislative decision what, for example, the Occupational Safety and Health Administration should spend relative to other agencies, OHSA's congressional mandate to protect worker safety at all costs is an example of Congress itself preventing the conditions that would allow a regulatory budget to work rationally. The Clean Air Act's Maximum Attainable Control Standards, which require expensive technology-intensive remedies for air contaminants that in many cases could have been addressed by less expensive means, are another. A budget would make the consequences of such trade-offs explicit, however, inducing Congress to do a better job placing the priorities of OSHA, EPA and other agencies in context. Congress — not anonymous bureaucrats — would be responsible to voters for the costs of regulations under a budget.

Competition for the "Right" to Regulate

A regulatory budget would formally acknowledge the inherent conflict between agency political rewards and admission that a rule has no benefits. A budget would relieve agencies of benefit calculation responsibilities altogether, requiring them to concentrate exclusively on properly assessing costs of their rules. Congress would have set an overall budget level within which an agency must attempt to maximize benefits lest its budget allocation be revoked or transferred elsewhere, so it would obviously be to agencies' advantage to monitor benefits. But Congress would not need to explicitly require it. Outside parties — such as regulated entities and scholars — would have incentives to perform cost calculations as well to compare with agency assessments.

Such a regime could simplify enforcement compared to the current situation. Beyond eliminating a politically insurmountable conflict of interest, relieving agencies of benefit calculating responsibilities would cut agency workloads by up to half that required of them under the Republican alternative of a hyper-stringent benefit-cost regime. Bureaucratic resources would be freed for focusing on keeping costs within budget and selecting only the most urgent regulatory targets.

The task of dividing compliance cost allocations among the various agencies and departments could become a competitive, even "cutthroat" endeavor. Congress would presumably base compliance cost allowances upon the potential benefits that could reasonably fall within a given agency's jurisdiction. Since agencies have differing impacts on human health (and on the economy), individual agency budgets will be unequal. Among third-party monitors of the federal bureaucracy, a statistic that might be expected to emerge under a regulatory budget could be the "cost of the last life saved" at a given agency. The calculation of such figures by outsiders for the purpose of cross-agency comparisons would likely become fixtures of public health and public policy literature. The crucial contribution of such data is that a competitive environment would be fueled in which regulatory benefits are actively calculated and monitored by *non*-agency personnel rather than primarily the agency as is the case today. Agencies would feel pressure to save lives at low cost or lose their budget allocations to other agencies that can do better with the same resources. Agencies, in other words, would compete against one another for the "right" to regulate.

Because budgeting would force health and safety agencies to compete with one another, each agency would want its least effective mandates to save more lives per dollar (or correct some alleged market imperfection better) than the rules of every other agency. The (unattainable) "perfect" regulatory budget would be distributed among health and safety agencies such that further reshuffling of regulatory cost caps among them could save no more lives and would actually do harm.

Limited Self-Enforcement of a Regulatory Budget

The incentives of agencies to underestimate compliance costs and of regulated parties to overstate them would persist under a budget. An initial CBO assessment of a law's regulatory burden, along with later public comment and OMB review of the resulting agency proposed regulations, could help force more reasonable values to gurgle to the surface. Aggressive comment from the academic community could also be vital. Interest group politics would remain a disruptive factor, but Congress would be unable to blame agencies for imposing too high a regulatory burden. Nonetheless, a regulatory budget will always deal only in approximations.

That said, self-correcting mechanisms potentially could be devised that might tend to force cost estimates of agencies and regulated parties to converge. An example proposed by economist Lawrence White is that of having agencies set non-compliance fees to be paid by those unable to obey a particular regulation, such as an emission standard.[33] If a non-compliance fee is set too high, an agency unnecessarily depletes part of its budget allowance and cannot address other potentially more serious hazards; too low a fee, and firms pay to "opt out." If firms opt out, the regulatory goal is never met and the budget will in all likelihood get transferred to another agency. Better estimates of the cost of regulatory goals could emerge from such interactions as agencies are forced to direct their budgets toward real hazards or lose their budget share to another agency. In an iterative process, such an approach would reveal techniques useful in developing future budgets and streamlining the overall process. An important caveat: this approach is presented here for thought experiment purposes only. Currently, many regulations are simply not enforced — nor should they be. White's proposal, under today's system of ubiquitous regulation, would bankrupt thousands of firms forced to pay non-compliance fees for those regulations for which they now escape liability. At the very least, the technique would have to be applied only prospectively.

POTENTIAL PITFALLS OF A REGULATORY BUDGET

Increasing the Legitimacy of Regulation

The most fundamental risk of a regulatory budget was suggested by Christopher DeMuth. While not regarding the risk as insurmountable, DeMuth noted that a regulatory budget could potentially bring more of the economy's private expenditures under purview of government by incorporating them into the workings of a *public* budget.[34] There is a risk — even if merely one of perception — of effectively conceding the legitimacy of government oversight of a vast new chunk of the economy, similar to the manner by which government reigns, with little protest, over 20 percent of the economy through its taxing, borrowing, and spending power. The risk is that the condition of *not* being subject to regulation could be seen as a type of government favor. There is a direct analogy to taxation today: Government implicitly regards all private income as belonging to it. Amounts that individuals and businesses are allowed to deduct from taxable income are referred to *officially* as "tax expenditures." They are explicitly regarded as losses to the federal Treasury and formally reported as such, as if the primary owner of the money is government rather than the earner.

A regulatory budget must expose and help *control* government's meddling in the economy, not *facilitate* it. The risk that exemption from regulation could somehow come to be perceived in some future policy debate as a government favor may be enough to warrant opposing a formalized regulatory budget. A budget should be designed such that cost estimates represent mere information; it should not be construed to present a moral case for furthering government shackles on the economy. Too much power is delegated to the agencies and to Congress already, and regulation has supplanted too many common law protections against civil and criminal wrongs.

A regulatory budget is not without risks, and a poorly executed one could be worse than no budget at all. A budget should merely make government's regulatory presence explicit. It ought to be regarded as a marginal control tool, most useful in a limited-government regime that relies less on administrative regulations than on congressional accountability and constitutional protections. Perhaps the way to regard the informational role of a budget is to recognize that, even if government collected only a negligible percentage of Americans' incomes in taxes, we would still want to keep track of those taxes. Scorecards for regulations are similarly important.

Embracing Utilitarianism

Despite critics' claims that cost-benefit analysis is immoral because it supposedly trades lives for dollars, cost-benefit analysis in the public sphere is in fact "a necessity logically compelled by the decisionmaking process."[35] Intentionally or not, Congress applies cost-benefit analysis merely by the act of deciding which industries to regulate.

In that sense, cost-benefit analysis is inescapable in regulatory matters. But cost-benefit analysis has deeper problems rarely acknowledged in the policy debate. Although advocated almost universally by regulatory reformers, cost-benefit analysis suffers from the fact that costs are subjective, and therefore are not directly measurable by "benevolent" third party public servants. Costs are more than mere dollars: they involve time lost and roads not taken, and other variables discernable only to the individual experiencing them. But more fundamentally, balancing *societal* costs with *societal* benefits is a utilitarian endeavor rather than one that recognizes individual rights. More accurately, the societal trade-off approach rejects individual rights even though its advocates do not intend such. Trading off social costs with social benefits entails a rejection of the property rights of those among whom such exchanges are made if compensation is not forthcoming.

Trading off aggregate costs and benefits merely seeks the greatest good for the greatest number without regard to individual harms. Likewise, a regulatory budget, if erroneously regarded as the pinnacle of regulatory reform, still embraces utilitarianism. But unlike standard cost-benefit analysis, a regulatory budget would place an upper bound on the possible amount of such utilitarian transfers. The risk of utilitarian trade-offs further highlights the fact that the real solution to regulatory overreach is to limit government power rather that to attempt the folly of balancing either individual or societal utilities.

A policy of maximizing benefits, even within a budget constraint, is heedless of fairness to those expected to pay the costs. But to the extent that utilitarian policy prevails, a regulatory budget would probably mitigate wealth transfers compared to cost-benefit analysis. A regulatory budget, by imposing only cost calculation duties on agencies, relieves them of the need to conduct benefit assessments and leaves such questions up to Congress. If treated properly as only an information gathering and reporting device recording the activities of an already limited government, a regulatory budget does not overstep its bounds and can improve upon the open-ended utilitarianism of cost-benefit analysis by making Congress fully answerable for utilitarian excess.

How Can Costs be Measured?

The difficulty of measuring costs is a criticism of regulatory budgeting that frequently arises, although the conventional cost-benefit analysis that reformers generally favor is plagued with the same problem to an even greater extent. Upon endorsing a regulatory budget, the Office of Management and Budget under President Bush noted the following potential cost-measurement difficulties:[36]

> (1) A regulatory budget can create confusion about conflicting cost estimates because agencies would have powerful incentives to understate costs to avoid depleting an imposed budget. Regulated parties have incentives to overstate for the opposite reason. (The deeper problem is the fundamental subjectivity of costs.);
>
> (2) A budget cannot isolate which expenditures actually result from regulation and which would have been made anyway, and;

> (3) A budget must cope with the critical challenge presented by indirect costs. OMB argued that incorporating only direct costs in a regulatory budget would create a bias toward banning (rather than regulating or controlling) products, to avoid having costs show up in the budget.

OMB believed these difficulties could be overcome, however, and argued that cost estimates need only be "unbiased and defensible" to be of value.[37]

The pitfalls of cost measurement are substantial, and all stem from the slipperiness of measuring costs and the fact that there are no "objectively identifiable magnitudes" available to the third-party regulator: "Cost cannot be measured by someone other than the decision-maker because there is no way that subjective experience can be directly observed."[38] Moreover, costs will change over time: for example, new technology will sometimes lower compliance costs. Determining which costs are due to regulation and which would have been incurred anyway is likewise tricky. Julius Allen of the Congressional Research Service argues that "most firms incur substantial expenditures independent of federal regulations."[39] On the other hand, John Morrall of the Office of Management and Budget does not regard this as a significant problem — especially if an incremental budget is used — noting that "the amount of workplace safety that firms provide is not likely to change much from one year to the next in the absence of new regulations."[40] Morrall further notes that:

> These practical problems [of cost measurement], however, are not insurmountable and mainly differ in degree from their fiscal analogue. For example. . .the spending forecasts for fiscal budgets do not have to be perfectly accurate for the fiscal budget process to be effective in controlling spending. As long as they are not systematically underestimated, projected cost ceilings serve as a constraint. Likewise the spending forecasts for regulatory budgets do not necessarily have to be accurate for the regulatory budget process to act as a constraining device for regulatory spending. Auditing costs for the regulatory budget can be kept to a minimum since all that is needed is *ex post* evaluations of a sample of situations in order to improve economic forecasting models.[41]

Coping adequately with indirect regulatory costs does present thornier problems than Morrall implies. But as long as preemptive regulation is the order of the day, one could do worse than rough cost estimates that nonetheless help allocate regulatory dollars in loose correspondence with where an *accountable* Congress believes benefits to lie. Accuracy of calculations may not be as important as requiring agencies to compete. A regulatory budget in this regard is a means to imposing greater congressional accountability, but budgeting remains secondary to explicit government rollback and requirements for a congressional vote on agency regulations.

Temptation to Include Benefits

Another pitfall of a regulatory budget will be the desire of agencies and proponents of regulation to include benefits in the budget calculation, and use those benefits to offset costs under a budget cap in an effort to create an agency-determined “net cost” of a regulation. But including benefits would defeat a regulatory budget’s purpose and render it useless. Congress itself must set the budget constraint based on the potential benefits that an agency provides, and leave it up to agencies to maximize benefits within that constraint. Benefits are subjective, and if an agency is allowed to offset the costs of a regulation with benefits, rarely will any regulation fail to qualify in the agency’s eyes. Policymakers should not be fooled into accepting such a scheme for controlling regulatory costs. Abuses can result from the fact that persons enjoying the benefits of regulations and persons paying for those benefits are not always, or perhaps rarely, the same people. A budget should not cement in place the ability for agencies to effect regulatory wealth transfers.

Under a budget that allows agencies to calculate benefits, those who gain from regulation — such as large firms vs. small firms — will have incentives to seek benefits by forcing a few unfortunates to shoulder regulatory costs. A benefit-cost standard that imposes the full costs of a rule on a few political losers when the regulation purportedly benefits society in general will be a standard biased toward excessive regulation. From the standpoint of society, regulation is cheap relative to everything else in the choice set, and society is induced to “buy” too much. Even benefits of federal on-budget activities are difficult to compare. How does one, for example, trade off benefits of federal outlays on trains versus money spent on welfare? Such fiscal ambiguities would be greatly exceeded by a regulatory regime that left benefit assessments up to agency whim.[42] Again, the net-public-benefit standard is *not* fair. Incorporating it into a regulatory budget would further entrench crude utilitarianism, or a policy of greatest good for the greatest number — or even greatest good for a few.

“Cutting Our Budget Costs Lives!”

Christopher DeMuth points out that agencies will appear before Congress during the budgetary process and will periodically be required to justify their regulatory choices.[43] By shedding light on comparative agency activity, congressional oversight hearings could be expected to mitigate agency overreach somewhat. A thornier matter is that of ensuring that Congress actually does strip an agency of regulatory authority when the facts warrant. Under a budget, agencies will regulate until their budget is exhausted. Therefore agencies threatened with an impending budget cut or a transfer to another agency will argue that “cutting our budget will cost lives.” As night follows day, this chant may be expected from any threatened agency.

Another risk posed by a regulatory budget is that a barrage of such grievances could lead policymakers to increase the entire regulatory budget ceiling (whatever it happens to be) rather than strip an agency of a portion of its budget and transfer the authority elsewhere. There is a risk that the overall regulatory budget will perpetually rise rather than stabilize or fall. This is quite a significant risk. One would expect that Congress would monitor and even refuse requests for increases in agency budgets as a matter of routine maintenance. But following through on actual cutbacks will be tougher. Ideally, if agencies can demonstrate in broad strokes that they can produce greater benefits within a budget constraint compared to other agencies, Congress should make the transfer. There remains a risk however, that agencies will collectively place constant pressure on Congress to increase the overall budget, within which they would all get to enjoy a corresponding increase in the size of their regulatory kingdom. But again, unlike today, Congress will have to explicitly *approve* such budget increases. It cannot escape accountability.

IMPLEMENTING A REGULATORY BUDGET

Competent and constructive legislative reforms — including regulatory budgeting — must acquire greater appreciation of political failure. Regulatory reform, whatever the tools chosen, should eliminate the ability of politicians and regulators to gain by masking regulatory costs or by transferring costs to political losers.

Given the array of potential hazards that accompany the potential benefits of a regulatory budget, implementing one that protects society from the budget's own threats presents a considerable challenge. Keeping budgeting in perspective is the most important step at the outset. In that context, a regulatory budget is simply one of many procedural tools that could be used to address regulation, but it can be most effective only in the context of a government already constitutionally limited. A regulatory budget could act as an anchor for an assortment of other procedural reforms. Sunsetting requirements and regulatory freezes (moratoria) are examples of complementary reforms, both of which were under consideration during the first session of the 104th Congress. Strengthening the independent review function at OMB's Office of Information and Regulatory Affairs is another option. Since OMB would probably monitor a regulatory budget, the latter enhancement is probably necessary for the workings of a budget as such, in addition to being a useful stand-alone reform.

Improper manipulation of regulatory budgeting is a significant threat while the regulatory state is as pervasive as it is now. That is why regulatory budgeting must be placed in context: The centerpiece of reform should not be regulatory budgeting or any other process reform, but should instead explicitly be the limitation of excessive government power, restrictions on delegation, restorations of individual rights, and the ending of preemptive regulation altogether in favor of marketplace and common law reforms. Such reforms are essential for keeping regulation in check, and are far more significant than even a comprehensive regulatory budget.

In the meantime, limited regulatory budgeting ventures can be appropriate. The proposed regulatory accountability bill of Rep. Lamar Smith, which extends the scope of the unfunded mandate bill to encompass more private sector regulation, would set a budget incrementally for each mandate contained in new laws or reauthorizations.

Several specific steps that can help promote a workable budget are described below. These include adopting an incremental budget; collecting key non-dollar statistics; freezing regulatory costs; establishing a regulatory reduction commission; establishing full congressional accountability for regulations; distinguishing between economic and environmental regulation; and controlling indirect costs.

Establish an Incremental Budget Rather than a Total Budget

Congress should not attempt to set an *overall* enforceable budget, although broad information-only collection efforts similar to those outlined in Rep. Bliley's bill can be appropriate. A total, enforceable regulatory budget would need to exceed $647 billion to encompass the regulatory state. There is no way now to validly determine what the level of a total budget should be, especially before taking more important steps to harness regulatory activity and shrink government. Mis-steps in regulatory budgeting are most likely to occur if Congress attempts a grand-scale budget without conducting at least a trial run first. One way to be certain a successful regulatory budget never gets off the ground is to attempt to bite off more than can be chewed.[44]

An incremental budget, such as Rep. Lamar Smith's proposal to build upon existing unfunded mandates reform legislation, would make the most sense early in the budgeting game. The downside of an incremental budget is that the opportunity cost trade-offs across agencies will not materialize until substantial time has passed. Significant numbers of "budget-constrained" mandates would need to have accumulated, enough to constitute a significant portion of each agency's regulatory portfolio, before serious trade-offs could be made under incremental budgeting. While learning, though, the existing regulatory burden should be reduced to lessen the scope and expectations of a more comprehensive budget.

Collect and Report "Quasi-Budgetary" Statistics

The difficulties of calculating regulatory costs for a broad-based budget means that a workable one will take considerable time to implement and to generate useful data. During the transition, Congress should take advantage of the significant amount of *non-cost* information that does exist, but which is not currently assembled in one location. Congress should require that this data be published officially and concisely. The table below depicts easily compiled data that should be published annually — by program, agency, and grand total — in the *Economic Report of the President* or as a chapter in the federal budget itself. By pinpointing exactly where cost estimates are and are not being conducted, this material would be of immense value to scholars and other observers of the regulatory process. A beneficial side effect of such data is that it will reveal to what extent Congress itself is responsible for the regulatory burden.

These items would isolate certain easily available but now dispersed specifics about regulatory policy that Congress could use in its deregulatory efforts and in budget development. Requiring this information to be published annually would acknowledge and validate its status as an important component of regulatory control and the budgetary process. Additionally, a chapter on the overall state of regulation on the macro-economy and any summary of regulatory impacts on specific industries and small businesses would be useful, as would descriptions of perverse regulatory effects.

Implement a Regulatory Cost Freeze and a Regulatory Reduction Commission

While non-cost data are being collected and while incremental regulatory budgeting efforts proceed, the aggregate regulatory state should be met head-on with a combination of measures. Cost freezes, or requirements that any new agency regulation be offset by the elimination of some existing regulation of roughly equivalent cost, is one ingredient. Meanwhile, Congress could target and reduce that "frozen" regulatory burden with a device like a formal Regulatory Reduction

Regulatory Statistics: Recommended Annual Summary Data

- Numbers of major rules, and numbers of minor rules
- Numbers of major and minor regulations required by statute
- Numbers of major and minor rules that are discretionary
- Numbers of major and minor rules featuring cost estimates
- Numbers of major and minor rules lacking cost estimates
- Tallies of cost estimates that exist
- Percentages of major and minor rules *without* cost estimates
- Explanations of ratios and reasons for lack of cost estimates
- Numbers of rules for which cost calculations are statutorily prohibited
- Percentages of rules reviewed at OMB, and actions taken
- *Federal Register* pages: Numbers of pages devoted to final rules and other data
- Full-time-equivalent employees
- Five-year historical tables for all the above.

Commission — an idea first proposed by Senator Phil Gramm.[45] Like the military Base Closure and Realignment Commission, a Regulatory Reduction Commission would hold hearings, assemble a broad package of regulations to eliminate, and then send the entire package to Congress for a vote, with no amendments permitted. Any Commission recommendation that did not require legislation would also be implemented by the President. The filtering process of hearings combined with bundling of disparate regulations cutting across interest group lines could make Commission recommendations difficult to oppose. The Commission's effort would be aided by the availability of quasi-budgetary data. As a Commission reduces the level of regulation in the economy it might become more palatable to consider an overall budget.

Revive Congressional Accountability

Regulatory budgeting would help establish in a limited sense the principle that Congress bears ultimate responsibility for regulations, since the budget would feature caps *explicitly set* by Congress. That still isn't enough. Congressional delegation of power to federal agencies should be tightly limited or eliminated altogether, with or without a regulatory budget. Whether or not within a budgeting framework, agency regulations should be turned into bills requiring passage by both Houses of Congress and a Presidential signature. That procedure would eliminate delegation of power and eliminates the autonomy of agencies. Congress might still regulate poorly under a budget with limited delegation of power; but the key difference is that voters then would have one answerable party with whom to settle the score at election time. This institutional framework would eliminate the need to await election-time "revolutions" — like that of 1994 — structured around reining in out-of-control federal agencies. With congressional accountability, anything done by agencies would by definition have been explicitly endorsed by Congress and would contain fingerprints galore. Despite campaign rhetoric, out-of-control agencies actually camouflage an out of control Congress, and limiting delegation would capitalize on that fact and place budgeting in proper perspective.

Employ Separate Budgets for Economic and Social/Environmental Regulation

The weakest excuse for government interference in the economy is that of economic intervention. This seems to be the case whether the issue at hand is grand-design government intervention — such as "fine-tuning" of the macro economy — or whether the issue is direct government management of an specific industry's output (such as agricultural quotas) or of entry into an industry (such as the trucking industry). The public choice branch of economic theory has gone to great lengths to demonstrate that regulation often works not in the public interest, but in the interests of the regulated parties themselves. Regulatory outcomes typically conform to the interpretation that regulation is secured by the regulated parties for their own benefit.

Since the expressed role of health and safety regulation is so utterly different from that of economic regulation, separate budgets make sense from the standpoint of comparing relative merits of regulations as the scope of budgeting grows. (Such conceptual distinctions would not be immediately necessary for incremental budgets that set caps on a case-by-case basis.) There are obvious conceptual differences that render meaningless comparisons of, for example, the economic benefits of a trade regulation with lives saved by an safety regulation. The two types of benefits allegedly achieved are on the one hand of the economic variety, and on the other of a health and safety variety. There is little basis for comparing the two, let alone trading such regulations off against one another. Today, economic regulation is losing its luster more rapidly than environmental or health and safety rules. To the extent that budgeting helps discredit economic regulation, such regulation can be removed from the budget and from the purview of government altogether (admittedly a utopian thought), leaving Congress the smaller task of controlling and reducing environmental, health, and safety regulations. As many health and safety rules reveal their true private interest origins, they too can be removed from the budgeting process.

Control Indirect Costs

A case can be made that, just as a fiscal budget accounts for direct dollar outlays alone rather than the indirect employment and output effects of taxes, a regulatory budget should be direct-compliance-cost based. Direct regulatory costs are difficult enough to assess without attempting to include indirect costs — such as higher prices and unemployment — in a budget. Moreover, if indirect costs are included in a budget, it's likely that *benefits* will also be included. Julius Allen of the Congressional Research Service argues that calculating indirect costs to the private sector "would require estimates on the benefits of a regulation, in order to arrive at net (versus gross) cost of regulation."[46] As already noted, benefits are impossible to assess objectively, partly evidenced by the fact that agencies either can not or will not provide quantitative benefit assessments of their regulations. One of a budget's selling advantages relative to cost-benefit analysis is that it would leave benefits out of regulators' assessments entirely, placing responsibility on Congress.

But some recognition of indirect costs imposed by regulations is necessary. Although these costs are the most difficult to measure, they may sometimes exceed direct costs. Recognizing and somehow incorporating indirect costs in a reasonable way represents the most critical challenge in regulatory budgeting. Ignoring indirect costs would lead to massive understatements of regulatory costs. But indirect costs are hardest to assess and the most likely to be left out of an agency's slipshod budget cost estimate, for pragmatic reasons if nothing else. Worsening this problem is the fact that there is no general agreement on the dividing line between direct and indirect costs. Although costs are subjective and substantially indirect, regulators using cost-benefit analysis have generally attempted to proxy total costs with mere engineering costs. And even direct engineering cost estimates are plagued by the impact of external changes in technology and shifts in market demand that make engineering costs fluctuate.

If Congress were to settle on a rule that allows regulators to overlook entire categories of indirect regulatory costs, then regulations will tend toward that very type. Imagine a regulatory budget were established that addressed only direct costs of regulations — such as the engineering costs of controlling an emission. But suppose outright input or product bans are not regarded as direct costs for budgeting purposes, and therefore not counted in the budget. Under that structure, nearly every environmental regulation could be expected to entail a ban so that regulators would avoid exhausting their budgets. The incentives set up by this sort of budget would be disastrous. Part of the answer to the indirect costs dilemma, therefore, is to forbid just those types of regulatory activities — such as product bans — most likely to produce indirect costs.

A budget stressing direct costs will be easier to manage, and eliminating outright those regulatory methods that generate indirect costs is more consistent with an approach to regulatory reform that stresses rolling back government power. A banning bias will emerge if budgets control direct costs. Therefore, outright product and input bans should be employed only where safety is a dire consideration. Prohibiting agencies from banning products or inputs, except in the most extreme circumstances, would eliminate a significant loophole in a compliance-cost-based regulatory budgeting. Where product or substance bans are deemed necessary, congressional approval should be required. This step alone would go far toward controlling one of the key indirect regulatory costs.

Where indirect costs are included in a budget, Congress should at least:

(1) Set performance standards rather than control standards for regulation so that at least high direct compliance costs are not locked in;

(2) Set a loose and preliminary indirect cost budget on top of the direct cost budget for each new mandate, monitor closely as "true" indirect costs are fleshed out in the rulemaking process, and formally approve any increases; and

(3) Remain vigilant against agencies' offsetting costs with benefits.

These steps will provide incentives for agencies to request cheaper alternative regulatory approaches that would achieve the same regulatory end. The burden would tend to fall to the agency to prove that its alternative is better or the least costly, inclusive of indirect costs.

While pitfalls in harnessing indirect costs undoubtedly exist, establishing a limited budget can help policymakers grasp costs in rough magnitudes despite their subjectivity. The key contribution of a budget is not accuracy, but accountability. And, as noted earlier, there may be ways of forcing out "true" costs and ensuring that costs are not systematically understated despite maneuverings by agencies and regulated parties. Ultimately, however, the only way to control the regulatory state is to limit governmental power, not simply to better measure the extent of that power with a budget — though the latter can help encourage the former.

CONCLUSION

Although regulatory trends over the past few years all seem to point upward rather than downward, there is still no formal scorekeeping for regulations. Controls such as formalized regulatory review and even presidential moratoria have been tried, with spotty success. Regulatory burdens increase while benefits grow more ambiguous, signifying an out of control regulatory system that itself needs to be regulated.

Further steps, far more fundamental in their recognition of the recent regime's failures and therefore far more politically contentious, call for coping with the legislative realities that prevent the making of rational regulatory policy. Regulatory reform, as opposed to tinkering, will require an unprecedented relinquishing of power by agencies and legislators. Though potential implementation problems abound, an incremental regulatory budget is one tool that can help cement greater control over the regulatory state. With or without a quantitative budget, effective regulatory reforms must ultimately come through institutional changes that tightly specify the purpose and reach of delegated regulatory power.

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ENDNOTES

[1] See Thomas D. Hopkins, et. al., *A Review of the Regulatory Interventions of the Council on Wage and Price Stability: 1974-1980*. Manuscript, January 1981.

[2] See for detail, James C. Miller III, James C., William F. Shughart II, and Robert D. Tollison, "A Note on Centralized Regulatory Review," *Public Choice*, 43, 1984.

[3] *Memorandum for Certain Department and Agency Heads (Subject: Reducing the Burden of Government Regulation.)*, President George Bush, The White House, January 28, 1992.

[4] See David Schoenbrod, *Power Without Responsibility: How Congress Abuses the People Through Delegation*, (New Haven: Yale University Press, 1993).

[5] Robert Crandall, "Federal Government Initiatives to Reduce the Price Level," *Curing Chronic Inflation* 165, A. Okun and G. Perry eds., (Washington: Brookings Institute, 1978), pp. 193-194.

[6] The bill numbers were S. 3550 in the 95th Congress, and S. 51 in the 96th Congress. A House companion bill (H.R. 76) was introduced by Rep. Brown of Ohio in the 96th Congress.

[7] From the *Congressional Record*, Vol. 125, March 5, 1979, p. S2024, as quoted by Julius Allen, *The Proposal for a Federal Regulatory Budget: An Overview*, Congressional Research Service, Report No. 79-197E, September 12, 1979, pp. 8-9.

[8] William Niskanen, "Reduce Federal Regulation," *Market Liberalism* (Washington, D.C.: Cato Institute, 1992), pp. 114.

[9] See, for example, Robert D. Tollison, "Rent Seeking: A Survey," *Kyklos*, Vol. 35, 1982, pp. 575-602.

[10] It's worth considering the possibility that regulation's public interest role is overwhelmed by misuse of the regulatory process to serve private ends. Control of the regulatory apparatus may be seized such that private benefits prevail generally rather than episodically. For example, those threatened by low-cost imported sugar lobby for quotas that lock out competition. Or, if too many electric power companies are threatening profitability, government may declare the electricity industry a "natural monopoly" and grant exclusive franchises to a few privileged, politically connected power companies.

[11] See Thomas D. Hopkins, "The Costs of Federal Regulation," *Journal of Regulation and Social Costs*, Vol. 2, No. 1, March 1992, pp. 5-31.

[12] General Accounting Office, Briefing Report to the Ranking Minority Member, Committee on Governmental Affairs, U.S. Senate, *Regulatory Reform: Information on Costs, Cost-Effectiveness, and Mandated Deadlines for Regulations* (GAO/PEMD-95-18BR), March 1995.

[13] Concern about regulatory costs on state and local governments resulted in the unfunded mandates bill during the 104th Congress.

[14] Hall, Arthur P., "Taxes Force American Family to Tighten Belt," *Tax Foundation Special Report*, No. 54, November 1995.

[15] Philp, Alan L., "True Cost of Government Day is July 9," *American Tax Reformer: Newspaper of Americans for Tax Reform Foundation*, June-July 1995.

[16] Office of Management and Budget, "Appendix IV: Executive Order No. 12291 Annual Report for 1991," *Regulatory Program of the United States Government: April 1, 1992-March 31, 1993*, 1993. p. 608.

[17] "Presidential Documents, Executive Order 12866 of September 30, 1993: Regulatory Planning and Review," 58 *Federal Register* 51735 (October 4, 1993).

[18] See data presented in Office of Management and Budget, "Reforming Regulation and Managing Risk Reduction," *Budget for Fiscal Year 1993*, Part One, Chapter 17, 1992, pp. 397-406.

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[20] OMB, 1993, p. 608.

[21] A. B. Laffer, V. A. Canto & Associates, "The Ubiquitous Regulatory Wedge," March 13, 1992.

[22] See *How Excessive Government Regulation Hurts the Economy: A Resource Book on Government Regulation*, United States Senate, Office of the Assistant Republican Leader, July 11, 1994, p. 12.

[23] See Hopkins, 1992.

[24] Environmental Protection Agency, *Reducing Risk: Setting Priorities and Strategies for Environmental Protection*, Science Advisory Board, September 1990.

[25] See Robert Crandall and John D. Graham, "The Effect of Fuel Economy Standards on Automobile Safety," *Journal of Law and Economics*, Vol. XXXII(1), April 1989, pp. 97-118.

[26] See, for example, Ralph Keeney, "Mortality Risks Induced by Economic Expenditures," *Risk Analysis*, Vol. 10, No. 1, 1990, pp. 147-159.

[27] *Congressional Record*, "Regulatory Accountability Starts Here," Floor Statement by Senator Orrin Hatch, Vol. 139, No. 43, Wednesday, March 31, 1993.

[28] United States House of Representatives, House Republican Conference, "Contract With America," *Legislative Digest*, September 27, 1994.

[29] A better alternative would be to privatize or establish property rights on publicly owned land and resources, which would permit their protection from harm through ordinary legal channels rather than regulation — and eliminate the need for regulatory budgeting.

[30] James M. Buchanan, *Cost and Choice: An Inquiry in Economic Theory*, University of Chicago Press: Chicago and London, 1969, p. pp. 42-43.

[31]See *Corrosion Proof Fittings v. EPA*, 947 F. 2d 1201 (5th Circuit, 1991).
[32]Christopher C. DeMuth, "The Regulatory Budget," *Regulation: AEI Journal on Government and Society*, March/April 1980, p. 30.
[33]See Lawrence J. White, "Truth in Regulatory Budgeting," *Regulation: AEI Journal on Government and Society*, March/April 1980, pp. 44-46.
[34]DeMuth, pp. 42-44
[35]Malcolm E. Wheeler, "Cost-Benefit Analysis on Trial: A Case of Delusion and Reality," *National Law Journal*. Oct. 20, 1980, p. 28.
[36]OMB, 1992, pp. 399-400.
[37]OMB, 1992, p. 400.
[38]Buchanan (1969), pp. 42-43.
[39]Allen, p. 19.
[40]John F. Morrall III, "Controlling Regulatory Costs: The Use of Regulatory Budgeting," *Public Management Occasional Papers, Regulatory Management and Reform Series No. 2* (Paris: Organization for Economic Cooperation and Development, 1992), p. 14.
[41]Morrall, p. 14.
[42]In the extreme, the "contingent valuation" debate highlights the critical problems that a regulatory budget incorporating benefits would create. Contingent valuation is a method of assessing the value of resources, sometimes intangible ones such as scenery, by polling individuals. Pollers ask for individuals' opinions about the value of resources — usually emotion-provoking resources such as the Grand Canyon — and attempt to attach dollar values to the resource. The problem with this approach is that benefits — even more so than costs — do not lend themselves to measurement by a third party or external observer. Benefits especially cannot be assessed by a third-party pollee who bears no relationship to — or responsibility for maintaining — the benefit in question. Contingent valuation polls give individuals an incentive to falsely value a good since nothing personal is at stake: like agencies in today's regulatory regime, they face no opportunity costs. There exists no risk of overextending oneself, since costs are to be imposed on *other* people. Allowing strict versions of contingent valuation assumes a property right in all things for the interviewee, though he has not "mixed" his labor with the land. The values determined by contingent valuation are close to intrinsic values, divorced from human experience. For an overview of contingent valuation issues, see Roger Bate, *Pick a Number: A Critique of Contingent Valuation Methodology and its Application in Public Policy*, Competitive Enterprise Institute, January 1994.
[43]DeMuth, p. 36.
[44]A warning articulated in Allen, p. 14.
[45]"Gramm Calls for a Halt to Clinton Regulations," press release, Office of U. S. Senator Phil Gramm, January 27, 1995.
[46]Allen, p. 17.