BOOK REVIEWS

REGULATING THE REGULATORS

REFORMING FEDERAL REGULATION. By Robert E. Litan and William D. Nordhaus. New Haven: Yale University Press, 1983. Pp. x, 204. Price $7.95.

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First we had market failure; so we tried regulating markets. Then we had regulatory failure; so we tried reforming regulation. Now, it seems, we have "reform failure." That, at least, is the message of a recent book on regulatory reform written by Robert Litan and William Nordhaus, based on their experience as "watchdogs of the regulatory process" in President Carter's Council of Economic Advisors.[1] *Reforming Federal Regulation* argues that, despite its promise, regulation has failed to cure market failure and that the reforms attempted to date have failed to cure regulatory failure.

But, say Litan and Nordhaus, there is hope—the reform agenda is not yet exhausted. The problem with regulatory reformers, like regulators themselves, is the insufficient grandeur of their vision. Regulatory reform has had too narrow a scope. What is needed, the authors maintain, is the establishment of a "centralized process for coordinating regulation to parallel that of expenditures . . . ."[2] Congress must set a "budget" for all major regulatory activities "so that scarce national resources would be channeled first toward meeting the problems of greatest importance."[3] *Reforming Federal Regulation*, then, pushes the visible-hand logic of regulation to its outermost limit—proposing to subject the many visible hands of industrial or topical regulation to an omnipo-

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[1] R. LITAN & W. NORDHAUS, REFORMING FEDERAL REGULATION 1-2 (1983). Nordhaus was a member of the Council and Litan served on its staff. *Id.* at vii. The CEA was an active participant in the Regulatory Analysis Review Group, created by President Carter in 1977 to review major regulatory initiatives undertaken by executive agencies. *Id.* at 69. The authors summarize the regulatory efforts of the Carter administration. *See id.* at 67-78. Litan is now a Washington attorney, and Nordhaus is a professor of economics at Yale.

[2] *Id.* at 4.

[3] *Id.*

tent paw of centralized regulatory planning. In so doing, the authors unwittingly lay bare both the irony and, I feel, the poverty of that logic.

I

Litan and Nordhaus make clear at the outset their devotion to the norm of economic efficiency. The only legitimate role for regulation, as they see it, is to remedy market failure: "By and large, we do not consider the regulatory system an appropriate tool for income redistribution . . . . In our view, regulation is appropriately aimed toward correcting inefficient markets rather than rewarding particular groups."[4] For this reason, they reject as inherently inefficient most forms of "economic regulation," that is, control of prices and market entry, at least in structurally competitive industries. The "obvious solution" to inefficient regulation in these sectors, they assert without elaboration, is "deregulation."[5]

Up to this point, *Reforming Federal Regulation* follows in lockstep most contemporary regulatory criticism.[6] But Litan and Nordhaus break rank with the deregulators when they come to "social regulation,"[7] measures designed to correct health, safety, and environmental side effects or externalities that attend economic activities. Social regulation, they maintain, is "a valuable but easily subverted tool for attaining worthwhile social objectives."[8] It cannot, like most economic regulation, be dismissed out of hand. Rather, it must be "managed to be effective."[9] The authors attempt to show us how social regulation should be managed.

The first half of the book is devoted to a demonstration of the need for management. The authors begin by reviewing the empirical literature on the impact of regulation. Their admittedly sketchy account concludes that "in certain areas, regulation has produced discernible benefits,"[10] but that estimates of the magnitude of those benefits are extremely sparse and unreliable.[11] Estimates of regulatory costs are

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[4] *Id.* at 7.

[5] *Id.* at 6.

[6] *See generally* S. BREYER, REGULATION AND ITS REFORM (1982); C. SCHULTZE, THE PUBLIC USE OF PRIVATE INTEREST (1977); M. WEIDENBAUM, BUSINESS, GOVERNMENT AND THE PUBLIC (2d ed. 1981).

[7] R. LITAN & W. NORDHAUS, *supra* note 1, at 6. The term is not original with Litan and Nordhaus. *See, e.g.*, Weaver, *Regulation, Social Policy, and Class Conflict*, in REGULATING BUSINESS: THE SEARCH FOR AN OPTIMUM 193 (C. Argyris ed. 1978).

[8] R. LITAN & W. NORDHAUS, *supra* note 1, at 2.

[9] *Id.*

[10] *Id.* at 16.

[11] *Id.* at 14-16.

more plentiful but still sketchy and elastic.[12] The data do, however, convince the authors that regulation has had a significant adverse effect on the economy, probably accounting for about one-third of a percentage point drop in annual productivity gains over the past ten years.[13]

The authors' principal evidence for the asserted inefficiency of social regulation is a series of structural arguments, by now so familiar as to sound hackneyed. Congress creates regulatory programs, not out of a disinterested desire to achieve efficiency, but in response to the competing pressures of interest groups motivated by economic or ideological concerns.[14] It entrusts the administration of the programs to "single mission agencies," often independent of the political branches,[15] and requires those agencies to pursue "unrealistic objectives by constraining their abilities to balance costs against benefits in making regulatory decisions."[16] The agencies then proceed to regulate "narrowly and incrementally"[17] by using a quasi-judicial process of rulemaking.[18] The "tunnel vision" resulting from that approach not only prevents agencies from making efficient tradeoffs among competing goals, but also distances their decisions from any sources of popular support.[19]

What, then, is to be done? As Litan and Nordhaus observe, there is no dearth of proposals for reforming regulation: increased supervision (by Congress, the executive, or the courts), regulatory analysis (comparing costs and benefits of regulatory proposals), and deregulation (repealing regulatory statutes, slowing down the issuance of new rules, relaxing enforcement of existing rules, or reducing agency operating budgets).[20] Conceding that many of these ideas have their attractions, the authors nonetheless ultimately find them all to be wanting. In one way or another each suggested reform is too clumsy, incomplete, or fragmented to fill the need for regulatory "management."[21] Only a comprehensive, centralized process of oversight will do.[22]

The ideal form of comprehensive oversight, according to the authors, is the "regulatory budget." The regulatory budget is not a new idea. It has been discussed extensively within the federal government—although less so in the published literature—at least since

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[12] *Id.* at 32.
[13] *Id.* at 33.
[14] *Id.* at 39-42.
[15] *Id.* at 45-51.
[16] *Id.* at 90.
[17] *Id.* at 54.
[18] *Id.* at 56.
[19] *Id.* at 58.
[20] *Id.* at 100-32.
[21] *Id.* at 108-09, 113, 115-16, 119, 132.
[22] *Id.* at 4.

1978.[23] The notion is conceptually simple. Each year Congress would enact a regulatory budget, setting a ceiling on the costs that regulatory agencies could impose upon the economy during the upcoming fiscal year. As with the expenditure budget currently enacted by Congress to limit direct federal spending, regulatory agencies would have to operate within their budget ceilings.[24] Once agencies reached their limit, they could take no further actions that added costs to the economy, unless they obtained an additional appropriation.[25]

The regulatory budget has two principal attractions for Litan and Nordhaus. First, the process of executive and legislative approval would assure comprehensive review of the government's regulatory policy by the politically accountable branches of government.[26] Second, by forcing agencies to make tradeoffs among possible regulatory activities, the fixed ceilings should induce agencies to choose the most cost-effective activities.[27]

Litan and Nordhaus concede that the design of a workable regulatory budget requires answers to some difficult questions. What kinds of regulatory activities—"major" rules, minor rules, orders—should the budget cover? Should the ceiling be cumulative (covering costs imposed under old as well as new rules) or prospective (applicable to new rules only)? How would compliance with the ceilings be monitored and enforced? How would regulatory costs be estimated? Who would do it and at what stage? What would be the procedure for budget preparation and approval? What entities would be involved? After confronting these and other challenges,[28] the authors conclude that "[i]n our view, none of the problems . . . is individually great enough to dissuade us of the desirability of a regulatory budget. But taken together, they are sufficiently severe to make it unwise to move toward a budget plan in one leap."[29] Instead, as a first step, they propose adoption of a "legislated regulatory calendar" (LRC).[30]

Under the LRC proposal Congress would enact an annual list or

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[23] *See* DeMuth, *The Regulatory Budget*, REG., Mar.-Apr. 1980, at 29, 30. For other accounts, see J. ALLEN, THE PROPOSAL FOR A FEDERAL REGULATORY BUDGET—AN OVERVIEW (Cong. Research Serv., Pub. No. JH 2005 U.S. 1979); Wood, Laws & Breen, *Restraining the Regulators: Legal Perspectives on a Regulatory Budget for Federal Agencies*, 18 HARV. J. ON LEGIS. 1 (1981).

[24] These ceilings might be an aggregate figure for the agency as a whole or separate ceilings for each regulatory program.

[25] R. LITAN & W. NORDHAUS, *supra* note 1, at 134-35.

[26] *Id.* at 139.

[27] *Id.* at 140.

[28] *Id.* at 140-57.

[29] *Id.* at 157.

[30] *Id.* at 159.

"calendar" of the major regulatory initiatives that each agency would be authorized to undertake during the coming fiscal year. Except in certain narrowly defined "emergency" cases, no agency would be permitted to promulgate a major rule without prior authorization by way of its annual calendar or a supplementary calendar. Like any other legislation, the calendar would be submitted to the President and, once signed or passed over his veto, would be binding on the agencies. While the calendar would set no fixed ceiling on regulatory costs, agencies would be required to prepare preliminary cost and benefit estimates that would accompany each major rulemaking notice through the review process.[31] The visibility of these figures would, Litan and Nordhaus predict, impose on the two political branches a degree of fiscal discipline comparable to that attainable through adoption of a regulatory budget.[32]

The LRC avoids the regulatory budget's main stumbling block—the difficulty of accurately estimating regulatory costs.[33] But its architects confront many of the other design problems presented by the regulatory budget, plus a few of their own. A major problem is how to prevent the legislative approval process from getting hopelessly bogged down in disputes about particular proposed rules.[34] A second involves defining the extent to which agencies may deviate from their original (authorized) proposal in adopting a final rule.[35] Once again the authors grapple candidly and thoughtfully with the various practical objections, but this time they emerge sufficiently confident of the tractability of the problems to recommend immediate adoption of the suggested reform.[36]

II

Reforming Federal Regulation performs a useful service in two ways. First, it reviews and summarizes much of the burgeoning literature on regulatory reform in a brief and readable volume. Second, it makes a serious effort to work out the formidable design problems presented by the regulatory budget proposal, a proposal that has thus far been dismissed as impractical. While the ideas of the regulatory budget and the regulatory calendar are not original, the authors have given those proposals their fullest development thus far, at least in a

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[31] *Id.* at 159-73.
[32] *Id.* at 173-81.
[33] Litan and Nordhaus refer to this as the "funny money" problem. *See id.* at 133.
[34] *Id.* at 163-67.
[35] *Id.* at 168-69.
[36] *Id.* at 181-82.

widely accessible medium.

The argument constructed by the authors to support their ultimate recommendations, however, exhibits a number of serious flaws that impair its persuasiveness. One of these flaws is the authors' ambivalence about the criterion by which to judge regulators' performance. While economic efficiency is clearly the authors' beacon, a strong democratic impulse also runs through the book. The authors want regulators to be politically responsive as well as economically efficient,[37] yet, as they themselves maintain, the political process often seems deliberately to adopt inefficient regulatory policies.[38] The authors content themselves with criticizing regulation as *both* inefficient and undemocratic, without squarely confronting the potential for conflict between the two goals.

This may explain the deficiency in the book's discussion of the use of economic incentives (taxes, fees, or marketable rights) to deal with the external costs of economic activities. The authors seem to side squarely with advocates of the "incentives" approach.[39]

Yet one can make the case that, under certain circumstances, command-and-control regulation is theoretically superior to the use of incentives. Indeed, a number of social scientists have done so.[40] But Litan and Nordhaus do not even discuss this literature, much less endorse its findings. Thus, their acceptance of social regulation appears to be based on its manifest popular (or at least legislative) support.

A second flaw is the book's disconcertingly conclusory style of argument. The problem with regulation, the reader is repeatedly informed, is its lack of coordination.[41] The solution is (voila!) coordination. But what precisely is coordination, and why is its absence to be lamented? To a large extent the authors' response to such questions is to bury them under a barrage of repetitious but non-illuminating assertions. At one point they attempt to justify the need for coordination with the following generalization: "There is a need in any organization or society for an oversight mechanism, that is, a process of higher-level review of the decisions made by individuals and institutions at lower

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[37] *Id.* at 102-03 (referring to a need for an institutional mechanism that would "increase the political accountability of the regulatory agencies").

[38] *See id.* at 34, 39. Support for this explanation of regulatory "failure" is legion. *See, e.g.*, Posner, *Taxation by Regulation*, 2 BELL J. ECON. 22 (1971); Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. 3 (1971).

[39] R. LITAN & W. NORDHAUS, *supra* note 1, at 37-39, 97-98. For a discussion of the incentives approach, see, e.g., W. BAXTER, PEOPLE OR PENGUINS: THE CASE FOR OPTIMAL POLLUTION (1974); J. DALES, POLLUTION, PROPERTY AND PRICES (1968); C. SCHULTZE, *supra* note 6.

[40] *See, e.g.*, White & Wittman, *A Comparison of Taxes, Regulation, and Liability Rules Under Imperfect Information*, 12 J. LEGAL STUD. 413 (1983).

[41] *See, e.g.*, R. LITAN & W. NORDHAUS, *supra* note 1, at 2, 3, 34, 45, 47, 49, 53.

levels."[42]

That plainly will not do. The social institution that the authors seem most to admire—the market—operates to a large extent without any coordination or "oversight" mechanism whatever. Admittedly, the authors do offer less conclusory arguments for regulatory oversight, but better argument cannot escape the basic contradiction inherent in proposing regulatory solutions to regulatory "failure." In this respect, *Reforming Federal Regulation* typifies much of the recent literature on regulatory reform. After taking great pains to show that command-and-control regulation has produced all sorts of perverse results,[43] Litan and Nordhaus recommend as a remedy a new system of command-and-control regulation to be applied to the regulators themselves. The danger, of course, is that the new system of regulation will be plagued by the same defects to which primary regulation is itself subject.[44]

III

To understand the irony of Litan and Nordhaus's argument, it is necessary first to understand what economists mean by regulatory failure. Regulation is a response to "market failures" such as monopoly, imperfect information, and externalities.[45] As Ronald Coase has shown, all the conventional categories of "market failure" can be reduced to "transaction costs"[46]—the costs for consumers to gather and assimilate product safety information, to bribe polluters to reduce emission levels, or to bribe monopolists to expand output. In other words, economists use the strikingly peculiar language of "failure" to acknowledge the reality that obtaining information and negotiating agreements consume resources.[47] Markets "fail," then, only *if* (and to the extent that) there exists some nonmarket mechanism that could reduce transaction costs. "Regulation" is one plausible candidate in the search for such a mechanism.

The normative basis for deciding whether to adopt or retain any particular regulatory program depends on whether the program increases social welfare by lowering transaction costs or by replicating the effects of market exchanges that might occur only if transaction costs

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[42] *Id.* at 60.
[43] *See id.* at 94-96.
[44] *See generally* Goldberg, *Institutional Change and the Quasi-Invisible Hand*, 17 J.L. & ECON. 461 (1974).
[45] R. LITAN & W. NORDHAUS, *supra* note 1, at 36.
[46] Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).
[47] *See generally* Calabresi, *Transaction Costs, Resource Allocation and Liability Rules—A Comment*, 11 J.L. & ECON. 67 (1968).

were lower. Positive or descriptive economic theory suggests some plausible reasons why government regulation *might* economize on the cost of transactions. Some of the activities involved in market transactions, such as production and dissemination of information, may be subject to economies of scale. As a centralized decisionmaker, the government can presumably realize economies of scale unavailable to individual consumers or producers. But scale economies by themselves provide no argument for *governmental* intervention. All that is required is a large enough private producer to realize those same efficiencies. Government's advantage lies instead in its coercive powers. By using those powers, the government can overcome difficulties, including the "free rider" problems, that would plague private efforts to organize consumers or producers.[48]

Positive economic theory, however, can equally well be used to predict that government regulation will not correct market failures. Regulators have, according to this theory, the same self-seeking motivations as private producers[49] but lack the constraints imposed by competition. As Litan and Nordhaus themselves argue, "There is no invisible hand to coordinate activities in the public sector, however; resources will not be allocated efficiently in the absence of some type of decisionmaking apparatus to perform the role that the market assumes in the private sector."[50] Like private monopolists, regulators will exploit the resulting "market power" to maximize such private goals as votes, future income, budgets, or prestige.

A vast literature catalogs the forms of behavior said to flow from the market power of public officials. Legislators vote to authorize programs in exchange for votes or campaign funds or as a way to generate future "casework opportunities."[51] Legislative districting and voting rules generate logrolling behavior.[52] The high transaction costs of legislating induce legislatures to delegate broad lawmaking authority to administrative agencies.[53] Agency heads cater to powerful, well-organized

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[48] *See* M. OLSON, THE LOGIC OF COLLECTIVE ACTION 148-53 (1971).

[49] *See, e.g.*, Eckert, *On the Incentives of Regulators: The Case of Taxicabs*, 14 PUB. CHOICE 83, 84-86 (1973); Hilton, *The Basic Behavior of Regulatory Commissions*, 62 AM. ECON. REV. 47 (1972).

[50] R. LITAN & W. NORDHAUS, *supra* note 1, at 45.

[51] Generating casework opportunities refers to the propensity of legislators to vote to create those programs that will give them an opportunity to intervene on behalf of their constituents. *See, e.g.*, M. FIORINA, CONGRESS: KEYSTONE OF THE WASHINGTON ESTABLISHMENT 44-45 (1977); Fiorina & Noll, *Voters, Legislators and Bureaucracy: Institutional Design in the Public Sector*, 68 AM. ECON. REV. 246 (1978).

[52] *See, e.g.*, Weingast, Shepsle & Johnsen, *The Political Economy of Benefits and Costs: A Neoclassical Approach to Distributive Politics*, 89 J. POL. ECON. 642 (1981).

[53] *See, e.g.*, Ehrlich & Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257, 267-68 (1974).

constituencies who can deliver present political support or future jobs.[54] Bureaucrats seek to expand their jurisdictions so as to increase their budgets.[55] Risk-averse rulemakers demand extravagant precautions against low-probability, high-visibility events and favor easily policed specification standards over more flexible performance standards.[56]

Of course, a system in which people behave this way *might* nonetheless produce efficient outcomes, but it could do so only as a result of either chance or some mechanism that would serve the same function as the market's invisible hand. Litan and Nordhaus are understandably not willing to put their faith in chance, and they flatly deny the existence of an invisible hand in the public sector.[57] Some observers might be content at this point simply to abandon the idea that regulation can improve upon the operation of markets. Litan and Nordhaus, however, are not prepared to give up on regulation. If the problem is the lack of an invisible hand, they reason, then we must create a visible one. We must, in other words, regulate the regulators.

The legislated regulatory calendar proposed by Litan and Nordhaus is a classic example of command-and-control regulation. Indeed, it bears a striking resemblance to the "antiquated" industry-specific economic regulatory schemes for which the authors have so few (and such unkind) words.[58] In the legislated regulatory calendar scheme, members of a regulated industry (regulatory agencies) are forbidden to enter a particular line of business (issue a "major" rule) without obtaining a license (prior legislative approval, memorialized by inclusion in a legislated regulatory calendar) from a regulatory body (Congress). If the system works as the authors expect (within a congressional ceiling on the number of major rules to be promulgated), the regulator will have to make many judgments among numerous applications, unguided by any articulated selection standards.

Analogies to this system that come readily to mind include broadcast licensing by the FCC, airline route awards by the CAB, or carrier certification by the ICC. The economically perverse results generated by these discredited regimes certainly do not counsel much optimism about the LRC. Indeed, the "regulated industry" affected by the LRC proposal is composed of precisely the same agencies whose regulatory

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[54] *See, e.g.*, M. BERNSTEIN, REGULATING BUSINESS BY INDEPENDENT COMMISSION 88-95 (1955).

[55] *See generally* W. NISKANEN, JR., BUREAUCRACY AND REPRESENTATIVE GOVERNMENT 36-42 (1971).

[56] *See, e.g.*, E. BARDACH & R. KAGAN, GOING BY THE BOOK: THE PROBLEM OF REGULATORY UNREASONABLENESS (1982).

[57] R. LITAN & W. NORDHAUS, *supra* note 1, at 45.

[58] *See id.* at 6.

behavior has been so insistently criticized as burdening the economy with excessively costly rules. And the "regulator" is the same Congress that a generation of revisionists has accused of deliberately using regulation as an engine for the redistribution of wealth and power in our society.

Litan and Nordhaus presumably would respond that their proposal does create new institutional actors not present in conventional regulation—the centralized bodies in the executive and legislative branches that must review agencies' requests and assemble them into a proposed calendar. They are probably correct in predicting that these entities, like their counterparts in the expenditure budget process, will develop an organizational bias in favor of reducing regulatory costs.[59] That is not, however, necessarily the same as a bias in favor of efficiency. Nor does that fact alone tell us how much influence these entities will actually have on legislative outcomes. The experience of centralized congressional budget review since 1974 does not counsel great optimism on that score.[60]

Of course, the principal difference between the LRC and conventional economic regulation is not so much the identity of the players as the rules of the game. Agencies would be required to justify and Congress to evaluate regulatory policy at a new stage (the notice of proposed rulemaking). The players would follow a new procedure (an annualized authorization) and apply a new criterion for justification (comparative merit). Arguably, the greater visibility of the process would impose an efficiency-promoting discipline on both sides, an influence not present in conventional regulation.[61]

But one can just as easily predict the opposite outcome, and for many of the same reasons that entry regulation has produced such economically perverse results in industries like broadcasting and transportation. Agencies will engage in evasive action to avoid the cost, delay, and uncertainty of securing a "license" by splitting "major" rules into smaller ones not subject to the LRC, proceeding by adjudication or jawboning rather than rulemaking, or by favoring rules with low visible costs but high secondary costs. Having obtained approval of relatively noncontroversial rules, licensees will exploit congressional inertia in an effort to obtain drastic modification of those previously approved

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[59] *See id.* at 148-49, 177-78.

[60] *See* D. IPPOLITO, CONGRESSIONAL SPENDING: A TWENTIETH CENTURY FUND REPORT (1981). Ippolito concludes that while the Senate Budget Committee has been "influential," *id.* at 103, the House Budget Committee has displayed "relative weakness," *id.* at 80. Overall, he asserts that budget centralization in Congress has had little effect on budget policy or spending levels. *Id.* at 243-44, 256.

[61] *See supra* note 32 and accompanying text.

regulations. The established support for existing programs will create barriers to entry by newer (and more efficient) programs that must compete for scarce legislative attention and authorizations.

As the analogy to the expenditure budget reminds us,[62] it will be impossible for Congress to give a full comparative evaluation to the dozens of proposals it will receive each year. Instead, Congress will examine closely only a handful of controversial measures, effectively delegating most of its authority to committees, legislative staff, or the executive. Lacking the revenue constraint that operates at least loosely in expenditure budgeting, it may follow the path of least resistance by including dubious proposals in the calendar. To their credit, Litan and Nordhaus anticipate many of these objections.[63] But they offer no convincing basis for reconciling so rosy a vision of legislative regulation with so bleak a vision of administrative regulation.

In theory, the regulatory budget escapes many of these criticisms. It does not rely on classical command-and-control techniques. Indeed, it most strongly resembles the financial incentive approaches so favored by economists.[64] The fixed dollar ceiling gives agencies an incentive to make tradeoffs among potential regulatory projects, favoring those that promise to have the greatest payoff relative to their costs. By accentuating the opportunity cost of each rulemaking proceeding—the cost of promulgating one rule in place of another—the budget forces agencies to "internalize" regulatory burdens rather than simply impose them upon others.[65]

Even in theory, however, the regulatory budget falls far short of a true cost-internalizing incentive scheme like a pollution tax.[66] While to some extent the budget encourages tradeoffs among regulatory proposals, it provides no assurance that agencies will use a currency even remotely resembling social benefit to value competing rules. By itself, the regulatory budget will not alter regulators' intrinsic motivations. They will presumably continue to value a proposal by its contribution to such private goals as votes, future income, prestige, or the like. The regulatory budget will simply put a cap on the amount of personal "profit" they can earn. It will enhance social welfare only if the rules scrapped to fit the budget would have produced less social benefit than cost. But, given the motivational assumptions underlying most theories of regula-

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[62] *See* A. WILDAVSKY, THE POLITICS OF THE BUDGETARY PROCESS 8-16 (1964).
[63] *See supra* notes 34-35 and accompanying text.
[64] *See* DeMuth, *supra* note 23, at 30.
[65] *See* R. LITAN & W. NORDHAUS, *supra* note 1, at 89.
[66] *See* J. DALES, *supra* note 39, at 81-100.

tory failure, such a result need not follow.[67]

The problems of valuation and enforcement that beset the architects of incentive schemes[68] are especially troublesome in this context. As Litan and Nordhaus concede, measuring regulatory costs is an extremely inexact science.[69] It is difficult not only to obtain reliable data on many cost items but also to distinguish effects caused by a particular rule from those that would have resulted in any event from competitive pressures, technological developments, or legal changes. Any workable system of regulatory cost accounting will require drastic simplification.

Litan and Nordhaus favor a prospective budget that sets a ceiling only on the cost of new rulemakings, a cost estimated once and for all at the time of promulgation of the rules.[70] This expedient greatly reduces the computational burden of a cumulative budgeting system. Yet, it introduces enormous difficulties of its own and in fact defeats some of the benefits of the budget. Estimation of the lifetime costs of a rule, made six to twenty-four months prior to its issuance and without benefit of extensive public comment on the rule's actual content, is hopelessly conjectural. Because regulators will have an incentive to underestimate the costs, some less interested entity will have to review the estimates. Yet, unless that entity conducts a full-scale review, its estimates will be no more credible than those of the regulators themselves. A prospective regulatory budget, then, creates ineluctable pressures to centralize regulatory decisionmaking. It effectively defeats the putative advantages of decentralized incentive systems, which appeared at first to be one of the major strengths of the regulatory budget.

The adoption of a prospective approach to regulatory budgeting, moreover, renders inapt the expenditure budget analogy on which the authors rely so heavily. A regulatory budget that controls the level of costs imposed on society over the life of a rule resembles a capital budget much more closely than an operating budget. Since each year's regulatory budget would aggregate a group of rules having varying lifetimes and temporal cost distributions, the ceiling figure would communicate little useful information about the absolute magnitude of the regulatory burden imposed on the economy. Nor could meaningful comparisons be drawn between the ceiling figures for two adjacent years. As a consequence, the budget ceilings would lose much of their

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[67] *See supra* notes 49-56 and accompanying text.

[68] For a discussion of these problems, see Russell, *What Can We Get From Effluent Charges?*, 5 POL'Y ANALYSIS 155 (1979); Wenner, *Pollution Control: Implementation Alternatives*, 4 POL'Y ANALYSIS 47 (1978).

[69] *See* R. LITAN & W. NORDHAUS, *supra* note 1, at 150-52.

[70] *Id.* at 142-43, 145.

value as a method of disciplining Congress. In addition, the notorious habit of politicians to mortgage the future would apply to a regulatory budget as fully as to a capital expenditure budget. Congress would discount future costs at a rate far higher than that set by the economy.[71]

Finally, some of the same problems of evasion that were evident with the LRC appear with the regulatory budget. Agencies would be able to circumvent the regulatory budget by avoiding "major" rulemakings and by favoring plans with low measurable costs but high indirect costs.

IV

Litan and Nordhaus justly criticize what they call the "lawyer-regulator's approach" to regulation—the philosophy "which simply orders that which is broken to be fixed . . . ."[72] As we have often learned to our regret, that which appears to be broken is often not broken at all, or the suggested cure may prove to be worse than the supposed disease. When Litan and Nordhaus turn from diagnosis to prescription, however, they fall into the same lawyer-regulator trap that they criticize. Regulation is broken (fragmented), they say; it must be fixed (coordinated).

Like the proregulatory zealots who find market failures under every rock, the authors too readily dismiss the idea that regulatory markets might be subject to an invisible hand.[73] As regulation progresses through cycles of authorization, promulgation, enforcement, and modification, it affords countless opportunities for interaction through political, legal, and bureaucratic processes[74] between those who produce and those who consume regulation. Moreover, by focusing almost exclusively on authorization and rulemaking, Litan and Nordhaus ignore the important role played by enforcement. Increasingly, students of regulation have observed that the enforcement process serves as a safety valve to relieve the apparent rigidity of specification standards.[75]

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[71] *See* Diver, *The Optimal Precision of Administrative Rules*, 93 YALE L.J. 65, 104 (1983).

[72] R. LITAN & W. NORDHAUS, *supra* note 1, at 95.

[73] For an argument that bureaucracy is subject to internal competitive forces, see Dobra, *Property Rights in Bureaucracies and Bureaucratic Efficiency*, 40 PUB. CHOICE 95 (1983).

[74] *See generally* C. LINDBLOM, THE INTELLIGENCE OF DEMOCRACY: DECISION MAKING THROUGH MUTUAL ADJUSTMENT (1965).

[75] *See, e.g.*, Diver, *A Theory of Regulatory Enforcement*, 28 PUB. POL'Y 257, 279 (1980); Easterbrook, *Criminal Procedure as a Market System*, 12 J. LEGAL STUD. 289 (1983); Veljanovski, *Regulatory Enforcement: An Economic Study of the British Factory Inspectorate*, 5 LAW & POL'Y Q. 75 (1983).

Of course this system does not operate as efficiently as the market of economists' dreams. Neither do real-world markets. The regulatory market will theoretically be most influenced by interest groups having low organization costs and concentrated, high stakes.[76] As recent history demonstrates, however, the regulatory market does not always work in this fashion and often rewards entrepreneurs skilled at aggregating a large number of very small claims against the system.[77] Whatever its flaws, the regulatory market ought to register reasonably accurately the magnitude of societal opposition to the costs of health, safety, and environmental regulation. For the most part, those costs fall initially on the business sector, that segment of society most likely to make effective use of existing political weapons. True, business may take a while to fashion an effective response, but it can, and demonstrably has responded.[78] The shift in regulatory policy during the Reagan administration[79] has resulted not so much from the creation of new visible-hand institutions, such as OMB's regulatory review, as from the enhanced political muscle of the businesses on whom regulatory costs have fallen.

Litan and Nordhaus would commit scarce social resources to institutionalize the political pressures now exerted on the regulatory process. They would propel all significant regulatory decisions to the uppermost level of political action where only the most powerful can play on any sustained basis. If they are genuinely concerned about efficiency, they should remember the power of marginal analysis. Scarce analytical, legal, and legislative resources should be expended on regulatory rules and programs where they will do the most good, not on the construction and maintenance of elaborate systemic reforms that are as likely to kill good projects by delay or inertia as to kill bad projects by analysis. Public policy is made incrementally, and it will be remade or unmade incrementally as well.

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[76] *See, e.g.*, R. NOLL, REFORMING REGULATION: AN EVALUATION OF THE ASH COUNCIL PROPOSALS 39-42 (1971).

[77] *See* Wilson, *The Politics of Regulation*, in THE POLITICS OF REGULATION 369 (J. Wilson ed. 1980).

[78] According to a recent survey of 400 business firms, there has been a substantial increase in the level of business lobbying during the past decade. *See* PUBLIC AFFAIRS RESEARCH GROUP, BOSTON UNIVERSITY SCHOOL OF MANAGEMENT, PUBLIC AFFAIRS OFFICERS AND THEIR FUNCTIONS, SUMMARY OF SURVEY RESPONSES 7-9, 11 (1981) (34% of Washington offices and 94% of corporate political action committees established during the period 1975-1979). The reporting companies expressed overall satisfaction with their degree of influence in federal policymaking. *See id.* at 12 (80% describing their Washington presence as at least "moderately" effective at influencing legislation and representing the company's interests before rulemaking agencies).

[79] *See* R. LITAN & W. NORDHAUS, *supra* note 1, at 119-32.