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Before the
Subcommittee on Administrative Law and Government Relations
Committee on the Judiciary
United States House of Representatives

On

The Regulation Reform Act of 1979 (H.R.3263)

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Mr. Chairman and Members of the Committee:

We are pleased to be here to testify on H.R.3263, the Regulation Reform Act of 1979, which we understand is the Administration's regulatory reform bill.

The GAO strongly supports the general thrust of this bill that regulatory agencies should carefully and comprehensively evaluate the effects of proposed and existing rules as has been required for Executive agencies by Executive Order 12044. We do, however, want to point out a number of issues that this Committee should consider and to make some specific suggestions for improving this bill.

DEFINITION OF A MAJOR RULE

H.R.3263 defines a major rule as one that is likely to result in an effect on the economy of at least $100 million. Additionally, the bill accounts for the problem of differential impact by adding to the $100 million threshold the additional standard that the rule is major if it will cause a substantial change in costs or prices for individual industries, geographic regions, or levels of government. The bill provides that a major rule is also any rule that an agency otherwise determines will have a "major impact."

It is not clear why the monetary standard is set at $100 million except that this is the amount that was used in Executive Order 12044. $100 million may be too high or not high enough. Or, it may be that no single dollar figure is appropriate and the purposes of the legislation may be served just as well by using qualitative standards. Indeed, in its assessment of the implementation of that Executive Order, the Office of Management and Budget acknowledged that the $100 million criterion had been used by agencies as a barrier to analysis.

If any specific dollar figure is to be used, the intended components of that figure need to be defined. As presently drafted, the bill is not clear about what is meant by a $100 million effect.

An effect on the national economy of $100 million might include new economic costs such as direct compliance costs and secondary costs, the shift of existing costs from one segment of society to another, and the transfer of monetary income from one group to another. Summing such costs is problematical because they are not additive and because that could result in double counting. Furthermore, an economic effect could also be interpreted as the sum of the costs and benefits of a rule. If you decide to retain a specific dollar criterion, we suggest that it be defined as the incremental costs of compliance to directly regulated industries or other entities (local governments, etc.). These projected compliance costs cannot be estimated precisely, but they are far easier to estimate in advance than any other specific economic effect.

The ease of measurement is important because agencies should not be required to perform extensive analysis just to determine if another analysis is required.

Although this triggering device cannot be too rigid or precise because it is based on prior estimates of cost impacts, setting a specific dollar figure in the legislation also could be troublesome. If there is continued inflation, an increasing number of regulations will come under this standard over the coming years. We therefore suggest that the impact standard be indexed to an appropriate inflation index such as the GNP deflator so that the monetary threshold will be implemented in constant dollars. Alternatively, the President could be given authority to adjust the figure.

THE SECTORAL IMPACT OF REGULATION

By including in the definition of major rules those that may cause a substantial change in costs or prices for individual industries, geographic regions, or levels of governments, H.R.3263 appropriately responds to an important regulatory issue. A proposed rule that might fall short of having a $100,000,000 impact nationally might still be of crucial importance to a small industry, a State or region, or municipal governments. Rules with such concentrated impacts should also be carefully analyzed.

A problem with some regulations in the past is that they had adverse effects on the structure of an industry. For example, regulations may impose such a heavy burden on small business, that smaller firms are shut down thereby increasing concentration in the industry. Conversely, regulations may create incentives for inefficiently small scale operations. For example, in a recent report to the Congress, U.S. Refining Capacity: How Much Is Enough? (EMD-78-77, January 15, 1979), GAO concluded that crude oil price reductions offered to small refiners under the Department of Energy Entitlements Program encourages the construction of small, inefficient refineries. The extent to which a regulation has an impact on the structure of an industry cannot be precisely known in advance. Nonetheless that potential projected impact should be part of a regulatory analysis and the potential for a significant structural change should lead to a regulatory analysis. Therefore, we suggest that the definition of a major rule in section 601(4)(c) also include rules that the proposing agency estimates will have a substantial impact on the structure of an affected industry.

Similarly, inasmuch as there are numerous government programs to protect and promote small business, we recommend that the regulatory analysis include the special effects, if any, on small businesses within affected industries.

GUIDELINES FOR ANALYSIS

With some reservations, we support the guidelines for the initial and final regulatory analyses set forth in the bill, and we would like to present our views on how those guidelines can be most effectively implemented.

The analysis is required to contain a succinct statement of the need for and the objectives of the rule. The goal of regulation is often the correction of some undesirable condition such as the sale of hazardous products, deceptive advertising or unstable economic conditions. There are, however, many possible causes of these and other undesirable conditions that are regulated. For example, economists offer the case of the market failure, i.e., an imperfection in the working of a market that does not allow a satisfactory outcome. Examples of market failures include the existence of a natural monopoly, destructive competition, interdependencies in natural resource extraction, inadequate information in the marketplace, and externalities. Other reasons for regulation include concern over the distribution of income and the protection of those deemed worthy of special consideration.

In order to formulate a better regulatory analysis it will be useful for agencies to state their objectives in terms of the condition that requires correction, as well as the assumed cause of that condition. For example, the Consumer Product Safety Commission regulation of a hazardous product may be based on the belief that the product is too dangerous to use, or alternatively on the assumption that the product is safe if used correctly, but that too many consumers lack adequate information to use it properly. Such a statement of regulatory rationale will also improve the evaluation and oversight of regulation by more clearly focusing on regulatory assumptions and objectives.

Among the components of the required regulatory analyses in section 202 is "an analysis of the projected benefits and the adverse economic and other effects of the rule." This implies a neat dichotomy which, as I stated before, may not apply in many regulatory situations. We suggest that the guideline be changed to include an analysis of the projected economic effects and the projected health, safety, and other noneconomic effects. These other considerations are important because estimating the costs and benefits of regulation is not a precise science.

A quantitative cost-benefit analysis requires information on all possible costs and benefits and the probabilities that they will occur. However, it is difficult to assess the outcomes of alternative approaches as demonstrated by the current debate over the health effects of specific food additives and pollutants. The difficulty of determining probabilities has been evidenced dramatically by the Nuclear Regulatory Commission's retraction of the Rasmussen report.

Furthermore, there are also qualitative benefits of regulation that reflect the values of our society. For example, how should we quantify the fear of parents for the long term health of children who have been exposed to excess radiation or toxic chemicals? It is equally difficult to place a value on the confidence in our financial institutions brought about by Federal regulation of banks. Providing security and peace of mind, are important benefits. The fact that they are intangible does not make them any less important. Indeed, they often constitute the primary objective of some government intervention, and therefore must be taken into account if the analysis is to be complete.

We also urge that regulatory analyses focus not only on the magnitude of costs, but on the distribution of these costs among different segments of the population. Many of the costs attributed to health, safety, and environmental regulation are not new, but have always been incurred in various forms by different sectors of society. What has changed is who now pays those costs. For example, the Business Roundtable Cost of Government Regulation Study found that the 48 participating firms spent an estimated $2 billion in incremental costs to comply with EPA regulations in 1977. This cost, however, may only represent a shift in one cost of production, pollution, from society to those firms and the consumers of their products. We as a nation, have decided that firms can no longer externalize those costs by the free dumping of wastes in the environment. Similarly, the reduction of workplace hazards involves the shift of a cost of production from the worker (the expected loss from injury, illness, or death) to the firm and its customers (the costs of removing hazards).

Another area where the distributional consequences of regulatory action are important is the case of economic deregulation. In many areas of transportation and communications a substantial body of economic analysis already indicates that regulation is no longer needed and that society as a whole will be better off if competition replaces government protected monopolies and cartels.

Although society as a whole will benefit from deregulation in such instances, there will be dislocations and adverse effects on particular firms and regions. These dislocations can and should be analyzed. Deregulation will result in winners and losers, and the regulatory analysis should identify them. Whether and how to compensate the losers, however, remains a political decision, not an economic or technical one.

These cautionary notes on calculating economic effects are not meant to suggest that agencies should not seek the most effective and least burdensome regulatory strategy capable of meeting the need. We do urge, however, that attention be paid to these considerations in estimating the costs of various alternatives. In particular, we believe that the distribution of costs as well as the net effects of regulation should be analyzed and stated so that the regulatory agencies and, ultimately, Congress, can make informed policy choices. In that sense, the guidelines of regulatory analysis in H.R.3263 which prescribe only a statement of adverse economic and other effects may be too narrow.

THE NEED FOR CONGRESSIONAL ANALYSIS

It is important to note that the obstacle to the choice of the least costly method of achieving regulatory goals is sometimes in the enabling legislation rather than in the implementation of that legislation. Congress occasionally has enacted legislation that mandates a particular regulation, and the regulatory agency is effectively foreclosed from considering alternative approaches. For example, the Motor Vehicle Information and Cost Savings Act, as amended, (15USC, 1901 et. seq.) set specific fleet fuel economy standards for cars that must be met by 1985. The Department of Transportation and EPA have only limited discretion in implementing the law and may not consider whether it is the optimal strategy to achieve the goal of reduced fuel consumption.

Similarly, the Water Pollution Control Act of 1972 required that publicly owned waste treatment facilities provide secondary treatment although in some cases the substantial expenditures would provide only marginal increases in water quality. Nonetheless, EPA was given discretion only to extend the deadline--in legislation enacted after the original deadline had already passed.

If Congress chooses to stipulate a particular regulatory requirement in legislation, it becomes most important for Congress to consider broadly the effects of that legislation just as agencies would be required to do by the bill being considered by this committee. Indeed, that kind of analysis is required by Senate Rule 29.5 which stipulates that a regulatory impact evaluation be included in the committee report accompanying all public bills and joint resolutions. This rule is important for consideration of regulatory legislation, but it has not yet been effectively implemented by the Senate.

REVIEW OF PAST REGULATIONS

Just as the projected effects of proposed regulations should be analyzed, the current effects of existing rules should also be evaluated in light of experience and changing circumstances. We have long supported the need for agencies to evaluate their own policies and programs. This is just as applicable to regulatory programs as to any other. We therefore support the bill's requirement for continuing evaluation of past regulations. Although Part C of the bill is entitled "Periodic Review of Regulatory Requirements," the language of the section does not appear to us to explicitly require more than a one-time review of existing regulations.

It should be recognized, however, that periodic regulatory review can be costly. The requirements levied under a bill such as H.R.3263 should be carefully planned to assure that agencies and those subject to regulation are able to meet other responsibilities, such as those emanating from strengthened congressional oversight.

POSSIBLE ADVERSE EFFECTS OF REGULATORY REVIEW

The need for regulatory review must be balanced against the need for business confidence and the problems of regulatory compliance. Review of regulation may breed uncertainty for those being regulated. Business needs some assurance that investments will not be unduly made obsolete by regulatory changes. The necessary attempt to modify the present regulations may create so much turbulance and uncertainty that businesses, for example, are unwilling to invest or enter new endeavors. A schedule of regulatory reviews may also create enforcement problems by providing firms with an additional incentive to challenge regulations through legal actions and noncompliance in the hope that the onerous and costly regulations will be changed.

One method of achieving this balance is to insure that any regulations that require major capital investment will apply to firms for a set time that is congruent with the firm's lead time and with the useful economic life of the firm's capital equipment. For example, if an automobile manufacturer, with its long product lead time, plans its marketing strategy and its production equipment purchases on a reasonable assumption that certain environmental, fuel economy, and safety requirements will be in place, it should not be penalized if those requirements are changed substantially, in a way that the firm could not anticipate, before the firm's next major re-design. New regulations and revisions of regulations should provide for a realistic lead time and could also have a schedule for compliance that takes into account the planning horizon of industries. These considerations do not argue against evaluation of regulations, but regulatory review processes should not hold out an incentive for noncompliance nor penalize firms who have invested in equipment needed to comply with existing regulations.

There may well be no way to revise regulations that is completely satisfactory. The only real solution to the problem is to assure that regulations are good enough to live with for a reasonably long time period in the absence of important changes in underlying conditions.

THE NEED FOR CONGRESSIONAL OVERSIGHT

H.R.3263 provides for oversight of the regulatory decisionmaking process by the Office of Management and Budget, but does not fully specify the nature of that oversight. The OMB is to receive copies of agencies initial and final regulatory analyses. However, the proposed legislation neither states what OMB is to do with these analyses nor establishes any specific responsibilities for OMB in monitoring agency compliance. In contrast, the bill does establish a more explicit structure of OMB oversight of the scheduling and implementation of agency reviews of existing regulation.

We are concerned that the H.R.3263 does not set forth an explicit role for congressional oversight. We believe that effective congressional oversight of the regulatory analyses and the review of past regulations is essential. Such oversight is all the more important because the proposed legislation would not permit judicial review of the regulatory analyses provided for in this bill.

In terms of oversight of the regulatory process, we prefer an approach which would have a Congressional support agency monitor compliance with the requirements for regulatory analysis and review. We believe the GAO is the appropriate agency for this role.

I am sure that members of this committee are aware of the serious consideration now being given to proposals for a more general strengthening of the congressional oversight processes. If legislation along those lines were enacted, it would go a long way toward satisfying the need for better congressional oversight of the substance of regulation. There would remain, however, a need for Congress to maintain oversight of the process by which regulations are developed, a subject which should be addressed in this bill. If both approaches were enacted it would become essential to assure a reasonable consistency in the two approaches from the standpoint both of the congressional oversight procedures and the underlying requirements levied on the affected agencies.

THE COST OF EVALUATION

In imposing greater analytic requirements on regulatory agencies, it is important to recognize that this process is not without cost. We have not seen any convincing hard numbers, but have received estimates that the required regulatory analyses cost up to a quarter of a million dollars for major rules. While it is more equitable for the Federal Government to absorb these planning and evaluation costs rather than have the burden of poorly formulated regulation fall on a particular segment of the private sector, the burden on the agencies should also be understood. Congress should be prepared to provide the added resources that may be necessary. Paradoxically it may be that for the costs of regulation to decrease, agencies must receive increased resources.

Similarly, the explicit assignment of oversight responsibilities to GAO would involve the commitment of substantial staff resources and would require the authorization of additional staff by the Congress.

IMPROVING THE ADMINISTRATIVE LAW PROCESS

Title II, Reorganizing and Improving Agency Proceedings and Administrative Law Judge Selection and Evaluation, addresses many of the issues we raised in our report, "Administrative Law Process: Better Management Is Needed," (FPCD-78-25, May 15, 1978), and in the follow-up report on agency responses and other developments since that report was issued (FPCD-79-44, May 23, 1979). We support the provisions of the bill which:

- --Clarify the agencies' power to adopt streamlined methods of adjudicating administrative disputes.
- --Limit agency review of Administrative Law Judge (ALJ) decisions to two review levels, including the agency itself, thus affording ALJ decisions greater finality.
- --Increase the number of qualified candidates referred to agencies for selection as ALJs, while prohibiting agency use of selective certification criteria, which have in the past raised doubts about ALJ impartiality.

The bill assigns responsibility for Administrative Law Judge (ALJ) performance appraisal to the Administrative Conference of the U.S. (ACUS). We have several concerns about this provision, although we support the assignment of the ALJ performance appraisal function to an organization outside the agencies.

We found that there has been little active personnel management for ALJ's. Both the Office of Personnel Management (OPM) and the agencies employing ALJ have a "hands-off" approach. Agencies do not want to infringe upon ALJ independence. The OPM has not been actively involved in ALJ personnel management because it believes its role is limited to ALJ qualification, compensation, and tenure--in other words, to Section 11 of the Administrative Procedure Act.

H.R.3263 partially remedies the current "hands-off" situation by clearly assigning ALJ performance appraisal to one organization outside the agencies employing ALJs. However, this provision does not relieve the agencies or the OPM of their responsibility for other ALJ personnel management functions. Although semi-independent from their agencies, ALJs remain civil service employees. Both the agencies as employers and the OPM as policymaker and evaluator should have clear authority to actively manage and oversee ALJs. Without that clarity, ALJ personnel management functions could become further diffused, since the number of organizations involved will have increased from two to three with ACUS'new role. We specifically recommended clarification about the OPM's performance of its normal personnel management functions in our report.

As one example of agency responsibility, we are concerned that the role of the chief ALJ as first-line ALJ management, in the on-going ALJ performance appraisal process, should not be diluted by assignment of the formal appraisal function outside the agency. We support the latter, but would note that this in no way relieves the chief ALJ of his managerial responsibility. The ultimate objective of any performance appraisal system should be improvement of the quality of service provided to the public. Frequent feedback about expectations, and about performance and how it might be improved is best provided by someone in direct daily contact with the employee.

We strongly believe that effective employee performance appraisals serve many purposes, only one of which is discipline of non-productive personnel. Appraisal is the crucial foundation of any personnel management system. The legislation could be improved by clearly stating the purpose of ALJ performance appraisal, similar to the statement provided by Section 4302 of the Civil Service Reform Act of 1978. As it is currently written, H.R.3263 proposes to evaluate ALJ performance for the purposes of discipline and for paying judges performance bonuses.

We have in the past recommended that performance appraisal systems should include four basic principles:

--First, that work objectives be clearly spelled out at the beginning of the appraisal period so that employees will know what is expected of them.

--Second, that employees participate in the process of establishing work objectives thereby taking advantage of their job knowledge as well as re-enforcing the understanding of what is expected.

--Third, that there be clear feedback on employee performance against the preset objectives.

--Fourth, that the results of performance appraisals be linked to such personnel actions as promotion, training, assignment, and reassignment, as well as to discipline.

Establishing an effective system for the ALJs will require complex links between ACUS, the agencies and the OPM.

As an example, in order for performance appraisal by the outside evaluator to be effective, it will be necessary for agencies to have established their own criteria, since ALJ performance should be considered in the context of the ALJ's employing organization. We believe, therefore, that the proposed legislation would be clarified by noting that agencies may establish such standards for ALJ performance.

We are concerned about two other provisions of Title II, bonuses and the establishment of an Administrative Law Judge Career Service. The Chairman of ACUS is charged with prescribing those ALJs who are to receive pay performance awards based on the results of performance appraisals. However, the bill only provides for appraisals at least once every 7 years. If bonuses are going to be paid, they should be based on a current appraisal.

The bill also does not explain the rationale for ALJ performance pay bonuses. In the Senior Executive Service (SES), for example, performance bonuses serve as an incentive for quality managers to participate, in part as a "quid pro quo" for the risks involved. SES members are subject to an annual pay adjustment which is separate from the comparability process for other civil service employees, including ALJs.

There is also a difference between the bonus approval system utilized in the SES and that outlined in this proposed legislation. While in the SES, bonuses must be reviewed and recommended by a performance review board, in the machinery established in this bill the Chairman, ACUS, has sole authority for the approval of bonus payments.

It is not clear whether the proposed Administrative Law Judge Career Service is to be analogous to the SES in areas other than performance bonuses. If so, we believe the new Service should closely parallel SES, instead of promulgating another, different personnel management system.

H.R.3263 assigns responsibility for evaluation of ALJs to the Administrative Conference. Additionally, it assigns the Administrative Conference responsibility for ALJ recruitment, but does not restructure it to accommodate its increased role in ALJ personnel management. These functions, particularly the ALJ recruitment process, are far beyond the current mission of the Administrative Conference, which is basically a small research organization.

We recommend that responsibility for initial screening of ALJ candidates should remain with the Office of Personnel Management in order to avoid wasteful duplication. If, however, Congress wishes to designate the Administrative Conference as the organization responsible for recruitment and/or evaluation of Administrative Law Judges, it will be necessary to restructure and increase the resources of the Administrative Conference. Currently, the size of the staff and its research orientation would make it impossible for the Administrative Conference to accomplish the ALJ personnel responsibilities set forth in this bill. We are concerned that imposing these additional functions on the Administrative Conference would detract from the valuable function it presently provides to agencies in making recommendations concerning administrative law formulated by an organization with a unique mixture of governmental and private expertise.

This concludes our statement. I will be pleased to answer any questions.