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Author(s): Edward P. Fuchs and James E. Anderson

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Executive-branch requirements for cost-benefit analysis in regulating agencies are not yet fully met.

The Institutionalization of Cost-Benefit Analysis

Edward P. Fuchs, James E. Anderson

The use of cost-benefit analysis was initiated in the federal government by the Flood Control Act of 1936, which authorized navigation-improvement projects and flood-control projects on navigable waters within the United States only when the projects' benefits exceeded their estimated costs. Cost-benefit analysis soon became an established feature of water resources policy. In the 1960s, the use of cost-benefit analysis expanded to other policy areas. Secretary Robert McNamara introduced it into the Department of Defense as part of the Planning Programming Budgeting System (PPBS). Impressed with its accomplishments there, in 1965 President Lyndon Johnson required the use of PPBS throughout the executive branch. As a budgetary tool it failed because, in the face of strong agency resistance and the lack of sustained presidential support, the process was too complex and demanding to be implemented effectively. Officially terminated in 1971, PPBS nevertheless left a residue of interest in policy analysis.

In the 1960s and the early 1970s, a major expansion of economic regulatory activity took place. It was focused especially on the protection of consumers, the environment, and industrial health and safety. A number of new regulatory agencies with extensive authority and discretion were created, and existing agencies were given enlarged regulatory mandates. Many of the new regulatory programs imposed substantial compliance

costs on American business. Concern developed in business and government quarters about the need to control the costs of this new regulation (often called social regulation) and to secure greater presidential control over and coordination of the regulatory bureaucracy.

Another development in the 1970s was an expansion of interest in policy analysis on the part of economists, political scientists, and other social scientists. New organizations, journals, and academic programs that centered on policy study and analysis were established. Government agencies expanded their capacity to perform policy analysis and often established special units for this purpose.

These developments—prior experience with cost-benefit analysis, expansion of economic regulation, and growth in policy analysis—contributed to the extension of cost-benefit analysis and evaluation into the regulatory arena. It is not the purpose of this article to discuss the mechanics of cost-benefit analysis, its strengths and limitations, and the like. Rather, our focus is on the prospects for the institutionalization of cost-benefit analysis in federal regulatory agencies. *Institutionalization*, as used here, designates the process by which an activity becomes generally accepted or routinized and is then handled in a regularized, structured, and systematic manner. An example of such institutionalization involves the presidential legislative liaison staff. Although previous presidents had sought in various ways to influence congressional action, President Dwight Eisenhower was the first to create a formal legislative liaison office. Since then, all presidents have had a legislative liaison staff in the White House. In short, legislative liaison has become an expected and accepted routine and is therefore institutionalized.

In the remainder of this article, we shall discuss the efforts of four presidents—Richard Nixon, Gerald Ford, Jimmy Carter, and Ronald Reagan—to exercise more control over regulatory agencies, and particularly to require agencies to consider the expected costs and benefits of their regulations. Because of space limitations, we shall do this rather broadly.

The Nixon Administration

The initial effort to strengthen presidential control over the federal regulatory agencies occurred during the Nixon administration (Eads and Fix, 1984). Industry officials quickly became disturbed about the number and cost of regulations being generated by the Environmental Protection Agency (EPA). Moreover, the Office of Management and Budget (OMB) was concerned about the budgetary and policy consequences of EPA's actions. Following discussions within the executive branch, OMB director George Shultz sent a memorandum to several executive-branch agencies establishing the Quality of Life Review process.

Under this process, an agency was supposed to submit proposed and final rules to OMB for interagency comment. The agency's statement accompanying any "significant" proposed rule was to include the main goals of the rule, the alternatives to it that had been considered, a comparison of expected costs and benefits, and the reasons for selecting the chosen alternative. Final decisional authority rested with the regulatory agency.

In practice, the Quality of Life Review process applied only to EPA. No effort was made by OMB officials to implement it for the other federal regulatory agencies. The OMB and the Department of Commerce (which was a strong critic of environmental regulation) were the main participants; occasionally such executive-office agencies as the Council on Environmental Quality and the Council of Economic Advisers also became involved. Although the process was terminated in early 1977, a lasting consequence of it was stimulation of EPA to strengthen its internal capacity for policy analysis.

The Ford Administration

Soon after he acceded to the presidency, Gerald Ford held two "economic summit meetings," which were attended mostly by economists. A theme expressed at both meetings was the need for government agencies to be more cognizant of the possible inflationary impacts of their regulatory actions. In terms of the compliance costs imposed on industry, regulation of the workplace and of the environment were identified as most burdensome. When Ford announced his WIN (Whip Inflation Now) program to the nation in October 1974, he indicated that regulatory reform would be a crucial part of the program. (Ford's actions also put deregulation on the national policy agenda, but that is another story.)

On November 27, 1974, Ford issued Executive Order 11821, "Inflation Impact Statements." It provided that all "major legislative proposals, regulations, and rules emanating from the executive branch of government must include a statement certifying that the inflationary impact of such actions on the nation [had] been carefully considered." The regulatory agencies were instructed to weigh the estimated costs and benefits of their proposals. A formal statement of their analyses was to be submitted to OMB for review and approval.

Also involved in the Ford program was the Council on Wage and Price Stability (CWPS), an executive-staff agency created by Congress in the fall of 1974 at the president's request. CWPS had authority to seek voluntary action by industry and labor to moderate price increases and wage demands. CWPS also reviewed government programs to determine whether they were contributing to inflation. Composed mostly of professional economists, CWPS provided technical staff assistance to OMB in

the evaluation of an agency's inflationary impact statement (IIS). CWPS held the view, which was shared by OMB, that the agencies were mandated by the executive order to perform cost-benefit analyses or proposed rules. Neither OMB nor CWPS had authority to make changes in regulations or to delay their impact.

OMB sought to maximize the scope of the requirement for inflationary impact statements by defining the executive branch of government to include fourteen of the larger independent agencies and regulatory commissions, as well as the executive department and the regulatory units within them. The independent regulatory commissions, such as the Interstate Commerce Commission and the Federal Trade Commission, resisted OMB control. They argued that OMB's purview in regulatory matters did not extend beyond that of the president, who lacked formal control over the independent regulatory commissions. It was finally decided to avoid controversy by granting the commissions voluntary status under the requirement. A variety of other agencies that did not make major rules also were exempted.

A major problem in maximizing the effectiveness of this program was the lack of agenda control by the executive-office staff. Regulatory agencies retained authority to decide whether the estimated costs of proposed rules were high enough to necessitate evaluation. James C. Miller III later recalled about his experience in CWPS: "I'd call up an agency [in 1976] and say 'We just saw this morning in the *Federal Register* a regulation you published. We think it is a major rule which requires an IIS.' They'd say no and that was the end of the conversation" (Pierce and Hamilton, 1981). Near the end of the Ford administration, OMB was considering requiring agencies also to list all minor rules in the *Federal Register* and to give CWPS authority to require the agencies to justify their classification of rules as minor (Hopkins and others, 1976). Only a few dozen rules had inflationary impact statements prepared for them during the Ford years.

The Ford administration's requirements for inflationary impact statements were originally scheduled to remain in effect until the end of 1976. They were then extended for another year and renamed the Economic Impact Statement (EIS) program. The new Carter administration permitted the program to remain in effect until early in 1978, and CWPS continued to involve itself aggressively in regulatory agency affairs. In 1977, the Council of Economic Advisers (CEA) sought unsuccessfully to change the EIS program by recommending that the cost-benefit approach be replaced with a cost-effectiveness approach that would focus on selection of the least costly regulatory alternative. This would have directed attention to methods of achieving regulatory goals, without seeking to influence the determination of the goals themselves (*Environmental Reporter*, 1977).

The Carter Administration

President Jimmy Carter expressed support for a variety of regulatory initiatives; at the same time, he expressed concern about the costs of regulation. This ambivalence was reflected throughout the tenure of his administration in its handling of regulatory matters. Carter's appointees to regulatory agencies were usually strong supporters of regulation. Some of the executive-office staff, however, such as CEA chairman Charles Schultze, wanted to minimize the costs of regulation.

In January 1978, Carter established the Regulatory Analysis Review Group (RARG), an interagency unit consisting of representatives from all the executive departments except State and Defense and from several other agencies. Chaired by Schultze, and drawing staff support from CWPS, the main task of RARG was to review annually ten to twenty major regulations and appraise their inflationary impact.

A few weeks later, in March, Carter issued Executive Order 12044, "Improving Government Regulations." Regulatory agencies in the executive branch were directed to prepare a regulatory analyses for proposed rules that would either have an impact of at least \$100 million on the economy or would cause a major price increase for an industry, a level of government, or a geographical area. The independent regulatory commissions, and formal rule-making proceedings under the Administration Procedure Act, were exempted. (Formal rule making is a highly judicialized form of decision making that, among other things, requires a decision to be supported by substantial evidence in a formal hearing record.)

Each regulatory analysis was to explain the problem being treated by the rule, as well as the rule's objectives; discuss the economic consequences of alternatives for dealing with the problem; and provide a detailed justification of the chosen alternative. Discussing what was required in the regulatory analysis, the executive order referred to burdens, gains, and overall economic impacts, rather than to costs, benefits, and cost-benefit analysis. Thus, the stress seemed to be on cost-effectiveness and on the use of least-cost alternatives for dealing with regulatory problems. In a statement pertaining to the order, President Carter said its purpose was to "ensure that Federal regulations are cost-effective and impose minimum economic burdens on the private sector" ("Improving Government Regulation," 1978). Nevertheless, the practical effect of the order was to sanction the continued use of cost-benefit analysis.

Under the Carter program, after RARG had selected a proposed regulation for review, the standard operating procedure was for CWPS to prepare an analysis of the rule for RARG. Once agreement on the analysis was reached by RARG's members, it was then filed as part of the agency's public rule-making record. The burden of proof that rules were not cost-effective rested with the executive office, rather than with the agencies.

Moreover, RARG lacked authority to alter or delay the promulgation of rules. (As a practical matter, however, RARG reports, which were issues from the Executive Office of the President, had a significant influence on agencies; presidential-level action is not easy for agencies to ignore.)

Regulatory agencies quickly expressed dissatisfaction with the intrusion of executive-office officials into regulatory decision making. In November 1978, responding to their entreaties, President Carter set up the Regulatory Council. Drawing its membership from executive-branch regulatory agencies, the Regulatory Council was chaired by Douglas Castle, head of EPA. Designated by Carter as an integral part of the regulatory decision-making process, the Regulatory Council had the main tasks of compiling a semiannual regulatory calendar or agenda and helping to coordinate the regulatory process. It also served to partially offset the influence of executive-office personnel.

Most of the attention of RARG centered on social regulations, especially those developed by EPA and the Occupational Safety and Health Administration. In its analyses, RARG consistently alleged that the agencies displayed a lack of concern for industry costs. In the final two years of the Carter administration, formal regulatory reviews by RARG became infrequent. The administration saw this change as a signal that the regulatory agencies had become more cost-conscious; officials maintained that the routinization of the analysis process permitted the simple threat of RARG action to accomplish what had previously required a formal RARG review (Clark, 1979).

The Reagan Administration

Regulatory reform and relief has been one of the central goals of the Reagan administration. President Reagan and various members of his administration were quite critical of the Carter administration's efforts in the regulatory field. Consequently, they moved quickly to implement their own regulatory control program.

On his second day in office, Reagan created the Presidential Task Force on Regulatory Relief (TFRR), which was composed of several department secretaries and executive-office officials and chaired by Vice-President George Bush. One of its tasks was to monitor and evaluate regulatory actions to ensure that they were beneficial to the economy ("Remarks . . .," 1982).

On February 17 of his first year in office, Reagan issued Executive Order 12291 "in order to reduce the burdens of existing and future regulations, increase agency accountability for regulatory actions, provide for presidential oversight of the regulatory process, minimize duplication and conflict of regulations, and ensure well-reasoned regulations." The order covered major rules, which were defined as (1) having an annual impact on the economy of \$100 million or more; (2) causing a major increase in

prices or costs for consumers, individual industries, government agencies, or geographical regions; or (3) having adverse economic impacts on such matters as competition, innovation, and productivity. Rules could also be designated as major by OMB. The independent regulatory commissions and formal rule making were not included under the order.

To the extent permitted by law, regulatory agencies were directed to prepare and consider regulatory impact analyses for major rules at two stages of the regulatory process: when notice was given of proposed rule making, and before a final rule was issued. A regulatory impact analysis was to determine the potential costs and potential benefits of a rule, including those that could not be quantified. A regulation was not to be issued unless its potential benefits outweighed its potential costs to society. If several alternatives for handling a problem met the standard, the least-cost alternative was to be selected.

Implementation of the order was assigned to the Office of Information and Regulatory Affairs (OIRA) in OMB. (The Regulatory Council, RARG, and CWPS were abolished.) Regulatory impact analyses, both at the proposed rule making and at the final stages of the rule-making process, were to be submitted to OIRA. With some exceptions, OIRA could suspend or delay an agency's action if it found that the analysis was unsatisfactory or that important alternatives had been neglected. The burden of proof that cost-benefit standards were met rested with the regulatory agencies. Actions taken by OIRA could be appealed to the Presidential Task Force on Regulatory Relief (which was staffed by OIRA) or, if an agency was really determined, to the president.

Thus, the Reagan program went considerably beyond those of previous administrations, in three respects: It explicitly required the use of cost-benefit analysis and converted it into a decision rule; authority to ensure compliance with the order was centralized in OIRA within OMB, which had substantial latitude to control agencies' actions; and the burden of proof was put on regulatory agencies to demonstrate compliance with the standards of Executive Order 12291. The Reagan program has provoked considerable controversy; for instance, critics in Congress have argued that OIRA has improperly interfered with the exercise of agencies' authority.

In the first two years of the Reagan program, 5,436 regulatory proposals were submitted to OIRA for consideration (most were approved without change); only 89 of the rules were classified as major and thus designated as subjects for regulatory impact analyses (Presidential Task Force on Regulatory Relief, 1983). Regulatory impact analyses were not done for some of these rules, however, because OIRA sometimes used its authority to exempt all regulations that "relax or defer regulatory requirements, or which delegate regulatory authority to the states." (For further discussion of the Reagan program, see West and Cooper, 1986; Strauss and

Sunstein, 1986.) This approach reflected the administration's concern with regulatory relief (reducing the number of regulations) rather than with regulatory reform.

Concluding Comments

What we have seen, from the Nixon to the Reagan administrations, is a progression in the effort to strengthen presidential control over regulatory agencies and a continuing concern to make them consider the economic consequences of their actions. As a result of this presidential activity, which has stretched over a decade and a half, we now need to ask whether the use of cost-benefit analysis has become institutionalized in the regulatory process at the agency level. Our judgment is that it has not.

Even in the Reagan administration, which has been most dedicated and persistent in its efforts to control regulatory activity, only 1 percent or so of rules have been subjected to cost-benefit analysis by the agencies. As in previous administrations, independent regulatory commissions and formal rule making are exempt from OIRA purview. The Reagan administration has been more concerned with regulatory "relief"—reducing the amount and impact of regulation by whatever means—than with regulatory reform, which would include strengthening the analytical capabilities of regulatory agencies. Moreover, OIRA does not appear to have given agencies effective guidance on how to handle the required cost-benefit analyses (U.S. General Accounting Office, 1982). Unfortunately, there is a shortage of good information about what is happening at the agency level, where cost-benefit analysis has to be performed in order for it to inform regulatory decisions most effectively.

Most of the attention and the controversy that have swirled around the use of cost-benefit analysis has been focused on the executive branch. This focus has created an inaccurate perception of what has been occurring at the agency level. The extent to which cost-benefit analysis has become incorporated into agencies' regulatory processes requires further empirical research.

The activity of the various administrations since the early 1970s, however, has not been without its own impact on the regulatory process. If, as we argue, cost-benefit analysis has not been fully institutionalized, two other developments have been (or at least are moving strongly in the direction of institutionalization). The first is greater and more systematic presidential control of regulatory agencies. That the president should exercise more control over regulatory agencies than was the case a decade ago seems accepted now; disagreement remains only about its desirable form and extent. The second development is greater agency concern with policy analysis, whether this activity involves cost-benefit analysis, cost-effectiveness analysis, or other analytical techniques. In recent years, many regula-

tory agencies have established offices to handle policy analysis and evaluation. Both of these developments are very likely to be continued in future administrations.

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Edward P. Fuchs is a visiting professor of political science at the University of Texas, El Paso. The major emphasis of his research is on public administration and public policy at the national level. He is the author of Presidential Management Strategies in Regulation.

James E. Anderson is a professor of political science at Texas A. & M. University. He is the author of books and articles on economic regulatory policies, the policy process, and the presidency. His most recent book (coauthored with Jared Hagleton) is Managing Macroeconomic Policy: The Johnson Presidency.