

ECONOMIC DIRECTIONS

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The Consumer's Stake in Deregulation

(The following is a transcript of a lecture delivered by Dr. Murray L. Weidenbaum, Mallinckrodt Distinguished University Professor and Director of the Center for the Study of American Business at Washington University, at Saint Vincent College, Latrobe, Pennsylvania, on November 14, 1990. The lecture was part of The Alex G. McKenna Economic Education Series of lectures on privatization and government deregulation. This lecture draws from his recent book, Rendezvous With Reality (paperback edition, Basic Books, 1990).)

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It is a pleasure to be back at Saint Vincent College and it is an honor to give this lecture dedicated to a fine American, Alex McKenna. To those like Mr. McKenna who are concerned about the future of the private enterprise system, tonight I want to talk about the new wave of government regulation of business.

You don't have to be a regular reader of the *Congressional Record* or even a C-SPAN junkie to observe that trend. The most casual observer of the Washington scene can spot the current upturn in federal regulation. Congressional action on well-intentioned but costly legislation is proceeding at a very rapid pace.

The budgets of the regulatory agencies are on a growth trajectory once again. It is hard to oppose this trend. After all, is any one here against clean air? But just look at the new clean air bill that Congress passed. There are two ways of reducing ozone (smog). One is to put controls on gasoline pumps. The other is to put the controls on the cars. Either approach would work. Congress was faced with a tough political choice: does it hit the gasoline companies or the auto manufac-



Dr. Murray L. Weidenbaum

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turers? It could not make up its mind, so it required both sets of controls. That means two sets of costs to achieve one set of benefits. It's like wearing a belt and suspenders at the same time — sheer waste.

At a time when so much attention is focused on the budget deficit and properly so, it is politically attractive for Congress to go "off budget". That is what makes regulation so popular in Washington. Let me try to explain.

At first glance, government imposing socially desirable requirements on business seems to be a cheap way of achieving national objectives. Moreover, regulation seems to cost the government very little and therefore is not much of a burden on the public.

But the public does not escape paying the full cost. Every time a government agency — in its attempt to safeguard the environment or foster occupational health or promote product safety — imposes on business a more expensive method of production, the cost of the products being made will necessarily go up.

If consumers knew how much they were paying for regulation, they probably would be very upset. Several years ago, when the cost of regulation was lower, I estimated that it came to several thousand dollars per family each year. But government agencies do not feel great pressure to worry about the expense. Those compliance costs do not show up in their budgets, but in the budgets of the private sector.

Increasing Intervention

More important than the amount of money involved is the increasing intervention by government in the daily lives of its citizens. Decisions by government agencies alter, influence, or even determine what we can buy, how we can use the goods and services we own, and how we earn our daily living. Government decisions increasingly affect what we wear, what we eat, and how we play. There are few items that businesses or consumers buy that escape regulation by one or more national, state, or local governments.

The pervasive expansion in regulation of business is also altering fundamentally the relations between business and government. The traditional concept of a regulated industry is out-of-date. We now live in an economy in which every company feels the power of government in its day-to-day operations.

You cannot overestimate the great variety of government involvement in business which has been occurring in the United States. No business today, large or small, can operate without obeying a myriad of

government restrictions and directives. Entrepreneurial decisions fundamental to the business enterprise have become subject to government influence, review or control — decisions such as: What lines of business to go into? What products and services to produce? Which investments to finance? How to produce goods and services? Where to make them? How to market them? What prices to charge? What profit to keep?

Public policy is dominated by the organized pressure groups who attain their benefits at the expense of consumers.

Every major department of the American corporation has one or more counterparts in government that controls or influences its internal decision making. There is almost a "shadow" organization chart of public officials matching the organizational structure of each private company. For example, the scientists in corporate research laboratories now spend much of their time trying to ensure that the products they develop are not rejected by lawyers in regulatory agencies.

The engineers in manufacturing departments must make sure the equipment

they specify meets the standards promulgated by the Labor Department. Marketing people must follow procedures established by government administrators in product safety agencies. The location of business facilities must conform to a variety of environmental statutes. Many activities of personnel staffs are geared to meeting the standards of the various agencies concerned with employment conditions. Finance departments bear the brunt of the rising paperwork burden that government imposes on business.

Increased Overhead

All this has forced companies to increase their overhead costs. The higher cost of complying with domestic regulation is a handicap in competing against foreign firms who produce under less burdensome restrictions.

Contrary to the old-fashioned textbooks, pressure to expand government power over business does not come from the industries being regulated. The push for new style of regulation comes, rather, from a variety of citizen groups concerned primarily with non-economic aspects of national life — environmentalists, consumer groups, labor unions, and civil rights organizations.

To talk or write about the regulated industry "capturing" its regulators is, to put it kindly, a quaint way of viewing the fundamental shift in business decision making now taking place. I am referring to the shift of power from private managers to public officials. Yet, the core of the economist's version of the "capture" theory still holds — public policy is

dominated by the organized pressure groups who attain their benefits at the expense of the more diffused and larger body of consumers.

Rather than the captain of industry (a relatively easy target for attack), the villains of the piece often are self-styled representatives of the public interest who have succeeded in identifying their personal prejudices with the national well-being.

Consider the extent to which business firms, in performing the traditional middleman function, serve the unappreciated role of proxy for the consumer interest. That is most apparent in the case of retailers opposing restrictions on imports that would raise the prices of the goods they buy — and sell.

At this point, let me issue a disclaimer. I do not represent the public interest either. I have spent many years in government helping to make public policy, but I have never met a mortal man or woman who truly represented the public interest. Good government policy, if we ever get it, reconciles a variety of legitimate interests. Is clean air a legitimate interest? How about creating new jobs? And bringing down inflation? And producing safer products? The answer is, "Yes, they are all important interests." But that is not how regulatory debates go these days. In fact, the clean air enthusiasts ignore the water or ground pollution that their controls cause — nothing else matters to them. We need a mechanism for balancing all of these interests — rather than taking the simple-minded approach of automatically labeling one set of interests "public in-



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Dr. Weidenbaum (center) is welcomed by The Rev. Martin R. Bartel, O.S.B. (right), who introduced the lecture; and Dr. Gary M. Quinlivan, Associate Professor of Economics and Director of the Series.



Dr. Weidenbaum (center) meets distinguished Saint Vincent College Alumni John A. Malone, C'83 (left), and Paul J. Shrum, CPA, C'68 (right).

terests," which are supposedly good, and labeling the other set "special or business interests," which are presumably bad. This is precisely why we need an approach that considers costs *and* benefits of proposed government actions.

Examining the Benefits

Make no mistake about it. The benefits of regulation are fundamental. To the extent that government rules result in healthier workplaces, safer products, and a cleaner environment, these benefits are very real. I have chosen these words carefully. The mere presence of a government agency does not automatically guarantee that its worthy objectives will be achieved. Nor are we justified in jumping to the opposite conclusion that no government agency can ever achieve any good.

The serious — and difficult — question is how much benefit the regulation does produce and whether it is worth the cost. Society's bottom line is not the impact of regulatory actions on government or on business, but the effect on consumers and on citizens generally.

The relevant issue therefore is not, "Are you for or against government regulating water pollution or unsafe products?" Rather, we must answer a far more practical question for each specific government activity: "Does it work?" The sad reality is that regulation often does not — or it works against the interest of the consumer. This reality has been recognized in some areas. Deregulation of the airlines has reduced the cost to the traveling public. Cutting back the regulation of railroads

and trucking likewise has benefited consumers, albeit indirectly, by reducing the cost of shipping commodities.

Deregulation Is Working

Much progress has been made during the last decade in cutting back the older forms of economic regulations — where competition in the marketplace can do a better job of protecting the consumer than imposing bureaucratic judgments on private enterprise.

The movement to deregulate transportation, communication, and energy over the past 10 years has been a triumph of ideas over entrenched political interests.

It was not a realignment of political forces that caused the shift toward deregulation. The main developments were supported by a bipartisan coalition in both the legislative and executive branches of the federal government. Consumer activists offered support at vital points, as did leaders of both political parties. But the most important role was played by a very unusual set of actors in the public arena: economists, political scientists, legal scholars, and similar purveyors of ideas.

I am pleased that our Center for the Study of American Business played a modest role in all this. By focusing on the high costs to consumers, we helped move the subject of regulation from the academic journals and the business pages to the front pages and the nightly news. The issue hit a responsive chord with the media, influential policy groups, and finally Congress. A few simple concepts made

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the issue attractive. First, in a period of rapidly rising prices, a strategy of reducing regulation presents policymakers with an opportunity to deal with inflation in a way that does not require a tradeoff with jobs. Indeed, curbing the proliferation of government rules cuts both costs and barriers to employment.

Secondly, the burdens of regulation are a hidden tax on the consumer. This cost is buried in the form of higher prices but it is very real and often regressive. "Specific motors" must fill out the same forms as General Motors.

Thirdly, a variety of carefully researched examples of regulatory silliness have reached the public consciousness. The first was the dead haul — the ICC requirement that resulted in trucks returning empty even though there was ample opportunity to fill them up with cargo. You need no great expertise in transportation to resent this waste.

Our research into regulatory nonsense



focused increasingly on the Occupational Safety and Health Administration. OSHA jokes (based on that research) became a staple of business conversation. Did you hear about the OSHA rule that spittoons have to be cleaned daily? Is it true that OSHA made one little company build separate his and her toilets even though the only two employees were married to each other? Did OSHA really issue a bulletin to farmers telling them to be careful around cows and not to step into manure pits?

Nevertheless, a decade of reform of regulation has drawn to a close. How do we rebuild that earlier momentum? The sensible goal is not to try to reduce the burden on business by easing the enforcement of existing regulations. The idea of reforming regulation is not to let anyone off the hook. Rather, the idea is to ensure that the regulations are designed in a way that benefits the consumer. The objective should be to determine which regulations make sense and enforce them, which do not — and change or drop them. Let us try to develop such an approach.

Another Wave of Regulatory Reform

The very first step is educational. The public must come to understand that it is paying very substantially for all those supposedly good things that government regulators are doing for it. Economists are like doctors. Whenever I see my doctor, he takes my blood pressure.

Economists are prone to take measurements of economic phenomena and that also is helpful for making a diagnosis.



Saint Vincent College Economics majors Wen-Tong (Wendy) Li (center) and Frank A. Gamrat (left) discuss deregulation with Dr. Weidenbaum.

Information on the costs and benefits that flow from government regulation shows the public and the government itself the large amounts of resources that are devoted to meet federal mandates.

This helps to shift the public dialogue onto higher ground. The pertinent policy questions are no longer, "Are you for or against clean air or safe products?" or any other such absolute. Increasingly, the public discussions are in terms of such less emotional and long-neglected questions as, "How well is the regulatory process working?" and, "Are there better and less expensive ways of achieving the public's desires?"

In passing new laws, Congress should use the kind of common sense that a federal appeals court did when it stopped OSHA from issuing new benzene regulations. Let me quote from the court's language: "Although the agency does not have to conduct an elaborate cost/benefit analysis . . . it does have to determine whether the benefits expected from the standards bear a reasonable relationship to the costs imposed by the standard."

The second step is to recognize that creating a government bureau and giving it large amounts of money and power does not necessarily mean that the air will be any cleaner or the water any purer. The results may be the reverse. The environmental label has been used to justify subsidies to politically powerful regions of the country. In a misguided effort to keep off the market medicines that may generate any adverse side-effects whatever the regulatory authorities often deprive patients of newer, and more effective products.



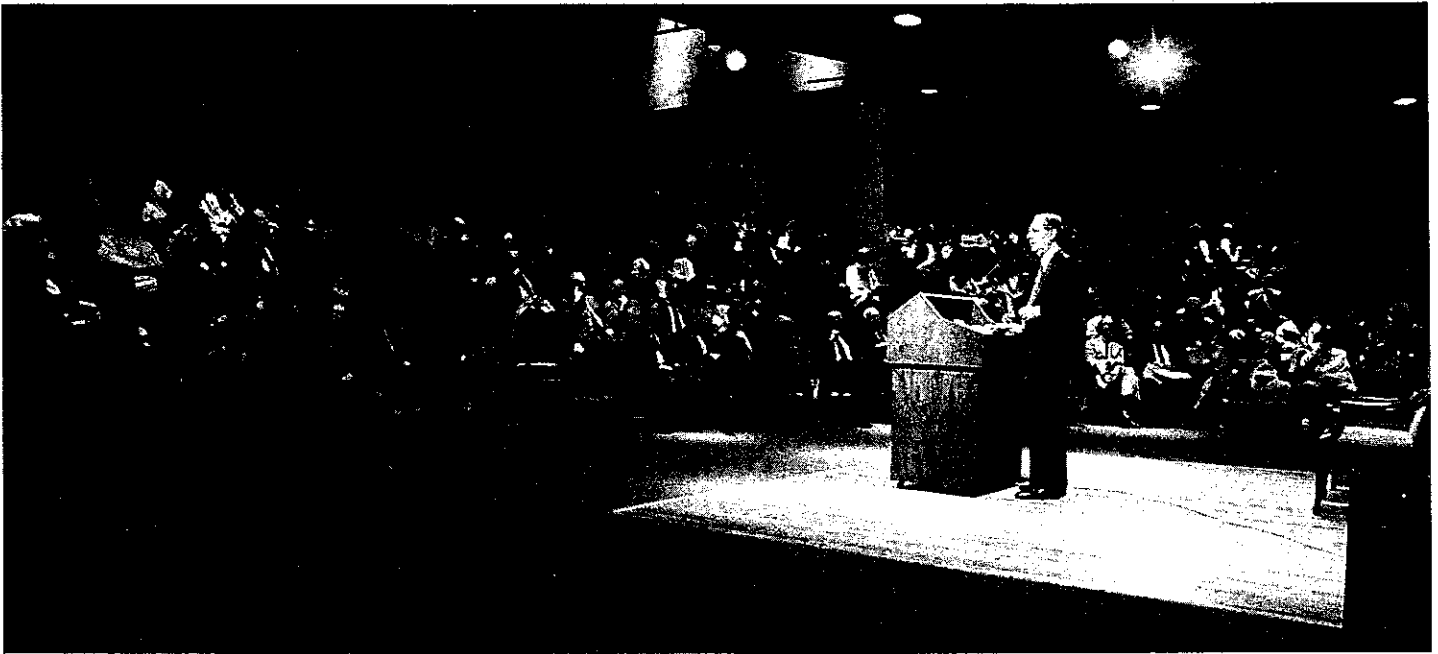
Government decisions increasingly affect what we wear, what we eat, and how we play . . .

Regulatory activity often generates unexpected negative effects, such as stifling innovation. I am not sure whether Henry Ford's original model T could have survived today's environmental challenges. Moreover, the darn thing was dangerous; why, you could break your arm cranking it.

The third step is to sort out those regulatory programs that are worth the costs they impose from those that fail a benefit/cost test. The regulation of the airline market by the now defunct Civil Aeronautics Board (CAB) was an example of regulatory activities not worthwhile. The elimination of the CAB has lowered the cost of air travel and increased the travel choices available to most passengers.

On the other hand, despite their many shortcomings, the social regulatory agencies such as the Food and Drug Administration do contribute to the public welfare. That does not necessarily mean that every FDA rule is well written or even necessary.

For all of these regulatory activities, we need to know more about their costs to the consumer and their impact on inflation and employment. We can draw a parallel



Dr. Weidenbaum address a full house in the Saint Vincent College Science Center Amphitheatre.

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to macroeconomic matters, where we always recognize that we have to deal with several important and conflicting objectives. Congress knows it has to tradeoff among such important goals, as less unemployment and less inflation. It's not an either/or matter.

In reforming regulatory programs, emphasis should be placed on developing basic principles (such as economic incen-

About the Series

The Alex G. McKenna Economic Education Series is presented by the Saint Vincent College Departments of Economics and Business Administration. These periodic lectures are open to the general public and their purpose is to explore the role of free markets in solving many of the social problems confronting the United States and the world today. Dr. Gary M. Quinlivan, associate professor of economics at Saint Vincent, directs the series.

The Alex G. McKenna Economic Education Series is made possible by a grant from the Philip M. McKenna Foundation Inc. of Latrobe.

tives) to guide the companies subject to regulation. Giving companies an incentive to do good is far more efficient than the traditional case-by-case adjudication so beloved by attorneys.

Requiring all regulatory agencies to perform benefit-cost analysis of proposed regulations is a useful check on counterproductive government activity. To an economist, "overregulation" is not an emotional term. It is merely shorthand for regulation for which the costs to the public are greater than the benefits.

Some supporters of the status quo in regulation are offended by the notion of subjecting regulation to a benefit/cost test. But they unwittingly expose the weakness of their position. They must fear that their pet rules would flunk the test. After all, showing that a regulatory activity generates an excess of benefits is a strong justification for continuing it.

Benefit/cost analysis is a neutral concept. It gives equal weight to a dollar of benefits and to a dollar of costs. Because resources available to safeguard human lives are limited, economists become concerned when we see regulation wasting those resources.

Regulatory reform is not a matter of technical measurements or administrative procedures. Government decision makers need to view the whole idea of regulation differently than they do now. Government should not rely on federal rules to control every facet of private behavior. Regulation is a powerful medicine to be used with great care and discretion and with full attention to its side effects.

Basically, it is attitudes that need to be changed. Experience with job safety

provides us with a cogent example. Although the government's safety rules have required billions of dollars in public and private outlays, the goal of a substantially safer work environment has not been achieved.

A more satisfying answer to improving the effectiveness of government regulation of private activity requires a major change in the approach to regulation, and one not limited to the job safety program. If the objective is to reduce accidents, then public policy should focus directly on the reduction of accidents. Excessively detailed regulations are often merely a substitute — the normal bureaucratic substitute — for hard policy decisions.

Rather than placing emphasis on issuing citations to employers who fail to fill forms out correctly or who do not post the required notices, stress should be placed on regulating those employers with high and rising accident rates. Perhaps fines should be levied on those establishments with the worst safety records. As the accident rates decline toward some sensible standard, the fines could be reduced or eliminated.

But the government should not be much concerned with the specific way an organization achieves a safer working environment. Some companies may find it more efficient to change work rules, others to buy equipment, and still others to retrain workers. Making this choice is precisely the kind of business decision that government is not good at and should avoid making.

Six-Part Agenda

If my four points have you convinced, let

me now offer a six-part agenda for revising the regulation of business in the United States:

1. *Environmental regulation should make much more use of market-based approaches.* For example, the legislation on water pollution control should be overhauled. Rather than requiring specific control technologies to be used to reduce pollution, government authorities should charge effluent fees on the amount of pollution being discharged into the nation's waterways. The primary objective of this approach is to provide an incentive for reducing pollution in the first place.

The idea is to allow the polluter to choose the methods to be used in achieving the desired level of environment cleanup. That alone will reduce compliance costs and simultaneously accelerate cleanup. Furthermore, by increasing prices of high-polluting products, consumers are motivated to purchase cheaper, less polluting competitive products. To be effective year in and year out, anti-pollution efforts cannot be based solely on idealism. Harnessing the power of the marketplace is much more reliable. It also would be more cost-effective than the present reliance on standards, which almost invariably are postponed because of court battles.

2. *Progress on deregulation of transportation should be accelerated.* The agencies that still regulate prices, entry and exit of firms in the transportation industry — the Interstate Commerce Commission and the Federal Maritime Commission — should be eliminated. Their interment would end the CAB's monopoly of the federal graveyard for regulatory commissions.

3. *Outmoded regulation of financial institutions should be reduced.* Statutes that unduly restrict competition in the banking system should be repealed. I mean the McFadden

Act which limited the geographic expansion of commercial banks and the Glass-Steagall Act which inhibits their entry into other types of financial services. Enforcement of banking regulation could then focus on serious cases of fraud and similar lawbreaking, rather than handicapping American banks in tough worldwide competition.

4. *The regulation of exports should be cut back drastically.* Of course, export controls on military equipment should remain. But the U.S. lost part of the world market for soybeans during a temporary embargo of that grain in the 1970s. Soybeans are hardly a military secret. That embargo convinced many countries that we are not a reliable supplier. Japan responded by investing in new soybean production in Brazil. I do not dump on the Japanese for doing that. Sometimes our government does very stupid things. These self-inflicted wounds should be avoided in the future.

5. *The regulation of imports through quotas should be stopped.* Numerical limits on imports hurt consumers far more than they benefit the industry they are designed to protect. At least tariffs raise revenue for the Treasury and that helps American taxpayers. Most of the benefits of the quotas on imported Japanese cars, in contrast, went to the Japanese because they could charge higher prices. The Feds forgot elementary economics: Reduce the supply and the price goes up.

6. *A fundamental rewrite is needed of the laws governing environmental regulation.* Setting unrealistic goals is more than merely wishful thinking by the Congress. It undermines public confidence in the overall effectiveness of government activities. For example, in giving EPA the task of overseeing the cleansing of the nation's water, the Congress established the goal of "zero discharge" of untreated waste

by 1984. Of course, the task was impossible but Congress knew it at the time.

Public Understanding

The most fundamental need is to help the public understand the limits of government regulation. Even if the EPA were staffed entirely with Newtons and Einsteins, it could not meet the present statutory expectations of cleaning all of the water, air, and land in and around the United States. Nor can the Consumer Product Safety Commission effectively regulate the 2 million companies producing the 10,000 products within its jurisdiction.

The need is not for greater compassion, commitment, or technological expertise — those we have in abundance. What is required now is the willingness and the courage to make difficult choices among the many alternative demands for government regulation of private activity.

To return to the medical analogy I used earlier, regulation is a powerful medicine. The congressional doctor should prescribe it in small doses. Moreover, it is an expensive medicine and the consumer winds up paying for it. But sometimes the congressional doctor is a quack, and he finds that it is a lot of fun to try to do good — with other people's money. But we citizens are those other people and it truly is our money.

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